The **BEPS** Monitoring Group

Submission to the Platform for Collaboration on Tax Public Consultation

on

THE DRAFT PRACITAL TOOLKIT TO SUPPORT THE SUCCESSFUL IMPLEMENTATION BY DEVELOPING COUNTRIES OF EFFECTIVE TRANSFER PRICING DOCUMENTATION REQUIREMENTS

These comments have been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organisations which research and campaign for tax justice, including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organisations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. They have been drafted by Joy Ndubai, with contributions and comments from Jeffrey Kadet, Sol Picciotto and Attiya Waris.

We appreciate the opportunity to provide these comments, and we are happy for them to be published.

8 November 2019

GENERAL COMMENTS

The Platform for Collaboration on Tax (PCT) draft transfer pricing toolkit aims to provide a practical overview of country approaches to transfer pricing (TP) documentation. Whilst this toolkit is welcomed as an opportunity to evaluate the difference in documentation requirements and emphasize the need for consistency in standard setting, it is difficult to establish its relevance given the current lack of consensus and continuing global debate over the effectiveness of the current transfer pricing rules. Most recently, the OECD secretariat has been working to produce a unified approach as a framework for a proposed 'new taxing right'.[1] On the agenda is the reform of the rules for allocation of income and tax paid by multinational enterprises (MNEs), which will begin from their global consolidated accounts.[2] It proposes a hybrid system, combining elements of formulary apportionment with retention of current transfer pricing rules. At the same time, the OECD has acknowledged the need for simplified

[1] BEPS Monitoring Group (2019), International Corporate Tax Reform and The 'New Taxing Right', BMG [online]. Available at: https://www.bepsmonitoringgroup.org/news/2019/9/10/international-corporate-tax-reform-and-the-new-taxing-right-b4ajr, pg. 1

[2] See our *Comments on the OECD Secretariat Proposals for a Unified Approach under Pillar 1*, 12 November 2019.

approaches to the allocation of MNE income especially for developing countries, and this has been stressed by bodies such as the African Tax Administration Forum.

Hence, significant changes are likely to these rules, which can be expected to require additional guidance and higher standards of transparency for purposes of effective administration. For instance, and emphasized below, publication of Country by Country reports (CBCRs) will become increasingly important, especially where companies with no physical presence but a digital or sales presence above an ascertained threshold, need to be evaluated for purposes of determining the profits arising in a market jurisdiction.

In addition, it is notable that no or minimal guidance has been provided for countries considering safe harbours, formulary apportionment and any other alternative approaches that simplify the allocation of income between related parties forming part of a MNE group. Such information would have been exceptionally useful considering the global debate. Some examples could be taken from Brazil, India, Mexico and the Dominican Republic.[3]

This draft toolkit could also further enhance its contribution to TP administration in developing countries if more information were required to be provided to enable auditing of the reliability of the TP study, which is where the divergence in treatment and assessment arises most frequently. The toolkit seems to be limited to establishing standardization of all TP documentation requirements, which has already been covered by the OECD TP Guidelines and the UN Manual on TP.

This toolkit could be a key opportunity to document and address the specific challenges being faced during audits, especially in developing countries, by taxpayers and revenue administrations of the reliability of the TP study. Some of the issues that could be documented include the most commonly contested transactions, the common challenges faced in identifying and allocating risks, the most difficult methods to evaluate, the frequency in differences of comparable search outcomes and how these are commonly resolved. This type of data would provide an opportunity to critically evaluate the actual operation of the ALP and, likely, evidence the practical difficulty of arriving at collective consensus on suitable comparables.

In addition to these general comments, we provide our specific comments below:

SPECIFIC COMMENTS

Options for countries to implement transfer pricing documentation

The consideration of who bears the burden of proof (who has to prove that the pricing is in accordance with the applicable rules) between the revenue administration and the taxpayer is important[4] and the initial burden should lie with the taxpayer as a standard. However, once the taxpayer has submitted accounts based on the methodology on which it has decided, the burden de facto shifts to the tax administration if it considers an adjustment is appropriate. The draft toolkit rightly recognizes that there is an information asymmetry, and in the absence of

[3] For more see: Sol Picciotto (2018), Problems of Transfer Pricing and Possibilities for Simplification, ICTD Working Paper 86 [online]. Available at: https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/14117/ICTD_WP86.pdf?sequence=1&isAllowed=y

[4] Platform for Collaboration on Tax (2019), Practical Toolkit to Support the Successful Implementation by Developing Countries of Effective Transfer Pricing Documentation, Platform for Collaboration on Tax [online]. Available at: http://www.oecd.org/tax/transfer-pricing-documentation-requirements-toolkit-platform-for-collaboration-on-tax.htm, pg. 16 - 17

adequate requirements for taxpayers to provide information, perverse incentives can arise.[5] Where the tax administration needs to request more information from taxpayers, they are often in the position to frustrate the process by withholding relevant information.

It should be noted that if an audit has been carried out and it is found that an adjustment is necessary, it has not been proven that the price is in line with the ALP and, there is a need to then address the standard of the burden of proof and who is required to fulfil it. How taxpayers can satisfy the documentation requirements is also often highly dependent on the information that their parent or related entities are willing or able to provide and this may often be used as a way to block any further scrutiny. This issue is particularly important for developing countries. One solution to address both challenges may be for revenue administrations opting to tax the adjusted profit until the taxpayer can prove that this creates double taxation.

Accessing documents or data held outside the local jurisdiction is a significant problem for both local companies and revenue administrations seeking information from foreign parents or related companies. The draft toolkit[6] does not address situations where exchange of information cannot take place due to no existing Double Taxation Agreement (DTA) and one or both countries are not parties to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. This limitation is especially important where large or dominant digital companies and market jurisdictions are concerned, and the draft toolkit should at least suggest some mechanism for dealing with this.

In addition, the penalties applied to failing to provide required documentation may not always pose a significant risk for certain large MNEs considering the amount of global profits earned. The draft toolkit should take this into consideration when making recommendations. However, complying with the TP documentation requirements is the minimum requirement and that is not often at issue. The information contained in that document and the extent to which it actually takes steps to provide reliable data should be subjected to greater regulation through penalties and compliance incentives.

We believe that section 2.5, 'Accessing documents held outside the jurisdiction', should be made much stronger. It is of course very good that the section advises that contentions that a local group member cannot obtain information from its affiliates should be resisted. However, the section should suggest the strongest possible measures and should be aligned with the right to access of information as set out in article 19 of the International Covenant on Civil and Political Rights. For example, in the absence of obtaining requested documentation, the local tax authority should have discretion to impose a transfer pricing adjustment with the burden of proof being on the taxpayer to dispute it.

The draft toolkit correctly recognizes that the cost of compliance with TP rules can be significant for taxpayers[7], but does not identify the major challenges it raises for administrators too. Some concerns include no usable comparables which would require constructing the comparable or formula to fit the specific taxpayer case, access to expensive comparable databases, the technical capacity required, the review of considerable information, and more often than not insufficient resources. Normally, administrations are dealing with much smaller budgets than large MNEs. Whilst taking measures to ensure that unnecessary or disproportional compliance costs do not arise when designing a TP study is important, how this may affect administration costs should also be considered.

Specific documentation elements

[5] *Ibid*
[6] Note 4, pg. 23
[7] Note 4, pg. 24

It is not entirely clear how it would be possible for transfer pricing returns to promote positive MNE behavioural changes[8] particularly considering that MNEs are not incentivized to comply where a TP return is unlikely to provide sufficient information to evaluate the reliability of the TP outcome[9]. Whether or not the MNE complies with ALP is generally difficult to ascertain since consensus on the acceptable set of comparables is not always easily arrived at and this could incentivize companies to be somewhat dishonest.

The recommendation[10] that the TP return should not request burdensome information from taxpayers is somewhat ambiguous since what could be considered burdensome would be a subjective matter. In addition, different countries are likely to require differing amounts of information depending on their administrative needs and constraints.

We support the recommendation that TP disclosure forms could follow a consistent regional format and likely address the prevention of tax competition and cooperation between countries.[11] TP returns should provide consistent information across the globe with some room for adjustments based on local administrative needs.

Transfer pricing studies

The draft toolkit rightly recognizes the importance of testing the reliability of the conclusions recorded in a transfer pricing study, but concludes that a detailed discussion would be outside of the scope of the toolkit.[12] This is often the most challenging area for developing countries, for instance in Kenya given the unreliability of the ALP, the resulting impossibility of sound technical analysis using comparables, TP issues are really being resolved more through political negotiation rather than by objective application of rules and regulations.[13] This can only encourage some MNEs to aggressively price transactions since they expect a negotiated agreement rather than one based on objective rules and the actual facts. Some unresolved technical obstacles faced by the Kenya Revenue Authority include the lack of additional data to inform and guide the selection of one of the TP methods and the failure of comparables databases to take into account the differences in quality of products or services.[14] It is unfortunate that the draft toolkit did not take this opportunity to address this complex area and therefore evaluate the effectiveness of the ALP.

The section addressing simplifications or exemptions for Small and Medium sized taxpayers considers parameters for exemption thresholds including the total turnover, revenue or gross operating income, assets and/or the number of employees. The number of employees may often be deceptive as companies can outsource certain services whilst earning a significant amount of revenue, whilst assets may be a difficult indicator since ownership is transferrable and leased assets may be used. The draft toolkit should consider these limitations and introduce additional factors such as amounts paid for and the nature of independent contractors and other service providers, the nature of and amounts paid for leased fixed assets, and unit and monetary volume of sales.

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[8] Note 4, pg. 28
[9] Note 4, pg. 27
[10] Note 4, pg. 28
[11] Note 4, pg. 28
[12] Note 4, pg. 37
[13] Attiya Waris (2017), How Kenya has Implemented and Adjusted to the Changes in International Transfer Pricing Regulations: 1920 - 2016, ICTD Working Paper 69 [online]. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3120551, pg. 33.

[14] Note 13, pg. 36

Country by Country Reporting

In March 2019, Vodafone published its CBCR[15] including information on their total tax contribution by country, the number of employees, total profits before tax, and all legal entities and their jurisdiction. The publication of this data demonstrated that the CBCR does not need to be a highly confidential document.

The draft toolkit should consider the potential advantages of public CBCR, particularly since some countries may not have concluded DTAs, entered into Tax Information Exchange Agreements or joined multilateral agreements that would permit the sharing of information. The draft toolkit should also consider whether subsidiaries may be required to submit the CBCR in their local jurisdiction together with the local file and master file. This would greatly facilitate access to this important documentation by countries that lack the resources to engage in the complex arrangements for exchange of this information. Determining the options for providing greater access to CBCR data will have implications for the proposals being developed in the current work of the OECD for the Inclusive Framework. The CBCR would be an important source of the information likely to be needed to exercise the 'new taxing right' that is under development.

Currently, revenue administrations are discouraged from introducing an adjustment based solely on the information provided within the CBCR. The condition on appropriate use contained in BEPS Action 13 indicates that jurisdictions should not propose adjustments to the income of any taxpayer on the bases of an income allocation formula based on the data from the CBCR. The draft toolkit should take steps to evaluate the implications of this limitation for market jurisdictions exercising their taxing rights since their decision to tax profits should be informed and guided by the CBCR. A review and assessment of how the transformation of the tax landscape could and should motivate some amendments on the guidelines for the use of CBCR should be included in this toolkit as it would likely be helpful for determining the most simplified way of executing the proposed 'new taxing right'.

Presently, there is no requirement that CBCRs be reconcilable with an MNE's consolidated financial statements. Guidance to developing countries could be useful on when and how to ask for reconciling information between the CBCR and group consolidated financial results and other information.

In considering the guidance on appropriate use of CBCR data, the draft toolkit highlights the need to control and monitor usage of the data.[16] It would be particularly useful for this section to provide recommendations on who would be expected to monitor and control use and how this would be executed. Care should be taken to ensure that companies are not vested with the duty to monitor and control use and that, where foreign revenue administrations are tasked with sharing the information, do not impede upon the sovereignty of the local jurisdiction by monitoring appropriate use. For this reason, further comments regarding the parameters of appropriate use, especially considering the 'new taxing right', should be included.

The Unified Approach includes an Amount B for certain activities that are 'baseline' or otherwise routine in nature. There are many activities, whether related to marketing and distribution or not, that will go beyond the 'baseline' or routine activities to which there will be established fixed returns. In theory, a local country can pursue additional taxable revenue

[15] For more see: Vodafone (2019), Taxation and our total economic contribution to public finances 2018, Vodafone [online]. Available at: https://www.vodafone.com/content/dam/vodcom/sustainability/pdfs/vodafone_2018_tax.pdf

[16] Note 4, pg. 64

as an Amount C. However, it is inevitable that there will be a lower level of audit activity due to the defined fixed returns for these 'baseline' or routine activities. As such, local tax administrations will seldom conduct the work necessary to identify Amount C situations.

Hence, the toolkit should provide guidance for mandatory taxpayer disclosure requirements that will highlight activities that go beyond the defined 'baseline' or routine activities. Only in this way will tax authorities be alerted to situations that legitimately warrant an Amount C.

Section 3.2.7, which concerns 'Confidentiality', includes just a simple blanket statement that "information contained in a transfer pricing return should be treated as confidential in the same way as information provided in a tax return."

Given the political momentum that may eventually result in public CBC reporting, perhaps the Toolkit should acknowledge this potentiality and provide that primary law, secondary law, and/or supplementary guidance, as appropriate, be made flexible to treat such CBCR information as non-confidential if this change does occur internationally. A specific provision that could be considered is that if any other country makes an MNE's CBCR public under its law, then that would trigger non-confidential treatment for that MNE's CBCR.