

September 13, 2013

By email

TransferPricing@oecd.org

Working party No.6 of the Committee on Fiscal Affairs

Organization for Economic Co-operation and Development (OECD)

Subject: Comments on the White paper on Transfer Pricing Documentation.

Below are the comments prepared by the Transfer Pricing Committee of the IFA Mexican branch (IFA Grupo Mexicano, A.C.) in connection with the abovementioned public consultation draft. We have outlined our comments first under Section “General Comments”, followed by our notes to each topic as analyzed in the referred document all together with notes to Table 1 (*Coordinated Documentation Approach – Masterfile*) and Table 2 (*Coordinated Documentation Approach – Local File*) in an attempt to connect the text premises with its conclusions on proposals of documentation.

General Comments

The document acknowledges the existence of local laws enacted in each specific country at the same time that recognizes that, given the importance of the globalization in today’s economy, *transfer pricing enforcement and compliance should be thought of as an issue with multijurisdictional ramifications and documentation rules should be developed with this in mind.*

In theory, this idea of global documentation available to all tax jurisdictions could be seen as a desirable approach to make sure each company and, therefore, tax administration obtains its fair share of the global profitability obtained by the MNEs. After carefully reviewing the document, we do consider that this global approach to the transfer pricing documentation of a multinational group must take into account different elements that tax administrations must also implement in their local legislation to avoid any double taxation issues.

Arbitration Process: In order for this global access to the transfer pricing documentation of MNEs by the tax administrations, it is important that an appropriate arbitration process on a global basis is available for the taxpayer. The arbitration process should consider not only those countries with which a given country has entered into tax treaties to avoid double taxation but also with any other with which the taxpayer has conducted intercompany transactions. Otherwise, a preliminary adjustment by a given tax administration will not necessarily imply a corresponding adjustment in the other tax jurisdiction and will, therefore, create double taxation for the MNEs.

This arbitration process is very important to smooth any audit process to be initiated by a given tax administration given that the document fails to appoint or recognize that in the

current economic situation, many tax administrations have focused their tax collection processes by implementing transfer pricing audit procedures and that several governments have publicly mentioned their intention to increase the tax revenues by conducting or increasing the number of transfer pricing audits. From a taxpayer standpoint, providing access to global documentation and/or tax positions of the MNEs to all tax administrations in which the MNEs conducts its business operations and considering the tax collection required by all tax administrations will most probably imply a significant increase in double taxation of the MNEs. On this regard, it is also critical to consider the appropriate use of said information by the tax authorities, which is a baseline assumption of the document but might not necessarily be the reality in all countries or by all tax administrations.

International Norms of Financial Information: Currently there are different norms of financial information been used by each country. There has also been an attempt to unify the reporting norms by using the IFRS. However, current documentation regulations require taxpayers to conduct economic analyses based on the locally accepted norms of financial information, which in most cases, differ from one country to the other. Another fact that the document does not consider is the financial information used to conduct the analyses. Will it be the generally accepted accounting norms used in the host country of the parent company? Will it be accepted by each local tax authority? The document focuses on simplifying initiating a risk assessment process by the tax authority but does not necessarily consider the economic costs involved in meeting the requirements detailed in the document or whether it will be feasible from a company-wide standpoint.

Language: A similar situation occurs with the language in which the global transfer pricing documentation must be written. Currently, some countries only accept documentation produced in local language. Therefore, in order for the documentation to be produced by each MNEs to be directly applicable to all tax jurisdictions, tax administrations must also agree to a given language. Otherwise, global documentation must be translated into each and every language applicable in the tax jurisdictions in which the taxpayer conducts its business operations (and/or intercompany transactions).

Thresholds: In many cases, there are inconsistencies in the intercompany transactions to be documented in each tax jurisdiction. In many jurisdictions all intercompany transactions must be documented notwithstanding the amount of the intercompany transaction. In other countries either because the documentation requirement only applies to intercompany transactions exceeding certain amounts or given that the documentation provides penalty protection and the penalties are only imposed when adjustment exceeds specific amounts, transactions that do not exceed specific amounts are not necessarily documented. This might imply that not all intercompany transactions are documented in all tax jurisdictions.

Deadlines: It should also be kept in mind that if MNEs are requested to provide their global documentation to all tax authorities, additional resources might need to be hired by multinational companies as all (i.e., worldwide) intercompany transactions will need to be documented the first months of the year to assure said documentation will need to be

provided to all subsidiaries in order to meet specific transfer pricing documentation requirements in the different tax jurisdictions. One simplification measure might be to include in all local tax regulations that documentation will need to be contemporaneous with the transaction instead of with the tax return.

In general terms, the document seems to assume that taxpayers are trying to find their way around transfer pricing documentation and that tax authorities are only trying to achieve the best interest for the MNEs as well as simplifying the audit process, and therefore, reducing the costs, for the tax administrations. However, the document fails to consider the significant increase of the compliance processes that the implementation of the documentation rules indicated in the document would imply for the taxpayers. Therefore, it might be reasonably concluded the document is not necessarily consistent with the simplification procedures that the OCDE is also trying to achieve for the benefit of taxpayers.

Finally, the document seems to be contradictory in itself as it initially considers that the European Masterfile did not actually meet the expectations and that it was actually a more complex process than expected with limited economies of scale for the MNEs; and, at the end, the document seems to be recommending said approach without having conducted a new interview process with the MNEs that are using said documentation approach or addressing the issues that were previously mentioned that would enabled an appropriate use of this Masterfile by both MNEs and tax administrations.

Comments per Topic

Section II. Overview of existing guidance and initiatives on transfer pricing documentation

Paragraph 12 establishes that *“the majority of countries adopt a strongly one-sided approach, focusing mainly on the domestic side of the controlled transaction”* and that *“the financial results of the related counterparties to those transactions are often not treated as required subjects for documentation.”*

In addition, Paragraph 13 establishes that *“documentation does not always yield a complete understanding of the global business”* and that *“few countries ask for information on the global business of the MNE group, other cross-border transactions between foreign associated enterprises belonging to the MNE group which may directly or indirectly affect the pricing of the taxpayer’s controlled transactions; income or tax paid by the MNE, a comprehensive description of the global supply chain or a comprehensive summary of the MNE’s global APAs and rulings in other countries on similar issues.”*

Although we understand the need to have an understanding of the global business, it should be acknowledged that providing the abovementioned information would, without a doubt, be even more be onerous and time consuming for taxpayer than it currently is, not only for what it would take to gather corresponding information but most important for what taxpayer would need to “do” with that information to customize it to local requirements (accounting differences, language differences, tax systems differences, various

businesses information within one single MNE, etc.) so that it would be clear how this information relates to local taxpayer's activity, tax position and the like.

Moreover, requesting taxpayers to include some of the suggested information pertaining to MNEs as part of the Transfer Pricing documentation might go beyond what Chapter 3 of the OECD TP Guidelines (Comparability Analysis) recommends when referring to the selection of the tested party, as follows:

“3.18 When applying a cost plus, resale price or transactional net margin method as described in Chapter II, it is necessary to choose the party to the transaction for which a financial indicator (mark-up on costs, gross margin, or net profit indicator) is tested. The choice of the tested party should be consistent with the functional analysis of the transaction. As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the less complex functional analysis.”

Thus, even when some of the information on the global business of the MNE group such as a comprehensive description of the global supply chain could provide a broader understanding of the controlled transactions, the rest of the suggested information such as income or tax paid by the MNE, or MNE's global APAs and rulings in other countries on similar issues do not necessarily relate to the taxpayer's compliance with domestic transfer pricing obligations, moreover when taxpayer's documentation complies with its function of “*providing for adequate information to apply the arm's length principle reliably*” as reference is made in Paragraph 19 to the emphasis given in Chapter V of the 1995 TPG of the need for reasonableness in the documentation process from the perspective of both taxpayers and tax administrations.

Section 2.C Discussions with Selected Business Representatives

Although this section gathers useful suggestions from businesses such as requirements to perform new comparable searches every three or four years and incorporating materiality thresholds, there is minimum recommendation and further guidance in the document (*Section C. Mechanics of Preparing Transfer Pricing Documentation*) to incorporate these simplification measures in local legislation which would benefit both, the taxpayers and the tax administrations by saving significant costs to businesses whereas at the same time by making sure only relevant information is provided. We would suggest incorporating recommendations and examples of thresholds that could be incorporated to domestic law; moreover when the document suggests requesting additional information regarding MNEs.

Section 2.D. Conclusions Regarding the Current Documentation Environment

As Paragraph 42 points out: *“International efforts to create uniformity in documentation practice have not been particularly effective. Some international efforts contain promising approaches, but because of their lack on universal application and a lack of flexibility they have not become as widely accepted or provided as important a savings in compliance burden as might be expected. Other international efforts premised on compiling every*

participating country's documentation demands into one omnibus set of requirements provide little in the way of simplification and have therefore not been widely used by taxpayers."

Although we agree with statement under Paragraph 42 it is difficult to understand how suggested information on Table 1 and Table 2 would help to counteract the excessive requirements under various existing jurisdictions; on the contrary, it seems to add to the taxpayer's compliance costs. In other words, to achieve simplification and simultaneously access useful information, it would be necessary to assure that in addition to suggested information under Table 1 and 2, simplification measures are incorporated in all jurisdictions. Having taxpayers required to provide additional information without assuring simplification measures are incorporated would only turn the already onerous transfer pricing documentation process in an even more excessive burden for taxpayers.

Not only that, even before incorporating simplification measures and suggesting the request of MNEs' information, it might be necessary to promote a consensus on basic concepts such as the one for "related parties"; otherwise important differences would still exist among jurisdictions that would not allow for simplification and information effectiveness to be reached.

III. Purposes of transfer pricing documentation requirements

Paragraph 46 refers to (at least) three identified reasons for governments to require the creation and submission of transfer pricing documentation which are:

- *"to provide governments with the information necessary to conduct an informed transfer pricing risk assessment at the commencement of a tax audit;*
- *To assure that taxpayers have given appropriate consideration to transfer pricing requirements in establishing prices and other conditions for related party transactions and in reporting the income derived from such transactions in their tax returns;*
- *To provide governments with all of the information that they require in order to conduct an appropriately thorough audit of the transfer pricing practices of entities subject to tax in their jurisdiction."*

As it might be considered that Table 1 and Table 2 suggest excessive additional information to be incorporated as part of the Transfer Pricing documentation process, it might be useful to connect each of the three identified reasons above with the proposed requirements of information especially when the latter is suggested to be available at the commencement of a tax audit.

III. A. Transfer Pricing Risk Assessment

Paragraph 47 provides that *"Because tax administrations operate with limited resources, it is important for them to accurately evaluate at the very outset of a possible audit, whether a taxpayer's transfer pricing arrangements warrant in depth review and a commitment of*

significant tax enforcement resources, or whether they do not warrant such a detailed examination.”

Even though Paragraphs 55 and 56 seem to acknowledge that taxpayers also operate with limited resources by facing important cost considerations and time constraints, suggested documentation under *Table I: Coordinated Documentation Approach* – Masterfile does not seem to take that into consideration, moreover when suggesting (Paragraph 47) that all this information should be available at the “very outset of a possible audit” or even worst as it is not clear, should be available as a regular compliance obligation (i.e. annual requirement?) and as such we recommend WP6 to revisit information included in Table I.

In our opinion, providing all suggested information would be more onerous for taxpayers and might be in conflict with what Chapter V of the TPG recommends in this regard, as follows:

“5.6...When requesting submission of these types of documents, the tax administration should take great care to balance its need for the documents against the cost and administrative burden to the taxpayer of creating or obtaining them. For example, the taxpayer should not be expected to incur disproportionately high costs and burdens to obtain documents from foreign associated enterprises...”

“5.7 Thus, while some of the documents that might reasonably be used or relied upon in determining arm's length transfer pricing for tax purposes may be of the type that would not have been prepared or obtained other than for tax purposes, the taxpayer should be expected to have prepared or obtained such documents only if they are indispensable for a reasonable assessment of whether the transfer pricing satisfies the arm's length principle and can be obtained or prepared by the taxpayer without a disproportionately high cost being incurred. The taxpayer should not be expected to have prepared or obtained documents beyond the minimum needed to make a reasonable assessment of whether it has complied with the arm's length principle.”

III. B. Taxpayer's assessment of its compliance with the arm's length principle

Paragraph 55 establishes that “*tax authorities and taxpayers report that the preparation of documentation can sometimes become a process driven primarily by penalty avoidance and minimum compliance rather than by a desire to provide a thoughtful defense of well thought out transfer pricing policies, supported by the best available factual and financial data...*” and thereafter concludes (Paragraph 56) that “*...while in theory taxpayers could use transfer pricing documentation as an opportunity to articulate a well thought out defense of their transfer pricing policies...costs, time constraints, and competing demands for the attention of relevant personnel can undermine these objectives...*”.

In our opinion, Paragraph 55 should be revisited as it leads to interpret that the general rule for taxpayers everywhere is to prepare transfer pricing documentation primarily to avoid penalties and achieve minimum compliance. If that were to be the case, (i) it would be recommended to include some references as to the sources that support such a statement; and (ii) Wouldn't it be an argument to support the use of simplification

measures rather than the increase of proposed information to be included in the TP documentation process as it seems to be the case under *Coordinated Documentation Approach – Masterfile*? In other words, Paragraph 55 seems to suggest that taxpayers find it difficult to comply with burdensome transfer pricing requirements because of time constraints, costs, personnel, etc. but on the other hand, Table I proposes for taxpayers to provide more information than they are actually required to under many jurisdictions.¹

How does statement in Paragraph 55 relate to Table 1? How would information proposed under *Coordinated Approach* minimize burdensome requirements for taxpayers?

III.C Provision of information necessary to start, conduct and complete an audit

Paragraph 60 proposes that “...country legislation should always include powers and processes that will allow the tax authority to obtain information from the taxpayer beyond what is included in the information relied on in a risk assessment at the beginning of the audit.”; whereas Paragraph 61 establishes that “...It is therefore essential that the tax administration’s power to compel production of information during the course of an audit extend beyond the country’s borders.”

We consider that this has already been properly addressed in a detailed manner in Chapter V of the TPG and that limiting to suggest adding powers to request information that goes beyond countries borders without further detail on specific recommendations or guidance, might give rise again to more burdensome documentation for taxpayers and could give rise to disproportionate requirements from tax administrations.

In this respect, Chapter V of the TPG addresses this problematic as follows:

“5.11 In many cases, information about foreign associated enterprises is essential to transfer pricing examinations. However, gathering such information may present a taxpayer with difficulties that it does not encounter in producing its own documents. When the taxpayer is a subsidiary of a foreign associated enterprise or is only a minority shareholder, information may be difficult to obtain because the taxpayer does not have control of the associated enterprise. In any case, accounting standards and legal documentation requirements (including time limits for preparation and submission) differ from country to country. The documents requested by the taxpayer may not be of the type that prudent business management principles would suggest the foreign associated enterprise would maintain, and substantial time and cost may be involved in translating and producing documents. These considerations should be taken into account in determining the taxpayer’s enforceable documentation obligation.”

“5.6...Tax administrations should also recognize that they can avail themselves of the exchange of information articles in bilateral double tax conventions to obtain such information, where it can be expected to be produced in a timely and efficient manner.”

¹ This document is prepared by IFA MEXICO and the proposed requirements under Table 1: Coordinated Documentation Approach – Masterfile are more onerous than what is requested under existing regulations.

“5.15 Tax administrations should limit the amount of information that is requested at the stage of filing the tax return. At that time, no particular transaction has been identified for transfer pricing review. It would be quite burdensome if detailed documentation were required at this stage on all cross-border transactions between associated enterprises, and on all enterprises engaging in such transactions. Therefore, it would be unreasonable to require the taxpayer to submit documents with the tax return specifically demonstrating the appropriateness of all transfer price determinations. The result could be to impede international trade and foreign investment. Any documentation requirement at the tax return filing stage should be limited to requiring the taxpayer to provide information sufficient to allow the tax administration to determine approximately which taxpayers need further examination.”

“5.12 It might not be necessary to extend the information required to all associated enterprises involved in the controlled transactions under review. For example, in establishing a transfer price for a distributor with limited functions performed, it might be adequate to obtain information about those functions without extending the information requested to other members of the MNE group.”

In our opinion, information under Table I goes beyond what could be considered under Paragraph 5.15 above as “sufficient information” to allow tax authorities to determine if further examination is required.

IV. A Tiered Approach to Transfer Pricing Documentation

IV.A. Information Required for a Transfer Pricing Risk Assessment

Paragraph 70 suggests that documentation would need to focus among others on:

- *“Identification of material cross border transactions between associated enterprises, including material payments for goods, services, intangibles, and interest flows...*
- *Information regarding the MNE’s global transfer pricing policies and the financial results of applying those transfer pricing policies. It would especially include a description of where in the group important intangibles are held. It would also include the identification of MNE Group’s existing APA and ruling arrangements related to income allocation with various countries.*
- *The taxpayer’s explanation of how its material transfer pricing arrangements comply with the arm’s length principle and local transfer pricing rules.*

It might be confusing and misleading the use and reference to terms such as “*material transactions*”. If and when taxpayer has proper support documentation to prove that its related party transactions comply with arm’s length principle, would it be relevant if transactions are “*material*” or not? What should be understood as a “*material*” transaction? A transaction that could be “*material*” for one taxpayer might not be “*material*” for another, so, would it be subject to the taxpayer’s size, activity, etc.? Additional guidance would be recommended.

Paragraph 70 later suggests that “It seems possible for businesses to provide without undue burden individual country data based on either management accounts, consolidating income statements and balance sheets, and / or tax returns that would provide tax administrators with a general sense as to how their global income is allocated and where pressure points in the transfer pricing arrangements might lie.”

Although Paragraph 70 refers to “individual country data” to provide “general sense on allocation of global income” afterwards and all along the document reference is made to the need of having access to information that corresponds to the corresponding foreign related party, which we assume is not considered as the “individual country data”. If individual country data is not requested, prepared or provided in a manner that would allow administrations to understand specifics of corresponding transactions such a requirement could turn out to be a “never ending story” where documentation that would go beyond existing requirements would need to be customized or explained in the context of the analyzed or corresponding controlled transactions.

IV. B Structure of a Global Documentation Package

Paragraph 74 suggests that “*the two-tier structure laid out in the EU documentation guidance has significant potential for simplifying transfer pricing documentation compliance.*” It refers to a master file that would include overall business descriptions and functional analysis, consolidated group income, tax rates, debt structure, business restructurings and transfer of intangibles but would not include specific transfer pricing analyses related to individual transactions as they would be reserved to local country documentation.

In addition, Paragraph 75 establishes that if local countries are provided with the MNE’s masterfile, then local country information could be “*limited*” to identification of material cross border transactions affecting local jurisdiction, “*detailed*” functional analysis of the business activities in the local countries and the taxpayers’ analysis and application of the most appropriate transfer pricing methodology.

The question would then be, if it is known that for many jurisdictions information provided under Paragraph 75 is already part of the existing requirements, how would providing (in addition) the MNE’s masterfile to local tax administrations facilitate compliance and enhance simplification for taxpayers? In other words, if under Paragraphs 55 and 56 costs, time restraints, etc. do not allow taxpayers to prepare transfer pricing documentation to support their transfer pricing policies, how is it that additional information such as the master-file that is not currently requested as part of local documentation requirements, would simplify taxpayer’s burden?

V. Development of a Coordinated Approach to Documentation

Paragraph 78 provides that “*In an attempt to move towards a simpler and more efficient compliance with transfer pricing documentation rules, this paper sets out a possible coordinated approach to transfer pricing documentation...a two-tier structure consisting of a masterfile and a local file*”

In turn, Paragraph 80 suggests that master-file should include: “a) information on the MNE group; b) description of the MNE’s business or businesses; c) information on the MNE’s intangibles; d) information on the MNE’s intercompany financial activities; e) information on the MNE’s financial and tax positions.”

How many specialized personnel would it be required to prepare or participate in the documentation of the master file? How often would the master file be required?

Tables 1 and 2 set out in detail the items of information “to be” included in the master file and local file. Some of that information is not listed in Annex 1 or 2². It would be useful to know (on a concept per concept basis) if that information is already requested in some jurisdictions (i.e. key management personnel, a description of important business restructuring transactions occurring during the last five years, etc.).

Under Paragraph 83, OECD believes that its proposal of documentation offers a “*balanced trade-off between greater transparency requested from MNE and more streamlined country transfer pricing documentation requirements*” and suggests that this approach “*has significant advantages to both tax authorities and taxpayers*”. As proposed additional information might not be seen as “*balanced*”, it would be recommended to point out what would be those “*significant*” advantages for taxpayers.

As the document suggests, a number of details related to the proposal remain to be worked out. It might be advisable to reconsider working out on suggestions for those details in advance; otherwise having taxpayers preparing information under Table 1 and 2 will be more onerous than what taxpayers in most of the countries currently are required to prepare under existing local laws.

Finally, we recommend revisiting sources of information in Annex 2 as in the case of Mexico it refers to Form 55 as the Informative return to report transactions with foreign related parties which has been replaced with Annex 9 (with differences among those 2 Forms).

* * * * *

Should you have any question or comment in connection with the foregoing, please do not hesitate to contact us.

Sincerely,

² It seems under Annex 2 Multi-country survey on TP documentation requirements, that many countries do not currently require for taxpayer to provide information under “Broad-Based Analysis of MNE Group and Taxpayer”