TAX EXECUTIVES INSTITUTE, INC.

22 February 2014

Centre for Tax Policy and Administration
Organisation for Economic Co-Operation
and Development
Paris, France

Via Email: TransferPricing@oecd.org

RE: Comments of Tax Executives Institute Regarding the OECD's Discussion Draft on Transfer Pricing Documentation and CbC Reporting

To Whom It May Concern:

On 19 July 2013, the OECD published an *Action Plan on Base Erosion and Profit Shifting* (the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries' tax bases are being eroded or profits shifted improperly. Pursuant to Action 13 of the Plan, "Re-examine transfer pricing documentation," on 30 January 2014, the OECD issued a *Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (Discussion Draft or Draft). The Discussion Draft sets forth a proposal to revise Chapter V – *Documentation* of the OECD Transfer Pricing Guidelines (Guidelines). The proposed revision includes a model template for country-by-country (CbC) reporting of certain information the OECD deems relevant to an analysis of transfer prices.

On behalf of TEI, I am pleased to submit this letter outlining the Institute's core points on the Discussion Draft, as well as an Annex with detailed comments from TEI members on the Draft, including responses to the OECD's specific requests for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 55 chapters in Europe, North America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at

all levels of government. Our nearly 7,000 members represent over 3,000 of the largest companies in Europe, the United States, Canada, and Asia.

Core TEI Points Regarding the Discussion Draft

TEI welcomes the opportunity to comment on the extremely important subject matter of the Discussion Draft, especially the newly created CbC reporting template. These topics, more than any others, constitute the portion of the OECD's Base Erosion and Profit Shifting (BEPS) project that touches the daily lives and operations of TEI's members and their employers. We recognise that the OECD has been tasked to provide guidance and recommendations on a wide variety of issues under Action 13 within a very short timeframe and generally outside of its normal stakeholder consultation process. Immediately below we set forth our core points regarding the Discussion Draft and closely related issues. Following our core points, the Annex provides detailed comments on the Discussion Draft, including the Institute's responses to the OECD's specific requests for comments.

1. It is regrettable that the OECD is rushing to finalise the CbC reporting template on the shortest possible deadline in the Action Plan – September 2014 – giving stakeholders a mere 25 days to comment on the template (and the Discussion Draft generally). Indeed, the Draft itself notes that "it reflects limited consideration of the issues in the short time since the publication of the Action Plan . . . ."[1] Because the template, and transfer pricing documentation generally, is about gathering information, a better approach would be to first complete the other Action Plan items. Then the OECD could determine, based on the output of those other items, what information is necessary to implement them and devise the documentation and CbC reporting standards at the end of the BEPS project. Instead, the OECD has done the reverse. By proceeding in this manner, the OECD introduces the significant possibility that the CbC reporting template will become obsolete after the OECD completes the other BEPS action items and countries begin to implement the OECD's recommended changes to the international tax system. At that point, after expending a substantial amount of resources to make the necessary systems, operational, and other changes to gather the information necessary to populate the original CbC reporting template, MNEs will be faced with making a second round (or more) of systems and other changes as the international tax rules evolve in response to the BEPS project.

For these reasons and others, the CbC reporting template is a critical issue for business. TEI strongly recommends the OECD sever the template from the Discussion Draft and delay the deadline for a final template to December 2015. This would allow both the OECD and stakeholders to give the template full consideration in a more realistic timeframe.

2. The Discussion Draft reflects the OECD's regrettable recent trend of minimising the importance of contracts between related parties for transfer pricing purposes and thus continues to undermine the arm's length principle. Parties doing business at arm's length

[1] Discussion Draft, p.1.

operate by adherence to contract, but it appears that the OECD views this as insufficient for associated enterprises in many cases. Thus, the OECD continues to move toward giving tax authorities' the OECD's blessing to recharacterise many legitimate commercial transactions and developing mechanisms that may be used for formulary apportionment purposes, such as the CbC reporting template.

3. The Discussion Draft imposes additional layers of complex and multi-jurisdictional transfer pricing documentation guidelines on top of the already costly and time consuming guidelines currently in place. This added complexity will only increase once countries integrate the final revisions to Chapter V into domestic law. The country-specific information proposed to be shared across jurisdictions is particularly problematic. It has been the experience of TEI's members that once tax authorities receive such information, particularly in regard to in-country profitability, they tend to focus on it to the exclusion of all else, such as obvious cross-jurisdictional market differences. Taxpayers are thus reluctant to turn over such information. All told, the information required by the Discussion Draft will result in increased compliance costs and tax controversy, with little additional revenue for governments. TEI recommends that instead the OECD adopt a "less is more" approach, limiting transfer pricing documentation requirements to information that is useful for risk assessment purposes, putting the emphasis on substance rather than form to ensure compliance. Local authorities could then request more detailed and exhaustive information (if necessary) on audit.

4. Much of the information to be disclosed under the Discussion Draft likely runs afoul of privacy and other information protection legislation in many countries and the European Union (*e.g.*, the EU Data Protection Directive). This is particularly true of the CbC reporting template. Companies will therefore refuse to provide protected information and courts will refuse to enforce the requested disclosure unless there is an accompanying change in local law. There is little indication that the OECD recognises this as an obstacle to its revisions to Chapter V, particularly the approach of mandating certain documentation and information. The OECD should therefore revise the Discussion Draft with these legal concerns in mind.

5. The Discussion Draft lacks the flexibility provided in current Chapter V by mandating certain information and documentation formats. Flexibility is critical for multi-national enterprises (MNEs) to collect and present transfer pricing documentation in a manner that best fits the MNE's reporting systems at a reasonable cost, and best meets tax authorities' requirements for relevant information. Thus, in TEI's view, standardised forms or guidelines are too rigid an approach to transfer pricing documentation, given the vast diversity in MNE operations and organisational structures. A more flexible approach is crucial.

6. The Discussion Draft states in paragraph 12 that countries should keep "documentation requirements reasonable and focused on material transactions in order to ensure mindful compliance on the most important matters." Unfortunately, the Draft does not provide detail on what constitutes a "material" transaction nor on what are the "most

important" matters, although it does request input from stakeholders on those items. In combination with the detail required by the Draft discussed above, this is likely to lead to mindless (and costly) compliance by MNEs and other businesses, and provides the opportunity for disputes between tax authorities and MNEs about the completeness of the documentation and compliance with local law. In TEI's view it is crucial that the OECD set clear transactional materiality thresholds to reduce the compliance burden on all businesses and ensure that tax administrations are not buried under a mass of irrelevant information. In addition, the OECD should establish a threshold to exclude small and medium sized enterprises (SMEs) from the Discussion Draft's most onerous requirements.

7. It is difficult to overstate the confidentiality concerns of TEI's members with respect to the highly sensitive information their employers are required to report under the Discussion Draft. For example, the Draft proposes sharing the master file with each country in which an MNE has an affiliate subject to tax. Given the wide variance in the ability and willingness of tax authorities to keep confidential information secret, the master file will inevitably make its way into the hands of an MNE's competitors. Such sharing is an unnecessary risk as most of the information in the master file will be irrelevant to a country conducting an audit of a local affiliate. Thus, TEI strongly recommends that the master file be prepared and filed in the parent company's jurisdiction and only shared under treaty information exchange provisions where the providing jurisdiction can ensure that the requesting jurisdiction has the necessary confidentiality safeguards in place and only relevant information is disclosed. Further, because of the disclosure risk, TEI recommends that MNEs be authorised to produce "high-level" descriptions of proprietary features of their operations.

8. The time and expense necessary to prepare the documentation required by the Discussion Draft is considerable. In recognition of this, and to give taxpayers an additional incentive to produce proper documentation in a timely fashion, we recommend that if taxpayers produce timely and complete transfer pricing documentation that satisfies the final requirements of Chapter V, then (i) the burden of proof should shift to tax authorities for any proposed adjustments to transactions covered by the documentation, and (ii) taxpayers should receive automatic protection from penalties if an adjustment is sustained.

9. The CbC reporting template requires both too much and too little information. TEI opposes the development of a CbC reporting template as part of a transfer pricing documentation standard due to its inherent complexity and notably because certain tax authorities will undoubtedly use it to improperly apply a formulary apportionment approach. Given that the OECD is under a mandate to develop a CbC reporting template, TEI recommends that the OECD limit the information required to three to five key metrics (in addition to severing the template from the master file as recommended above). The present level of detail gives the impression that the information could well be used for proposing adjustments based on formulary apportionment as a substitute for a detailed audit of individual transactions that applies the arm's length principle. In this respect, the template requires "too

little" information. At the same time, the Discussion Draft states that the template may be useful for risk assessment purposes, a goal that TEI can support. However, to provide an indication of an MNE's risk profile, only a few key metrics are necessary. Thus, in this sense, the template requires "too much information." The template should be revised accordingly.

10. The CbC reporting template also presents potentially intractable comparison issues across entities, jurisdictions, and time periods. These include different financial accounting methods (U.S. GAAP, IFRS, and special industry rules), tax reporting and accounting differences (cash versus accrual), differing tax timing issues (*e.g.*, depreciation methods, allowable versus capitalised deductions, elections, *etc.*), net taxable profits versus net book profits, *etc*. Other local law differences will impair the comparability of information, group relief versus consolidation, R&D credits (refundable or not), patent box regimes, book and tax year end differences, currency differences, statute of limitations issues, different rules on place of business (managed and controlled versus place of incorporation), *etc*. The list of comparability difficulties is practically endless. Even seemingly manageable and comparable information such as "Total Employee Expense," raises difficult issues. These issues would be minimised, but not eliminated, if the OECD were to adopt our recommendation above and limit the template to a few key metrics. As devised, taxpayers will expend a substantial amount of effort explaining variances in the template that are due to differing tax rules, standards, methods, and deadlines, rather than economics.

11. To promote transparency and efficiency, tax authorities should be required to share and discuss their transfer pricing risk assessment with the affected taxpayer. This should occur before the risk assessment is final to give taxpayers the opportunity to correct misconceptions and miscommunications, which should save tax authorities and taxpayers substantial time and effort on audit.

12. The Discussion Draft should include a definition(s) of a "line of business." Possible definitions include: (i) a business unit as defined for financial reporting purposes (broadest definition); (ii) a unit under common management (a broad definition, but not as broad as for financial reporting purposes); and (iii) a unit working as a separate, integrated business (a flexible definition). Depending on an MNE's organisational structure, providing the required information under one definition rather than another definition may be much more practical and cost effective, and the information would be more relevant to tax authorities. TEI therefore recommends that the OECD define line of business in the alternative and permit a taxpayer to select the definition that best fits its organisation for purposes of preparing the master file, as long as the taxpayer does so on a consistent basis.

13. Annex II to the Discussion Draft sets forth the information and documentation to be included in the local file. It is unclear why the OECD does not include all elements of a comparability analysis in this proposed file. For example, the contractual terms, economic circumstances, and specific business strategy are not listed, which is methodologically

inconsistent with the Guidelines. This regrettably tends to confirm that the OECD is giving more weight to the functional analysis/people functions approach along the lines of the approach set forth in new Chapter VI, and less to a full comparability analysis. TEI requests that the OECD explain why certain elements of a full comparability analysis have been omitted from Annex II.

14. The Discussion Draft does not address when the new documentation and reporting requirements of the master and local files, including the CbC reporting template, should take effect. Further, the Draft lacks critical transition rules as taxpayers move from one standard to another. The OECD should clearly delineate a timeline for implementation of a revised Chapter V and should give taxpayers ample time to make the necessary changes (*e.g.*, to systems, reporting standards, operations, *etc.*) to comply. For example, implementation should only commence after all, or a certain number, of the Member States and G20 have agreed to the revised documentation and reporting standards. Even in such a case, taxpayers should be given one to two years to come into full compliance before authorities may apply penalties.

As noted, the attached Annex sets forth TEI's responses to the OECD's specific requests for comments, along with our additional comments on the Discussion Draft.

TEI appreciates the opportunity to comment on the OECD's Discussion Draft on Transfer Pricing Documentation and CbC Reporting. If the OECD believes our participation in the announced public consultation in May 2014 is warranted, we would be pleased to do so.[2] These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +352 26 20 77 46, nickha@herbalife.com, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Terilea J. Wielenga
International President

[2] TEI representatives presented at the OECD's public consultation on its *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* and *White Paper on Transfer Pricing Documentation* in November 2013.

ANNEX to TEI's Comments on the OECD's Discussion Draft on Transfer Pricing Documentation and CbC Reporting

This Annex sets forth TEI's additional comments and recommendations on the Discussion Draft, including: (i) responses to the OECD's specific requests for comment; (ii) comments on Annexes I-III of the Draft regarding the master file, local file, and CbC reporting template; and (iii) additional overall comments on the Draft and its text.

I. TEI Responses to Requests for Comments from the OECD

A. Discussion Draft Section B.1. "Transfer pricing risk assessment"

Comments are requested as to whether work on BEPS Action 13 should include development of additional standard forms and questionnaires beyond the country-by-country reporting template.

The OECD should not include additional standard forms and questionnaires in its work on BEPS Action 13. TEI might support a common, standardised OECD framework for transfer pricing documentation, but only if that framework were consistently enacted and applied across jurisdictions. Such an approach would eliminate local documentation differences and significantly reduce the compliance burden on taxpayers. Correctly applied, the master/local file approach has the potential to comprise a common framework, which could facilitate the presentation of standardised information for tax authorities and assist with the authorities' risk assessments.

However, it seems clear that the tiered, master/local file framework will increase the compliance burden for many MNE's, while reducing the relevance and usefulness of their transfer pricing documentation to tax authorities. The compliance burden will only increase as it is unlikely that the necessary legislative changes to achieve consistency across the Member States and other participants in the BEPS project will be achieved in practice. Indeed, the Draft itself states that it "does not necessarily reflect consensus views of either" the Committee on Fiscal Affairs (CFA) or of Working Party Number 6.[3]

In addition, while the idea of "standard" or quantitative disclosures may be appealing in theory, the diversity of MNE organisation and global operations will make standard form development and understanding difficult for taxpayers and tax authorities alike. For example, a bank will have a completely different profile than a large, integrated consumer products company, which will in turn differ from an industrial conglomerate. Further, additional standardised forms or templates raise the significant risk that they will be used by tax authorities in place of a thorough audit, or misused by taxpayers who might withhold important information because a specific question has not been asked. Standardised forms also

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[3] Discussion Draft, p.1.

raise difficult questions with respect to differing accounting methods, year ends, timing of tax deductions, other domestic tax statutes, currencies, *etc*., that affect the relevance and comparability of the information provided, which then necessitates substantial additional explanations to provide context.

Overall, while the inclusion of more focused and standardised information within the master file and local file should be encouraged, TEI submits that transfer pricing documentation requirements should remain principled-based rather than formalistic.

Comments are also requested regarding the circumstances in which it might be appropriate for tax authorities to share their risk assessment with taxpayers.

TEI is very concerned that a request regarding when it "might" be appropriate for tax authorities to share their risk assessment demonstrates a belief among tax authorities that sharing the assessment should be the exception rather than the rule. On the contrary, TEI would recommend that tax authorities be required to share their risk assessments with taxpayers except in rare and unusual circumstances. A "best practice" would be to share the risk assessment before it is finalised to give taxpayers an opportunity to correct misperceptions or miscommunications. This is essential to avoid wasted time and effort by both tax authorities and taxpayers, especially on audit. Taxpayers should also have an opportunity to challenge an adverse risk assessment to indicate why it may be incorrect and document their view.

An additional "best practice" would be to make the risk assessment criteria publicly available in advance. Taxpayers could then assess whether they may be rated as "high risk" and, if so, they could more properly prepare for the inevitable examination in advance. It would also permit taxpayers to improve and properly target their front-end, transfer pricing documentation compliance practices and avoid audits and controversy. Open publication of risk assessment criteria also would help address the need for consistent risk assessments across jurisdictions. This, in turn, would mitigate taxpayer compliance costs and help prevent tax authorities from taking inconsistent views of risk with respect different sides of the same transaction.

In sum, eliminating information asymmetry between tax authorities and taxpayers is a key element for successfully addressing base erosion and profit shifting. The OECD and the CFA have been working on "Cooperative Compliance," which improves mutual trust between tax authorities and business. The concept enables both parties to reduce uncertainties over a company's tax position more efficiently and effectively. Sharing tax risk assessments with business should be a standard part of Cooperative Compliance and would demonstrate to taxpayers that transparency is a "two-way street."

B. Discussion Draft Section B.3. "Transfer pricing audit"

Comments are specifically requested on the appropriate scope and nature of possible rules relating to the production of information and documents in the possession of associated enterprises outside the jurisdiction requesting the information.

Tax authorities should use existing information-exchange mechanisms to obtain information in the possession of associated enterprises located outside their jurisdictions. In general, questions related to group-wide issues should be directed by local tax authorities to the tax authority of the country of the MNE's parent company through the official exchange of information protocol. The tax authority of the parent company could then liaise with an appropriately high-level employee of the parent to obtain and disclose the relevant information (such as the MNE's overall tax director or CFO). TEI agrees that tax authorities should have access to relevant information to conduct a transfer pricing risk assessment and audit. In many cases, however, local taxpayers will not (and, notably for the protection of certain trade secrets and arm's length negotiation between business units of the same MNE, should not) have direct access to certain information requested by tax authorities. While taxpayers should make reasonable efforts to provide relevant documentation, there should be no change to the principle that an entity cannot be required to provide information or documents to which it has no access.

Practical difficulties also arise when requesting extra-jurisdictional information from associated enterprises, including timing issues. Should the information be produced at the time of the transaction (or shortly thereafter) or by the time the return is filed, or some other deadline? Further complicating these questions is that year ends differ amongst countries and entities, as do filing deadlines. Thus, a single transaction may have two (or more) differing deadlines depending upon the countries involved. The rules for producing such information should account for these difficulties.

Finally, cross-jurisdictional information requests require consideration of laws outside the transfer pricing and tax areas.[4] Privacy laws are a major obstacle to disclosure of information from a parent company to an associated enterprise located in a separate jurisdiction. In many cases, individuals that disclose information in contravention of privacy laws expose themselves to criminal penalties, and thus will not disclose the information no matter the severity of the penalties imposed on the local affiliated enterprise for non-compliance with local transfer pricing documentation rules. These prohibitions on cross-border information disclosure need to be considered when developing rules for extra-jurisdictional information requests.

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[4] For example, the Intergovernmental Agreements that have accompanied the U.S. government's implementation of its Foreign Account Tax Compliance Act (FATCA) regime were necessary because of the strict privacy laws in place in many jurisdictions that are generally not tax related.

C. Discussion Draft Section C.1. "Master file"

Comments are requested as to whether preparation of the master file should be undertaken on a line of business or entity wide basis. Consideration should be given to the level of flexibility that can be accommodated in terms of sharing different business line information among relevant countries. Consideration should also be given to how governments could ensure that the master file covers all MNE income and activities if line of business reporting is permitted.

Taxpayers should be given the option of preparing the master file on a line of business or entity wide basis. This would be in line with the ability of taxpayers to select the most appropriate transfer pricing method and documentation methodology, depending on the facts and circumstances of the transaction, under revised Chapters I–III of the Guidelines.

It is inappropriate for the OECD to mandate a business line or entity or transactional approach, given the multitude of ways in which MNEs organise their global operations. For example, MNEs often operate across both different industries and business lines. In those cases, the preparation of global information on a group-wide basis will be extremely difficult and would likely result in a master file document that is too voluminous and complex for taxpayers to prepare and tax authorities to effectively process and review. Even preparation of this information on a business line basis will be a difficult process for these MNEs.[5] For MNEs that choose to prepare the master file on a line of business basis, the individual business line master file should only be available to jurisdictions in which that line conducts business.

A difficulty here is that the Discussion Draft does not define a "line of business." As noted above, TEI recommends that the OECD define "line of business" in the alternative and permit taxpayers to select the definition that best fits their organisation for purposes of preparing the master file, as long as the taxpayer does so on a consistent basis. The Draft also states that certain information is only necessary for "major" business lines. Clear guidance on what constitutes a major business line is essential.

TEI also urges, for the reasons detailed below, that the OECD separate the CbC reporting template from the master file. To highlight just one difficulty of including the

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[5] Take, for example, a company that prepares transfer pricing documentation on a transactional basis. Even if the OECD followed TEI's recommendations with respect to business line preparation of the master file, preparing such documentation would in many cases triple the size of such a company's transfer pricing reports because: (i) the transaction in question will have to be included in two reports (master and local file); (ii) global transactions, such as management fees and cash pooling arrangements, will be included in multiple reports instead of being enshrined in one; and (iii) the business unit information will appear in reports where the business unit has no intercompany transactions with the local entity being scrutinised. In other words, as applied to such a company, the master file concept is a confusing and misleading exercise that will severely delay the production of documentation until all reports are ready for the entire MNE, which may expose the local entity to significant penalties.

template with the master file, paragraph 28 of the Discussion Draft states that "best practice would extend the date for completion of the [CbC reporting] template to one year following the last day of the fiscal year of the ultimate parent entity of the MNE group." And yet paragraph 27 states that "best practice is to require that both the master file and local file be prepared no later than the due date for the filing of the tax return for the fiscal year in question." These dates are incompatible.

Finally, tax authorities currently have access to detailed information (*e.g.*, a company's annual report and corporate income tax return) to ensure that all of an MNE's income and activities taking place within their jurisdiction are known and reported. Indeed, much of the information requested in the master file is already reported in the publicly available financial statements of publicly traded companies. TEI submits that in certain cases, these public filings could take the place of the master file or a substantial portion of the master file, saving taxpayers substantial time and effort.

A number of difficult technical questions arise in designing the country-by-country template on which there were a wide variety of views expressed by countries at the meeting of Working Party n°6 held in November 2013. Specific comments are requested on the following issues, as well on any other issues commentators may identify:

- *Should the country-by-country report be part of the master file or should it be a completely separate document?*

TEI urges the OECD to completely separate the CbC reporting template from the master file. Once separated, the template should be used solely for risk assessment purposes and not for proposing transfer pricing adjustments.[6] The Discussion Draft notes that the purposes of the transfer pricing documentation requirements in Chapter V are risk assessment, taxpayer awareness and compliance, and audit. The CbC reporting template is not relevant to the latter two purposes. Some tax authorities, however, will find it difficult to resist using the information in the template to propose formulary apportionment-type transfer pricing adjustments, without going through an appropriately thorough, transactionally based audit.

TEI notes that the information in the CbC reporting template goes well beyond what is necessary for a high-level risk assessment. Reporting revenues, earnings before tax, cash tax

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[6] Paragraph 21 of the Discussion Draft states that "information [from the CbC report] should not be used as a substitute for a detailed transfer pricing analysis of individual transactions and prices, a full functional analysis or a full comparability analysis" and that "the information in the country-by-country reporting template would not constitute conclusive evidence that transfer prices are or are not appropriate." These statements are welcome, but in TEI's view and, based on the practical experience of its members, will be ignored by many tax authorities if the CbC reporting template is implemented as currently proposed.

paid, employee numbers and a useful and relevant activity code is sufficient for such an assessment.

Another complication with including the CbC reporting template in the master file is that many countries have imported the OECD transfer pricing documentation principles into their laws, and would therefore bring the master file and local file concepts, including the CbC reporting template, into domestic law once the changes are made part of the Guidelines. By proposing the deletion of the text of Chapter V in its entirety and replacing it with the version in the Discussion Draft, the OECD would effect immediate implementation of the template in the countries that have incorporated into their laws the Guidelines by reference. However, the CbC reporting template is not transfer pricing documentation in the traditional sense, but more akin to information reporting. In many cases, information reporting is a different area of the local tax code that does not generally reference guidance from the OECD. Thus, a wholesale change to Chapter V that included an information reporting component would come without harmonisation with the existing, in-country reporting requirements and likely without the proper technical or human resources to ensure adequate use of the template as a transfer pricing risk assessment tool. This could be avoided by introducing the CbC reporting template as a separate document, which would allow harmonisation upon the adoption of this tool through legislation in countries that currently require reporting in different forms.

In addition, as noted above, it is unlikely that the CbC reporting template can be completed to meet the transfer pricing reporting deadlines in many countries (*e.g.*, by the time the tax return is filed). Including the template would thus delay the completion of the master file, potentially subjecting taxpayers to significant penalties for failing to meet documentation deadlines or providing incomplete documentation.

Further, the OECD notes that the CbC reporting template may be used for purposes other than transfer pricing administration, including general tax administration and addressing other BEPS action items.[7] Including it in Chapter V would therefore be inconsistent with a future expansion of its role. The template also lends itself to digitalised reporting, which may facilitate the review of its voluminous data by tax authorities. This would not be possible if the template is part of the master file.

Finally, the OECD should exempt MNEs from preparing a CbC reporting template if the MNE is subject to a separate CbC reporting requirement, such as in the case of extractive industries pursuant to the 2010 "Dodd-Frank" financial reform legislation in the United States, or under the European Union Capital Requirements Directive. In that case, tax authorities could refer to the report prepared under the other requirement. Another way to limit the number of MNEs required to complete the template would be by excusing MNEs whose

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7 Discussion Draft, p.1.

worldwide effective tax rate is above a certain threshold (*e.g.*, above 20% or an MNE with a worldwide effective tax rate that is not more than 25% lower than the OECD's average).

- *Should the country-by-country template be compiled using "bottom-up" reporting from local statutory accounts as in the current draft, or should it require (or permit) a "top-down" allocation of the MNE group's consolidated income among countries? What are the additional systems requirements and compliance costs, if any, that would need to be taken into account for either the "bottom-up" or "top-down" approach?*

The OECD should permit taxpayers the flexibility to compile the information in the CbC reporting template through either a "top-down" or "bottom-up" approach. As a threshold matter, it should be remembered that the template's purpose is not to provide a comparison across MNEs, but within the individual MNE's operations. Therefore, so long as the template is completed using consistent principles by each MNE, the data should allow tax authorities to see directional information to undertake a high-level risk assessment.

International business includes a broad range of MNEs, which are organised differently and use different systems to report financial information, both internally and externally. The CbC reporting template should be designed to permit an MNE to populate the template with minimal additional cost and, where possible, based on information it already reports, or at least collects in some form. For example, it is unlikely that most entities currently report to their parent company earnings before income tax by country based on the country's corporate income tax law. Instead, they likely report book income and book tax expense. For an MNE with hundreds or thousands of legal entities, the compilation of such information in the CbC reporting template would be nearly impossible. The requirement to prepare or analyse new data should be kept to a minimum.

Systems changes to provide the requested information will require significant investment in both time and expense. For some organisations, the necessary systems changes will be minimised by adopting a top-down approach; for others, it will be a bottom-up approach. Any cost and burden associated with the preparation of the CbC reporting template should be commensurate with its purpose as a high-level risk assessment tool, and significant systems updates should not be required. Mandating only one approach would unnecessarily impose substantial compliance costs on a significant portion of the business community.

Both approaches present difficulties, however, which makes permitting taxpayers the flexibility to choose either approach crucial. A top-down approach would require methods to allocate an MNE's consolidated income across countries in which the MNE has a taxable presence (which itself may change as a result of the OECD's work on Action 7, "Prevent the artificial avoidance of PE status"). It also presents difficulties where the MNE is operating at a loss in one country and a profit in another – is the former country nevertheless entitled to tax a share of the MNE's consolidated income?

Under a bottom-up approach, on the other hand, consolidation may neither be feasible nor meaningful, depending on the circumstances, as: (i) separate reporting guidelines, such as revenue recognition, are used by separate entities even in the same country, depending on the business model, and (ii) statutory accounts are prepared under very different rules (*e.g.* revenue recognition is often based on percentage of completion rather than delivery, certain taxes are sometimes above the line in statutory accounts and below the line in IFRS/U.S. GAAP, *etc.*). These differences compromise the comparability of the data.

- *Should the country-by-country template be prepared on an entity by entity basis as in the current draft or should it require separate individual country consolidations reporting one aggregate revenue and income number per country if the "bottom-up" approach is used? Those suggesting top-down reporting usually suggest reporting one aggregate revenue and income number per country. In responding, commenters should understand that it is the tentative view of WP6 that to be useful, top-down reporting would need to reflect revenue and earnings attributable to cross-border transactions between associated enterprises but eliminate revenue and transactions between group entities within the same country. Would a requirement for separate individual country consolidations impose significant additional burdens on taxpayers? What additional guidance would be required regarding source and characterization of income and allocation of costs to permit consistent country-by-country reporting under a top-down model?*

TEI again recommends that the OECD give taxpayers the choice of consistently preparing the CbC reporting template on either an entity or country basis. Some MNEs may have hundreds or thousands of entities and reporting each one on the template would run to hundreds of pages. For those groups, some level of country consolidation may be required to ensure that the data is manageable and the information collected is useful for high level risk assessment purposes. For smaller groups, preparing the information on an entity basis may be more practical.

Mandating separate individual country consolidations and the accompanying necessary adjustments would impose a substantial administrative burden on a significant number of taxpayers. Part of the difficulty is the inability to leverage information the MNE compiles for accounting and financial reporting purposes. Instead, an MNE's in-house tax department must gather and compile a substantial amount of such information from scratch, or hire outside advisors and consultants to do so. Unfortunately, automating the production of this information would require reporting systems reprogramming that could span many years. The OECD should recognise that MNEs do not have unlimited resources to devote to tax reporting; they are just as subject to budgetary constraints and resource allocation issues as tax authorities.

Country-level consolidations could be prepared in a number of ways, for example, by simply aggregating entity level data (*e.g.*, from statutory accounts) or by using country consolidations prepared for other purposes. If the former approach is used, it should be accepted that differences in accounting methods or the presence of some double counting will

result in irreconcilable differences. Nevertheless, this data should be useful for high-level risk assessment purposes and guidance could be developed for any such double-counting that may render the data unusable (*e.g.*, due to holding company structures).

A separate challenge with a country-level consolidation for taxpayers with multiple entities in a single jurisdiction arises when those entities conduct unrelated businesses. Combining such entities would inappropriately reflect net country returns by blending differing business risks and functions. Similar issues (and others) arise in acquisitions and dispositions. It is also unclear, for example, how revenue eliminations across entities apply to cost centers. Further, revenue elimination might cause a fully-fledged manufacturing site with only intercompany sales to appear solely as a cost center, which we believe cannot be the aim of this exercise.

A separate misleading aspect of the CbC reporting template is the column for income tax paid (on a cash basis) "To All Other Countries." There is no information requested about the amounts and countries to which these taxes are paid. Thus, there is no way for a particular country tax authority to know the total amount of taxes it receives from a particular MNE based upon the CbC reporting template because of the taxes paid by the MNE's Constituent Entities organised outside that country.

Finally, the format currently proposed by the OECD would produce sales made *from that country*, and not sales made *in that country*. The OECD may wish to clarify what its objective is in this regard.

- *Should the country-by-country template require one aggregate number for corporate income tax paid on a cash or due basis per country?*

TEI strongly recommends that the OECD give taxpayers the flexibility to decide whether to report corporate income tax paid on a cash or accrued basis based on information that is readily available to the taxpayer, provided that the taxpayer reports the information consistently from year to year.

We also note that significant timing and comparison challenges arise with respect to tax payments across various countries. For example, some countries have an estimated tax system based solely on prior year results; others have minimum taxes that must be paid. In addition, in most countries, final tax payments are not normally made in the tax year to which they relate, but in the following year. Similarly, taxes paid as result of audits and litigation complicate matters as they always relate to prior years, sometimes in the distant past (*e.g.*, ten years ago or more). If a company settles a large adjustment and pays the tax four years later, then on a cash basis tax is understated in the year it is due and overstated in the year of payment. The reverse is true for refunds.

More broadly, yet another shortcoming of the CbC reporting template is that taxes paid will reflect the effect of preferential regimes and rates promoted by many Member States, such as those associated with a patent box, R&D credits, bonus depreciation, *etc*. Thus, the amount of tax paid (on a cash or accrued basis) for companies that take advantage of these benefits and the resulting lower effective tax rate will flow from specifically enacted tax policy choices, and not the result of base erosion or profit shifting. Nevertheless, companies in this situation will attract undue attention from tax authorities who may consider a taxpayer high risk solely because of a low tax payment, when in fact the taxpayer has behaved in accordance with the country's tax policy.

- *Should the country-by-country template require the reporting of withholding tax paid? Would a requirement for reporting withholding tax paid impose significant additional burdens on taxpayers?*

Reporting aggregate withholding tax payments is not generally currently required, so this requirement would be an additional burden on businesses. TEI recommends that MNEs be given the option of reporting such taxes as in certain cases it may give a more accurate picture of total taxes paid.

If the OECD requires such reporting, it will be necessary to clarify exactly which payments should be disclosed. Large groups often collect hundreds of thousands of pieces of withholding tax payment data across a significant number of categories. Sorting through this data without a clear understanding of what must be reported will be an impossible task. Further, income tax paid often includes withholding taxes paid. If withholding tax is to be reported, the OECD should clarify what is to be included in income tax paid to avoid confusion and double reporting.

The OECD should also clarify how to report withholding taxes that are credited against income taxes. These may be material amounts (*e.g.*, withholding on royalties, dividends, *etc*.) or very immaterial (*e.g.*, interest on bank accounts).

- *Should reporting of aggregate cross-border payments between associated enterprises be required? If so at what level of detail? Would a requirement for reporting intra-group payments of royalties, interest and service fees impose significant additional burdens on taxpayers?*

This information should already be documented in the master and local files under Annex I and II. BEPS Action 13 calls for a template that sets out "the global allocation of the income, economic activity and taxes paid." It is not clear how the inclusion of cross-border payments between associated enterprises will significantly contribute to achieving this aim, especially if similar information is provided to tax authorities in the master and local files. Requiring this information also increases the administrative burden of preparing the CbC reporting template; the level of detail proposed by the local file should be considered sufficient. As noted above, reporting revenues, earnings before tax, cash tax paid, employee numbers and

a relevant activity code (or codes) should provide tax authorities with sufficient information to conduct a high-level risk assessment, which is the proper purpose of the template. For these reasons, information regarding cross-border payments between associated enterprises should not be included in the CbC reporting template.

If the OECD decides to include this information in the CbC reporting template, then a materiality threshold should be applied to avoid overwhelming taxpayers with the administrative burden of collecting and reporting the information and the tax authorities who must process and review it. Many companies will not have the necessary systems in place to capture the payments at the level of detail required in the proposed template. In addition, we note that U.S.-based MNEs report a portion of this information on Schedule M of U.S. Internal Revenue Service Form 5471. The OECD should permit those MNEs to use the information reported on Form 5471 to populate the relevant sections of the CbC reporting template.

- *Should the country-by-country template require reporting the nature of the business activities carried out in a jurisdiction? Are there any features of specialist sectors that would need to be accommodated in such an approach? Would a requirement for reporting the nature of the business activities carried out in a jurisdiction impose significant additional burdens on taxpayers? What other measures of economic activity should be reported?*

This type of information should already be included in the master and/or local file, and much of it is also available in the financial statements of publicly traded companies. It is therefore unclear what purpose is served by repeating the information in the CbC reporting template.

Activity codes may prove useful to tax authorities in certain circumstances, but it should be recognised that their use may often be limited when conducting a high level risk assessment depending on the organisation of an MNE and the other information used on conjunction with the codes. Many entities conduct a range of different activities, so the activity code or codes may not be useful in the risk assessment process if the purpose is to determine whether the other information in the CbC reporting template is comparable to the typical "profile" of a business engaged in those activities.

D. Discussion Draft Section D.3. "Materiality"

Comments are requested as to whether any more specific guideline on materiality could be provided and what form such materiality standards could take.

A specific guideline and definition incorporating a reasonable level of materiality is critical to avoid creating an excessive burden on taxpayers and allowing tax authorities to focus on higher risk transactions. Excess documentation burdens for transfer pricing purposes

discourage international commerce, especially with respect to SMEs with fewer resources.[8] Guidance should take into account materiality from a group's perspective, but also from the perspectives of the countries in which the group operates. Further, differing levels of materiality are needed for the CbC reporting template, master and local files, and SMEs.

A materiality standard could take many forms. It could focus on the amount of the transaction, either in absolute terms (*e.g.*, a specific monetary threshold) or in relative terms (*e.g.*, as a percentage of turnover, assets, or income generated by a specific activity). A combination of the two could also be used. In addition, the OECD may need to give separate consideration to particular types of income or payments to account for their special nature (*e.g.*, interest, royalties, payments for services, *etc.*).

A materiality threshold could also be used to exempt SMEs from the transfer pricing documentation burden altogether, or from certain aspects of it. The threshold could be based on the amount of intercompany sales compared to unrelated party sales, the gross revenue of the group, the number of countries the group has a presence in, or some combination of the three (or some other measure).

More broadly, numerous questions will need to be addressed when developing a materiality standard. How should an MNE determine or define company size or size of transaction for purposes of materiality? Should it look to the entire multinational, the local subsidiary, or an aggregation of all the subsidiaries in one country? Should it look to the size of the transaction compared to the operations of the entire group, country, or local entity? How should it document and prove that either no comparables exist or that the costs of conducting a study would be prohibitive without incurring costs, at some level, to make this assessment? Essentially, the MNE will need to undertake some type of review and documentation to show that transfer pricing documentation is not worth the effort. Regrettably, the analysis becomes more difficult, and the outcome will not be clear, when tax authorities have differing views on what is "cost prohibitive."

Another materiality threshold could be implemented for large MNEs, which could be allowed to exclude all countries from the CbC reporting template or master file reporting where (a) intercompany revenues in that country are less than the lesser of (i) $10 million, or (ii) 10% of the enterprises' total consolidated revenue; or (b) the country is not an OECD or G20 member and has not agreed to use the common OECD framework.

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[8] For example, extensive documentation and reporting requirements may thwart highly innovative, new, immediately global businesses, which are possible today because of technology and lower barriers to accessing global markets. A substantial, tax-based transfer pricing documentation burden that prices these enterprises out of the international market does not promote economic co-operation and development.

E. *Discussion Draft Section D.5. "Frequency of documentation updates"*

Comments are requested regarding reasonable measures that could be taken to simplify the documentation process. Is the suggestion in paragraph 34 helpful? Does it raise issues regarding consistent application of the most appropriate transfer pricing method?

TEI welcomes the statement in paragraph 34 that database searches for comparables supporting the local file only need to be conducted every three years. Of course, taxpayers should have the option to update its comparables search more often if there are material changes to its business or market conditions.

To significantly ease the compliance and documentation burden on taxpayers, one approach would be to have MNEs prepare the master file and local file in their entirety every three years rather than annually, so long as there is no material change in operating conditions and the MNE has not been required to make material transfer pricing adjustments in the latest audit cycle (*i.e.*, not required to pay the transfer pricing adjustment penalty). Where there is a change in only a segment of the business (*e.g.*, where there had been an acquisition or new product line introduced) but where all other businesses remain materially unchanged, then the MNE should only be required to prepare supplemental information regarding that business segment.

While paragraph 34 recommends a once in three years update cycle, paragraph 23 seems to suggest that a comparables analysis is required every year for each transaction in a local file. A requirement for an annual analysis of all transactions would be incredibly burdensome and nearly impossible to comply with on a timely basis. Indeed, paragraph 26 notes specifically that taxpayers should not be asked to search for comparables if such work would create an undue burden where the "cost of locating the comparable data would be disproportionately high relative to the amounts at issues . . . ."[9] TEI submits that this principle of proportionality should apply across all master file and local file requirements.

TEI also urges that the OECD provide clearer guidance on the permissible use of regional (*e.g.*, pan-European, Asian, Latin American) benchmarks as opposed to local comparables. Reliable information can only be found in a limited number of countries and is almost entirely absent in emerging countries (*e.g.*, generally only in Japan in Asia). While paragraph 42 notes that local comparables are preferred to regional ones when the local comparables are "reasonably available," views on reasonableness often differ between taxpayers and tax authorities, and between tax authorities themselves. Because of these difficulties and potential differences of opinion, tax authorities should also bear the burden of proof when challenging the geographical scope of the comparables selected by the taxpayer.

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[9] Discussion Draft, p.7.

Paragraph 27 states that a timing "best-practice" for preparing the master and local file would be no later than the due date for the filing of the tax return for the fiscal year in question, while recognising that countries have different filing deadlines. Regrettably, what appears to go unrecognised is that if the documentation is due on the tax return filing deadline, the differences in dates (including extensions) around the world would force MNEs to complete the transfer pricing documentation by its earliest tax return filing due date (*e.g.*, March 31 for a calendar year taxpayer). Given that many MNEs only report their consolidated financial statements four to eight weeks after year end, the requirement to have transfer pricing documentation complete by the earliest tax return filing due date would be almost impossible to satisfy. In this regard, TEI recommends that the OECD use this opportunity to further encourage consistency across its Member States with respect to when an analysis should be performed, when it should be documented, and how penalties should be structured. We recommend that the countries adopt a consistent, reasonable time frame, such as one year after the fiscal year end for final documentation (*i.e.*, the master and local files).

Finally, the OECD should strongly recommend that countries who adopt the OECD's proposed tiered approach in a revised Chapter V reduce or eliminate their existing transfer pricing documentation requirements. Otherwise, the OECD approach is simply an additional burden on taxpayers without any simplification or standardisation benefits.

F. *Discussion Draft Section D.6. "Language"*

Comments are requested regarding the most appropriate approach to translation requirements, considering the need of both taxpayers and governments.

TEI strongly supports the OECD recommendation that the master file generally be prepared and submitted to tax authorities in English. TEI also appreciates the statement that sufficient time should be granted for translation of relevant parts of the master file if deemed necessary by local tax authorities.

TEI also recommends that English be the language of the CbC reporting template (if it is separated from the master file) and the local file. Summaries could then be prepared for local tax authorities in their native language in the course of tax examinations, either by the tax administration translation services or by the taxpayer. Translation of transfer pricing documentation is not generally advisable, not only because it is extremely time consuming and comes at a significant cost, but also because practice shows that a translation often does not reflect the nuances of the original documentation. For the same reasons, transfer pricing specialists at tax authorities should want to develop a familiarity with English (and many have already done so) to understand the original documentation properly.[10] Translation generates

[10] Tax authorities also familiarise themselves with English to have a clear understanding of international regulation, such as, *inter alia*, the OECD Transfer Pricing Guidelines.

unnecessary tax risks due to the complexity of the original analysis. These risks can only be minimised, but not eliminated, by hiring transfer pricing experts to do the translation, which only further increases the cost incurred and time spent.

G. Discussion Draft Section D.8. "Confidentiality"

Comments are requested as to measures that can be taken to safeguard the confidentiality of sensitive information without limiting tax administration access to relevant information.

TEI endorses the statement in the Discussion Draft that "Tax administrations should ensure that there is no public disclosure of trade secrets, scientific secrets, or other confidential information."[11] This principle should apply to all information received by tax authorities. Measures that could be taken to safeguard confidentiality include:

- Limiting information disclosure within a tax administration to "need to know" personnel only;
- Civil, and even criminal, penalties for tax administrators who improperly disclose taxpayer information (broadly defined);
- Specific secure means for information exchange between taxpayers and tax authorities; and
- Reviewing sensitive information at taxpayer premises, rather than filing it with tax authorities.

For disclosures between tax authorities (sensitive or not), only relevant information concerning the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes concerned should be provided. The tax authority making the disclosure should also be required to notify the affected taxpayer of the disclosure.

Further, information exchanges should only take place between tax authorities whose countries have entered into formal information exchange agreements, either via a treaty, a tax information exchange agreement, or some other bi-lateral or multi-lateral agreement. Regrettably, it appears that the overall information sharing aspect of the Discussion Draft assumes that these formal agreements will be in place to facilitate information exchange, when in fact they are generally absent from many important areas of the world (*e.g.*, the BRICS, Latin America, Asia-Pacific, *etc.*). The lack of formal agreements results in a concomitant lack of confidentiality mechanisms, which makes taxpayers reluctant to share information in the first place. The Discussion Draft does not address how information would be confidentially shared in these circumstances, other than by requiring a parent company to share the master file with

[11] Discussion Draft, p.9.

its local associated enterprise, which itself creates confidentiality issues and disclosure risks (as noted).

H. Discussion Draft Section E. "Implementation"

Comments are requested regarding the most appropriate mechanism for making the master file and country-by-country reporting template available to relevant tax administrations. Possibilities include:

- *The direct local filing of the information by MNE group members subject to tax in the jurisdiction;*
- *Filing of information in the parent company's jurisdiction and sharing it under treaty information exchange provisions;*
- *Some combination of the above.*

TEI strongly recommends that taxpayers file the CbC reporting template and master file solely with the jurisdiction of the taxpayer's parent company. That jurisdiction can then share the information under treaty information exchange provisions or similar formal bi-lateral or multi-lateral agreements. Disclosure of the master file and CbC reporting template to local affiliates to turn over to local tax authorities would result in countries receiving information about the taxpayer's global business operations that is not relevant to the transactions under review. For large groups, a substantial amount of the master file and CbC reporting template information would not be relevant for local risk assessment purposes or for facilitating the tax authorities' understanding of how local functions and risks fit into the group's activities. The more circumspect information sharing that takes place through official channels would help ensure that only relevant information is disclosed to the requesting jurisdiction.

Further, in TEI's view the disclosing tax authority should act as a gatekeeper to ensure that the information requested is relevant and necessary for the requesting tax authority in conducting its tax collection function. Indeed, it should be stated clearly that information requested by tax authorities must be relevant to the risk assessment or audit in question. TEI would welcome clear guidance in a revised Chapter V on that point. This approach would also facilitate maintaining information confidentiality.

Finally, making master file information available only through official exchange of information channels would encourage countries to enter into formal information exchange agreements. This would increase the information available to tax authorities for tax administration purposes other than transfer pricing.

I. Discussion Draft "Annex I to Chapter V: Transfer pricing documentation – Master file"

Comments are specifically requested as to whether reporting of APAs, other rulings and MAP cases should be required as part of the master file.

TEI recommends that the master file not include a reporting of APAs, other rulings, and MAP cases. Routine disclosure of these items will only lead to unnecessary additional transfer pricing controversy, especially when they have no relevance or direct link to transactions in the local jurisdiction and are therefore irrelevant. In many cases, tax authorities have a regrettable tendency to focus on certain terms and conditions of these documents, such as prices and markup percentages, and to argue for higher local results without recognising that the local market or the affiliate's specific situation may not be comparable to the facts in the APAs and rulings.

If a local country feels it necessary to obtain an APA, ruling, or details of a MAP case, it can do so through its existing information exchange network.

II. TEI Comments on Annexes I-III to Chapter V

A. Annex I to Chapter V: Transfer pricing documentation - Master file

Annex I to the Discussion Draft sets forth the information and documentation to be included in the master file. A significant portion of the information in the master file is available for publicly traded entities in their quarterly and annual financial statements. TEI therefore recommends that publicly traded MNEs, and other businesses that prepare financial statements on the same basis, be permitted to provide such financial statements as part of the master file. The MNEs could then supplement the master file with any necessary additional material.

In addition, TEI notes that the information requested in the master file, and in fact much of revised Chapter V as proposed in the Discussion Draft, is extremely difficult to apply to certain industries. For example, information regarding a supply chain and much of the CbC reporting template makes little sense as applied to a bank. As noted above, flexibility in transfer pricing documentation is crucial to the ability of MNEs to comply in a cost effective manner, and for the information supplied to be useful to tax authorities. Thus, the OECD should consider whether alternatives should be developed for differing sectors, especially if it continues the use of standardised forms or templates.

Below we comment on specific sections of Annex I (heading references are to those in Annex I).

"Organisational structure." Large or even medium-sized MNEs often do not have an easily accessible, complete organisation chart for all companies of the group due to the

organisation structure of the MNE, size, complexity, sheer number of entities, and in certain cases for government required security purposes. Indeed, a full chart would be difficult to produce in a useful or manageable manner. Moreover, a full organisation chart for an MNE of any significant size would be unhelpful to tax authorities for transfer pricing purposes, as most of the information would be irrelevant. An organisational chart by business line that is comprised solely of operating entities would be easier to provide, but it is unclear whether this is what the master file requires (*i.e.*, does "operating entities" at the end of the organisational structure request limit "legal and ownership structure"?). TEI suggests that OECD permit MNEs to provide organisational charts relevant for transfer pricing purposes on a business line by business line basis and that exclude dormant entities and entities with immaterial activity.

"Description of the MNE's business(es)"

"Important drivers of business profit." This is competitively sensitive information that should not be required to be disclosed. The information supplied in the functional analysis is sufficient to determine key functions and risks, which are key drivers of profitability.

"Chart showing supply chain for material products and services." TEI recommends that the OECD only require this information for MNEs that have a fully integrated supply chain. In other cases, such a chart would be overwhelming, would not provide useful information (if it made sense at all) and change significantly from year to year.

"Chart showing important service arrangements between members of the MNE group other than R&D services." The OECD should make clear that this chart is only for recurring services and not for one-time contracts as part of a tender. In addition, the OECD should make clear that transactions reported on this chart should not appear on the chart showing the supply chain for material products and services.

"A description of the main geographic markets for material products and services." The OECD should permit MNEs that do not have stable markets (such as tender based businesses) to include this information as part of the local file.

"A written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used." The OECD should require only MNEs that have a fully integrated supply chain to include this information. In certain other cases, this information would be a book length document describing the functions of integrated, independent companies within an MNE with no intercompany transactions, and would be useless for transfer pricing purposes.

"The title and country of the principal office of each of the 25 most highly compensated employees in the business line." TEI urges the OECD to drop this requirement from the master file as it does not appear to have, *prima facie*, any connection to transfer pricing. While the Discussion Draft does not require disclosure of the names of these individuals, their identity

will be impossible to preserve. This will jeopardise their safety in certain jurisdictions. In addition, as noted above, the disclosure of such information in the manner suggested almost certainly violates the privacy protection legislation of many countries and the European Union (*see*, *e.g.*, the EU Data Protection Directive).

Aside from these considerations, a definition of compensation needs to be developed, which raises difficult issues. While base salary may be simple to determine, other components of compensation are often much larger and more important, but also more difficult to measure. For example, how would options and shares be valued and when (grant, vesting, exercise)? How would bonuses be included? What other types of compensation would be included and how would they be valued (*e.g.*, company cars, housing allowances, tuition, pension fund contributions, health and life insurance, *etc.*)? Other issues abound, such as turnover, secondments, contractors, *etc*. Thus, at a certain point, a fully inclusive definition of compensation becomes unworkable and yet reporting based on salary alone is potentially misleading.

In place of reporting the top 25 most highly compensated individuals, TEI notes that a simplified organogram is available as part of a company's published financial statements. This shows the first level of company directors/managers reporting functionally to the business line CEO without indicating the principal office of the individuals and should be sufficient for risk assessment purposes. A similar organogram could be developed for private entities. Any further information can be gathered as part of an audit by local tax authorities.

"MNE's intangibles." The information requested in this section would only be useful, if at all, for master files for fully integrated MNEs or business units. Companies that do not utilise an integrated supply chain will not have a centrally organised "overall strategy for the development, ownership and exploitation of intangibles" or a principal location of R&D facilities and management.

Even for those MNEs with integrated supply chains, describing the "overall strategy for the development, ownership and exploitation of intangibles" goes well beyond the information normally supplied as part of transfer pricing documentation and the information needed for risk assessment. Regular transfer pricing documentation includes a functional analysis that must include who owns and uses intangibles as that is a critical component of determining the tested party. Such a functional analysis, with information about intangibles, is included in a separate part of the master file. Therefore, it is unnecessary to require information about the MNE's "overall strategy" with respect to intangibles as part of the master file.

More broadly, the inclusion of the section ''MNE's intangibles'' in the master file combined with the newly developed guidance under Chapter VI of the Guidelines (which can and will be interpreted differently by different jurisdictions) will greatly increase the compliance burden. Tax authorities will wish to discuss intangibles with taxpayers, even when

the intangibles do not relate to the transaction under review, which will ultimately lead to additional unnecessary adjustment attempts. This would not be the result of improved tax assessments, but rather different interpretations of the same rules and the inclusion of intangibles in the master file, which will be shared with tax authorities on a potentially global basis.

B. Annex II to Chapter V: Transfer pricing documentation - Local file

Annex II to the Discussion Draft sets forth the information and documentation to be included in the local file. It is unclear why the OECD does not include all elements of a comparability analysis in its proposed local file. For example, the contractual terms, economic circumstances, and specific business strategy are not listed, which is methodologically inconsistent with the Guidelines. This regrettably confirms that the OECD is giving more weight to the functional analysis/people functions approach along the lines of the approach set forth in new Chapter VI, and less to a full comparability analysis. TEI requests that the OECD explain why certain elements of a full comparability analysis have been omitted from Annex II.

Below we comment on specific sections of Annex II (heading references are to those in Annex II).

"Local entity." The Discussion Draft should clearly define the terms local entity and entity. Is the latter the same as Constituent Entity for purposes of Annex III?

"Controlled transactions."

"A detailed functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, i.e. functions performed, assets used and/or contributed (including intangibles) and risks borne, including any changes compared to prior years." TEI notes that the requirement to include any changes compared to prior years is new, extremely cumbersome, and would make the entire local file voluminous and difficult to analyse with little added value. Details on changes from prior periods are generally irrelevant for fixing transfer prices. Moreover, the master file already includes a section on major restructurings. If the OECD intends to keep the requirement to document changes, then at a minimum the word "material" should be inserted between "any" and "changes" at the end of the sentence.

"Identification and description of other controlled transactions of the taxpayer that can directly or indirectly affect the pricing of the controlled transaction being documented." It is unclear what this requirement is asking for, particularly the scope of "directly or indirectly." Thus, additional detail from the OECD would be helpful in assisting taxpayers in complying with this new requirement of Annex II.

C. Annex III to Chapter V: A Model Template of Country-by-Country Reporting

Annex III to the Discussion Draft provides the OECD's proposed CbC reporting template. Many of TEI's comments on the template are set forth above in our core points and responses to the specific requests for comment by the OECD. Below we provide additional comments on the template.

To a certain extent, the CbC reporting template proposed in the Discussion Draft is premature. What is needed is guidance and consensus from the OECD on the other open issues in the Discussion Draft and in the Action Plan generally, before developing a CbC reporting template, especially if it is not severed from the master file. In addition, part of the development process should include identifying the template's purpose and its proper use. Presently, the Discussion Draft states that the template is to be used for risk assessment purposes, but as noted the proposed template requires a great deal more information than necessary for such an assessment, whereas much of the information is useful for a formulary apportionment approach to transfer pricing.

Further, the functions performed and risks assumed by an MNE in each country in which it operates are generally not comparable and, in any event, are not reflected in the proposed CbC reporting template. Local tax authorities are only permitted to tax profit attributable to what is earned in their jurisdiction, and tangible assets and employee information do not give proper recognition to the importance of intangibles such as technology ownership, R&D, and new product funding, which are often far more important than routine sales and marketing activity in the local jurisdiction. Thus, even for purposes of a high-level risk assessment, the CbC reporting template is potentially very misleading regarding the value drivers of an MNE's operations.

The CbC reporting template also presents potentially intractable comparison issues across entities, jurisdictions and time periods. As discussed in our outline of core points above, the list of differences that would compromise the comparability of the information in the proposed CbC reporting template is potentially endless. Even seemingly manageable and comparable information such as "Total Employee Expense," raises difficult issues, as discussed above.

For these reasons, TEI urges the OECD to clearly delineate the purpose or purposes behind the CbC reporting template and conduct a detailed assessment of what the template should be used for, before enshrining the template in Chapter V or anywhere in official OECD guidance. As currently proposed, the risk that many tax authorities will use the information in the current template to propose transfer pricing adjustments that are inconsistent with the arm's length principle is palpable. Thus, TEI strongly recommends that the OECD sever the CbC reporting template from Chapter V and change the deadline for its completion to the end of the

BEPS project (*i.e.*, December 2015) to allow for proper development of the template with considered stakeholder input.

Finally, to the extent that the CbC reporting template is an attempt to quantify the economic contribution of an MNE to a particular country for purposes of assessing whether it is doing its part in supporting the country's government, the amount of income tax paid on a cash basis (plus some amount of withholding taxes) is a poor measure taken alone. It ignores other benefits an MNE provides to the jurisdictions in which it operates, such as employment, capital expenditures, charitable contributions, *etc.*, not to mention taxes other than income taxes.

Below we comment on specific sections of the CbC reporting template (heading references are to those in the template).

"General Instructions"

"Reporting MNE." The term "Reporting MNE" is confusing in this context. As the Discussion Draft proposes including the CbC reporting template in transfer pricing documentation, one would expect the OECD to follow the definition of control in the relevant transfer pricing regulations (perhaps of the jurisdiction of the MNE's parent?). However, the OECD's aim seems to make this the level of a publicly traded enterprise or the top holding company of a private MNE. This would exclude many entities from the CbC reporting template, including: (i) entities in which the MNE holds a minority interest, yet with sufficient common ownership to trigger a transfer pricing documentation requirement; (ii) entities that are controlled under transfer pricing regulations because the MNE is the sole customer of such entities; and (iii) entities that have a common main shareholder, yet different management and are separately quoted on the stock exchange. We recommend that the OECD clarify at which level the CbC reporting template should be prepared.

"Constituent Entity." The Discuss Draft provides that a Constituent Entity "is any separate business unit of the MNE group that is an associated enterprise to the reporting MNE . . . ." The term "business unit" seems to be misplaced, unless the OECD is using it in a specific manner. If so, then a definition of business unit should be provided, as recommended above.

According to the OECD's definition of "Constituent Entity," a permanent establishment that does not prepare a separate income statement for regulatory, financial reporting, internal management, or tax purposes, is not separately reported. The OECD should consider supplementing this definition for representative offices that pay taxes under local legislation.

"Specific Instructions"

"Important business activity code(s)." The activity codes appear to be based on a typical large consumer products company and thus are irrelevant to many industries. TEI therefore recommends that the OECD revise the activity codes to take into account a wider swath of

multi-national business activity. For example, a revised Chapter V could reference the codes under the Standard Industry Classification (SIC) system or the North American Industry Classification System (NAICS). In addition, Sales, Marketing and Distribution should be listed as separate activities with their own code.

"Earnings Before Income Tax." It is unclear why revenues may be translated (on a consistent basis) to a single currency while earnings before income tax need to be reported in the Constituent Entity's functional currency. Translation should be permitted for reporting earnings before income tax.

"Income Tax Paid (on Cash Basis)." The Discussion Draft states income taxes paid on a cash basis should be grouped based on the amounts paid during the "relevant" year. If this is the financial year for which the reporting is done it will often be irrelevant. An approach that required reporting of taxes incurred by the entity based on its profit and loss statement would likely be more representative of the contributions of the Constituent Entity to its country's fisc.

The OECD should also clarify whether it considers certain taxes, such as the French CVAE or the Italian IRAP, as income taxes and thus includible in the CbC reporting template. This could be done by developing a definition of income taxes for purposes of the template or by importing one from elsewhere.

"Stated capital and accumulated earnings." The OECD should clarify whether and how taxpayers should report amounts such as surplus, paid in capital, goodwill, accumulated other comprehensive income, and legal reserves.

"Number of Employees." Determining the exact number of employees employed by each Constituent Entity as of the end of the entity's fiscal year would be a difficult and cumbersome process. The definition of a Constituent Entity includes permanent establishments, which do not have employees as a legal matter. Further, use of secondment arrangements is widespread in MNEs, with varying degrees of formality. Thus, a better approach would be to permit Constituent Entities to report the number of employees within a range (*e.g.*, less than 10, 10 to 25, 25 to 50, more than 50). The OECD should also clarify whether MNEs should report employees on a full time equivalent (FTE) basis and whether independent contractors should be included as well (*i.e.*, a definition of "employee" may be necessary as who is considered an employee varies from jurisdiction to jurisdiction). Finally, there should be an exception for reporting this information when it poses an unacceptable risk to the safety of an MNE's employees in a particular jurisdiction.

"Intercompany Payments." In general, MNEs do not have information regarding intercompany payments readily available as it would involve reporting transactions between hundreds or thousands of entities. In addition, it is not clear how this information is relevant to the purported reason for the CbC reporting template: a disconnect between taxes paid and where income is earned. Action Plan item 13 states "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." This notably does not include reporting of intercompany payments.

Further, it is unclear why these items are reported on a paid basis rather than an accrual basis, since the effect on income taxes is upon accrual in the vast majority of cases. In addition, it is unclear why royalties are listed, but not outright sales of intellectual property (*i.e.*, why report only related party payments for the use of intellectual property over time but not up-front, lump sum payments for the intellectual property itself?). Clarification of these points would be helpful to taxpayers.

III. Additional Overall and Specific Comments on Other Sections of the Discussion Draft

A. Additional Overall TEI Comments on the Discussion Draft

1. Balancing the Need for Information Against the Compliance Burden

The Discussion Draft repeats the OECD's previous message from its *White Paper on Transfer Pricing Documentation* (White Paper) that there should be a balance between the information needs of tax authorities and the compliance burden on taxpayers. However, as in the White Paper, the burden on taxpayers tends to be forgotten as the Discussion Draft progresses. This is perhaps understandable as the OECD does not appear to have a thorough understanding of the overall cost of producing transfer pricing documentation to MNEs. A detailed study or survey of such cost is necessary for the OECD and tax authorities to properly balance their need for transfer pricing information against the compliance burden on taxpayers. TEI recommends that the OECD conduct a study regarding the burden of transfer pricing documentation in the present environment, which should include an assessment of the potential impact of the revised Chapter V on such a burden.

2. Need for Consensus

The OECD notes at the beginning of the Discussion Draft that "This document does not necessarily reflect consensus views of either the Committee on Fiscal Affairs (CFA) or of Working Party n°6 (WP6) regarding the issues it addresses. Rather, it reflects limited consideration of the issues in the short time since the publication of the Action Plan and seeks to identify issues for public comment." TEI believes that consensus is essential to the success of Action 13 of the Plan. Without consensus, the already exceptionally varied transfer pricing documentation requirements across jurisdictions will continue to multiply until both taxpayers and tax authorities are overwhelmed and the system collapses under its own weight. In the end, if a consensus cannot be reached on a revised Chapter V of the Guidelines, then in TEI's view it would be preferable to keep Chapter V in its current form.

3. Consistent Application of the Draft's Principles to Losses

The Discussion Draft, like the Action Plan and other OECD work product from the BEPS project, situates the discussion of the effort to combat perceived base erosion and profit shifting by MNEs in the context of profitable enterprises. This is unsurprising as without profits there would be little reason to erode and nothing to shift. Nevertheless, MNEs do, on occasion and regrettably, operate at a loss. Thus, there should be explicit recognition by the OECD in the Discussion Draft, and in other output of the BEPS project, that jurisdictions who reach out to assess their "proper" share of an MNE's global profits in good times should be prepared to accept their share of an MNE's losses in bad times. In other words, the OECD Member States and other G20 nations should acknowledge that this endeavour is a two-way street and be prepared to act consistently when the shoe is on the other foot.

4. Burden of Proof Issues

The Discussion Draft also raises burden of proof issues. Paragraph 40 notes the possibility of shifting the burden of proof in the taxpayer's favor if the taxpayer provides adequate and timely transfer pricing documentation. TEI agrees that the burden of proof should shift to the tax authority to show that the taxpayer's transfer price is incorrect once the taxpayer provides the required documentation. In addition, ancillary burden of proof issues arise with respect to transfer pricing documentation. For example, who is required to show that a transaction did or did not need documentation due to cost and/or materiality? Will taxpayers be required to undertake extensive work to document cost and/or materiality? What if one country agrees with the taxpayer's view that cost and materiality does not warrant the work of producing transfer pricing documentation for a particular transaction and the other country takes a different view? The Discussion Draft should address these and similar questions regarding the burden of proof.

B. Additional TEI Comments on Specific Sections of the Discussion Draft

1. Discussion Draft Section B. "Objectives of transfer pricing documentation requirements"

Paragraph 5.1 notes that the two-tiered approach to transfer pricing documentation should satisfy the objectives of a transfer pricing risk assessment. If that is the case, and if all transfer pricing documentation components must be available at the same time, then there will be an extremely limited opportunity to reduce the compliance burden for low risk businesses. For such businesses, the OECD should align its approach to transfer pricing documentation closely with the development of its Draft Handbook on Transfer Pricing Risk Assessment to ensure that the documentation requirements proposed meet the objectives of reducing the burden on businesses and tax authorities, each of whom operate with scarce resources.

If businesses provide useful information for risk assessment purposes and the tax authorities identify the taxpayer as low risk, then there should be some mechanism through which the subsequent documentation compliance burden can be reduced. This could include a reduced level of detail required for completing the master and local files. Regrettably, the Discussion Draft is silent on how this might be accomplished for businesses identified as low risk through the contemplated risk assessment process.

2. Discussion Draft Section B.2. "Taxpayer's assessment of its compliance with the arm's length principle"

In paragraph 10, the sentence "Moreover, contemporaneous documentation requirements can restrain taxpayers from developing justifications for their positions after the fact" should be changed to read "Moreover, contemporaneous documentation requirements can restrain taxpayers **and tax authorities** from developing justifications for their positions after the fact." As stated, the Discussion Draft gives the impression that it is permissible for tax authorities to use hindsight in developing their transfer pricing positions, which should not be the case.

3. Discussion Draft Section C. "A two-tiered approach to transfer pricing documentation"

Paragraph 19 of the Discussion Draft refers to the (i) "MNE group's organisational structure"; (ii) the "MNE's intercompany financial activities; and (iii) the "MNE's financial and tax positions." It is unclear what these terms refer to, and thus taxpayers would benefit if the OECD provided more detail with respect to each.

4. Discussion Draft Section D.1. "Contemporaneous documentation"

Paragraph 25 states that "a taxpayer ordinarily should give consideration to whether its transfer pricing is appropriate for tax purposes before the pricing is established and should confirm the arm's length nature of its financial results at the time of filing its tax return." This should instead read "a taxpayer ordinarily should give consideration to whether its transfer pricing is appropriate for tax purposes before the pricing is established and**/or** should confirm the arm's length nature of its financial results at the time of filing its tax return." Many taxpayers let their business units negotiate prices between themselves and document the arm's length result. Requiring them to further confirm the arm's length nature of the financial results at the time of filing its tax returns would place an additional documentation burden on such taxpayers.

Paragraph 26 states that "tax administrations should balance requests for documentation against the expected cost and administrative burden to the taxpayer of creating it. Where a taxpayer reasonably demonstrates . . . that either no comparable data exists . . . ." This should instead read "tax administrations should balance requests for documentation against the

expected cost and administrative burden to the taxpayer of creating it. **E.g., w**~~**W**~~here a taxpayer reasonably demonstrates . . . that either no comparable data exists . . . ." As currently phrased, the second sentence significantly curtails the scope of the first sentence, which appears to be unintentional. That is, tax authorities should balance documentation requests against the expected costs and administrative burden to taxpayers in all circumstances, not just where a taxpayer makes a demonstration of the type described in the second sentence.

5. Discussion Draft Section D.9 "Other issues"

TEI agrees that certification of transfer pricing documentation by external auditors or other third parties, as mandated in some countries, should not be required and should be abandoned where it is currently mandated. Documentation prepared by external tax consultants should not be given more credence than that prepared by an MNE's employees with comparable expertise.