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## **EU JOINT TRANSFER PRICING FORUM**

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

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

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## 1. THE MASTERFILE CONCEPT

In the context of the discussions on documentation concepts, one of the concepts which met with great interest from Members was the so-called "masterfile" concept which will be discussed in more detail hereafter.

### 1.1. General approach

The "masterfile" is an enhanced version of the centralised 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.

### 1.2. Possible purpose of a masterfile

The tax authorities of the Member States concerned would have access to the information contained in the masterfile which would serve both as a basic set of information for the assessment of the transfer prices as well as a risk-analysis tool for case-selection purposes.

### 1.3. What could be the advantages of a masterfile ?

#### 1.3.1. *For both tax payers and tax administrations*

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

More consistency in the functional analyses.

Leverage from experience/prior work wherever possible.

Centralisation of the review of any material prepared at a local level to avoid misunderstandings.

Facilitate compliance

#### 1.3.2. *From a taxpayers perspective*

Centralised documentation could substantially **reduce taxpayers' compliance costs** by fulfilling the documentation requirements in all EU countries in a similar and efficient way (economies of scale), and consequently reduce the compliance burden on intra-community trade.

#### 1.3.3. *From a tax administration perspective*

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 on a decentralised, national basis. 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.

#### **1.4. An illustrative example (Without pre-empting discussions on the actual content of the masterfile)**

Consider a headquarter company A in Member State A providing HQ services to subsidiary B (a production company) in Member State B and to subsidiary C (a distribution company) in Member State C (controlled transaction 1). B delivers goods to its sister company C (controlled transaction 2).

What content could possibly be required for documentation ?

Description of the business, the group's organisational chart, description of controlled transactions 1 and 2;

Description of the comparability factors of chapter I of the OECD Guidelines, including a functional analysis, an explanation of the selection and application of the transfer pricing method and a substantiation of the price regarding transaction 1 and 2. The file also contains financial data regarding transactions 1 and 2.

This means that Member State A also receives information regarding controlled transaction 2 (between Member State B and C).

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

- i) have more information about all intra-group transactions
- ii) more effectively perform their risk assessment and
- iii) reduce administration costs.

Although this seems to benefit substantially Member States, the benefits for the company are beside those listed under 1.3.2:

- i) reduction of chance of being audited
- ii) smaller chance of penalties
- iii) less possibility for double taxation

***Question 1: In order to reduce taxpayer compliance cost and to improve the quality of the available documentation, do Members in principle recognise the potential of a EU-wide standardised and centralised approach?***

## 2. THE BASIC FUNCTIONING OF THE MASTERFILE

### 2.1. Best practice vs. general acceptance by tax authorities

Whereas doc. JTPF/019/2003/EN deals with the masterfile concept under the centralised standardised approach, the idea was expressed that the masterfile concept could be introduced under a Code of "best practice", the latter being defined as *the description of certain aspects of legislation, administrative rules and practices on documentation requirements applied by countries (or to be developed) that Member States are recommended to follow.*

However a "best practice approach", involving the possibility for Member States to opt-in to the masterfile concept would seem incompatible with the principles of the masterfile itself.

#### **An example:**

A company has its headquarters in country A and subsidiaries in countries B, and C.

In the masterfile concept, the single set of EU-wide documentation covering all intra-group transactions would be kept centrally at the company's headquarters in country A.

The tax authorities of country B opting in would be able to have access to this single set of documentation and extract data for their local purposes.

Country C, not opting in, would require the company to prepare and maintain its documentation at the local level in country C.

In this case the company would not fully benefit from the masterfile, since it would need to prepare and maintain the masterfile and in addition possibly also non-standardised local documentation for country C. On the contrary, the compliance burden would even be higher than having three separate sets of local documentation, because the information of companies A, B and C needs to be included into the masterfile.

***Question 2.1: Do Members agree in principle with this particular type of masterfile concept ?***

***Question 2.2: Do Members agree that the most efficient way to reduce companies' compliance burden would be that all EU tax authorities were willing to accept the masterfile concept?***

***Question 2.3: If this were not the case, do business Members agree that it would be workable if only a limited number of tax administrations would accept the masterfile concept?***

## **2.2. Mandatory vs. optional application for taxpayers**

Whereas for integrated MNEs the masterfile concept definitely seems to bring a reduction of the compliance burden and has a potential to increase the quality of its documentation, this is not necessarily the case for smaller businesses, specific sectors 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 to comply with local documentation requirements. Subscribing to the masterfile concept should therefore be optional for business.

*Question 3: Do Members agree that considering the characteristics of certain businesses, the implementation of the masterfile concept should be optional for tax payers ?*

## **2.3. Role of the different actors**

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 which in any event is responsible although he might not be the physical owner of the masterfile and regardless of its location.

The tax authorities of the country where the masterfile is kept, would, like any other tax authority involved, have access to the masterfile for their own local purposes.

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

## **2.4. Consequences for Member States not having legal documentation requirements**

One of the concerns expressed in the aforementioned "Issue Paper" (doc. JTPF/003/2002/EN/FR/DE) was 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.

At this moment not all current EU Member States, nor all Acceding Countries have legislation on documentation requirements. 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.

Accepting this concept would equally involve that Member States which have currently no documentation requirements in their domestic legislation, would need to accept that companies with parent companies or headquarters in their jurisdiction, could be required to set-up and maintain group documentation according to the masterfile concept.

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

Without pre-empting the possible content of the masterfile, it seems obvious that to fulfil the purpose of the masterfile concept (see 1.2), a simple aggregation of all the documentation requirements of all the Member States would not be appropriate. Although the benefit of a centralised approach would be achieved it seems unreasonable to increase requirements to the currently most extensive ones. In this respect two alternatives could be envisaged:

i) Member States agree that the content of the masterfile should be limited to the purpose (see 1.2) and Member States retain the possibility of requiring more exhaustive documentation during the tax audit (this question is addressed in more detail under 3)

ii) Member States do not agree on i) and would require the taxpayer to prepare additional documentation to what is already available in the masterfile as described under (i) when filing the tax return to comply with domestic rules. This alternative would however not relieve the compliance burden for companies.

***Question 4: Do Members of tax administrations agree in principle to look for a solution as described under i)?***

## **3. POSSIBLE CONTENT OF THE MASTERFILE AND RELATED ASPECTS**

### **3.1. Substantial content**

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).

The masterfile could contain the following items:

- a) Description of the business
- b) The group's organisational chart
- c) Description of controlled transactions
- d) Description of the comparability factors of chapter I of the OECD Guidelines, including a functional analysis
- e) Justification of the selection and application of the transfer pricing method(s) used
- f) Explanation of the transfer price

g) An undertaking by the taxpayer to provide within a reasonable time frame, upon request, such information as is necessary for a Member State's tax administration for carrying out the provisions of the Arbitration Convention or the relevant Double Tax Convention and/or of its domestic laws.

Each item should be completed, taking into account the complexity of the company and the complexity of 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.

***Question 5: Do Members of tax administrations agree that the aforementioned items, if reasonably and honestly documented, would be sufficient for the purpose of the masterfile?***

***Question 5.1: Do Members of tax administrations agree that if a taxpayer has made reasonable efforts to comply with the masterfile documentation requirements and shows good faith, he would not be liable to penalties for non-compliance?***

### **3.2. Use of language**

Serving the purpose of the masterfile concept (i.e. the reduction of the compliance burden), it should be expected that such a masterfile would be set up in a common language that is accepted in different countries. It would depend however on each local tax administration whether it is willing and legally allowed to accept a file in a language other than the domestic language(s).

***Question 6: Do Members of tax administrations in principle undertake to accept the masterfile to be in a common language and to request translation only if strictly necessary and on a case by case basis?***

### **3.3. Preparation and submission of the masterfile**

Independent of the outcome of the discussions on the concrete content of the masterfile, the evidence required for its preparation can reasonably be expected to be available to the company at the time of the transaction.

Independent also of the scope of application of the masterfile (definition of the group), it seems obvious that in a centralised approach the headquarters or the parent company of a group, are the best placed to fulfil the masterfile obligations.

Taking into account the aforementioned and 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 origination from one of the tax administrations involved.

The way documentation is stored (for example, original documents or in a form involving some degree of processing) should be at the discretion of the enterprise. The enterprise also 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.

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 could therefore be recommended.

***Question 7: Do Members agree that the masterfile, preferably in digital format, should be made available upon request of a tax administration, within 30 days of the request ?***

#### **4. POSSIBLE SCOPE OF APPLICATION OF THE MASTERFILE**

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?***

Community legislation has defined the concept of "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.

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 20 % in the capital of a company of another Member State fulfilling the same conditions..."

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.



*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?*

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).

***Question 8: 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 ?***

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

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.

***Question 9: 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 group EU- entities ?***