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By e-mail: TransferPricing@oecd.org

Rotterdam, 1 October 2013

Subject: OECD White Paper on Transfer Pricing Documentation

Dear Mr. Saint-Amans,

By means of this letter, EY would like to respond to the OECD's invitation to comment on the White Paper on Transfer Pricing Documentation that was published by the OECD on 30 July 2013. EY highly appreciates the OECD's continuing efforts as part of its program on transfer pricing simplification, and in particular on the simplification and streamlining of transfer pricing documentation requirements. In this respect, we welcome the subject White Paper and the public consultations that will be held in connection therewith.

We believe that the White Paper in general provides a valuable contribution to the global conversation about transfer pricing documentation and is helpful in advancing toward achievement of the OECD's goals of increased transparency toward tax authorities; allowing tax authorities to perform risk assessments; and allowing for a streamlined reporting and simplification of transfer pricing documentation (processes) to reduce the administrative burden and cost of compliance. In consideration of these goals, as well as the OECD's discussion of the purposes of transfer pricing documentation, we believe it is important to take a measured approach towards materiality and proportionality in identifying the content as well as the timing of information that is to be provided by taxpayers to tax authorities – that is, what and how much information should be provided as part of the transfer pricing documentation versus the audit process.

In general, we support the two-tiered approach as described in the White Paper to the extent it is consistent with the goal of simplification. In light of the overall goal of simplification (e.g. reduce costs of compliance), we recommend an approach that balances providing tax administrations with sufficient information to perform a high-level risk assessment on the one hand, and the administrative burden for taxpayers on the other hand, in particular when introducing a global value chain reporting requirement. In view hereof, we believe that a risk-based approach should also be available for taxpayers when

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assessing which transactions to document. As mentioned in our comments on the OECD handbook on transfer pricing risk assessment dated 11 September 2013, we believe that the mere absence of transfer pricing documentation (in light of lack of materiality or complexity of a transaction) should not be seen as an indication of transfer pricing risk. Finally, with regard to materiality and proportionality, we suggest the guidance considers the perspective of smaller taxpayers that may have fewer resources to devote to compliance. Small taxpayers' business decisions can be particularly vulnerable to overly burdensome administrative requirements.

Our more detailed comments with respect to the White Paper are presented below.

Masterfile Comments

Purpose and Balance

As stated above we subscribe to the dual purpose of documentation and the OECD's focus on tax authorities' ability to assess risk as well as the taxpayer's assessment of its compliance with the arm's length principle. Similarly, the purpose of the Masterfile is essentially two-fold: (1) to provide MNEs a format to provide information relevant to its legal organization, structure and transactions in a single document that can be leveraged to meet certain transfer pricing documentation requirements across multiple jurisdictions; and (2) to achieve the OECD's goal of providing consistent, transparent information to tax authorities to allow them to perform a high level risk assessment. In determining what information should be required as part of the Masterfile for risk assessment purposes, it should be sufficient to allow tax authorities an efficient decision process as to which cases will require further review, thereby avoiding wasted audit time by tax authorities and taxpayers alike. As stated in the White Paper, "As long as all involved in preparing and reviewing such data understand that risk assessment is a first step and that precision may not be necessary, greater overall reporting might productively be required for risk assessment purposes."[1] In order for the OECD Masterfile to achieve broader success than prior multinational documentation standards, it must necessarily focus on the right balance between allowing for streamlined reporting for MNEs and requiring relevant supplemental information for taxing authorities.

Country-by-Country Reporting Requirement

Paragraph 72 of the White Paper, and action point 13 of the BEPS action plan promote a form of country-by-country reporting. This reporting is intended to include high-level information to be used for risk assessment purposes, such as taxable income, employees and assets by country. As pointed out in the introduction of the White Paper, the communiqué issued in connection with the G8 summit meeting held on 17 – 18 June 2013 included a call on the OECD to develop a common template for country-by-country reporting to tax authorities by major multinational enterprises, taking account of concerns regarding non-cooperative jurisdictions. Based on this it is expected that the OECD will develop a template that will specify the particular categories of information that is to be reported on a country-by-country basis and that such information will be required to be reported to all "relevant" countries. It should be noted that the White Paper is not entirely clear as to whether such country reporting would be part of the Masterfile or would be a separate document.

The high level information that the OECD likely will include in this template may represent sensitive business information. It is critical that the confidentiality of this information be protected by all tax authorities with which it is filed. It also is critical that how this information is to be used and how it should not be used be made very clear. It would be inappropriate and could create misunderstandings

[1] OECD White Paper, Para. 72.

and disputes if this information, and information like this, were to be used for transfer pricing determination purposes rather than for risk assessment purposes. Paragraph 72 of the White Paper in this respect states that "[a]s long as all involved in preparing and reviewing such data understand that risk assessment is a first step and that precision may not be necessary, greater overall reporting might productively be required for risk assessment purposes." To avoid misunderstandings and disputes about the use of certain information, we recommend the OECD make sure that it is clear for both taxpayers and tax authorities which information can be used for risk assessment purposes and which information can and should be used for a detailed transfer pricing analysis.

Given the commercial sensitivities and significance of this country-by-country reporting, we urge the OECD to consult closely with the business community on the development of the new template to be used for such reporting. In our view the OECD needs input from MNEs regarding the best way to develop the template for this purpose. For instance, we believe the OECD should obtain more information about how much country data MNEs typically have available and how the template can be aimed toward information that is most informative and reliable. We also believe that the OECD should release any template for this information in draft form first so that interested parties can submit comments and consult with the OECD regarding specific issues with respect to the template.

Disclosure of APAs and Tax Rulings

The White Paper suggests the inclusion in the Masterfile documentation of all relevant Advance Pricing Agreements ("APAs") and tax rulings between a taxpayer and different tax agencies. This suggestion might be a bridge too far. If tax agencies were to use this information on APAs primarily to double-check on the reasonableness of the big picture provided by the taxpayer, it would not be a problem. However, taxpayers will be concerned that tax authorities may seek to use this information to strengthen their own position vis-à-vis the taxpayer and tax authorities in other jurisdictions. This may well give rise to misunderstandings, erroneous interpretations and inappropriate demands for extra information, with an increase in costly and time-consuming disputes among tax agencies and between tax authorities and taxpayers. This also follows from the experience with the Code of Conduct on Transfer Pricing Documentation for Associated Enterprises in the European Union ("EUTPD"), as discussed in paragraph 28 of the White Paper.

What's more, if required, this disclosure may have the unintended consequence of reducing the incentive for MNEs to seek APAs that have thus far been a successful vehicle to reducing controversy and increasing cooperation and transparency between taxpayers and taxing authorities. Therefore, we strongly recommend that the disclosure of APAs as part of the Masterfile be voluntary on the part of the taxpayer.

A Judicious Approach

Finally, it is very important that tax authorities take a judicious approach in the use of supplemental Masterfile data for risk assessment purposes. Risk assessment is merely a first step. The economic analysis supporting the arm's-length nature of an MNE's transfer pricing policies, whether presented in the Masterfile or local country modules, must ultimately be given primary weight in determining whether or not an MNE has made a good faith effort to comply with arm's-length principles. In this regard, the OECD has provided detailed guidance on the most appropriate transfer pricing methods for various types of transactions. The reporting of country-by-country data may provide tax authorities with more information to understand the overall allocation of system-wide profits, however such information is of limited usefulness in applying most of the arm's-length transfer pricing methods endorsed by the OECD. Any requirement to report supplemental financial data in the Masterfile should in no way undermine the OECD's existing transfer pricing guidance on performing transfer pricing analyses, where selection and application of the most appropriate transfer pricing method is based on a thorough analysis of functions

performed, risks assumed and assets employed, as well as a comparability analysis. Conclusions whether the pricing for a transaction is at arm's length should not be based on the high level data included in the Masterfile and/or country-by-country reporting only.

Local File Comments

Encouraging substantive compliance with local documentation requirements

A key objective of the White Paper is to promote substantive compliance of MNEs with the arm's length principle. Legislating documentation requirements alone does not promote substantive compliance. At least two additional conditions will need to be met in order for documentation requirements to promote substantive compliance:

- The amount of information must be balanced and the information required relevant.
- Substantive documentation demonstrating compliance with the arm's length principle should put the taxpayer in a better position with respect to sustaining its transfer pricing.

Balanced and relevant information

The Masterfile will already include a substantial amount of relevant information, especially where country-by-country data is reported, and the information required in the local documentation will need to build on this in a balanced manner. It is imperative that the ultimate report balances tax authorities' need for information and the costs of identifying and collating information to the taxpayer. We attach as appendix 1 our view on what would achieve an appropriate balance of information for a reasonable assessment of whether transfer prices adhere to the arm's length principle. We also attach as appendix 2 specific comments on Table 2.

Penalties

Taxpayers that prepare quality documentation demonstrating their reasonable adherence to the arm's length principle should not be subject to penalties if adjustments are made. The final report should in our view include a recommendation to this effect.

Burden of Proof

We also advocate including a shift in the burden of proof to the tax authorities (or, confirming that the burden of proof that transfer prices are not at arm's length is on the tax authorities) where appropriate substantive documentation is maintained. We understand that the rules on burden of proof and penalties diverge significantly between countries and are typically intertwined with their general tax systems. We also acknowledge the resulting difficulties in arriving at a consensus with respect to how the burden of proof should be affected by documentation. Notwithstanding this difficulty, we submit that the working party should survey the key approaches of countries to the burden of proof and that the report should include a best practice recommendation in relation to the burden of proof for each of these approaches.

Simplified rules for small taxpayers and non-material transactions

Not all taxpayers are the same and have access to the same resources. Similarly, not all taxpayers and transactions provide a similar level of risk to tax revenue. It is important that any documentation requirements factor this in and allow for a risk differentiated approach whereby smaller taxpayers or taxpayers with relatively small or low risk transactions can align the effort required to prepare documentation with the risk.

It may be difficult to include objective measures as to what taxpayers or transaction sizes and types should allow for a more streamlined and less fact intensive approach to documentation. Therefore it would be prudent to allow taxpayers perform their own risk assessment with regards to materiality thresholds. In order for a taxpayer to conduct an informed risk assessment regarding materiality, there must be clear guidance as to what consequences could exist for taxpayers that choose not to document certain transactions based on materiality.

Comparables

A difficult question for many MNEs, tax authorities and advisers is the use of non-local comparables. The mere fact that no agreement has been reached despite it being debated for several decades shows that there is no immediate and clear solution. As such, we support the pragmatic approach advocated in the paper, i.e. select local comparables if these are more reliable than non-local ones, but allow the use of non-local comparables where this makes sense from a comparability perspective. Of course, this should not lead to tax authorities routinely demanding local comparables based on the blanket argument that they provide better comparability where this is not supported by genuine market differences. The mere fact that a taxpayer does not use local comparables in itself should not lead to adverse consequences for the taxpayer.

An area that significantly increases the costs of documentation in some countries without any substantial benefit to taxpayers or tax authorities is the detailed scrutiny of financials for comparable companies. It is clear that information from commercial databases has its limits; however, it would seem that a taxpayer that relies on financial information in databases over which the taxpayer has no control should be credited with a good faith attempt to apply the arm's length principle.

Safe Harbors

We refer to our comments on the separate initiative in relation to safe harbors, but reiterate that appropriate safe harbors could significantly reduce compliance costs while not significantly increasing the tax revenue at risk.

Translation

Translation of documentation may be required in certain situations, but due to the cost of translating documents a judicious approach needs to be taken. Therefore, documentation should only be required to be translated if the tax authorities affirmatively request a translation; in the case of such a request, the taxpayer should be allowed a reasonable period of time to produce it.

Timing

Information required to prepare substantial documentation can be gathered at various times. Experience shows that there are typically three relevant periods:

- Before the transaction takes place (typically for ex-ante transfer pricing systems where parameters are set prior to the start of a year);
- At the time the transaction takes place (e.g. CUP information for commodities); or
- After the end of the financial year in which the transaction takes place (e.g. comparables searches to test the outcome for ex-post transfer pricing systems).

Information gathered at any of these moments can result in appropriate documentation provided the timing can reasonably be supported. As indicated in our 2012 contribution with regard to the OECD draft on "Timing Issues Relating to Transfer Pricing", EY is of the view that in principle the tax administration should follow the strategy applied by the taxpayer. So if the taxpayer applies an ex-ante approach on a reasonable basis and the application of such an approach is allowed in that country, the

tax administration should respect this method and should be very restrictive in applying post-transaction date developments given the risk of hindsight.

We believe it would be beneficial to explicitly state this in the report. If the guidance would seek to be more prescriptive as to which of these approaches should be applied, it needs to ensure a consistent global application. If the OECD considers taking the position that post-transaction information can be used, even if the taxpayer applied the ex-ante approach in a reasonable way, the OECD should consider providing some examples. We have difficulties with identifying situations in which it would be reasonable and at arm's length to use such information without it leading to hindsight.

It should also be made clear that, once a part of the documentation has been prepared, there should be no obligation on the taxpayer to update it for additional information that becomes available after this point in time. This is especially relevant for comparables searches where financial information only becomes available well after the end of the financial year. In these situations, documentation based on the most recent available information at the time of preparing the analysis should be sufficient.

Should documentation be submitted?
It is the prerogative of individual governments and tax authorities to determine whether documentation should be submitted to the tax authorities or whether it merely is prepared and kept by the taxpayer, to be submitted or shared upon request. However, it is difficult to see an objective benefit for requiring documentation to be submitted. On the reverse, there are substantial costs, including environmental costs. Therefore, we recommend documentation should only be required to be submitted at the specific request of the relevant authorities.

Update frequency and years covered
In order to achieve the objectives, one would expect that taxpayers review the alignment with the arm's length principle for each fiscal year. This would also align with the tax authorities' risk assessment objective. The final report should allow taxpayers to prepare confirmation that no material change of facts has taken place. We believe it would be disproportionate to require an annual update of comparables, in particular when applying a profit based method.

Given the objectives of documentation and an expectation that documentation will be frequently updated, it is difficult to see the added benefit of covering additional years in a documentation report unless the information provided elucidates the results for the year under review.

Inconsistent forms
We would like to reiterate our comments made in respect of the OECD Risk Assessment Handbook. Currently the information that tax authorities require from taxpayers for their risk assessment purposes varies across countries. Certain countries even require very detailed tax return disclosures. Some countries for example have introduced very detailed transfer pricing information forms. Completion of such forms is a very time-consuming exercise which often requires extraction of significant data from the ERP systems of taxpayers, analysis of these data and then presenting them in the format required. For some taxpayers it is in practice often not reasonably possible to disclose the details of all inter-company transactions in certain countries. This also involves costs which for large taxpayers can be material and in some cases can even exceed the amount of potential tax at stake from transfer pricing risks. At the same time, there is no clear understanding as to whether all information required on that form would be relevant and useful for the transfer pricing risk assessment purposes by the tax authorities. For example, it is questionable to what extent pricing information about each product sold in an inter-company transaction may be relevant in cases where the profit-based methods are used by taxpayers.

We would therefore suggest that the OECD should include specific guidance in view of harmonizing the information that needs to be provided to tax authorities across countries for their risk assessment purposes or for documentation purposes. Also should there be a focus on proportionality; the magnitude of information to be provided to tax authorities should be proportionate to the magnitude of the business of a taxpayer in the specific country.

Closing Remarks

We would like to recommend that the OECD provide some further insight into the anticipated end results of the project on the simplification or streamlining of transfer pricing documentation requirements. On the one hand, we would expect the OECD to provide a set of global rules and clear guidance on the two-tiered approach and on the other hand to provide and share best practice recommendations that would help tax administrations to apply these rules appropriately in view of complexity and materiality of transactions and taxpayers concerned.

Finally, we recommend the OECD make an effort to invite non-OECD member countries to actively participate in the global conversation on how transfer pricing documentation rules can be improved, standardized and simplified. By doing so, potential differences between transfer pricing documentation requirements in OECD member countries and non-OECD member countries may – to a certain extent – be mitigated. Obviously, this would be desirable in view of the overall goal to streamline such documentation requirements and to reduce the administrative burden and compliance costs for taxpayers.

We hope that these suggestions and recommendations are of assistance. We would welcome the opportunity to contribute further either through participation in a consultation meeting or by providing further clarification. In the meantime, do not hesitate to let us know how we can be of further assistance.

If you have any comments or questions, please feel free to contact any of the following:

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Yours Sincerely,
On behalf of EY

Thomas Borstell / Ronald van den Brekel

Appendix – 1. Documentation to allow a reasonable assessment of the arm's length principle
2. Comments on table two

Appendix 1 – Documentation to allow a reasonable assessment of the arm's length principle

We submit that the following documentation would typically allow an assessment of whether the transfer prices meet the arm's length principle:

- A description and quantification of the transactions undertaken to which the documentation applies.
- The position of the local company in the global value chain.
- The results reported by the local company.
- A summary of material events that occurred during the year including any material business restructuring or material intangibles transfers.
- A confirmation that the functions align with the functional analysis contained in the Masterfile, or alternatively, a differential functional analysis that summarizes where local activities deviate from the Masterfile.
- A confirmation of the characterization, or alternatively, a differential characterization should a differential functional analysis give rise to this.
- The selection of method based on the characterization and taking into account local guidance on methods.
- An appropriate comparability analysis including an explanation of the selection of the profit level indicator, the search process and any adjustments made. If non-local comparables are used this should also contain an explanation as to why these were not used and why the comparables used provide a reliable benchmark.
- An analysis of specific circumstances affecting the results of the local company if relevant.
- A conclusion on whether the transfer prices align with the arm's length principle.

We acknowledge that other information may become relevant in an audit scenario, but submit this information is sufficient to make an initial assessment of the application of the arm's length principle.

Appendix 2 – Comments on table two

Most items mentioned are appropriate in our view and would currently be reflected in documentation that is of sufficient quality. The following recommendations are therefore intended to fine-tune the content and to align it with other sections of the OECD Guidelines:

Information outside the year under review
Assuming the documentation requirements are aligned with the income tax year, there is an expectation that documentation would typically be prepared on an annual basis. As such, it is not clear why information in relation to earlier years needs to be included unless it elucidates the current year information. This applies to both financial information and information of a more contextual nature. Requiring to include information on prior can be expected to promote a copy-paste culture and is therefore not recommended.

Functional analysis
Rather than a detailed local functional analysis, the local functional analysis should validate the functional analysis in the Masterfile or identify differences. This assumes a Masterfile functional analysis that is of sufficient quality for the transactions reviewed and has sufficient detail to allow an appropriate selection and application of the transfer pricing method.

Identification of transactions that could influence
This is worded very broadly and in our experience transactions that materially influence another transaction are rare and often not obvious to MNEs or advisors. This kind of information is better requested as part of an audit. Alternatively, more specific guidance would be required.

Identification of the tested party
This requires clarification that a selection of a tested party is not relevant in Comparable Uncontrolled Price ("CUP") and profit split situations.

Application of method –comparability analysis
It would be beneficial to align the guidance with existing taxing authority, MNE and advisor practices where they meet the objectives. In our view, current practices are not fundamentally flawed and we recommend the following components should be addressed:

- List and describe in broad terms internal and external dealings that could be expected to provide CUPs, if any, and describe why they have or have not been used. Where comparable uncontrolled prices have been identified, add relevant details of the transactions.
- List and describe other internal transactions that could serve as an internal comparable from a margin, or allocation of profits, perspective and describe why they have or have not been used. Where comparable uncontrolled transactions have been identified that can serve as internal comparables, add relevant details of the transactions.
- List and describe external transactions that have been identified as potential comparables, if any, and describe why they have or have not been used.
- List and describe the search process for external comparables used to apply the method, if relevant.
- Provide an explanation of the manner in which the method was applied including:

- An explanation of the selection of the profit level indicator for Transactional Net Margin Method purposes;
- Why non-local comparables have been used, where relevant;
- Comparability adjustments made to the comparables;
- The reason for selecting a one-year or multi-year analysis.