



PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft

Mr. Joe Andrus
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration OECD
2, rue Andre Pascal
75775 Paris
France

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White Paper on Transfer Pricing Documentation

Dear Mr. Andrus,

We appreciate the opportunity to provide our comments on the White Paper on Transfer Pricing Documentation, especially with respect to potential implications on the German transfer pricing practice after having a ten year experience of local transfer pricing documentation regulation.

For an export oriented country such as Germany, globalisation is not new, but the pace of integration of national economies and markets especially outside the EU has substantially accelerated in recent years. Combined with an ever-increasing importance of managing risks and of developing, protecting and exploiting intellectual property, this development has an important impact on the way cross-border activities take place.

Against this background, new additions to the list of countries requiring preparation of transfer pricing documentation as well as permanent changes of the existing regulations on transfer pricing documentation in many countries make transfer pricing documentation one of the top tax compliance priorities for many multi-national enterprises (MNE).

From the perspective of a MNE, the compliance burden regarding transfer pricing documentation is already high and is still substantially increasing. Therefore, the focus of the Working Party No. 6 (WP 6) of the Committee on Fiscal Affairs (CFA) of the OECD to simplify or streamline the transfer pricing documentation is highly appreciated.

Transfer Pricing Documentation and BEPS

In the introduction of the White Paper, the WP 6 also takes reference to Action 13 “Re-examine transfer pricing documentation” of the Action Plan on Base Erosion and Profit Shifting (BEPS): “Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE’s provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template. “

Globalisation has resulted in a shift from country-specific operating models to global models based on matrix management organisations and integrated supply chains that centralise several functions at a regional or global level. A fierce competition is the flip side of the coin “globalisation”, which makes it necessary for MNEs to be as efficient and productive as ever possible in the game “survival of the fittest”. The optimization need does also include identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, while at the same time fulfilling the public notion of good corporate citizenship.

Against this background a general word on transparency: For sound decision making transparency is obviously helpful und therefore from the perspective of a pure rational decision maker desirable. Unfortunately, as the recent history has shown, the pure rational decision maker is not reality. Surveys have shown that public availability on sensitive information such as the salary of management has not increased satisfaction, but rather increased dissatisfaction and has thus created an environment of envy. Regarding transparency on the global allocation of income and taxes paid one might expect a similar effect. This might eventually even support calls for a formulary apportionment of profits, which is according to the OECD’s BEPS Action plan not a viable way forward. We agree with the OECD (BEPS Action plan, page 14) that “... it is also unclear that the behavioural changes companies might adopt in response to the use of a formula would lead to investment decisions that are more efficient and tax-neutral than under a separate entity approach.”

What we do understand is transparency on the economic activity of the tax payer to enhance knowledge on the value drivers of the business as well as the associated chances and risks globally as well as locally.

In Action 13 of the BEPS Action plan the OECD, does not only consider the perspective of the tax authorities but also acknowledges the necessity of MNEs to achieve risk assurance, to avoid double taxation as well as penalty protection:

“The actions to counter BEPS must be completed with actions that ensure certainty and predictability for business. Work to improve the effectiveness of the mutual agreement procedure (MAP) will be an important complement to the work on BEPS issues. The interpretation and application of novel rules resulting from the work described above could introduce elements of uncertainty that should be minimised as much as possible. Work will therefore be undertaken in order to examine and address obstacles that prevent countries from solving treaty-related disputes under the MAP. Consideration will also be given to supplementing the existing MAP provisions in tax treaties with a mandatory and binding arbitration provision.”

Double taxation is not just a nuisance for the respective MNE, but can lead to adverse effects on growth and global prosperity. Increasing certainty and predictability would be a key factor for MNEs to ensure sound investment decisions. Therefore we would welcome, if the MAP would be mandatory and binding and to be finalized in a certain time frame, e.g. two years.

Purpose of the White Paper

The White Paper on Transfer Pricing Documentation surveys the current state of affairs regarding transfer pricing documentation, considers the purposes and objectives of transfer pricing documentation, and makes suggestions as to how transfer pricing rules might be modified to make transfer pricing compliance simpler and more straightforward, while at the same time providing tax authorities with more focused and useful information for consideration in connection with transfer pricing risk assessment and transfer pricing audits.



The White Paper notes that clear and accurate understanding of transfer pricing risk features will typically require more information of a “big picture” nature than is often obtained through existing individual country focused documentation requirements and suggests a two tiered approach through which both the “big picture” information is made available for risk assessment purposes and detailed information on the related party transactions can be asked for when the arm’s length character of specific transactions need to be assessed. As Action 13 of the BEBS Action Plan is also directed towards making “big picture” financial information available to tax authorities, the work reflected in this White Paper is of direct relevance for, and will be integrated with, the work on transfer pricing documentation identified in the BEPS Action Plan.

We indeed support the “big picture” approach of the OECD to provide an economic analysis as well as a risk assessment regarding the intercompany transactions.

We also believe that the suggested two tier approach of the OECD based on a master file concept supported by a local file should often help to streamline transfer pricing documentation and thus reduce the compliance burden for the taxpayer.

Overview of existing guidance and initiatives on transfer pricing documentation

Local Country Documentation Regimes

Transfer pricing documentation rules are, and will continue to be, elements of local law enacted in individual countries. Transfer pricing documentation requirements are either articulated through a statutory obligation or through an explicit recommendation to have transfer pricing documentation in place. As documentation practices are governed by domestic legislation and regulations, they are implemented with a strong domestic tax enforcement point of view. For MNEs seeking compliance and penalty protection, the following would seem helpful:

- Local transfer pricing documentation regulation should precisely describe the purpose of each required information and the connection to the risk assessment of the tax auditor.
- Information requirements should be as concise as possible to avoid an overload of information and to save both parties time.
- Country rules should focus on the content and not on the format of documentation submission.
- Local transfer pricing regulations should take a global view and align country specific information requirements to international standards such as the (new) OECD recommendations.
- If country rules have been enacted quite some time ago, they should regularly be updated to reflect the experience with this documentation as well as to take into account trends in the global economy.
- Local transfer pricing documentation regulations should allow for enough time for documentation disclosure, say 6 to 8 months after fiscal year end.

However, in today’s globally integrated economy, transfer pricing documentation should not be seen purely as a local country compliance tool related to enforcement of the transfer pricing rules in an individual jurisdiction. When viewed in this light, efficient operation of the international transfer pricing system in a global economy present an opportunity for international coordination in order to simplify and consolidate the compliance obligations of business, while at the same time ensuring



that tax authorities have ready access to the information necessary to efficiently enforce transfer pricing laws.

Documentation Guidance Provided by International Organisations

There have been efforts at an international level to develop a standardised description of the documentation that MNEs should provide to tax authorities to demonstrate the arm's length nature of their cross-border-intra-group transactions. However, these initiatives have, for several reasons, not fully met the needs of either taxpayers or tax administrations. We therefore appreciate the OECD White Paper on Transfer Pricing Documentation as well as Action 13 of the BEPS Action Plan. It would be a considerable step forward, if an OECD standard gave guidance on the purpose, content and process of transfer pricing documentation from a global perspective. Local tax authorities could then align their rules to take into account "the big picture" and to serve the purpose of a true global economy.

Purposes of transfer pricing documentation requirements

Any consideration of the simplification or streamlining of transfer pricing documentation practices around the world should start with a consideration of the purposes for requiring transfer pricing documentation. We support the suggestion of the White Paper that three purposes are of high importance.

Transfer pricing risk assessment

As both, the tax administrations as well as the taxpayer, have limited resources, it is worthwhile focussing on the most important issues. It would therefore be beneficial for MNEs, if tax administration would publicly release their risk assessment and case selection approaches. According to our understanding, the risk assessment should not stop at the level whether an audit will take place at all, but should in a second step provide information on the risk assessment regarding the transfer pricing system as well as on a transactional level. Regarding the transactions, the kind of transactions in focus should be defined and a materiality threshold should typically be declared. For some countries, it might also be beneficial to introduce mechanisms for a cooperative approach to engage taxpayers in a dialogue with the tax administrations to enhance transparency and provide greater certainty. Although this might already happen on a case by case basis depending on an enhanced personal relationship, a more structural approach might change the general tax environment. Especially with the current public discussion regarding BEPS, mutual trust is of high value.

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

As transfer pricing focuses on arm's length pricing, the second important purpose of the documentation is to provide sound information how the pricing of the intercompany transactions was derived at and why it is or at least was intended to be at the time of the transaction (price-setting approach) at arm's length.

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

In general, transfer pricing documentation should provide a reasonably concise and sufficient information basis for the tax authorities to start, conduct and complete their audit. Only where the risk assessment has shown a high level of risk regarding certain transactions, a more detailed analysis seems necessary. In that respect, the tax auditor should clearly specify the additional infor-



mation request as well as the purpose of the additional analysis to increase transparency for the taxpayer.

Content and process: A two tiered approach to Transfer Pricing Documentation

For truly global MNEs, global transfer pricing documentation does require a good amount of organizational and project management skills. Therefore, not only the content, but also the process or as the White Paper puts it “the mechanics” are of high importance for a successful implementation of the global transfer pricing documentation of MNEs. A “new style” transfer pricing documentation might take the following aspects into account:

Information required for a Transfer Pricing Risk Assessment and for Enhanced Transparency

As kind of introduction, transfer pricing documentation might start with a risk assessment on the transfer pricing system as well as on certain transactions:

- Changes of the transfer pricing system and potential effects on the financial developments,
- Business restructuring including the transfer of intangibles,
- Information on the determination of the transfer prices, i.e. price-setting versus outcome testing approach and its effect regarding the volatility of the pricing,
- Information on potential double taxation due to different transfer pricing regulation or interpretation.

For enhanced transparency and as kind of supplement to the transfer pricing risk assessment, transfer pricing documentation might provide an economic analysis of the MNE, the major competitors as well as the respective global and local market. This should help understanding the value drivers of the market, the competitive situation of the MNE, the local and global development perspectives and the overall profitability. An understanding of these factors is crucial to realistically consider, what profits are available for an international allocation.

Structure of a Global Documentation Package

Regarding the coordinated documentation approach we have sympathy for the preference of the White Paper to follow a two tier master file and local file approach. To a certain extent we would say this to be already best practice. In general, we see the merits of the content suggested in Table 1, although we would like to recommend that some information can be eliminated as it would already be included under the heading “risk assessment” and “enhanced transparency”. Maybe it would also be possible to structure the proposed content somewhat more according to the respective purpose of the information, in order to give clear guidance why such information should be provided and what the possible conclusions could be.

Process or Mechanics of Preparing Transfer Pricing Documentation

An important topic regarding the reliability of transfer pricing data used for the determination of the transaction volume is certainly the internal process of data compilation. As accounting and controlling departments do regularly not focus on a transactional level, it is not trivial to derive a consistent data set, especially with numbers aligned between the different countries involved. This is also why an appropriate time frame should be allowed until final submission of the transfer pricing



documentation. To judge the reliability of data and volatility, information on the setting of the prices (i.e. price-setting versus outcome-testing approach) might potentially be asked for. As both aspects are important for the risk assessment, one could consider to include it at the beginning of the transfer pricing documentation under the heading “risk assessment”.

Summary of our Recommendations

As stated in the introduction of the White Paper of the CFA, the purpose of the White Paper on Transfer Pricing Documentation is to launch a global conversation on how transfer pricing documentation rules can be improved, standardised and simplified. The OECD also invites comments on whether additional or other possible mechanisms can be developed for complying with the transfer pricing documentation elements of the BEPS Action Plan.

We suggest developing an international standard on purpose, content and process of transfer pricing documentation requirements to allow for the necessary “big picture” in a global economy. The aim would be to enable local tax authorities to align their country rules with this international standard. The result should be to reduce the compliance burden for MNEs as well as to give tax auditors the appropriate information, both in terms of content and quantity, for their audit.

We hope our recommendations are helpful to foster the further discussion.

Please do not hesitate to contact us, if we can be of any further assistance.

Kind regards

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

WP StB Dr. Jutta Menninger
Partner Transfer Pricing

Bernhard-Wicki-Straße 8
80636 München
www.pwc.de
jutta.menninger@de.pwc.com