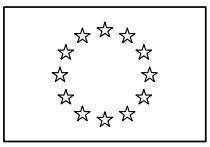

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Report on the Activities of the EU Joint Transfer Pricing Forum in the Field of Documentation Requirements
Report prepared by the EU Joint Transfer Pricing Forum
(COM(2005)543 final)

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1. SUMMARY OF PROCEEDINGS

Under the Chairmanship of Mr. Bruno GIBERT, partner of CMS Bureau Francis Lefebvre and the Vice-Chairmanship of Mr. Guy KERSCH, Tax Counsel - Europe, Pfizer Enterprises SARL, Luxemburg and Mrs. Montserrat TRAPE VILADOMAT, Deputy Head of the International Taxation Unit from Spain for representatives from business and tax administrations respectively, meetings were held on 18 March 2004, 10 June 2004, 16 September 2004, 14 December 2004 and 16 and 17 March 2005.

From the meeting of 10 June 2004 onward, the previous observers from the acceding countries (Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia and Slovakia) became effective Members of the Forum.

These meetings followed-up on the discussion on transfer pricing documentation requirements initiated already at the end of 2003.

The Forum started its discussions by examining questions such as the purpose and content of good and effective documentation and who has the burden of proof, compared existing systems some being considered as restrictive by providing a detailed list of documents to be submitted by the taxpayer and some being more flexible and working on a case by case basis. Work on transfer pricing documentation in other international fora was also considered.

Having in mind that a EU-wide common approach on documentation requirements could be beneficial both for taxpayers and tax administrations in terms of reducing compliance and operational costs and would lead to a substantial increase of quality, transparency and consistency, the following traditional approaches were initially identified as possible common approaches and were examined by comparing their pros and cons: "a code of best practice", "EU-wide standardized documentation rules" and the "centralised (integrated global) documentation" approach.

In light of the pros and cons of the traditional approaches (see para. 93), the Forum decided at the second meeting in 2004 to explore the potential of a new approach, i.e. a standardized "EU Transfer Pricing Documentation" (EU TPD), which is an enhanced version of the centralised (integrated global) documentation approach. The main features of the EU TPD, which was eventually considered the most appropriate approach, are:

a) standardisation of the documentation requirements necessary for a tax administration as a risk assessment tool and to obtain sufficient information for the assessment of the group's transfer prices;

b) the possibility for centralisation of the core part of the documentation (the "masterfile") at group level; and

c) availability to all EU Member States concerned of common standardised transfer pricing information relevant for all EU affiliates of a multinational enterprise.

The EU TPD would consist of two main parts: (i) one set of standardized and consistent documentation relevant for all EU group members of a multinational enterprise (the "masterfile"), and (ii) several sets of standardized documentation each containing country

specific information that fit together with the "masterfile". An important advantage for business would be that producing the EU TPD would reduce compliance costs and producing it in good faith and in a timely manner would certainly avoid the imposition of documentation related penalties.

The Forum further discussed the use of database searches for comparables and proposals for more general recommendations related to timing and preparation of documentation, aggregation of transactions, simplification for SMEs, language regimes and the application of documentation rules to permanent establishments.

Considering the re-entry into force of the Arbitration Convention on 1 November 2004, the Forum also discussed briefly at its meeting of 14 December 2004, Member States' positions arising from this event and in particular those related to pending cases.

The Forum adopted this report and the annexed recommendations by consensus in May 2005.

2. BACKGROUND AND GENERAL ISSUES RELATED TO DOCUMENTATION REQUIREMENTS

2.1. Introduction and context

2.1.1. EU - The Internal Market

The Commission study "Company taxation in the internal market" SEC (01) 1681 of 23 October 2001 identified high compliance costs and potential double taxation for intra-group transactions as a major tax obstacle to cross-border economic activities in the internal market. The study showed that compliance costs relating to transfer pricing result primarily from the obligation to prepare appropriate documentation and find comparables. The study concluded that, while there is evidence of aggressive transfer pricing by some companies, there are equally genuine concerns for companies which are making a bona fide attempt to comply with the complex and sometimes incompatible transfer pricing rules of different countries. Such concerns are becoming the most important international tax issue for companies as demonstrated by the survey conducted in the framework of this study and several others.

Conversely, Member States are, for example, concerned about the risk of a loss of tax through the artificial setting of transfer prices so that profits arise in other countries than they would under arm's length conditions. With corporate tax rates varying widely around the world, including a range of 0% to 35% for retained profits amongst Member States, this may be caused by the intention to avoid tax and is seen by some Member States as a serious problem even in the Internal Market.

Some EU Member States, wanting to ensure effective application of transfer pricing rules, have recently introduced new or additional transfer pricing documentation requirements. Others currently place higher priority on avoiding the need to impose extensive documentation requirements and on keeping compliance costs down. Documentation requirements overall have increased within the EU in the sense that some Member States either by legislation or by administrative guidance have introduced documentation rules or tightened existing requirements and it can be expected that this trend will continue.

The existence of different sets of documentation requirements in the Internal Market represents a burden for a company in one Member State that wants to set-up and/or conduct

business with an affiliated company in another Member State. The preparation of separate and unique documentation packages in different Member States is uneconomic. Small and medium-sized enterprises especially can be hit by these problems.

Business representatives strongly expressed the view that transfer pricing documentation requirements in the EU create unduly high compliance costs. Generally, it is said that they often go beyond the requirements which can be met by management accounting, thus creating a substantial and growing compliance cost for businesses involved in cross-border activities. Business also maintains that some Member States do not follow the OECD Guidelines in a coherent way and that there are significant differences in documentation requirements between Member States. Member States on the other hand argue that it is necessary that the national documentation requirements must be met and that they are often unable to examine transfer prices correctly due to non-compliance of taxpayers.

Compliance with multiple documentation rules within the EU must be recognized as a real problem because of the jurisdictional variances of several key factors, such as:

- substantive rules;
- penalties; and
- administrative policies.

The Commission's company tax study concludes that the compliance costs and the uncertainty could be reduced by better co-ordination between Member States of documentation requirements and developing best practices. A more uniform approach by EU Member States, within the framework of the OECD Guidelines, would also contribute to a stronger position in relation to countries outside the EU.

Some Member States have begun to introduce transfer pricing documentation requirements also for domestic transactions. However, in order to alleviate the compliance burden for domestic transactions tax administrations might need to limit or reduce documentation requirements in this context

2.1.2. OECD - Transfer Pricing Guidelines (Chapter 5)

In addressing the issue of documentation, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter called "OECD Guidelines") aim at maintaining a balance between the right of tax administrations to obtain from taxpayers the necessary information to ascertain whether the transfer pricing is at arm's length and the compliance cost of documentation rules for the taxpayer. The OECD Guidelines recognize that the taxpayer should make reasonable efforts, at the time transfer prices are set, to determine whether the arm's length principle is satisfied and that tax administrations can expect or oblige the taxpayer to produce documentation about its transfer pricing.

Tax administrations should have the right to obtain the documentation prepared or referred to in this process as a means of verifying compliance with the arm's length principle (see paragraph 5.28 of the OECD Guidelines).

To that effect, the OECD Guidelines provide a list of items, which are likely to be necessary or at least useful in most cases, and other types of information that will be useful in many cases. Given the specific nature of transfer pricing, i.e. the variety of cases and the different

facts and circumstances of each case, the list is neither exhaustive nor should it be viewed as a minimum compliance requirement (see paragraph 5.16 of the OECD Guidelines).

The OECD Guidelines state that it would be reasonable for tax administrations to expect taxpayers when establishing their transfer pricing for a particular business activity to prepare or to obtain such materials regarding the nature of the activity and the transfer pricing and to retain such material for production if necessary in the course of a tax examination. However, there should be no contemporaneous obligation at the time the pricing is determined or the tax return is filed to produce these types of documents or to prepare them for review by a tax administration (see paragraph 5.4 of the OECD Guidelines).

Each taxpayer should endeavour to determine transfer pricing for tax purposes in accordance with the arm's length principle, based upon information reasonably available at the time of the determination (see paragraph 5.3 of the OECD Guidelines).

Paragraph 5.15 of the OECD Guidelines indicates that it would be unreasonable to require the taxpayer to submit documents with the tax return specifically demonstrating the appropriateness of transfer prices. Any documentation requirement at the tax return filing stage should be limited to requiring the taxpayer to provide information sufficient to allow the tax administration to determine approximately which taxpayers need further examination.

2.1.3. PATA - Experience with a multilateral documentation package

In this respect, it might be interesting to note that the PATA (Pacific Association of Tax Administrators) including Australia, Canada, Japan and the United States, released on 12 March 2003 its final transfer pricing documentation package. This multilateral documentation package is intended to enable taxpayers to prepare – on a voluntary basis – a uniform set of documentation that would satisfy the transfer pricing documentation requirements in all PATA jurisdictions.

Taxpayers electing to apply the PATA documentation package must comply with three operative principles: (1) reasonable efforts, (2) contemporaneous documentation and (3) timely production. The PATA documentation package contains 10 broad categories and 48 specific items that should be included in the taxpayer's documentation. It is more specific than the regulations of any individual PATA member country.

In particular, small- and medium-sized enterprises may, therefore, be faced with comparatively large documentation compliance burdens.

The PATA documentation package does not protect taxpayers from transfer pricing adjustments and subsequent double taxation. The purpose of the PATA approach was mainly to simplify the process of preparing and maintaining transfer pricing documentation.

2.2. Purpose of good and effective documentation

2.2.1. Business point of view

For taxpayers, the intended benefit of good and effective documentation is less time and expense spent on preparing documentation and a substantially reduced risk of penalties. Businesses are, therefore, looking for pragmatic, user friendly solutions, preferably not exceeding the documents available from the ongoing own company reporting; not least, because staff applying documentation rules are not normally tax experts but operational staff.

2.2.2. Tax administration's point of view

For tax administrations the purpose of good and effective documentation is to ensure that the tax administration has sufficient information to identify the relevant inter-company transactions and allow the tax administration to determine whether a taxpayer's transfer pricing is in accordance with the arm's length principle. The main benefit of good documentation is less complicated and time-consuming transfer pricing examinations.

2.2.3. Benefit of risk assessment

A taxpayer's own risk assessment could help companies focus on necessary improvements in their transfer pricing system and make the tax audit process more efficient. Such a process should mirror that followed by a diligent and prudent business manager acting according to economic principles, who will be concerned to follow the arm's length principle. The existing procedures gather data for the tax administration to evaluate. By focusing directly on risk areas, the whole process could become much more efficient.

For tax administrations, which do not normally have the resources to check everything, making a risk assessment may be helpful in deciding which company to audit or which transactions of a business to examine. One of the factors that a tax administration may take into account in selecting a case for transfer pricing examination is its own knowledge about the nature of the documentation produced by the enterprise.

An effective risk assessment may be beneficial for both tax administrations and taxpayers. However, to achieve this, tax administrations must be prepared to give due consideration to the facts and analysis in the taxpayer's documentation and taxpayers must be prepared to produce documentation in good faith.

2.3. Content of good and effective documentation

2.3.1. Evidence

As far as both enterprises and tax administrations are concerned, it is necessary to establish whether the pricing of any particular transaction satisfies the arm's length principle. There has to be evidence of this.

Chapter 5 of the OECD Guidelines contains a general discussion of documentation. The critical role of comparability (looking at comparable transactions that have taken place between independent enterprises) in applying the arm's length principle from Article 9 of the OECD Model Tax Convention is stated in Chapter I of the Guidelines and developed in Chapters II and III with respect to each of the traditional and profit methods.

The "prudent business management principle", based on economic principles, implies that the sort of evidence that would be appropriate in relation to a transaction of large value might be very different from the sort of evidence that would be appropriate in relation to a transaction where the overall value is significantly smaller. It is not possible to prescribe detailed rules on this point.

Given the nature of controlled transactions, it may be necessary for the taxpayer in applying the prudent business management principle to prepare or refer to written materials that would not otherwise be prepared or referred to in the absence of tax considerations. When requesting submission of these types of documents, the tax administration should take great care to

balance its need for the documents against the cost and administrative burden to the taxpayer of creating or obtaining them. (cf. paragraph 5.6 of the OECD Guidelines).

In order to establish whether transfer pricing is at arm's length, many Member States, including Member States where the burden of proof is on the tax administration, oblige enterprises to identify comparable uncontrolled transactions. Internal comparables where they exist should be preferred to external comparables when applying traditional methods and the TNMM (see paragraphs 2.15, 2.33 and 3.26 of the Guidelines). However, it is not always the case that the taxpayer has internal comparables and because of the difficulties in locating adequate external uncontrolled transactions for which the comparability analysis can be satisfied, in practice taxpayers as well as some tax administrations frequently rely on publicly available data, e.g. net profit data from commercial databases (although the use of such commercial database is neither prescribed by the OECD Guidelines, nor by EU countries domestic legislations). Some special questions concerning the use of database searches for comparables are addressed in more detail in Chapter 5 below.

However, a coherent and transparent approach in identifying comparable uncontrolled transactions is important in ensuring, for example, that there is no "cherry picking" to suit either the taxpayer or the tax administration. Moreover, the issue of transparency with respect to identifying such comparable transactions is equally important in MAPs between competent authorities.

2.3.2. Documentation

Taxpayers are obliged to determine transfer prices for tax purposes according to the arm's length principle and are expected to prepare and keep documentation concerning how prices and conditions for the controlled transactions are set. The documentation must - on request - be presented to the tax administration and must be of a nature that enables the tax administration to assess whether the prices and conditions are those which would have existed had the transactions been concluded between independent parties.

A key issue for transfer pricing is, therefore, the question of what kind of documentation an enterprise needs to prepare as evidence to demonstrate it has applied the arm's length principle.

The OECD Guidelines say that the need for documentation should be balanced by the costs and administrative burdens and that documentation requirements should not impose on taxpayers costs and burdens disproportionate to the circumstances. In other words, the amount and type of documentation required should be in proportion to the circumstances of each case and the amounts at issue. For instance, especially for small and medium sized enterprises, the documentation requirements potentially impose an extra burden; this may be increased in the start up phase of their international expansion. Documentation requirements should keep this in mind.

The OECD Guidelines go on to say that it is not possible to define in any generalised way the precise extent and nature of the evidence or documentation that it would be reasonable for the tax administration to require or for the enterprise to produce for the purpose of an enquiry.

It could be argued that Member States should avoid developing rules that are very prescriptive, specifying long lists of material to be produced by all companies affected by transfer pricing regardless of individual circumstances. This prevents flexibility that could

otherwise take account of the specific facts and circumstances of a case. For businesses, the growing array of prescriptive transfer pricing rules may result in an onerous compliance burden which is felt to be particularly frustrating within the Internal Market but reflects the different systems and understanding of direct taxation in the Member States.

A flexible approach taken by tax administrations also allows the taxpayer to avoid the preparation and collection of data that may not be necessary in the situation of the specific taxpayer. This leaves some uncertainty but allows a company the flexibility to make reasonable decisions on what is relevant under the facts and circumstances that prevail in their particular business. On the other hand, tax administrations have to assess whether the decisions taken by the taxpayer reflect the arm's length standard. A prescriptive approach might appear to offer greater clarity and certainty for both taxpayers and tax administrations but at a significant cost to companies or those with relatively straightforward and transparent transfer pricing issues.

Each of the documentation approaches as presented in Chapter 3 below has its own merits as regards flexibility and pragmatism on one hand and certainty and reduced compliance costs on the other hand. It is obvious that there is some tension between these two opposing main objectives and some Member States prefer to be more flexible whereas others tend to be more prescriptive.

Chapter 5 of the OECD Guidelines discuss (in a way that is intended to be illustrative; that is to say it is neither compulsory nor exhaustive) what documentation might be expected. The information relevant to an individual transfer pricing enquiry depends on the facts and circumstances of the case. Chapter 5 of the OECD Guidelines outlines the information that could be relevant, depending on the individual circumstances.

On that basis, the following information could be relevant:

a) In general, information about the associated enterprises involved in the controlled transactions. It may be useful to include:

   i) an outline of the business;

   ii) the structure of the organization;

   iii) ownerships linkages within the multinational enterprise (MNE) group;

   iv) the amount of sales and operating results from the last few years preceding the transaction; and

   v) the level of the taxpayer's transactions with foreign associated enterprises; for example the amount of sales of inventory assets, the rendering of services, the rent of tangible assets, the use and transfer of intangible property and interest on loans.

b) In general, information about the controlled transactions at issue. It may also be useful to include additional information on the nature and terms of the transaction, economic conditions and property involved in the transactions, how the product or service flows among the associated enterprises and changes in trading conditions or renegotiations of existing arrangements. Also, a description of the circumstances of any known transactions between the

taxpayer and unrelated parties that are similar to the controlled transactions (internal comparables) and any information that might bear upon whether independent enterprises dealing at arm's length under comparable circumstances would have entered into a similarly structured transaction. Other useful information may include a list of any known comparable independent companies having transactions similar to the controlled ones (external comparables).

c) Information about the transfer pricing policy of the taxpayer and the whole MNE group, e.g. an explanation of the selection, application of the transfer pricing method[s] used and their consistency with the arm's length principle.

d) It would be useful for the enterprise to explain furthermore:

i) details concerning any set-off transactions that could have any influence on the arm's length price

ii) special circumstances that could involve the commercial and management strategy or the type of business;

iii) general commercial and industry conditions affecting the taxpayer such as competitive conditions, the regulatory framework, e.g. price regulations in a specific country or industry, the current and forecast business and technological environment and foreign exchange markets.

e) The following information could also be useful:

i) Information about the functions performed (taking into account assets used and risks assumed) necessary to carry out the functional analysis;

ii) financial information; and

iii) documents showing the process of negotiations for determining or revising prices in controlled transactions.

A taxpayer may reasonably be expected to prepare specific, more detailed documentation for extraordinary transactions, e.g. the transfer of intangibles or a substantive change of the functions and risks of the company. An enterprise should, however, not be required to justify why it has rejected the transfer pricing methods that it has not selected (the OECD Guidelines do not call for the company to prepare a comparison between prices prepared under different methodologies).

2.3.3. Burden of proof

Differences in Member States' rules on documentation requirements may in part be explained by differences in the burden of proof. Where the taxpayer bears the burden of proof, it appears relatively easy for the tax administration to keep transfer pricing documentation rules short and simple.

In most Member States the burden of proof is on the tax administration, even though in most of these countries the burden of proof is shifted to the taxpayer if he does not fulfil his

documentation requirements, e.g. where information is missing that only the taxpayer can provide.

In any case, as the OECD Guidelines state, "both the tax administration and the taxpayer should endeavour to make a good faith showing that their determinations of transfer pricing are consistent with the arm's length principle regardless of where the burden of proof lies".

2.4. Preparation, submission and storage of documentation

On the issue of timing, there was consensus that tax administrations can reasonably expect that some evidence for preparing transfer pricing documentation in relation to transactions within a period should be available at the time the tax return for the period is made to the tax administration. This includes evidence that the enterprise can reasonably be expected to obtain from another party.

The taxpayer should have to submit its 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 short questionnaire or an appropriate risk assessment form. Where a Member State requires a taxpayer to make in its tax return an adjustment to its taxable profit resulting from the application of the arm's length principle, documentation explaining such an adjustment should be available.

Information and documents going beyond what was required at the time a tax return was made would not need to exist at that time, and might never exist at all if the tax administration does not request it. The period for providing this additional information and documents should, therefore, be determined on a case-by-case basis taking into account the amount and detail of the information and documents requested. Depending on specific local regulations, the timing should give the taxpayer a reasonable period to prepare the additional information that can vary depending on the complexity of the transaction.

The Forum further shared the opinion that it should be irrelevant for tax administrations where and in which format - whether on paper, in electronic form or in any other system - a taxpayer prepares and stores its documentation. The way that documentation should be stored should, therefore, be at the discretion of the business, provided that the documentation could be made available to the tax administration in a timely manner and in a reasonable way.

The enterprise should retain documentation for a reasonable period consistent with the requirements of domestic law both at parent company and group entity level.

2.5. Aggregation of transactions

Although featured in the OECD Guidelines, the Forum was also of the opinion that additional guidance on the aggregation of transactions could usefully contribute to a better understanding between tax administrations and business. The Forum notes that the OECD is currently conducting a review of the comparability standard which includes a discussion of aggregation of transactions.

2.6. Attitude of tax administrations

Similarly, the Forum discussed some measures for clarifying and guiding the attitude tax administrations should have to the particular case. The attitude should be even-handed taking into account the documentation already available and the characteristics of the enterprise.

2.7. Application to SMEs

The Forum saw no specific need to develop particular transfer pricing documentation rules for Small and Medium Sized Enterprises but agreed that as a matter of pragmatism, a "reasonableness" test should be applied by tax administrations to assess the appropriate compliance standards for different types and sizes of business. Placing, for example, a lower compliance burden on SMEs as compared to subsidiaries of large multinational enterprises would not in principle contravene the OECD Guidelines.

2.8. Language

An important issue for tax administrations and businesses was the question in which language transfer pricing documentation should be presented. There was agreement that there was scope for minimizing costs and delays caused by translation requests which are not always strictly necessary. Tax administrations should only require a limited number of documents to be translated into their national languages when the documentation is due. Translation of other documents can reasonably be required upon specific request of during the tax audit.

2.9. Application to permanent establishments

In line with international trends and the work undertaken by the OECD, the Forum was also of the opinion that transfer pricing documentation requirements should also apply to transactions between a permanent establishment and an associated enterprise, to dealings between a headquarters and its permanent establishments and between permanent establishments of the same entity. In these cases the documents to be provided should also include relevant documentation to support recognition and characterization of intra-entity dealings

In order to come to an as large EU-wide common approach on transfer pricing documentation requirements as possible, the Forum agreed by consensus to issue some general conclusions on these topics discussed under Chapter 2. These conclusions are listed in Chapters 1.1 and 1.2 of the Annex.

3. POSSIBLE APPROACHES OF EU-WIDE DOCUMENTATION

3.1. The purpose of a EU-wide common approach

In reviewing transfer pricing documentation generally, the interrelation of a common or standardized approach within the EU with different documentation requirements in non-EU countries has to be taken into consideration, e.g. in case of a non-EU parent company having subsidiaries in several EU Member States. A consistent EU approach will, of course, not bind non-EU countries but in setting a good example it may influence the legislation and administrative practices in non-EU countries.

Problems with different documentation requirements will persist for multinational enterprises doing business both inside and outside the EU. They will generally still have to prepare separate documentation packages for EU and non-EU purposes.

Another aspect examined was the scope of a consistent EU approach, i.e. which entities of a multinational group of companies doing business beyond the EU should be covered by a

common EU transfer pricing documentation approach. It seemed clear that all group entities resident in the EU should follow the common EU approach. As regards associated enterprises resident outside the EU, the Forum agreed that the common EU approach should also encompass controlled transactions between those companies and group entities resident in the EU. However, problems could arise especially with a centralised approach, where an EU company is an associated enterprise of a non-EU company.

More particularly, the Forum considered what a tax administration may legitimately expect in terms of documentation and what a taxpayer that prepares it in good faith may expect in return. To this effect the discussions attempted to develop a common approach (including questions of language) in setting up documentation standards which would benefit business and tax administrations in terms of transparency, consistency, reduction of compliance cost (in particular for SMEs) and improvement in taxpayer compliance.

From the tax administrations' perspective the main benefits of the possible recommendations were considered to be

- to ensure that tax administrations obtain sufficient information to identify the relevant inter-company transactions;
- to allow the tax administration to assess whether a taxpayer's transfer pricing is in accordance with the arm's length principle; and
- to allow for less complicated and time-consuming transfer pricing examinations.

From the taxpayers' perspective the most important goals of the possible recommendations were:

- to assist taxpayers to efficiently prepare and maintain useful transfer pricing documentation as far as possible in line with the ongoing own company reporting;
- to respond to the difficulties that enterprises in EU Member States face in complying with the laws and administrative requirements of multiple jurisdictions;
- to avoid the imposition of transfer pricing documentation-related penalties on taxpayers; and
- to prevent double taxation.

For example, establishing a common framework for documentation would help taxpayers comply because a consistent EU position could facilitate both the documentation process and the central administration of transfer pricing policies. This would reduce taxpayers' compliance costs and record keeping tasks that are a burden on intra-community trade.

An important influence on documentation requirements in the documentation chapter of the OECD Guidelines is the approach of the prudent business manager. This approach states that the process of considering transfer prices should be determined in accordance with the same prudent business management principles that would govern the process of evaluating a business decision of the same complexity and importance. Business claims that this implies

that tax administrations cannot expect taxpayers to devote more resources to setting transfer prices at arm's length than they would for other aspects of their business.

The level of documentation should, however, reflect the complexity and importance of the controlled transactions. In that context, the OECD Guidelines state in para. 5.4 that "…the application of these principles will require the taxpayer to prepare or refer to written materials that could serve as documentation of the efforts undertaken to comply with the arm's length principle…" Tax administrations take the view that the prudent business management principle also implies that an enterprise prepares its documentation within a reasonable time frame. According to the OECD Guidelines (paragraph 5.6), it may be necessary in applying principles of prudent business management for the taxpayer to prepare or refer to written materials that would not otherwise be prepared or referred to in the absence of tax considerations, including documents from foreign associated enterprises.

The practical application of the prudent business management principle is difficult, but this makes it all the more important that Member States adopt the same approach, not least because this principle implies that on each side of a transaction there is a prudent business manager following economic principles on behalf of his company.

Many multinational enterprises favour integrated global documentation for tax purposes. The main reason given for this is that an integrated approach provides consistent documentation. However, many multinational enterprises, in practice, do not apply such a global approach. One of the main reasons is the different documentation requirements (including questions of language). The existence of a common EU documentation guidance could serve as a major incentive for business to prepare EU and, as necessary, global documentation.

Multinational enterprises are often active in both the EU and other (OECD) countries. It is, therefore, important that common EU documentation requirements do not interfere with the OECD Guidelines. The proposed conclusions hereafter are, therefore, based on the OECD Guidelines and are intended to complement these Guidelines and not to hamper more global solutions within that particular OECD framework.

The proposed documentation standards should not preclude tax administrations from making further enquiries beyond the information contained in the documentation. Also, they should not inhibit the tax audit process. If they improve taxpayer compliance and the quality of documentation, they will instead assist the tax administrations in their work. In some countries, transfer pricing documentation has to be made available outside of a tax audit. In such a case the proposed documentation package should enable the tax administration to decide whether or not to commence a tax audit. Additional information requests shall, therefore, only be made outside of a tax audit in cases where the principles of fairness and appropriateness justify the need of a tax administration for additional information or documents.

For tax administrations the main benefit of a common approach would be a co-ordination of documentation requirements and thus a level playing field. Tax administrations would be less concerned that taxpayers might be inclined to shift income to those countries where the strictest documentation requirements are in place.

In developing rules and/or procedures on documentation requirements it should be born in mind that both taxpayers and tax administrations have legitimate concerns to which it is necessary to seek a balanced solution. Any compromise must, therefore, take account of

taxpayers' legitimate interest to reduce their compliance costs and to be less exposed to penalties and of tax administrations' legitimate interest to protect their tax base. Both sides share, however, the common interest to concentrate their resources on areas where there is more tax at risk.

A common approach to the issues related to documentation requirements throughout the EU is desirable in order to make progress at EU level on reducing uncertainties, compliance burdens, the risk of double taxation and on promoting the Internal Market. Forum Members initially discussed three different approaches:

(i) best practice;

(ii) a set of EU-wide standardized documentation rules; and

(iii) a centralised (integrated global) documentation approach.

3.2. Best practice

Under the best practice approach different countries' current legislation, administrative rules and practices on documentation requirements would be examined. On the basis of consensus the most suitable features would be identified and Member States would be recommended to align themselves to these rules and practices.

A best practice approach is the least prescriptive common approach to avoid the fragmentation of documentation rules in Member States. It would avoid the problems associated with standardisation, e.g. reaching agreement on a uniform set of documentation and revising it simultaneously in 25 Member States. Also, taxpayers could be more flexible in the way they prepare their documentation. On the other hand, under the best practice approach taxpayers would still be obliged to prepare a large number of separate and unique documentation packages. It would also provide taxpayers with less certainty as to what documents the tax administrations might require.

3.3. Standardized documentation

The goals of a standardized EU-wide set of rules for documentation requirements, according to which all enterprises in Member States continue to prepare separate and unique documentation packages but in accordance with one set of rules, are transparency and more certainty in the context of transfer pricing examinations. This more prescriptive approach aims at arriving at a decentralised but standardized set of documentation.

Because they would have to deal with only one set of rules the main advantages for taxpayers are less compliance costs in preparing transfer pricing documentation, more certainty as to what level of documents tax administrations might expect and protection against penalties. However, this leaves less flexibility for taxpayers to make reasonable decisions on what is relevant under the facts and circumstances that prevail.

For tax administrations, the main benefit of standardized documentation would be similar to the best practice approach. As the level of co-ordination would be even higher, differences in documentation requirements could no longer be an incentive for taxpayers to shift income.

In addition, standardized documentation might make MAPs easier as all documentations in the Member States concerned would be in accordance with the same set of rules.

3.4. Centralised (integrated global) documentation

Under a centralised (or integrated global) documentation approach a multinational group would prepare a single set of documentation that could serve as the basis for preparing specific local country documentation from both local and central sources. This centralised documentation would provide a "blue print" of the company and its transfer pricing system that would be relevant for all Member States concerned. The centralised documentation approach would not aim to shift the obligation to provide transfer pricing documentation from the domestic enterprise to an associated enterprise in a foreign jurisdiction. This obligation would remain with the taxpayer.

The framework of such centralised documentation could consist of a standardized list of information that could be filled in with the facts and circumstances of the specific situation, taking into account the complexity of the enterprise and the transactions. Its contents should be consistent in all EU Member States.

Centralised documentation could substantially reduce taxpayers' compliance costs thus promoting intra-community trade. Much would depend, however, on the precise nature of the proposal. It could also help taxpayers comply because it would both facilitate the documentation process and the central administration of transfer pricing policies.

A centralised approach could be in the interests of a tax administration. 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 of the quality necessary to assess transfer prices, a centralised approach could rather be to its advantage, if one of the main results of this was an improvement in the quality of the documentation. This would help safeguard a tax administration's tax base and achieve fair solutions. Centralised documentation could also contribute to more transparency as regards a company's transfer pricing policy.

It should be noted that centralised documentation would not necessarily satisfy the documentation requirements in each Member State. Tax administrations would, therefore, be entitled to request from a taxpayer additional country- or transaction-specific information that is not included in the centralised documentation.

A centralised approach may, however, pose more problems than a decentralised approach as regards the scope of application. For example, in a centralised approach it must be decided whether or not non-EU subsidiaries of an EU parent company should be included in the centralised EU documentation. The consequences of a centralised approach on EU enterprises with non-EU shareholders also need to be examined. It would be difficult to oblige a non-EU company to comply with EU documentation rules. This would not, however, preclude multinational enterprises preparing a centralised documentation package on a voluntary basis. A centralised approach, therefore, might call for a more global solution within the framework of the OECD.

Each of the three documentation approaches has specific features and has its own pros and cons. For example centralised documentation seems not to be appropriate in all cases. In decentralised companies it generally seems to be more difficult to implement centralised

documentation. It follows that the use of a centralised documentation depends on the group structure and may not in all cases be appropriate for decentralised companies.

3.5. Summary of pros and cons of the three different approaches

Although the Forum did not discuss in detail the three approaches but pursued the EU TPD as the most appropriate one (see chapter 4), it became clear that business and tax administrations had different perspectives on the pros and cons of the three documentation approaches. Based on a preliminary analysis the possible pros and cons are summarised in an enumerative manner in the grid below. It should be noted, however, that the only purpose of this table is to illustrate the possible pros and cons by way of a simplified overview.

DOCUMENTATION APPROACH	PROS	CONS
Best Practice (descriptive, modifications possible)	<u>For taxpayers</u> flexibility avoids problems associated with standardisation, e.g. reaching agreement on a uniform set of documentation and revising it simultaneously in MS <u>For tax administrations</u> flexibility	<u>For taxpayers</u> may be too vague still required to prepare a large number of separate and unique documentation sets (possibly in 25 MS) little certainty, because maybe too vague and application may vary from country to country <u>For tax administrations</u> may be too vague level playing field only insofar as MS adopt best practice rules
Standardized Documentation (prescriptive, no modifications possible)	<u>For taxpayers</u> potential of reduced compliance costs certainty with respect to documentation requirements reduced number of double taxation cases due to common approach in MS <u>For tax administrations</u> more transparency level playing field among MS avoids profit shifting due to differences in documentation requirements in MS in combination with uniform penalty rules for non-compliance in MS: even less incentive for profit shifting reduced number of double taxation cases due to common approach in MS facilitates MAPs	<u>For taxpayers</u> less flexibility to decide what documents may be relevant <u>For tax administrations</u> less flexibility, i.e. requires agreement on common set of documentation simultaneous revision in all MS necessary
Centralised (integrated global) Documentation (prescriptive, no modifications possible)	<u>For taxpayers</u> (in addition to standardized documentation) higher degree of certainty	<u>For taxpayers</u> (in addition to standardized documentation) not suitable for decentralised group structures

	For tax administrations (in addition to standardized documentation) better quality of taxpayers' documentation enhanced taxpayers' compliance useful for risk assessment purposes more transparency	difficulty in some instances to identify parent company / headquarters For tax administrations (in addition to standardized documentation) common definition of „associated/ affiliated enterprise" and „headquarters" necessary coverage of standardized and centralised documentation needs to be agreed upon access to documentation abroad more difficult for non-EU group members: relation to documentation requirements in non-EU countries needs to be clarified

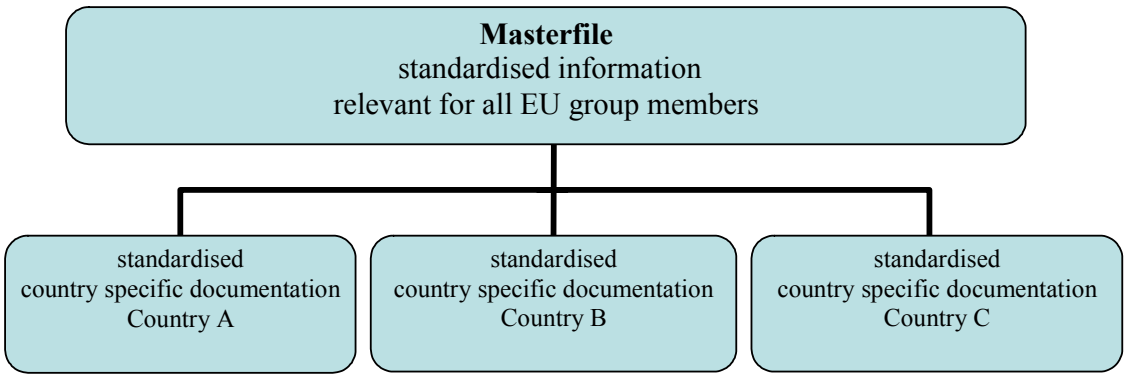
4. THE "EU TRANSFER PRICING DOCUMENTATION" (EU TPD) - A NEW APPROACH

4.1. Description of the approach

After having briefly examined the aforementioned three approaches discussed in chapter 3 the Forum was of the opinion that none of these approaches was fully compatible with the objectives of a common EU wide transfer pricing documentation. FORUM Members, therefore, agreed to explore a new approach for the purpose of common EU-wide transfer pricing documentation that could assist taxpayers to efficiently prepare and maintain useful transfer pricing documentation and would respond to the potential difficulties that multinational enterprises face in complying with documentation requirements in multiple tax jurisdictions. At the same time, this new documentation approach could assist tax administrations in carrying out tax examinations more efficiently.

The new EU TPD approach combines aspects of the standardized approach and the centralised (integrated global) documentation approach as described in chapter 3 above. In an EU-wide context a multinational group would generally prepare one set of transfer pricing documents that would consist of two main parts (i) one set of documentation containing common standardized information relevant for all EU group members (the "masterfile") and (ii) several sets of standardized documentation each containing country-specific information ("country specific documentation"). The EU TPD approach means, therefore, that a multinational group of companies has a standardized and consistent set of documentation (the "masterfile" supplemented by "country specific documentation") at company level, i.e. one single file for each Member State concerned (one common masterfile to be used in all Member States concerned and a different set of country-specific documentation for each Member State) 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 (see paragraph 132 for those cases where a company may be exempted from the EU TPD).

The EU TPD approach can best be illustrated with the following chart:



The documentation set for country A would consist of the masterfile supplemented by the standardised country specific documentation for country A; the documentation set for country B would consist of the same masterfile supplemented by the standardised country specific documentation for country B. The masterfile would be available to tax administrations of all Member States concerned whereas the country specific documentation would be available only to the tax administration with a legitimate interest in the appropriate tax treatment of the transactions covered by the documentation.

4.2. Purpose of the EU TPD

The EU TPD 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 EU TPD would have the potential to 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. Standardisation should, therefore, not be more prescriptive than it needs to be to achieve these objectives and should not impose an excessive compliance cost on businesses. The EU TPD should follow the OECD Transfer Pricing Guidelines as described in chapter 2.1.2. and in particular paragraphs 22 and 23 of this report.

4.3. Advantages of the EU TPD approach

4.3.1. For both taxpayers and tax administrations

One of the main benefits of the EU TPD approach is the fact that all tax administrations involved would have access to the same common documentation and information in the masterfile element. Furthermore, taxpayers and tax administrations alike would benefit from the following advantages of the EU TPD:

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

b) Consistency in the comparability analyses (including functional analyses);

c) 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.

4.3.2. From a taxpayer perspective

Standardized and - to the extent possible - centralised documentation could substantially reduce a taxpayer's compliance costs by fulfilling the documentation requirements in all EU Member States in a similar way (economies of scale).

Tax administrations should not impose documentation related penalties on a taxpayer acting in good faith and complying with the EU TPD by providing in a timely manner appropriate documentation (as described in chapter 4.5. below) and implementing it, i.e. properly applying his documentation to determine the arm's length transfer prices. Tax administrations should, however, be entitled to impose penalties provided for in their national legislation if the taxpayer fails to submit additional information and documents going beyond the EU TPD as described in paragraph 127 upon specific request or during a tax audit (so-called "co-operation related penalties").

Related benefits for taxpayers are:

a) less probability of being audited;

b) reduced risk of double taxation; and

c) shorter tax audits.

4.3.3. From a tax administration perspective

From the steps often followed by multinational enterprises engaged in this process, it is likely that documentation based on the EU TPD approach 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 acquiring information to allow an assessment of the arm’s length nature the transfer prices, 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.

The Member States concerned would benefit substantially because they would have insight into the EU-wide transfer pricing policy of the company. The contents of the EU TPD as specified in chapter 4.5. 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.

4.4. The basic functioning of the standardized EU TPD approach

4.4.1. *Status for tax administrations*

A necessary feature of the EU TPD approach is a standardisation of the type of information and documents that Member States' tax administrations may require from a multinational group opting for this approach. A Member State may decide not to require transfer pricing documentation at all or require a shorter version of the EU TPD, i.e. require less items in the masterfile or the country specific documentation. However, a Member State should not require more items in the masterfile or the country specific documentation. Nevertheless, additional information and documents can be required upon specific request (see paragraphs 114 and 127 below). In order for taxpayers to fully benefit from the advantages of the EU TPD approach all Member States should implement this approach or adopt it in their administrative practices.

4.4.2. *Application for taxpayers optional*

Whereas for centralised MNE groups the EU TPD may reduce the compliance burden and has a potential to increase the quality of its documentation, this is not necessarily the case for decentralised MNE groups, smaller businesses or groups of companies with limited cross-border dealings. Considering the fact that creating and maintaining a masterfile and several sets of country specific documentation might entail costs that are not always compensated for by economies of scale, certain businesses might prefer a decentralised approach. The use of the EU TPD approach should, therefore, be optional for businesses and businesses deciding not to use the EU TPD should not be subjected to sanctions merely because of this decision. A MNE group should, however, not arbitrarily opt in and out of the EU TPD approach for its documentation purposes but retain consistency and continuity in its documentation policy. Therefore, a MNE group that adopts the EU TPD should do so in a way that is consistent throughout the EU and that is consistent from year to year.

4.4.3. *Rights and obligations of taxpayers and tax administrations*

The EU TPD approach would not aim to shift the obligation to provide transfer pricing documentation from the domestic taxpayer to an associated enterprise in 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 (see also paragraph 128 below).

Each of the tax authorities involved would also keep the right to assess whether, in the context of the EU TPD approach, the company has met its documentation requirements. In other words, acceptance by one tax administration of a taxpayer's documentation as valid EU TPD would not bind other tax administrations.

4.4.4. Implementing the EU TPD Approach

Standardisation in the framework of the EU TPD should be achieved through "soft law". That is to say, it would not be implemented through a Directive and it would be up to Member States to decide how to implement it at the national level, e.g. through domestic legislation, guidance, administrative practices, etc. so as to allow acceptance of the EU TPD at the national level. It would also be up to Member States to decide how to interpret the terms of the EU TPD within the meaning of the OECD Guidelines and within the spirit and goal of the EU TPD, bearing in mind that a reduction of compliance costs for companies doing business in the EU should be achieved. The EU TPD should be implemented flexibly and should recognise the particular circumstances of the business concerned. In particular, smaller and less complex businesses should not be expected to produce the amount or complexity of documentation that might be expected from larger and more complex businesses.

4.4.5. Consequences for Member States having different or no legal documentation requirements

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.

Currently not all EU Member States have legislation on documentation requirements in place. If in the future more countries introduce national documentation requirements (which is of course not unlikely), it would be helpful if these were compatible with the EU TPD approach.

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

As the EU TPD approach is a standardized approach, it follows that the type of transfer pricing documentation should be the same for all countries that have decided to implement the EU TPD. 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 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 2 above (the contents of both is addressed in more detail in chapter 4.5. below).

A Member State in its domestic law retains the right to require a taxpayer to provide more information and documents upon specific request or during a tax audit than would be contained in the EU TPD (cf. paragraph 127 below).

If 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. 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.

4.5. Contents of the EU TPD

4.5.1. In general

The content of the EU TPD is generally understood to be a roadmap (or standardized, consistent 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, to ask relevant and precise questions regarding the company's transfer pricing and assess the transfer prices of the inter-company transactions.

Each of the following items of the EU TPD 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 (e.g. for management purposes). However, a company might be required to produce documentation for this purpose that otherwise would not have been in existence.

4.5.2. The masterfile

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 EU Member States concerned.

The masterfile should contain the following items:

a) a general description of the business and business strategy including changes in the business strategy compared to the previous tax year;

b) a general description of the group's organisational, legal and operational structure (including an organisation chart, a list of group members and a description of the participation of the parent company in the subsidiaries);

c) the general identification of the associated enterprises engaged in controlled transactions involving enterprises in the EU;

d) a general description of the controlled transactions involving enterprises in the EU, i.e. a general description of

   i) flows of transactions (tangible and intangible assets, services, financial);

   ii) invoice flows; and

   iii) amounts of transaction flows;

e) a general description of functions performed and risks assumed and a description of changes in respect of functions and risks compared to the previous tax year, e.g. the change from a full fledged distributor to a commissionaire;

f) the ownership of intangibles (patents, trademarks, brand names, know how etc.) and royalties paid or received;

g) the group's inter-company transfer pricing policy or a description of the group's transfer pricing system that explains the arm's length nature of the company's transfer prices;

h) a list of Cost Contribution Agreements, APAs and Rulings covering transfer pricing aspects as far as group members in the EU are affected; and

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

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

Consider a company A that provides services to its subsidiaries B, C, D and E in Member States B, C and D and Non-Member State E (controlled transactions 1-4). Subsidiary B is a production company that delivers its products to distribution companies (its sister companies) C, D and E (controlled transactions 5-7).

The masterfile would contain, among other things, the following information:

- The kind of services A is providing to B, C, D and E (controlled transactions 1-4), the transfer pricing method (s) applied, an assuming the cost plus method is applied, the mark up(s) for the different services;

- The kind of activities performed by B (e.g. full fledged manufacturer and entrepreneur or contract manufacturer), identification of the associated enterprises C, D and E as B's customers (controlled transactions 5-7), the transfer pricing method(s) applied and the cost plus mark up(s), resale price margin(s) or the commission(s) determined;

- What kind of distributors C, D and E are (e.g commission agent of full-fledged distributor), the transfer pricing method(s) used (for controlled transactions 5 to 7), and, the commission(s) determined or the resale price margin(s) .

This means that Member State A is also informed about the controlled transactions 5 to 7 (between B and C, D and E), the transfer pricing method applied and the commission, cost plus mark up or resale price margin determined.

4.5.3. Country specific documentation

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 TPD requirements, a country specific documentation should contain, in addition to the content of the masterfile, the following items:

a) a detailed description of the taxpayer's business and business strategy including changes in the business strategy compared to the previous tax year;

b) information, i.e. description and explanation, on country specific controlled transactions; including

i) flows of transactions (tangible and intangible assets, services, financial);

ii) invoice flows; and

iii) amounts of transaction flows;

c) a comparability analysis, i.e.

i) characteristics of property and services;

ii) functional analysis (functions performed, assets used, risks assumed);

iii) contractual terms;

iv) economic circumstances; and

v) specific business strategies;

d) an explanation about the selection and application of the transfer pricing method[s], i.e. why a specific transfer pricing method was selected and how it was applied;

e) relevant information on internal and/or external comparables, if available; and

f) a description of the implementation and application of the group's inter-company transfer pricing policy.

As the organisational and operational structures of MNE groups vary widely, a MNE group should be free to move items from the country specific documentation to the masterfile, keeping, however, the same level of detail as in the country specific documentation. This should allow a multinational group sufficient flexibility to accommodate specific circumstances. The following two examples illustrate the flexibility:

Example 1:

Masterfile	**minimum requirement for masterfile**
a) general description of the business b) the group's organisational, legal and operational structure c) general 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) inter-company transfer pricing policy h) list of Cost Contribution Agreements, APAs and Rulings i) undertaking by the taxpayer to provide additional information upon request	

Country specific documentation
a) detailed description of the business and business strategy b) information on country specific controlled transactions c) comparability analysis d) explanation about the selection and application of the transfer pricing method[s] e) relevant information on internal and/or external comparables if available f) a description of the implementation and application of the group's transfer pricing policy

Example 2:

Masterfile	**minimum requirement for masterfile**
a) general description of the business b) the group's organisational, legal and operational structure c) general 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) inter-company transfer pricing policy h) list of Cost Contribution Agreements, APAs and Rulings i) undertaking by the taxpayer to provide additional information upon request j) explanation about the selection and application of the transfer pricing method[s]	

Country specific documentation
a) detailed description of the business and business strategy b) information on country specific controlled transactions c) comparability analysis d) relevant information on internal and/or external comparables if available f) a description of the implementation and application of the group's transfer pricing policy

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 para. 119 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) – f) as described in para. 121 above, unless these information and documents are contained in the masterfile.

4.5.4. Use of language

To aid the purpose of the EU TPD approach, i.e. the reduction of the compliance burden, tax administrations should be prepared to accept the masterfile in a commonly understood language for the Member States concerned. Translation of the masterfile should be made available only upon request. The country specific documentation, as specified in paragraph 121, should be prepared in a language prescribed by the specific Member State concerned, even if the taxpayer has opted to keep the country-specific documentation in the masterfile.

4.6. Preparation, submission and storage of the documentation

The taxpayer should have to submit its EU TPD 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 short questionnaire or an appropriate risk assessment form. Where a Member States requires a taxpayer to make in its tax return an adjustment to its taxable profit resulting from the application of the arm's length principle, documentation explaining such an adjustment should be available.

Taking into account the basic principles of the EU TPD approach, it can be expected that the parent company undertakes to prepare in good time the masterfile in order to comply with any legitimate 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 the tax administration within a reasonable time dependant on the complexity of the transactions.

A Member State could, however, have rules to require a business to make available information and documents 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 EU TPD approach, the scope of such additional information and documents might legitimately go beyond what was required by the EU TPD. Depending on specific local regulations the taxpayer should be given a reasonable time to prepare this additional information.

The business responsible for making documentation available to the tax administration would be the business that was requested to make the tax return and this business would be liable to a penalty if adequate documentation was 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.

If a Member State adopted the EU TPD approach, a MNE group opting in would need to apply it to all of its affiliates in the Member States concerned subject to paragraph 132 below.

If a MNE group has opted for the EU TPD for a given fiscal year each member of the group should inform the tax administration accordingly.

4.7. Scope of application of the EU TPD approach

A multinational group of companies that opts for the EU TPD should generally apply this approach collectively to all associated enterprises to which transfer pricing rules apply.

However, some MNE groups have a decentralised organisational, legal or operational structure, or consist of several large divisions with completely different product lines and transfer pricing policies. In other cases the divisions of a MNE group have no inter-company transactions. Also, implementing a MNE's EU TPD in the group or in a recently acquired company may take some time. In all those cases, one single masterfile covering all EU group members might be inappropriate. In well justified cases, a MNE group should, therefore, be allowed to produce more than one masterfile or exempt specific group members from the EU TPD.

The Forum agreed by consensus to adopt the EU TPD approach as the preferred approach for EU-wide common transfer pricing documentation requirements and to issue conclusions on the EU TPD. These conclusions are listed in Chapter 2 of the Annex.

5. THE USE OF DATABASE SEARCHES FOR COMPARABLES

5.1. General

To support the arm's length nature of intra-group transactions by using comparables, both the taxpayer and the tax administration have various possibilities for obtaining evidence; these range from the preferred source of information readily available within the company or group (internal comparables) to external comparables that can be obtained from a variety of sources, including searches of databases when the latter satisfy the comparability requirements and the rules on the aggregation of transactions.

According to the OECD Guidelines, a comparability analysis does not primarily rely on a search for external comparables, nor is the latter always necessary. Internal comparables, where they exist, should generally be preferred.

Practice shows, however, that taxpayers and tax authorities sometimes use searches for external comparables. In those cases, the search for external comparable transactions may be performed in a number of ways, including the current practice of searching databases containing companies' financial and economic information. It is not compulsory for a taxpayer to use a commercial database if more reliable information is available from other sources. On the other hand, there is no reason to systematically rule out the use of all commercial databases as in some cases they provide the best available information. Using a database should, however, not be intended to relax the comparability standard. Where commercial databases are used, they should be handled with care and in particular taxpayers or practitioners should make their best efforts to comply with the five comparability factors

identified in the OECD Transfer Pricing Guidelines as well as with the rules on the aggregation of transactions.

5.2. The business point of view

The business position is clearly that in cases where traditional methods cannot be applied and, therefore, the transactional net margin method (TNMM) needs to be used, non-domestic data base comparability searches should be accepted by national tax authorities as documentation to support the arm's length nature of a particular intra-group transaction. Business considers that a broad aggregation of activities should be allowed as no specific product or market combinations can be retrieved from the publicly available databases and consequently benchmarks for single transactions are not an option.

The first argument advanced is the purported existence of a genuine European single market. The results of a statistical analysis under the TNMM approach performed by business, gave evidence that it is highly likely that a country-specific data base comparability analysis and a pan-European data base comparability analysis would result in inter-quartile arm's length ranges of results that were not statistically different at a 95 percent level of confidence.

A further argument is that compliance costs should be kept at an acceptable level. The access to databases is not free of charge and companies operating at global level can hardly be expected to pay for access to a multitude of local databases. Business, therefore, favours the acceptability of pan-European database searches by all national tax administrations.

5.3. State of play and the Member States' point of view

In some Member States a local (or other) search for comparable transactions (unlike company wide data) is a statutory requirement. Many tax authorities, however, may accept a comparable search performed at company-wide level using databases, if comparable transactions (which are the basis for all methods accepted by the OECD, traditional methods as well as transactional profit methods) cannot be found.

If applied, preference is given to local comparables but in general, regional or pan-European comparables are accepted in so far as they respect the comparability factors and/or the results do not show any significant differences from the rest of a set of comparables. The position of Member States is consequently that, for example, comparables found in pan-European databases should not be rejected automatically.

5.4. Conclusions of the Forum

In using certain traditional methods such as cost plus or resale minus, or the TNMM (in specific cases as a method of last resort), database searches for comparables may be useful to identify gross profit factors such as cost plus or resale minus margins or, in the case of TNMM, net profit margins in order to approximate arm's length conditions.

However, it is also recognised that these searches have some weaknesses, and whenever they are used they should be handled with the necessary precautions.

The Forum therefore agreed to issue conclusions on the use of database searches for comparables as reflected in Section 1.4 of the Annex.

6. GLOSSARY

BEST PRACTICE

The description of certain aspects of legislation, administrative rules and practices on documentation requirements currently applied by countries that Member States are recommended to follow. This is the least prescriptive common approach to avoid the fragmentation of documentation rules in Member States.

STANDARDIZED DOCUMENTATION

A uniform, EU-wide set of rules for documentation requirements according to which all enterprises in Member States prepare separate and unique documentation packages. This more prescriptive approach aims at arriving at a decentralised but standardized set of documentation, i.e. each entity of a multinational group prepares its own documentation, albeit according to the same rules.

CENTRALISED (INTEGRATED GLOBAL) DOCUMENTATION

A single documentation package (core documentation) on a global or regional basis that is prepared by the parent company or headquarters of a group of companies in a EU-wide standardized and consistent form. This documentation package can serve as the basis to prepare local country documentation from both local and central sources.

EU TRANSFER PRICING DOCUMENTATION (EU TPD)

The EU Transfer Pricing Documentation (EU TPD) approach combines aspects of the standardized and the centralized (integrated global) documentation approach. A multinational group would prepare one set of standardized and consistent transfer pricing documentation that would consist of two main parts: (i) one uniform set of documentation containing common standardized information relevant for all EU group members (the "masterfile") and (ii) several sets of standardized documentation each containing country-specific information ("country specific documentation"). The documentation set for a given country would consist of the common masterfile supplemented by the standardized country specific documentation for that country.

DOCUMENTATION RELATED PENALTY

An administrative (or civil) penalty imposed for failure to comply with the EU TPD or the domestic documentation requirements of a Member State at the time the EU TPD or the domestic documentation requirements of a Member State was due to be submitted to the tax administration

CO-OPERATION RELATED PENALTY

An administrative (or civil) penalty imposed for failure to comply in a timely manner with a specific request of a tax administration to submit additional information or documents going beyond the EU TPD or the domestic documentation requirements of a Member State

ADJUSTMENT RELATED PENALTY

A penalty imposed for failure to comply with the arm's length principle usually levied in the form of a surcharge at a fixed amount or a certain percentage of the transfer pricing adjustment or the tax understatement

7. ANNEX: CONCLUSIONS ON DOCUMENTATION RULES

7.1. TRANSFER PRICING DOCUMENTATION IN THE EU

7.1.1. General Conclusions

The Forum concludes that standardised and partially centralised (integrated) global documentation required in Member States to support transfer pricing on an arm's length basis could benefit the development of the Single Market, especially where larger businesses are concerned. Transfer pricing documentation in the EU must be viewed in the framework of the OECD Transfer Pricing Guidelines.

The Forum recognizes that standardisation and partially centralisation (integrated global documentation) should be achieved through "soft law".That is to say, it would not be implemented through a Directive. It would be up to Member States to decide how to implement it through their domestic legislation, guidance and administrative practices and how to interpret the terms of standardised and partially centralised documentation within both the meaning of the OECD Transfer Pricing Guidelines and the spirit and goal of standardised and partially centralised documentation. This should be done keeping in mind that a reduction of compliance costs for companies doing business in the EU should be achieved.

Since a standardised and partially centralised documentation is a basic set of information for the assessment of the group's transfer prices, the Forum recognises that, in its domestic law, a Member State would be entitled to request more and different information and documents (by specific request or during a tax audit) than would be contained in standardised and partially centralised (integrated global) documentation.

The Forum concludes that standardisation and partially centralisation (integrated global documentation) should not be more prescriptive than it needs to be to achieve its objectives.

The Forum concludes that standardisation and partially centralisation (integrated global documentation) should be implemented flexibly and should recognise the particular circumstances of the business concerned. In particular, smaller and less complex businesses should not be expected to produce the amount or complexity of documentation that might be expected from larger and more complex businesses.

7.1.2. Application of documentation rules

7.1.2.1. Specific conclusions concerning tax administrations

Tax administrations should

a) not impose unreasonable compliance costs or administrative burden on enterprises in requesting documentation to be created or obtained;

b) not request documentation that has no bearing on transactions under review; and

c) secure that there is no public disclosure of confidential information contained in documentation.

7.1.2.2. Aggregation of transactions

The aggregation of transactions must be applied consistently, be transparent to the tax administration and be in accordance with paragraph 1.42 of the OECD Transfer Pricing Guidelines (which allow aggregation of transactions that are so closely linked or continuous that they cannot be evaluated adequately on a separate basis.) These rules should be applied in a reasonable manner, taking into account in particular the number and complexity of the transactions.

7.1.2.3. Language

It may not always be necessary for documents to be translated into a local language. In order to minimise costs and delays caused by translation, tax administrations should accept documents in a foreign language as far as possible. As far as the EU Transfer Pricing Documentation (hereafter: "EU TPD"; see chapter 2 below) is concerned, tax administrations should be prepared to accept the masterfile in a commonly understood language for the Member States concerned. Translation of the masterfile should be made available only if strictly necessary and upon specific request. The country specific documentation should be prepared in a language prescribed by the specific Member State concerned.

7.1.2.4. Application to permanent establishments

Similar considerations should apply to documentation requirements relating to the attribution of profits to a permanent establishment as apply to transfer pricing.

7.1.2.5. Other conclusions

Where documentation produced for one period remains relevant for subsequent periods and continues to provide evidence of arm's length pricing, it may be appropriate for the documentation for subsequent periods to refer to earlier documentation rather than to repeat it.

Documentation does not need to replicate the documentation that might be found in negotiations between enterprises acting at arm's length (for example in agreeing to a borrowing facility or a large contract) as long as it includes adequate information to assess whether an arm's length pricing has been applied.

The sort of documentation that needs to be produced by an enterprise that is a subsidiary company in a group may be different from that needed to be produced by a parent company; i.e. a subsidiary company would not need to produce information about all of the cross-border relationships and transactions between associated enterprises within the group but only about those relationships and transactions relevant to the subsidiary in question.

7.1.3. Timing, preparation and submission of documentation

The period for providing additional information and documents upon specific request (see paragraph 3) should be determined on a case-by-case basis taking into account the amount and detail of the information and documents requested. Depending on specific local regulations the timing should give the taxpayer a reasonable time (which can vary dependent

on the complexity of the transaction) to prepare the additional information (see paragraphs 32 to 34 as regards the EU TPD).

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 in a timely manner to the tax administrations involved upon request. The taxpayer should, therefore, be free to keep his documentation, including his EU TPD (see chapter 2), either in a centralized or in a decentralized manner.

The way that documentation is stored - whether on paper, in electronic form or in any other system - should be at the discretion of the business, provided that it can be made available to the tax administration in a reasonable way.

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.

7.1.4. The use of non-domestic comparables

Tax administrations should evaluate domestic or non-domestic comparables with respect to the specific facts and circumstances of the case. For example, comparables found in pan-European databases should not be rejected automatically.

The use of non-domestic comparables by itself should not subject the taxpayer to penalties for non-compliance.

7.2. CONCLUSIONS ON THE EU TPD APPROACH

7.2.1. Content of the EU TPD

7.2.1.1. General description

A company's standardized and consistent EU TPD consists of two main parts (i) one set of documentation containing common standardized information relevant for all EU group members (the "masterfile") and (ii) several sets of standardized documentation each containing country-specific information ("country specific documentation"). The EU TPD 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, ask relevant and precise questions regarding the company's transfer pricing and assess the transfer prices of the inter-company transactions. Subject to paragraph 31, the company would produce one single file for each Member State concerned, i.e. one common masterfile to be used in all Member States concerned and a different set of country-specific documentation for each Member State.

Each of the following items of the EU TPD should be completed, taking into account the complexity of the company and the transactions. As far as possible, information should be used that is already in existence within the group (e.g. for management purposes). However, a company might be required to produce documentation for this purpose that otherwise would not have been in existence.

7.2.1.2. The masterfile

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 and available to all EU Member States concerned.

The masterfile should contain the following items:

a) a general description of the business and business strategy including changes in the business strategy compared to the previous tax year;

b) a general description of the group's organisational, legal and operational structure (including an organisation chart, a list of group members and a description of the participation of the parent company in the subsidiaries);

c) the general identification of the associated enterprises engaged in controlled transactions involving enterprises in the EU;

d) a general description of the controlled transactions involving enterprises in the EU, i.e. a general description of

   i) flows of transactions (tangible and intangible assets, services, financial);

   ii) invoice flows; and

   iii) amounts of transaction flows;

e) a general description of functions performed, risks assumed and a description of changes in respect of functions and risks compared to the previous tax year, e.g. the change from a full fledged distributor to a commissionaire;

f) the ownership of intangibles (patents, trademarks, brand names, know how etc.) and royalties paid or received;

g) the group's inter-company transfer pricing policy or a description of the group's transfer pricing system that explains the arm's length nature of the company's transfer prices;

h) a list of Cost Contribution Agreements, APAs and Rulings covering transfer pricing aspects as far as group members in the EU are affected; and

i) an undertaking by each domestic taxpayer to provide supplementary information upon request and within a reasonable time frame according to national rules .

7.2.1.3. Country specific documentation

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. The country specific documentation would be available to those tax administrations with a legitimate interest in the appropriate tax treatment of the transactions covered by the documentation.

A country specific documentation should contain, in addition to the content of the masterfile, the following items:

a) a detailed description of the business and business strategy including changes in the business strategy compared to the previous tax year; and

b) information, i.e. description and explanation, on country specific controlled transactions; including

   i) flows of transactions (tangible and intangible assets, services, financial);

   ii) invoice flows; and

   iii) amounts of transaction flows;

c) a comparability analysis, i.e.

   i) characteristics of property and services;

   ii) functional analysis (functions performed, assets used, risks assumed);

   iii) contractual terms;

   iv) economic circumstances; and

   v) specific business strategies;

d) an explanation about the selection and application of the transfer pricing method[s], i.e. why a specific transfer pricing method was selected and how it was applied;

e) relevant information on internal and/or external comparables if available; and

f) a description of the implementation and application of the group's inter-company transfer pricing policy.

A multinational enterprise should have the possibility of including items in the masterfile instead of the country specific documentation, keeping, however, the same level of detail as in the country specific documentation. The country specific documentation, as specified in paragraph 24, should be prepared in a language prescribed by the specific Member State concerned, even if the taxpayer has opted to keep the country-specific documentation in the masterfile.

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.

7.2.2. General application rules

7.2.2.1. For tax administrations

It is recognised that a Member State may decide not to have transfer pricing documentation requirements at all. However, Member States that intend to introduce or amend legal or

administrative documentation requirements should take care that the new rules are compatible with the EU TPD approach so that a company's EU TPD can be accepted in all Member States. Within this context, a Member State may decide to have an EU TPD, the content of which is shorter than that referred to in paragraphs 22 and 24 above.

7.2.2.2. For taxpayers

The use of the EU TPD should be optional for businesses.

A multinational group of companies should not arbitrarily opt in and out of the EU Transfer Pricing Documentation approach for its documentation purposes but apply the EU TPD in a way that is consistent throughout the EU and that is consistent from year to year.

A multinational group of companies that opts for the EU TPD should generally apply this approach collectively to all associated enterprises engaged in controlled transactions involving enterprises in the EU to which transfer pricing rules apply.

In well justified cases, e.g. where a multinational enterprise (hereafter: "MNE") group has a decentralised organisational, legal or operational structure or consists of several large divisions with completely different product lines and transfer pricing policies or no inter-company transactions, and in case of a recently acquired company, a MNE group should be allowed to produce more than one masterfile or exempt specific group members from the EU TPD.

7.2.3. Preparation, storage and submission of the documentation

The taxpayer should have to submit its EU TPD, 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. Where a Member State requires a taxpayer to submit information about transfer pricing with its tax return, that information should be no more than a short questionnaire or an appropriate risk assessment form. Where a Member State requires a taxpayer to make in its tax return an adjustment to its taxable profit resulting from the application of the arm's length principle, documentation demonstrating such an adjustment should be available.

A multinational enterprise should undertake to prepare the masterfile in time to comply with any legitimate request originating from one of the tax administrations involved.

The taxpayer in a given Member State should make its EU TPD available upon request of a tax administration, within a reasonable time dependant on the complexity of the transactions.

The business responsible for making documentation available to the tax administration would be the business that was requested to make the tax return and this Business would be liable to a penalty if adequate documentation was 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. The decision of a MNE group to apply the EU TPD implies the commitment towards all associated enterprises in the EU to make the masterfile and the respective country-specific documentation available.

If a Member State adopted the EU TPD approach, a MNE group opting in would, subject to paragraph 31, need to keep documentation as specified in the masterfile approach in respect of all its members in the Member State concerned, including permanent establishments.

Where a MNE group has opted for the EU TPD for a given fiscal year, each member of the MNE group should inform its tax administration accordingly.

7.2.4. Penalties

A Member State should not impose a documentation related penalty where a taxpayer complies in good faith, in a reasonable manner, and within a reasonable time

with standardized and consistent documentation as described in paragraphs 19 to 26 or with a Member State's domestic documentation requirements;

and properly applies his documentation to determine his arm's length transfer prices. A taxpayer avoids the imposition of a co-operation related penalty where he has agreed to adopt the EU TPD approach and provides, upon specific request or during a tax audit, in a reasonable manner and within a reasonable time additional information and documents going beyond the EU TPD (cf. paragraph 3).