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## **EU JOINT TRANSFER PRICING FORUM**

### **DRAFT REVISED SECRETARIAT DISCUSSION PAPER ON THE MASTERFILE CONCEPT**

**Meeting of Thursday 16 September 2004**

**Centre de Conférences Albert Borschette  
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**Working paper**

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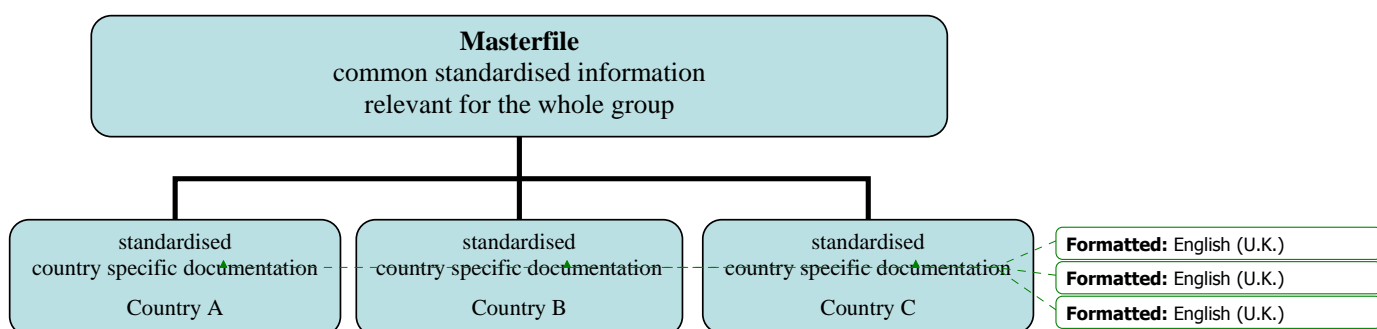
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# 1. THE MASTERFILE CONCEPT

## 1.1 General approach

1. The "masterfile" concept is an enhanced version of the centralised, standardised documentation concept. In an EU-wide context a multinational group would prepare **one set of standardised EU Transfer Pricing Documentation** ("EU TP Documentation") that would consist of two main parts (i) one uniform set of documentation containing common standardised information relevant for all EU group members (the "masterfile") and (ii) several sets of standardised documentation each containing country-specific information ("country specific documentation"). The masterfile concept means, therefore, that a multinational group of companies has a standardised set of documentation (the "masterfile" supplemented by "country specific 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.

The masterfile concept can best be illustrated with the following chart:



The documentation set for country A would consist of the common masterfile supplemented by the standardised country specific documentation for country A; the documentation set for country B would consist of the same common masterfile supplemented by the standardised country specific documentation for country B.

## 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 (i) for taxpayers to identify transactions that may require more detailed explanations and documentation and (ii) for tax administrations for case selection purposes and as a starting point for the examination of the company's transfer pricing. The masterfile concept would improve the quality of the documentation and enhance taxpayers' compliance with transfer pricing documentation requirements in EU Member States. It would thus reduce the risk of double taxation and the exposure to documentation related penalties.

### 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 tax administrations involved would have access to the same common documentation and information as far as they are relevant for the Member States concerned. 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) Enhanced transparency of the transfer pricing process;
  - e) Leverage from experience and prior work wherever possible;
  - f) Centralisation of the review of any material prepared at local level to avoid misunderstandings;
  - g) Facilitation of compliance; and
  - h) Reduction, 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). At the same time, by complying with the standardised EU TP Documentation in all EU Member States, taxpayers would benefit by avoiding to be subjected to documentation related penalties.

*[Substance taken from para. 6 a) below. The Member from the Portuguese tax administration disagrees with the last sentence of this paragraph.]*

5. A taxpayer acting in good faith and providing in a timely manner appropriate documentation as described in chapter 3.2 and 3.3 below and implementing it, i.e. properly applying its documentation to determine its arm's length transfer prices, should not be subjected to documentation related penalties or denied access to the EU Arbitration Convention.

*[The Member from the Portuguese tax administration disagrees with this paragraph].*

*[Business Members propose adding the following text (new wording suggested by the Secretariat):*

*"Such a taxpayer should also be free of penalties related to transfer pricing adjustments. While the taxpayer and the tax administration may disagree on the range of arm's length transfer prices and an adjustment may be made by the tax administration, the serious taxpayer, having done its part in good faith and in a*

*professional manner, should not be penalised by documentation or adjustment related penalties.]*

6. Additional benefits for taxpayers are:

- [shifted to paras. 4 and 5 above]a) reduced probability of being audited; and
- b) reduced risk of double taxation.

*[Substance shifted to paras. 4 and 5 above]1.3.3. From a tax administration perspective*

- 7. From the steps often followed by multinational enterprises engaged in this process, it is likely that documentation based on the masterfile concept would be prepared by individuals with more experience of transfer pricing and with more information to hand than would be the case if documentation were prepared at a decentralised country level. Given that the objective of a tax administration is information, a centralised and thus consistent approach would be to its advantage, because one of the main benefits of a consistent approach would be an improvement in the quality of the documentation. This would help safeguard a tax administration's tax base.
- 8. The Member States concerned would benefit substantially because they would have insight in the EU-wide transfer pricing policy of the company. The contents of the EU TP Documentation as specified in chapter 3.2 and 3.3 below would allow Member States to:
  - a) have more information about intra-group transactions that are relevant for the Member States concerned
  - b) more effectively perform their risk assessment;
  - c) reduce administrative costs; and
  - d) assess the transfer prices of the inter-company transactions.

## **2. THE BASIC FUNCTIONING OF THE MASTERFILE CONCEPT**

### **2.1. General acceptance by tax authorities mandatory**

- 9. A necessary feature of the masterfile concept is a standardisation of the type of information and documents required by Member States' tax administrations. , i.e. require less items in the masterfile or the country specific documentation. Obviously, a country may decide not to have transfer pricing documentation at all or have a shorter version of the masterfile. However, a Member State that adds items to the masterfile or the country specific documentation would depart from the masterfile concept. In order for taxpayers to fully benefit from the advantages of the masterfile concept, i.e. notably the reduction of compliance costs and the avoidance of documentation related penalties, all Member States should accept it.

## 2.2. Mandatory vs. optional application for taxpayers

10. 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. A company should, however, not arbitrarily opt in and out of the masterfile concept for its documentation purposes but retain a certain degree of consistency and continuity in its documentation policy. Also, a multinational group of companies should apply the masterfile concept collectively to all group members within the EU.

## 2.3. Rights and obligations of taxpayers and tax administrations

11. The masterfile 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 under domestic law for complying with documentation requirements although it might not be the physical owner of the masterfile. (see also paragraph 38 below)
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.

*[The Member from the Greek Tax Administration proposes adding the following three paragraphs:*

*"Imposing penalties on a subsidiary (whose only actual power would be to ask its parent to hand over requested documents or information) for the delay or failure of its foreign parent company to comply may not always be an effective remedy, not least because, depending on the legal system of each country, this might be legally ambivalent and lead to litigation and even longer delays.*

*To overcome these problems and render the masterfile system more effective for all parties concerned, the masterfile information could be filed and stored in a central database directly accessible by certain authorized users from national tax administrations. Care should be taken that the information is structured in a way that allows the users to locate easily the specific pieces that are essential for their operations.*

*The authorized users could be offered limited access each time, depending on the specific case. The technical features of the system should, of course, be the object of further elaboration. The data should be filed in a common language (English) and the authorized users should be tax officials with a good command of the language. They would be bound to secrecy by strict obligation. In order to improve the system's efficiency, consistency and reliability a formula should be found (e.g through work in the OECD) so that non-EU parent companies can participate as well."*

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

In both cases adoption of the masterfile concept by a Member State would confer a legally enforceable right to the taxpayer to be exempt from documentation related penalties if the documentation requirements as specified in chapter 3.2 and 3.3. below were met (see Annex II "Draft Recommendation from the Council to the Member States").

*[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.

*[The Member from the UK Tax Administration proposes deleting the second sentence reasoning that a Member State could have transfer pricing documentation requirements but decide not to implement the masterfile concept. He, therefore, holds the second sentence meaningless. The Secretariat, however, is of the opinion that the second sentence expresses a recommendation that should be maintained.]*

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

16. As the masterfile concept is a standardised approach, it follows that the type of transfer pricing documentation 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 consistent 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.

*[The Member from the UK Tax Administration proposes deleting the first sentence. For the reason and the position of the Secretariat see para. 15 above.]*

17. The contents of the masterfile and the country specific documentation should, therefore, be as complete as necessary but as limited as possible to serve its purpose as described in chapter 1.2 above (the contents of both 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.
18. A Member State who requires taxpayers in accordance with domestic documentation rules to prepare additional documentation to what is already available in the masterfile or the country specific documentation as specified in chapter 3.2 and 3.3 below, would deviate from the masterfile concept. It should be noted that such 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.
19. 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.
20. 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 3.2 and 3.3 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.

### **3. CONTENTS OF THE EU TP DOCUMENTATION**

#### **In general**

21. The content of the master file and the country specific documentation is generally understood to be a roadmap (or standardized document) of a multinational group's intercompany relations and transactions. It should contain enough details to allow the tax administration to make a risk assessment for case selection purposes or at the beginning of a tax audit and ask relevant and precise questions regarding the company's transfer pricing.
22. Each of the following items of the EU TP Documentation, i.e. the masterfile supplemented by the country specific documentation, 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.

*[Shifted from para. 26 below]*

### **3.2. The masterfile**

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.

24. The masterfile should contain the following items:

- a) description of the business and business strategy including changes in the business strategy compared to previous tax years;
- b) *[Proposal from Tax Administration Members]*the group’s organisational, legal and operational structure where relevant for EU Member States (including an organisation chart, a list of group members and a description of the participation of the parent company in the subsidiaries) ;  
*[Proposal from Tax Administration Members]*
- c) identification of the associated enterprises engaged in controlled transactions with and within the EU;
- d) general description of the controlled transactions with and within the EU, i.e.
  - i) flows of transactions (tangibles, intangibles, services);
  - ii) invoice flows;
  - iii) values of transaction flows;*[Proposal from Tax Administration Members]*
- e) general description of functions performed and risks assumed including description of changes in respect of functions and risks compared to previous tax years, e.g. the change from a full fledged distributor to a commissionaire;  
*[Proposal from Tax Administration Members]*
- f) ownership of intangibles (patents, trademarks, brand names, know how etc.) and royalties paid or received;  
*[Proposal from a Tax Administration Member]*  
*[Shifted to para. 26 below][Shifted to para. 26 below]*
- 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;
- h) an undertaking by the taxpayer to provide within a reasonable time frame according to national rules supplementary information upon request; and



- i) Cost Contribution Agreements, APAs and Rulings as far as group members in the EU are affected.

*[Proposal from a Tax Administration Member]*

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 Non-Member State C (controlled transactions 1 and 2, cost plus method applied). Subsidiary B delivers goods to its sister company C (controlled transaction 3, resale price method applied). In order to allow the tax administrations in Member States A and B to obtain information on the transactions between A and B and between B and C (controlled transactions 1 and 3) the masterfile has to contain information concerning controlled transactions 1 and 3 in all three States. This means, for example, that Member State A may also obtain information regarding controlled transaction 3 (between Member State B and Non-Member State C).*

*[Shifted to para. 22 above]*

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

### **3.3 Country specific documentation**

26. The content of a country specific documentation is a supplement to the masterfile. Both together constitute the documentation file for the respective EU Member State. In order to meet the EU TP documentation requirements, a country specific documentation should contain, in addition to the content of the masterfile, the following items:

*[Proposal from the Secretariat]*

- a) details of country specific controlled transactions;
- b) comparability analyses, i.e.
  - i) characteristics of property and services;
  - ii) detailed functional and risk analyses;
  - iii) contractual terms;
  - iv) economic circumstances;
  - v) specific business strategies; and
  - vi) benchmark studies if available; and

*[Shifted from para. 24 above]*

- c) an explanation about the selection and application of the transfer pricing method, i.e. why a specific transfer pricing method was selected and how it was applied.

27. [Shifted from para. 24 above]As the organisational and operational structures of MNEs vary widely, a multinational group should be free to shift items from the country specific documentation to the masterfile. This should allow taxpayers sufficient flexibility to accommodate for specific circumstances. The following two examples illustrate the flexibility:

Example 1:

<p><b>Masterfile</b></p> <ul style="list-style-type: none"> <li>a) description of the business</li> <li>b) the group’s organisational, legal and operational structure</li> <li>c) identification of the associated enterprises engaged in controlled transactions</li> <li>d) general description of the controlled transactions</li> <li>e) general description of functions and risks</li> <li>f) ownership of intangibles</li> <li>g) substantiation of the arm's length nature of the company's transfer pricing</li> <li>h) an undertaking by the taxpayer to provide supplementary information upon request</li> <li>i) Cost Contribution Agreements, APAs and Rulings</li> </ul>	<p><b>minimum requirement</b></p>
<p><b>Standardised country specific documentation</b></p> <ul style="list-style-type: none"> <li>a) details of country specific controlled transactions</li> <li>b) comparability analyses</li> <li>c) explanation about the selection and application of the transfer pricing method</li> </ul>	

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Example 2:

<b>Masterfile</b> a) description of the business b) the group's organisational, legal and operational structure c) identification of the associated enterprises engaged in controlled transactions d) general description of the controlled transactions e) general description of functions and risks f) ownership of intangibles g) substantiation of the arm's length nature of the company's transfer pricing h) an undertaking by the taxpayer to provide supplementary information upon request i) Cost Contribution Agreements and APAs and Rulings j) comparability analyses k) explanation about the selection and application of the transfer pricing method	<b>minimum requirement</b>
<b>Standardised country specific documentation</b> a) details of country specific controlled transactions	

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[Proposal from the Secretariat]

28. Any country specific information and documents that relate to a controlled transaction involving one or more Member States must be contained either in the country specific documentation of all the Member States concerned or in the common masterfile.

Example:

*The Swiss subsidiary of a French parent company provides R&D services to its Austrian sister company. In relation to the Swiss subsidiary the masterfile of the group must contain the items a) – i) as described in paras. 24 and 25 above. In addition, the country specific documentation for the Austrian subsidiary must also contain country specific information and documents in relation to the Swiss subsidiary, i.e. the items a) – c) as described in para. 26 above, unless these information and documents are contained in the masterfile.*

[Proposal from the Secretariat]

#### 4. Use of language

29. Serving the purpose of the masterfile concept, i.e. the reduction of the compliance burden, only a limited number of 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

*[Comment from the Member of the UK Tax Administration: "The drafting of paragraph 29 depends on the legal status of the masterfile. If it confers a legal right (such as an exemption from penalties), Member States should be entitled to prescribe the language in which it is compiled. If it is a statement of best practice, the report could only make a recommendation."]*

## 5. Preparation, submission and storage of the documentation

30. The evidence required for preparing the masterfile and country specific documentation can reasonably be expected to be available to the company at the time of the transaction. However, the taxpayer should have to submit its documentation, i.e. the masterfile and the country specific documentation, to the tax administration only at the beginning of a tax audit or upon specific request. By contrast, when filing the tax return, a taxpayer may only be required to submit a questionnaire or risk assessment form of no more than two or three pages. An example of such a questionnaire can be found in annex I of this paper [*document Denmark\_Annex\_I*].

*[Deletion of the last three lines proposed by the Secretariat. Reason: whether or not a taxpayer is liable to a documentation related penalty can only be determined at the time when the taxpayer must submit his documentation, i.e. at the beginning of a tax audit or within a reasonable time upon specific request from the tax administration.]*

31. A Member State could, however, have rules to require a business to make available documentation in response to a specific 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 EU TP Documentation.

*[Proposal from a Tax Administration Member]*

32. 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 and the country specific documentation 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 and the country specific documentation was due to have been made.

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

33. 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 and the country specific documentation. It might be appropriate to specify that the Member State should not apply such penalties by reference to a time less than 60 days after an appropriate request has been made by the tax administration.

*[Proposal from a Tax Administration Member reasoning that 90 days is too long given the limited time available in some Member States for a tax audit]*

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

*[Proposal from a Tax Administration Member and Business Members]*

*[Proposal from a Tax Administration Member]*

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 in a given Member State should make the masterfile and the country specific documentation 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. See also para. 33 on additional documentation to be made available upon specific request]*

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.

*[Proposal from a Tax Administration Member]*

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]*

39. If a Member State adopted the masterfile concept, a corporate group would need to keep documentation as specified in the masterfile concept 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.

*[Proposal from a Tax Administration Member. Reason: This paragraph is required if the masterfile is going to have any legal status. If company A and company B are members of the same group, and both are resident in the same Member State, company A could only opt for the masterfile concept if company B did so as well. The Secretariat believes that this paragraph is consistent with para. 10 above.]*

40. A parent company or headquarter has access to all information and documents concerning its subsidiaries. A subsidiary, on the other hand, must have access to all information and documents concerning its transactions with related parties.

Information and documents, however, that do not relate to a subsidiary's own transactions do not have to be contained in the masterfile or in the subsidiary's country specific documentation. A tax administration should, therefore, not impose the obligation on a subsidiary to supply such information or documents. Rather, such information or documents can be obtained by making a request for information to the other tax administration involved under the exchange of information article of the bilateral double tax treaty or the Council Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums, as amended by Council Directive 2004/56/EC of 21 April 2004 (Mutual Assistance Directive).

*[Proposal from the Secretariat]*

## **6. Scope of application of the masterfile concept**

41. For the masterfile concept to be applied consistently within the EU, the following question needs to be addressed:

*[Proposal from the Secretariat. As centralisation at the parent company or headquarter level is not considered mandatory (see para. 34 above) paras 40-42 above are obsolete.]*

***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?***

42. 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, subparagraphs 1a) and 1b) 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.

*[The Member from the UK Tax Administration proposes adding the following paragraph, which the Secretariat believes is redundant, because it is covered by para. 42:*

*"The masterfile concept should not be confined to groups of companies. It should apply to any enterprise to which transfer pricing rules apply. The masterfile concept should, therefore, also apply to enterprises that are under common control including, for example, circumstances in which an individual is the controlling shareholder in two companies." ]*

***Question: Considering the aforementioned OECD definition of "associated enterprises" do Members agree to adopt this definition for the masterfile concept which would also include individual taxpayers?***

*[Proposal from the Secretariat. As centralisation is not considered an essential feature of the masterfile concept (see para. 34 above), paras. 40-44 (old) have been deleted. Also, it*

*seems unnecessary for a non-EU parent company to designate one of its EU-subidiaries as being responsible for establishing and maintaining the masterfile. Rather, any group member can establish and keep the masterfile even if it is located outside the EU. If a non-EU multinational company opts for the masterfile but does not submit its documentation (masterfile and country specific documentition) as required, its EU subsidiary will be liable to documentation related penalties.]*

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

ANNEX II

DRAFT RECOMMENDATION FROM THE COUNCIL TO THE MEMBER  
STATES

1. A Member State should not impose any transfer pricing penalty 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. A transfer pricing penalty specified in paragraph 1 above is
  - (a) a penalty for failing to make documentation available;
  - (b) a penalty for making a transfer pricing adjustment; or
  - (c) a serious penalty for purposes of the Arbitration Convention
  
3. 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.

4. 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.

5. 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.
6. The reasonable time referred to in paragraph 1(b) above should not be less than 30 days.
7. The reasonable time referred to in paragraph 4(b) above should not be less than 90 days.
8. The reasonable manner referred to in paragraphs 1(c) and 5(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.