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EU JOINT TRANSFER PRICING FORUM

DRAFT
REVISED SECRETARIAT DISCUSSION PAPER ON THE MASTERFILE CONCEPT

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Working paper

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1. THE MASTERFILE CONCEPT

1.1. General approach

1. The "masterfile" is an enhanced version of the centralised, standardised documentation concept. In an EU-wide centralised approach a multinational group would prepare **one single set of standardised documentation ("masterfile")** that could serve as the basis for preparing specific local country documentation from both local and central sources. The masterfile concept means, therefore, that a multinational group of companies has a standardised set of documentation at company level for all associated enterprises in all countries as opposed to standardisation of documentation at country level for all companies in that country regardless of the industry sector or group to which they belong.

1.2. Purpose of a masterfile

2. The masterfile would serve both as a basic set of information for the assessment of the group's transfer prices and as a risk assessment tool for case selection purposes.

1.3. Advantages of a masterfile

1.3.1. For both taxpayers and tax administrations

3. One of the main benefits of a masterfile is the fact that all administrations involved would have access to the same documentation and information. Taxpayers and tax administrations alike would benefit from the following advantages of a masterfile:

   a) Possibility to prepare more detailed material on the group as a whole, analysing group accounts, accumulating inter-company contracts, etc.;

   b) More consistency in the functional analyses;

   c) More consistency in the application of transfer pricing methods;

   d) Leverage from experience and prior work wherever possible;

   e) Centralisation of the review of any material prepared at local level to avoid misunderstandings;

   f) Facilitation of compliance; and

   g) Facilitation and expedition of mutual agreement procedures.

1.3.2. From a taxpayer perspective

4. Standardised and centralised documentation would substantially reduce a taxpayer's compliance costs by fulfilling the documentation requirements in all EU Member States in a similar and efficient way (economies of scale).

5. Additional benefits for taxpayers are:

   a) Exemption from documentation related penalties;

   b) Reduced chance of being audited; and

   c) Reduced risk of double taxation.

   [*Business Members propose adding the following text:*

   "A taxpayer that hands over its seriously prepared masterfile in a timely manner should be free of the following penalties:

   a) Adjustment related penalties: because the taxpayer and the tax inspector may disagree on the range of transfer prices and an adjustment may be made by the inspector, the serious taxpayer, having done its part in good faith and in a professional manner, should not be punished through additional penalties;and

   b) Serious penalties (as defined by the Arbitration Convention) that precludes the access to the said Convention: when a taxpayer has done his master file and the attached documentation in a serious manner, there should be no room for the administration to make an argument that would prevent the taxpayer from accessing the Arbitration Convention."]

1.3.3. From a tax administration perspective

6. From the steps often followed by multinational enterprises engaged in this process, it is likely that documentation would be prepared by individuals with more experience of transfer pricing and with more information to hand than would be the case if it were prepared at a decentralised country level. Given that the objective of a tax administration is information, a centralised approach would be to its advantage, because one of the main benefits of the centralised approach would be an improvement in the quality of the documentation. This would help safeguard a tax administration's tax base.

7. The Member States concerned would benefit substantially because they would have insight in the EU-wide transfer pricing policy of the company. This means that Member States could:

   a) have more information about all intra-group transactions;

   b) more effectively perform their risk assessment; and

   c) reduce administrative costs.

2. THE BASIC FUNCTIONING OF THE MASTERFILE

2.1. General acceptance by tax authorities mandatory

8. The masterfile should be the same for all countries that decide that transfer pricing documentation is required. Obviously a country may decide not to have transfer pricing documentation at all or have a shorter version of the masterfile. A country that adds items to the masterfile would depart from the masterfile concept. In other

words, acceptance of the masterfile concept can only be optional for those tax administrations that have no documentation requirements in place. It should also be noted that the masterfile concept is not workable if only few countries accept it.

[*Proposal from Business Members and the Secretariat*]

2.2. Mandatory vs. optional application for taxpayers

9. Whereas for centralised MNEs the masterfile concept may reduce the compliance burden and has a potential to increase the quality of its documentation, this is not necessarily the case for decentralised MNEs, smaller businesses or groups of companies with limited cross-border dealings. Considering the fact that creating and maintaining a masterfile might entail costs that are not always compensated for by economies of scale, certain businesses might prefer a decentralised approach. The use of the masterfile concept should therefore be optional for businesses.

2.3. Rights and obligations of taxpayers and tax administrations

10. The centralised documentation concept would not aim to shift the obligation to provide transfer pricing documentation from the domestic enterprise to a foreign jurisdiction. This obligation would remain with the domestic taxpayer who in any event is responsible for complying with documentation requirements although he might not be the physical owner of the masterfile.

11. Each of the tax authorities involved must be legally entitled to have access to the masterfile regardless of its location.

12. Each of the tax authorities involved would also keep the right to assess whether in the context of the agreed masterfile concept, the company has met its documentation requirements.

2.4. Implementing the Masterfile Concept

13. There are two ways in which a Member State could adopt the masterfile concept:

    a) by legislating for it in national law (which would provide the greatest certainty);

    b) if such an approach were possible under national law, by including it in administrative guidelines on which businesses would be entitled to rely.

    [*Proposal from a Tax Administration Member*]

2.5. Consequences for Member States not having legal documentation requirements

14. In relation to documentation requirements, one of the main concerns expressed by the business community is that the mere existence of different sets of documentation requirements and its potential to expand to over 25, represents an additional burden for a company in one Member State to set up and/or conduct business with an affiliated company in another Member State.

15. Currently not all EU Member States have legislation on documentation requirements in place. If, which is of course not unlikely, in the future more

countries will introduce national documentation requirements, these should be compatible with the masterfile concept.

16. Accepting the masterfile concept would equally imply that Member States which have currently no documentation requirements in their domestic legislation, would need to ensure that parent companies or headquarters in their jurisdiction can be obliged to set up and maintain group documentation according to the masterfile concept.

2.6. Consequences for Member States who already have legal documentation requirements

17. As the masterfile concept is a standardised approach, it follows that the masterfile should be the same for all countries that decide that transfer pricing documentation is required. An aggregation of all existing documentation requirements of all Member States would, however, not be appropriate. Although the benefit of a centralised approach would still be achieved, Member States should not follow the "race to the top" and increase documentation requirements to the currently most extensive ones.

18. The content of the masterfile should, therefore, be as complete as necessary but as limited as possible to serve its purpose as described in chapter 1.2 above (the content of the masterfile is addressed in more detail in chapter 3 below). Member States should, however, retain the right to require a taxpayer to provide further information upon specific request or during a tax audit.

19. A Member State who requires taxpayers in accordance with domestic documentation rules to prepare additional documentation when filing the tax return to what is already available in the masterfile as described in chapter 3 below, would deviate from the masterfile concept. It should be noted that additional documentation requirements might not only be incompatible with the main purposes of the masterfile concept, i.e. to relieve taxpayers' compliance burden and safeguard from documentation related penalties, but might also distort the level playing field among Member States. By contrast, a Member State may obviously decide not to have transfer pricing documentation at all or have a shorter version of the masterfile.

20. Penalties for failing to comply with transfer pricing documentation rules are imposed under national law. Any guarantee that penalties would not be imposed if certain conditions were met would also need to be delivered through national law. In adopting such law, a Member State should only be concerned with whether the conditions had been met in relation to transactions within the scope of its national tax law. On that basis, a Member State would not be concerned with whether the group involved had satisfied any particular quality of documentation in respect of transactions that might be within the scope of the tax laws of other Member States but were not within the scope of its own tax laws.

    [*Proposal from a Tax Administration Member*]

21. A Member State should, therefore, not impose any penalty on a business for failing to make transfer pricing documentation available to its tax administration if the

business, or another business with which it was associated (whether or not that other business was resident in the Member State) :

(a) had documentation available as specified in chapter 3 below;

(b) that documentation was made available to the tax administration within a reasonable time after the tax administration had made a reasonable request; and

(c) that documentation was made available in a reasonable manner.

[*Proposal from a Tax Administration Member*]

3. CONTENT OF THE MASTERFILE AND RELATED ASPECTS

3.1. Substantial content

22. The content of the master file is generally understood to be a roadmap (or standardized document) that would and should allow the tax administration to select a company for audit and ask relevant and precise questions regarding intercompany relations. Because the timing when a master file must be available (when filing the return, at the start of the audit) may vary from country to country, its content should be kept short, clear, but with enough details to allow the tax administration to ask relevant and precise questions.

[*Proposal from Business Members*]

23. The “masterfile” should follow the economic reality of the enterprise and provide a “blue print” of the company and its transfer pricing system that would be relevant for all Member States concerned (for example, for management control purposes).

24. The masterfile should contain the following items:

a) description of the business;

b) the group’s organisational structure [*within the EU*];

c) identification of the associated enterprises engaged in controlled transactions [*within the EU*];

d) description of the controlled transactions [*within the EU*];

e) comparability analysis, i.e.

i) characteristics of property and services;

ii) functional and risk analysis;

iii) contractual terms;

iv) economic circumstances; and

v) business strategies;

f) explanation and justification about the selection and application of the transfer pricing method;

g) substantiation of the arm's length nature of the company's transfer pricing, e.g. by providing the group's inter-company transfer pricing instructions or a description of the group's transfer pricing system; and

h) an undertaking by the taxpayer to provide within a reasonable time frame according to national rules supplementary information upon request.

[*Proposal from Tax Administration Members and the Secretariat*]

25. The possible scope of the enterprises and transactions to be included in the masterfile can best be described with the following example:

Consider a headquarter company A in Member State A providing HQ services to subsidiary B (a production company) in Member State B and subsidiary C (a distribution company) in Member State C (controlled transactions 1 and 2). Sub B delivers goods to its sister company C (controlled transaction 3). In order to allow the tax administration in Member State A to obtain information on the controlled transactions 1 and 2, and tax administrations in Member States B and C to obtain information on the transaction between B and C (controlled transaction 3) the masterfile has to contain information concerning all controlled transactions in all three Member States. This means, for example, that Member State A may also obtain information regarding controlled transaction 3 (between Member States B and C), and Member State C may also obtain information regarding controlled transaction 1 (between Member States A and B).

26. Each item should be completed, taking into account the complexity of the company and the transactions. It is recommended that information is used that is already in existence within the group (for management purposes). However, a company might be required to produce documentation for this purpose that otherwise would not have been in existence.

27. To provide to as large an extent as possible for transparency and consistency of the approach, it would be helpful if Member States could at some point in time agree on a uniform, internationally accepted accountancy standard for transfer pricing purposes.

[*Proposal from a Tax Administration Member*]

3.2. Use of language

28. Serving the purpose of the masterfile concept, i.e. the reduction of the compliance burden, only a limited number of masterfile documents should be available in the relevant national languages from the outset and translation of all documents should be made available only upon request during a tax audit

3.3. Preparation, submission and storage of the masterfile

29. The evidence required for preparing the masterfile can reasonably be expected to be available to the company at the time of the transaction. However, the taxpayer should have to submit the masterfile to the tax administration only at the beginning of a tax audit or upon specific request. By contrast, when filing the tax return, only a limited number of documents should be submitted in order for the taxpayer to

have certainty that he would not be liable to a penalty in that Member State for failing to provide adequate documentation.

30. A Member State could, however, have rules to require a business to make available documentation in response to a request made by the tax administration or at the start of a tax audit. Even if the Member State had adopted the masterfile concept, the scope of such additional documentation might go beyond what was required by the masterfile.

[*Proposal from a Tax Administration Member and the Secretariat*]

31. The Member State might have rules imposing a penalty for failing to make such additional documentation available. But, if it had adopted the masterfile concept, the Member State could not have rules imposing a penalty for failing to make available such additional documentation at the time the masterfile was due to have been made. Any such rules imposing a penalty could only apply to a failure to make documentation available in response to an appropriate request made by the tax administration after the masterfile was due to have been made.

[*Proposal from a Tax Administration Member and the Secretariat*]

32. The rules should allow the business a reasonable amount of time to make the additional documentation available. Since the documentation would not need to exist at the time the tax return was due to be made, and might never exist at all if the tax administration did not request it, this period should be longer than the period that the business would need to make available documentation covered by the masterfile. It might be appropriate to specify that the Member State should not apply such penalties by reference to a time less than 90 days after an appropriate request has been made by the tax administration.

[*Proposal from a Tax Administration Member*]

33. Generally speaking, it should be irrelevant for tax administrations where a taxpayer prepares and stores its documentation as long as the documentation is sufficient and made available to the tax administrations involved upon request. It seems obvious, however, that in a centralised approach the headquarters or the parent company of a group are the best place to fulfil the masterfile obligations.

[*Business Members propose adding the following text:*

"The taxpayer should, however, be free to keep the masterfile either in a centralized or in a decentralized manner."

The Secretariat believes that this proposal is consistent with the masterfile concept as long as "decentralised manner" does not mean that the masterfile is split between the headquarters/parent company and subsidiaries, i.e. that part of the masterfile documentation is kept at group level and part at local sub level.]

34. In practice, a subsidiary would prepare documentation on the facts and circumstances of its intercompay transactions, whereas the parent company would prepare documentation on the arm's length nature of the company's transfer pricing.

35. Taking into account the basic principles of the masterfile concept, it can be expected that the parent company undertakes to prepare timely the masterfile in

order to comply with any reasonable request originating from one of the tax administrations involved. The taxpayer should make the masterfile available upon request of a tax administration, within 30 days from the date of the request.

[*Please note: Business Members are of the opinion that 30 days is too short taking into consideration that the masterfile or parts of it might need to be translated into the national language of the tax administration requesting it. A Tax Administration Member, on the other hand, proposes that the reasonable time for a Member State to require a business to make documentation available should not be less than 14 days. The Secretariat, therefore, believes that 30 days may be a reasonable compromise.*]

36. The way that documentation should be stored - whether on paper, in electronic form or in any other system - should be at the discretion of the business, provided that it could be made available to the tax administration in a reasonable way. Considering however that the masterfile concept would be a service to all national tax administrations, taxpayers should be held responsible for maintaining the masterfile in a format which can be made easily and quickly accessible for all national tax administrations. Digital processing of the masterfile should, therefore, be recommended.

[*Proposal from a Tax Administration Member and the Secretariat*]

37. The enterprise should not be obliged to retain documentation beyond a reasonable period consistent with the requirements of domestic law both at parent company and group entity level.

38. The business that would be responsible for making documentation available to the tax administration would be the business that was requested to make the tax return and that would be liable to a penalty if adequate documentation were not made available. This would be the case even if the documentation was prepared and stored by one company within a group on behalf of another.

[*Proposal from a Tax Administration Member*]

[*A Tax Administration Member proposes adding the following paragraph, which the Secretariat believes is incompatible with the masterfile concept as a centralisd approach and inconsistent with what is said elsewhere in this document and in particular in paragraph 33:*

"If a Member State adopted the masterfile concept, a corporate group would need to keep documentation as specified in the masterfile in respect of all its members, including permanent establishments, in that Member State if it wanted to enjoy the freedom from penalties in respect of any particular member company or permanent establishment."]

4. SCOPE OF APPLICATION OF THE MASTERFILE

39. A centralised documentation approach such as the masterfile concept poses some problems related to its scope of application. Three questions need to be addressed:

i) Which entity is the parent company or headquarters that is responsible for preparing and keeping the masterfile?

40. Community legislation has defined a "parent company" in Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States as amended by Council directive 2003/123/EEC of 22 December 2003 (Parent-Subsidiary Directive).

41. In this Directive a parent company is defined as: "…any company of a Member State which fulfils the conditions set out in Article 2 (of the Directive) and has a minimum holding of 25 % in the capital of a company of another Member State fulfilling the same conditions…".

42. Article 2 of this Directive is referring to the legal form of the company, the condition that for tax purposes the company is considered to be a Community resident company and is subject to one of the domestic taxes listed. The definition of a parent company in the Parent-Subsidiary Directive does not cover transparent entities and individual taxpayers.

ii) Which legal entities should be considered to be included in the group structure, i.e. need to be considered as "associated enterprises" for including documentation on the intra-group transactions in the masterfile?

43. Whereas Member States have adopted a variety of definitions of "associated enterprise" for various purposes, according to the OECD Guidelines, an associated enterprise is an enterprise that satisfies the conditions set forth in Article 9, sub-paragraphs 1*a)* and 1*b)* of the OECD Model Tax Convention. Under these conditions, two enterprises are associated if one of the enterprises participates directly or indirectly in the management, control, or capital of the other or if "the same persons participate directly or indirectly in the management, control, or capital" of both enterprises (i.e. if both enterprises are under common control).

<u>Question 1:</u> Considering the aforementioned Community standard to define a "parent company" and the OECD definition of "associated enterprises" do Members agree to adopt these definitions for the masterfile concept or should the definition of "parent company" also include transparent entities and individual taxpayers?

iii) What about EU subsidiaries of non-EU parent companies/headquarters?

44. In this respect it would of course be difficult to oblige a non-EU company to comply with EU documentation rules but the proposal is that the choice of the masterfile concept is optional for companies. It would not preclude multinational enterprises with a non-EU parent preparing a centralised EU-documentation package for its subsidiaries. Such a type of company could for example opt to select one of its EU-subsidiaries as being responsible for the masterfile which would enable easy and quick access for all EU tax authorities to the masterfile.

<u>Question 2:</u> Do Members agree that a non-EU parent company should have the possibility to designate one of its EU subsidiaries as being responsible for establishing and maintaining the masterfile for all of its EU group entities ?

[Please note: The following Annex is a contribution from a Tax Administration Member]

ANNEX

DRAFT RECOMMENDATION FROM THE COUNCIL TO THE MEMBER STATES

1. A Member State should not impose any penalty on a business for failing to make transfer pricing documentation available to its tax administration if, at the time the business was due to make its tax return, the business, or another business with which it was associated (whether or not that other business was resident in the Member State) :

   (a) had documentation available as specified in paragraph 2 below;

   (b) that documentation was made available to the tax administration within a reasonable time after the tax administration had made a reasonable request;

   (c) that documentation was made available in a reasonable manner.

2. The documentation specified in paragraph 1 above consists of:

   (a) an identification of all the businesses with which the business in question had transactions to which transfer pricing rules applied during the period covered by the tax return;

   (b) an explanation of the ownership relationship (in terms of shareholding or other powers through which control can be exercised) between the businesses in question and the associated businesses specified in (a) above throughout the period covered by the tax return;

   (c) an explanation of any creditor/debtor relationship between the businesses in question and the associated businesses specified in (a) above at any time in the period covered by the tax return;

   (d) an identification of the transactions to which transfer pricing rules applied between the business in question and the businesses specified in (a) above during the period covered

by the tax return;

(e) an explanation of the activities or relationship in respect of which the transactions specified in (d) above took place;

(f) an explanation of the role played by the business in question and the businesses specified in (a) above in the activities or relationship specified in (e) above and, in particular, an explanation of the risk borne by each party in terms of, for example, inventory and exchange rate fluctuations;

(g) an identification of the method used to establish an arm's length result for the transactions specified in (d) above and an explanation of why that method was the most appropriate;

(h) an identification of the values reflected in the tax return of the transactions specified in (d) above, including identification of any difference between those values and the values for the same transactions in the accounts of the business prepared for general reporting purposes.

3. The Member State would not necessarily impose a penalty for failing to make documentation available if the conditions described in paragraph 2 above were not met. Whether a penalty would be appropriate would depend on the particular circumstances.

4. The Member State could require a business to make documentation available going beyond that listed in paragraph 2 above. The Member State should not impose any penalty on a business for failing to make such additional documentation available if the documentation:

(a) was not available at the time the tax return was due to be made, but

(b) was made available to the tax administration within a reasonable time after the tax administration had made an appropriate request, and

(c) was made available in a reasonable manner.

5. The reasonable time referred to in paragraph 1(b) above should not be less than 14 days.

6. The reasonable time referred to in paragraph 4(b) above should not be less than 90 days.

7. The reasonable manner referred to in paragraphs 1(c) and 4(c) above:

(a) can include a specification of the language in which the documentation should be made available;

(b) should not otherwise insist on the documentation being made available in a particular form if the business could make it available in a reasonable manner in another form.