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Update of the United Nations Practical Manual on Transfer Pricing for Developing Countries

Chapter 7

DOCUMENTATION

~~7.~~C.2.1. Introduction

~~7.C.2.~~**C.2.1.1.** Adequate transfer pricing documentation can serve several useful functions. Quality transfer pricing documentation will: (i) ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices for transactions between associated enterprises; (ii) provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and (iii) provide tax administrations with useful information to use in evaluating a taxpayer's transfer pricing positions upon audit, thereby contributing to the avoidance of many disputes and to the timely resolution of any transfer pricing disputes that may arise.

~~7.~~C.2.**1.2.** Recently, the G20 / OECD BEPS Project has included an effort to create a more consistent and useful documentation standard for use by countries. Insofar as possible, countries should conform their transfer pricing documentation requirements to established international standards in order to limit compliance burdens imposed on taxpayers. When these international standards are followed, documentation will be characterized by (i) sufficient detail to demonstrate the taxpayer's compliance with the arm's length principle, and (ii) the timely delivery of such useful information to tax authorities, enabling them to assess tax risks and begin

audit investigations in appropriate cases. A taxpayer should make reasonable efforts to reflect in its documentation an adequate transfer pricing analysis of its material transactions with associated enterprises in order to establish its good faith effort to apply the arm's length principle.

~~7.~~~~C.2.~~C.2.**1.3.** This chapter first summarises recent developments regarding the establishment of international guidelines on transfer pricing documentation. It then provides a more in-depth discussion on several topical issues that developing countries will need to address in adapting the international standards to their own needs. The goal of the chapter is to provide practical guidance on these documentation related issues.

~~7.~~~~C.2.~~C.2.2. International Guidelines on Transfer Pricing Documentation

~~7.~~~~C.2.~~C.2.2.1. G20 / OECD Transfer Pricing Documentation Standard

The OECD first published guidance on transfer pricing documentation in 1995, shortly after the first individual country rules on documentation were developed. The original OECD guidelines contained general principles but did not prescribe a list of specific items to be included in transfer pricing documentation. Over the ensuing 20 years, numerous countries adopted transfer pricing documentation rules and gained experience administering those rules. Several multinational bodies also sought to develop consistent transfer pricing documentation standards. Notwithstanding these efforts by multinational bodies to encourage consistency, the various country rules differ from one another in many ways, a fact which complicates taxpayer compliance with global documentation requirements. Accordingly, in 2015, in connection with the G20 / OECD BEPS Project, the OECD guidance on transfer pricing documentation was updated to establish a uniform documentation standard.[1]

~~7.~~ C.2.2.1.2. The new G20 / OECD guidance sets out a standardised three-tiered approach to transfer pricing documentation. It suggests that documentation should include: (i) a master file containing general information about the MNE group relevant to all MNE group members; (ii) a local file referring specifically to material transactions of the MNE group members resident in the local jurisdiction and setting out the taxpayer's transfer pricing methodology for such material transactions; and (iii) a Country-by-Country Report ("CbC Report") containing certain information relating to the global allocation among taxing jurisdictions of the MNE group's income and taxes paid, together with certain general indicators of the location of economic activity within the MNE group. The Final BEPS Report also includes agreed guidance on implementing the new documentation and reporting rules. The OECD work builds on earlier work of other bodies, particularly that of the EU.

[1] OECD (2015), *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015 Final Report,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. *http://dx.doi.org/10.1787/9789264241480-en* (hereafter "OECD / G20 Final Documentation Report).

~~7.~~C.2.2.1.3. Master File. The master file is intended to provide a high level overview of the MNE's global operations. The new G20/OECD documentation standard calls for the following information to be included in the master file:

- A chart illustrating the MNE's legal and ownership structure and the geographical location of operating entities.

- A general description of the MNE's business including: (a) Important drivers of business profit; (b) A description (which may be in the form of a chart) of the supply chain for the group's five largest products and / or service offerings by turnover and any other products or services amounting to more than 5 percent of group turnover; (c) A list and brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services, including a description of the principal locations providing important services and the transfer pricing policies for allocating service costs and determining prices for intragroup services; (d) A description of the main geographic markets for the group's products and services referred to in (b), above; (e) A brief written functional analysis describing the principal contributions to value creation by individual entities within the group; and (f) A description of important business restructuring transactions, acquisitions, and divestitures occurring during the fiscal year.

- A description of the MNE's intangibles, including: (a) A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management; (b) A list of intangibles of the MNE group that are important for transfer pricing purposes and which entities own them; (c) A list of important agreements among identified associated enterprises related to intangibles, including cost contribution agreements, principal R&D service arrangements, and licence arrangements; (d) A general description of the group's transfer pricing policies related to R&D and intangibles; and (e) A general description of transfers of interests in intangibles among associated enterprises during the fiscal year, including the entities, countries and compensation involved.

- A description of the MNE's intercompany financial arrangements, including: (a) A general description of how the group is financed, including important financing arrangements with unrelated lenders; (b) The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws each entity is organized and its place of effective management; and (c) A general description of the MNE's transfer pricing policies related to financing arrangements between associated enterprises.

- The MNE's annual consolidated financial statement for the fiscal year if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.

- A list and brief description of the MNE group's existing unilateral advance pricing agreements and other tax rulings relating to the allocation of income among countries.

~~7.~~C.2.2.1.4. Local File. The new G20 / OECD documentation standard suggests that the local file should contain the following information:

- A description of the entity or entities in the MNE Group that operate in the local country, including: (a) A description of the management structure of the local entity, a local organization chart and a description of the individuals to whom local management reports and the country where their offices are located; (b) A detailed description of the business and business strategy pursued by the local entity including a description of recent business restructurings or intangibles transfers in the present or previous year involving the local entity and an explanation of aspects affecting the local entity; and (c) A description of key competitors of the local entity.

- Information related to material controlled transactions involving the local entity, including: (a) A description of the transaction and the context in which it takes place; (b) The amount of intercompany payments or receipts for each category of controlled transactions involving the local entity, broken down by tax jurisdiction of the foreign payor or recipient; (c) Identification of the associated enterprises involved in each category of controlled transaction and how they are related; (d) Copies of all material agreements ~~related to the transactions~~concluded by the local entity; (e) ~~a~~A detailed comparability and functional analysis of the taxpayer and the relevant associated enterprises with respect to each documented category of controlled transactions including changes from prior years; (e) An indication of the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method; (f) An indication of which associated enterprise is selected as the tested party, if applicable, with an explanation; (g) A summary of the important assumptions made in applying the transfer pricing methodology; (h) An explanation of the reasons for using a multi-year analysis if relevant; (i) A list and description of selected comparable uncontrolled transactions, if any, and information on relevant financial indicators for independent enterprises used in the transfer pricing analysis including a description of the comparable search methodology and the source of the information; (j) A description of any comparability adjustments performed; (k) A description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method; (l) A summary of the financial information used in applying the transfer pricing methodology; and (m) A copy of existing unilateral and bilateral / multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to the controlled transactions being analysed.

- Relevant financial information, including: (a) Annual local entity financial accounts for the year concerned; (b) Information and allocation schedules showing how the financial data used in the transfer pricing analysis may be tied to the annual financial statements; and (c) Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that information was derived.

~~7.~~C.2.2.1.5. CbC Report. The CbC Report is intended to provide a general overview of the allocation of the MNE's global income and taxes paid among countries. It is intended to be used for the purpose of assessing transfer pricing and other tax risks. The G20 / OECD BEPS guidance contains a template for the CbC Report. On the first page of the template, the MNE is required to report on a jurisdiction-by-jurisdiction basis for constituent entities resident in the relevant jurisdiction:

- Total revenue, broken down into unrelated party revenue and related party revenue;
- Profit (loss) before income tax;
- Income tax paid (on a cash basis);
- Income tax accrued for the current year;
- Stated capital;
- Accumulated earnings;
- Number of employees;
- Tangible assets other than cash and cash equivalents.

On the second page of the template, the MNE should report, on a jurisdiction-by-jurisdiction basis:

- Each constituent entity in the group that is resident in the jurisdiction;
- The jurisdiction of organisation or incorporation for each constituent entity if different from the jurisdiction of residence;~~,~~ and
- The main business activities for each constituent entity of the MNE group.

~~7.~~C.2.2.1.6. In addition to prescribing standardized content for the master file, local file and the CbC Report, the G20/OECD BEPS guidance addresses several important implementation issues. [2]

- It is recommended in the BEPS Report that the master file and local file elements of the documentation package be implemented through local country legislation or administrative procedures, and that the master file and local file be filed directly by the taxpayer with the local tax administration in each relevant jurisdiction.

- It is recommended in the BEPS Report that the CbC Report be filed with the jurisdiction of the parent company of the MNE Group and shared by that country with other interested countries through automatic exchange of information under the Multinational Convention on Mutual Assistance in Tax Matters, under bilateral tax treaties, or under TIEAs. It is recognised, however, that backup local filing requirements may be necessary in situations where the country of the parent company does not adopt the CbC filing requirement or where other specified circumstances make it impossible for the local jurisdiction to gain access to the CbC Report through treaty exchange mechanisms. Accordingly, if developing countries are to have ready access to the CbC Report, they will need to either (i) join the Multilateral Convention on Mutual Assistance in Tax Matters, (ii) develop an extensive set of bilateral tax treaties and/or TIEAs that provide

[2] See OECD/G20 Final Documentation Report, Annex IV.

a basis for automatic exchange of CbC Reports filed in parent company jurisdictions, or (iii) develop mechanisms for enforcing backup local filing rules in situations where MNE group members operating in their jurisdictions may not have ready access to all of the global MNE data contained in the CbC Report to which ~~they~~the tax administration are entitled. Model competent authority agreements have been drafted to implement ~~treat~~the exchange of CbC reports and numerous countries have already adopted the implementing agreement under the Multilateral Convention. It is expected that most countries will opt for joining the Multilateral Convention.

- It is recognised that important confidentiality concerns arise in connection with the CbC Report. Tax administrations should take all reasonable steps to ensure that there is no public disclosure of confidential information contained in the CbC Report or other elements of the transfer pricing documentation package, including adopting appropriate legal measures to protect confidentiality. Protection of confidentiality is one of the principal reasons that countries agreed to use treaty exchange mechanisms as the primary sharing mechanism for the CbC Report.

- It is recognised that the CbC Report will be helpful for high level transfer pricing risk assessment purposes. It may also be used by tax administrations in evaluating other BEPS related risks and, where appropriate, for economic and statistical analysis. However, the information in the CbC Report should not be used as a substitute for a transfer pricing analysis of individual transactions and prices based on a functional analysis and a comparability analysis. The information in the CbC Report on its own does not constitute conclusive evidence that transfer prices are or are not appropriate. The CbC Report should not be used by tax administrations to propose transfer pricing adjustments based on a global formulary apportionment of income. Countries participating in the BEPS project commit that if such formulary apportionment adjustments are proposed based on CbC Report data, they will promptly concede the adjustment in any relevant competent authority proceeding. However, this does not imply that jurisdictions would be prevented from using the CbC Report data as a basis for making further enquiries into the MNE's transfer pricing arrangements or into other tax matters in the course of a tax audit.

- It is recommended that only MNE groups with annual consolidated revenue of at least EUR 750 million (or an equivalent amount stated in local currency using January 2015 exchange rates) be required to file the CbC Report.

- Jurisdictions should utilise the standard template set out in the OECD / G20 BEPS Report for the CbC Report, not requiring either more or less information to be reported.

- It was agreed that all aspects of the CbC Report, including its content and its implementation by taxpayers and tax authorities, will be reviewed again in 2020 after some experience is gained in preparing and using the CbC Report.

~~7.~~C.2.2.3. Implementation of Global Documentation Standards in Developing Countries

~~7.~~C.2.2.3.1. The international guidelines above were designed by the countries involved in the BEPS Project for adoption by them in the context of their own transfer pricing legislation, priorities, capabilities, and experience. It cannot automatically be assumed that these international guidelines should be adopted wholesale in every developing country. It is therefore important to examine these guidelines from the perspective of how they may work in practice in a developing country context, bearing in mind the administrative constraints that may exist in the tax administration and the MNE. In considering the international guidelines, however, all countries should also consider the great benefit of having consistent documentation rules from country to country to minimise transfer pricing compliance burdens.

~~7.~~C.2.2.3.2. Developing countries can assume that, in the future, MNE's will prepare the master file and that large MNE's will prepare the CbC Report. Requiring these documents to be delivered to the local tax administration in a developing country should therefore impose no marginal compliance burden on the MNE. The important question for developing countries, therefore, will likely be whether the local file envisioned by the G20 / OECD guidance should be adopted without modification in the local country.

~~7.~~C.2.2.3.3. The international standards are not self-executing. As noted above, local laws and / or administrative requirements ~~must~~ must be adopted in each country to require local filing of the master file and local file. As many developing countries are engaged in a modernization process for their tax administrations, including in most cases, significant investments in automation, countries can consider what new technologies are available in this regard to minimize compliance costs for both tax administrations and taxpayers.

~~7.~~C.2.2.3.4 Not all transactions that occur between associated enterprises are sufficiently material to require full documentation in the local file. Individual country transfer pricing documentation requirements based on the OECD / G20 guidance on the content of the local file should include specific materiality thresholds that take into account the size and the nature of the local economy, the importance of the MNE group in that economy, and the size and nature of local operating entities, as well as the overall size and nature of the MNE group. Measures of materiality may be considered in relative terms (e.g. transactions not exceeding a percentage of revenue or a percentage of cost measure) or in absolute amount terms (e.g. transactions not exceeding a certain fixed amount). Individual countries should establish their own objective materiality standards for local file purposes based on local conditions. As discussed in greater detail below, consideration should also be given to rules that exempt small or medium sized enterprises from documentation requirements or that limit the extent of the documentation to be provided by such entities.

~~7.~~C.2.2.3.5 Similarly, in setting out local law requirements related to the master file, it should be recognised that taxpayers should use prudent business judgment in determining the appropriate level of detail ~~to~~ for the information to be supplied. It should be kept in mind that the purpose of the master file is to provide tax administrations with a high-level overview of the MNE's global operations and policies. Information should be considered important if its omission would affect the reliability of the transfer pricing outcomes.

~~7.~~C.2.2.3.6 The CbC Report is likely to be delivered to the local jurisdiction of the MNE's parent company and to be forwarded to developing countries under treaty exchange mechanisms. However, as noted above, developing countries may need to adopt the Multilateral Convention on Mutual Assistance in Tax Matters or expand their networks of bilateral tax treaties and TIEAs in order to get access to the CbC Reports. The implementation materials in the BEPS Report contain model legislation and competent authority agreements that can be tailored to local country needs in adopting the CbC reporting requirement.

~~7.~~C.2.2.3.7. In considering the implementation of documentation rules, developing countries could decide to use a disclosure form as an alternative to the list of required documentation contained in the G20/OECD description of the local file. If such a disclosure form is used as a substitute for the local file, it should strike a balance between taxpayer effort required and its usefulness for tax authorities to make a proper assessment. The form should only be completed in relation to inter-company transactions of significant size. See the discussion of materiality at paragraph ~~7.~~C.2.2.3.4. Completing the form (supplemented by the master file and CbC Report otherwise prepared by the taxpayer) could be sufficient to comply with initial documentation requirements. Under this approach~~,~~ a full detailed transfer pricing report may need to be produced only upon request, rather than being produced with the tax return in every case. The compliance burden and compliance costs for MNEs may be reduced by introducing such a form, while not compromising the information available to tax authorities. Forms used in Canada and Nigeria may be useful examples.~~.~~ If disclosure forms are to be used rather than the local file format~~,~~ tax authorities may want to consider that to the extent these disclosure forms can follow a consistent format (i.e. list the same information as that required in disclosure forms used by neighbouring countries where the taxpayer may conduct business activities), the taxpayer burden ~~to prepare~~in preparing the forms might be reduced. This in turn may serve to help enhance taxpayer compliance.

~~7.~~C.2.3. Experiences of Multinational Enterprises with Existing International Guidelines on Documentation

~~7.~~C.2.3.1. The documentation compliance burden has increased significantly in the last decade with more and more countries introducing specific transfer pricing documentation requirements. At the beginning of this millennium~~,~~ there were approximately 15 countries with specific transfer pricing documentation requirements, rising to almost 60 countries in 2012 with even more countries introducing new documentation rules since then. As noted, there is a risk that countries may introduce transfer pricing documentation requirements that differ significantly from country to country, resulting in a substantial increase in compliance costs for MNEs.

~~7.~~C.2.3.2. MNEs welcome initiatives to reduce the compliance burden and the relat~~ed~~ed~~ing~~ compliance costs by introducing standards of required information that are relevant for multiple countries. The above mentioned international guidelines should help to harmonise rules so ~~that~~ the preparation of documentation will not become a business in itself instead of a support to the MNEs business and global tax compliance.

~~7.~~C.2.3.3. Currently a large number of transfer pricing reports are prepared annually just to satisfy local requirements, e.g. country-specific nuances, local language, annual searches and

increasing focus on local comparables. As many businesses do not undergo major changes and/or restructuring every year~~,~~ the added value of an annual transfer pricing report may be open to question. It is recommended that transfer pricing documentation be periodically reviewed in order to determine whether functional and economic analyses are still accurate and relevant and to confirm the validity of the applied transfer pricing methodology. In general~~,~~ the master file, the local file~~,~~ and the Country-by-Country Report should be reviewed and updated annually. It is recognised, however, that in many situations business descriptions, functional analyses~~,~~ and descriptions of comparables may not change significantly from year to year. In order to simplify compliance burdens on taxpayers~~,~~ the tax administration~~s~~ may determine, as long as operating conditions remain unchanged, that the searches in databases for comparables supporting part of the local file be updated every three years rather than annually. Financial data for the comparables should nonetheless be updated every year in order to apply the arm's length principle reliably. See the OECD / G20 Final Documentation Report, paragraphs D.5.37 and D.5.38.

~~7.~~C.2.3.4. If more consistency can be achieved with regard to information required, MNEs may develop a system that retrieves (part of) this information automatically from their financial information systems, ultimately reducing their compliance costs significantly.

~~7.~~C.2.3.5 It is important that the documentation rules be broad enough to capture the reality of the related party transaction without being excessively burdensome on the mere chance that, though unlikely, a particular piece of information may be relevant.

~~7.~~C.2.4. Practical Guidance on Documentation Rules and Procedures

~~7.~~C.2.4.1. Burden of Proof

~~7.~~C.2.4.1.1. In a number of countries~~,~~ the tax administration bears the burden of proof with respect to tax assessments unless a tax law specifically provides otherwise. Generally, that means that taxpayers need not prove the correctness of their transfer pricing unless the tax administration challenges taxpayers with concrete and clear reasons for such challenges. For further information consult Chapter 3, Paragraph 3.6.

~~7.~~C.2.4.1.2. However, if a country has a set of specific documentation rules in its tax law or regulations, it may be the case that the burden of proof for the transfer price at which a taxpayer transfers goods or services with related parties falls on the taxpayer, unless the taxpayer is believed to have fulfilled the obligations imposed by such documentation rules. Even where the burden of proof rests on the tax administration, the tax administration might require the taxpayer to provide documentation about its transfer pricing, because without adequate documentation, the tax administration cannot assess the case properly. In some countries, where the taxpayer does not provide adequate documentation, there may be a shifting of the burden of proof in the manner of a rebuttable presumption in favour of the adjustment proposed by the tax administration.

~~7.~~C.2.4.1.3. In countries where the burden of proof generally lies with the taxpayer~~,~~ the burden of proof may shift to the tax administration if a taxpayer presents to the tax administration (or a court) a reasonable argument and evidence to suggest that the transfer pricing was at arm's length. Further, in some countries with specific documentation rules, the burden of proof shifts to the tax administration if a taxpayer has reasonably complied with the documentation rules.

~~7.~~C.2.4.1.4. Developing countries should ~~assure~~ensure that the relationships between documentation rules and the burden of proof are clear in their domestic law. The burden of proof should not be misused by the tax administration or taxpayers as a justification for making assertions that may be difficult to substantiate through an ordinary level of transfer pricing documentation. In other words, both the tax administration and the taxpayer should practice good faith through reasonable documentation that their determinations on transfer pricing are consistent with the arm's length principle regardless of where the burden of proof lies.

~~7.~~C.2.4.2. Timeframe to Produce Transfer Pricing Documentation

~~7.~~C.2.4.2.1. In general, countries have different timing requirements for the production of transfer pricing documentation. Any requirement that requires preparation of documentation at the time of the transaction, at the time the tax return is filed, or at the beginning of an audit may be referred to as a "contemporaneous" documentation requirement. Because timing rules differ from country to country, however, ~~we~~ the Committee ~~have~~ refrained from using the word "contemporaneous" to describe documentation requirements in this chapter in order to avoid confusion. Countries should ~~need to~~ consider what timing requirements best suit their needs and is consistent with their administrative procedures. Types of documentation ~~*timing*~~ requirements in use around the world may involve one or more of the following:

- Prepare information at the time of the transactions, to be submitted at the time of filing the tax return ~~filing~~;
- Prepare information at the time of the transactions, to be submitted upon request in case of an audit;
- Prepare information at the time of filing the tax return ~~filing~~;
- Prepare information only if requested upon audit; or
- No documentation requirement.

~~7.~~C.2.4.2.2. Taxpayers, in some cases, establish transfer pricing documentation to demonstrate that they have made reasonable efforts to comply with the arm's length principle at the time their intra-group transactions were undertaken based on information that was reasonably available to them at that point~~,~~ (hereinafter ~~called~~referred to as the "arm's length price-setting" approach). Such information includes not only information on comparable transactions from previous years, but also information on economic and market changes that may have occurred between those previous years and the year of the controlled transaction. In many countries, however, taxpayers are required to test the actual outcome of their controlled transactions to demonstrate that the conditions of these transactions were consistent with the arm's length principle, hereinafter called "the arm's length outcome-testing" approach. Such tests typically take place as part of the process for establishing the tax return at the end of a tax

year. See Chapter 5, Paragraph 5.4., for a detailed discussion of this area. See also OECD TPG paragraphs 3.69 – 3.71.

~~7.~~C.2.4.2.3. A country that wishes to establish a transfer pricing documentation rule should take into account the existence of the two pricing approaches mentioned above. Whether the arm's length price setting or outcome-testing approach is used, data for external comparables may not be readily available at the time of the analysis.

~~7.~~C.2.4.2.4. The G20/OECD documentation standards do not mandate specific rules regarding the time at which documentation should be prepared or presented to the tax authorities.[3] The guidance contained in the OECD/G20 Final Documentation Report suggests that the CbC Report be completed one year from the close of the MNE group's fiscal year to which the CbC Report relates.

~~7.~~C.2.4.2.5. The OECD Transfer Pricing Guidelines note that it would be quite burdensome if detailed documentation were required on all cross-border transactions between associated enterprises~~,~~ and by all enterprises engaging in such transactions. Therefore, it would be unreasonable to require the taxpayer to submit documents with the tax return specifically demonstrating the appropriateness of all transfer price determinations. The local file, in particular, should be limited to material transactions. As noted above, under the G20/OECD guidance, the definition of materiality is left to local law and should be specified in light of local conditions.

~~7.~~C.2.4.3. Penalties

~~7.~~C.2.4.3.1. A country that requires its taxpayers to prepare transfer pricing documentation may operate a penalty system to ensure proper compliance with its documentation requirements. Penalties in relation to the transfer pricing regime can be generally divided into two groups based on the reason for imposing them: (i) penalties for underpayment of tax that is due; and (ii) penalties for non-compliance with documentation requirements.

~~7.~~C.2.4.3.2. However, a number of countries also have incentive measures eliminating penalties for underpayment of taxes in cases where obligations for proper documentation have been fulfilled by taxpayers even in cases where the amount of taxable income turns out to be

[3] Ultimately issues regarding the storage of relevant documents may depend on domestic law. Most countries may require taxpayers to keep documentation in paper format. However, depending on the development status of a country's electronic technology, some countries may require the taxpayer to store the material in a [readily searchable] electronic format instead of paper format. For example, Korea provides in Article 85-3 of the National Basic Tax Act (NBTA) that taxpayers shall faithfully prepare and keep books and relevant documents relating to all transactions until the expiry of the statute of limitation. However, according to the NBTA, taxpayers are also allowed to prepare the above mentioned books and the relevant documents through an electronic system and, in this case, they are required to keep that information on a magnetic tape, disk or any other electronic storage. See OECD TPG paragraphs 5.35 – 5.36.

increased as a result of a tax audit. The principle governing these incentive measures is often referred to as the "no-fault, no-penalty principle".

~~7.~~C.2.4.3.3. In general, penalties can entail civil (or administrative) or criminal sanctions. Penalties imposed for failure to meet transfer pricing documentation requirements are usually monetary sanctions of a civil or administrative, rather than a criminal, nature. In some countries, a failure of the taxpayer to comply with documentation rules may lead to greater scrutiny by the tax administration and risk assessment and adjustments based on other information available to the tax administration or on the basis of other transfer pricing methods (see, section 1.6.11 – 13, above). These cases are more closely scrutinized, and can equally be seen as giving rise to greater risks of non-compliance.

~~7.~~C.2.4.3.4. It would be unfair to impose sizable penalties on taxpayers that exert reasonable efforts in good faith to undertake a sound transfer pricing analysis to ascertain arm's length pricing, even if they do not fully satisfy documentation requirements. In particular, it would be unproductive to impose penalties on taxpayers for failing to submit data to which the MNE group did not have access at the time of the documentation process, or for failure to apply a transfer pricing method that would have required the use of data unavailable to the MNE group. However, this does not mean that a transfer price cannot be adjusted retroactively, with interest accruing on that amount.

~~7.~~C.2.4.3.5. Some countries consider that a penalty imposed due to a lack of proper documentation can be addressed through the Mutual Agreement Procedure between competent authorities under an applicable tax treaty, as it relates to the taxes to which the relevant treaty applies. Other countries consider that the issue of penalties, especially in relation to documentation, is distinct from the adjustments made and also from the issue of whether taxes have been imposed in accordance with the relevant tax treaty.

~~7.~~C.2.4.3.6. However, even where such a penalty is not covered by a tax treaty's Mutual Agreement Procedure, the penalty should not be applied in a manner that would severely discourage or invalidate a taxpayers' reasonable reliance on the benefits of the tax treaty. This includes the right to initiate the Mutual Agreement Procedure as provided in the relevant tax treaty.

~~7.~~C.2.4.3.7. For example, a country's requirements concerning the payment of an outstanding penalty should not be more onerous to taxpayers in the context of the Mutual Agreement Procedure than they would be in the context of a domestic law review initiated by the taxpayer.

~~7.~~C.2.4.4. Special Considerations for Small and Medium-sized Enterprises

~~7.~~C.2.4.4.1. Comprehensive documentation requirements and subsequent penalties imposed on non-compliant taxpayers in a country may place a significant burden on taxpayers, especially on small and medium-sized enterprises (SMEs) who engage in cross-border transactions with overseas related parties. A number of countries have introduced certain special considerations in their transfer pricing documentation rules, based on which SME taxpayers or taxpayers without

heavy involvement in international transactions can be exempted from the transfer pricing documentation requirements.[4] The G20/OECD BEPS guidance on documentation exempts MNEs with global revenues of less than EUR 750 million from the obligation to file the CbC Report, but rules as to whether SMEs should prepare the local file and master file are left to local law.

~~7.~~C.2.4.4.2. The following countries have been selected as samples to demonstrate special considerations for Transfer Pricing documentation in the case of SMEs:

France

France has issued guidance for SMEs, with the effect that the mandatory transfer pricing documentation requirements in the legislative proposal will only apply to large enterprises.~~.a~~ Thus, SMEs should only ~~undertake~~submit ~~T~~transfer p~~P~~ricing documentation upon a specific request of the French tax authorities (FTA) in the course of a tax audit. In principle, such requests may occur only under exceptional circumstances if the FTA has gathered sufficient evidence suggesting a transfer of profit to related foreign entities. However~~,~~ small companies are also encouraged to prepare contemporary transfer pricing documentation. (a)

Germany

SMEs~~b~~ do not have a duty to issue Transfer Pricing documentation. However, they are obliged to provide further information and documents about the foreign business transactions when requested by the tax authorities. In this case~~,~~ less detailed transfer pricing documentation is required. (b)

Netherlands

There are no specific rules applicable to SMEs; all enterprises are obliged to prepare and keep transfer pricing documentation. However, in practice, the transfer pricing documentation obligation is applied in a flexible manner; small companies are often permitted to provide less detailed transfer pricing documentation as compared to large companies.

Poland

Enterprise size does not have an influence on transfer pricing documentation requirements. However~~,~~ the volume of the transactions does. The transfer pricing documentation requirements only apply to transactions where the annual turnover in a given tax year exceeds the equivalent of:

EUR 100,000~~€~~ (c) — if the value of the transaction does not exceed 20 per cent of the share capital of the company;
EUR 30,000 — in the case of rendering services or sale of intangible values;
EUR 50,000 — in all other cases; or
EUR 20,000 — for all payments made to tax haven jurisdictions.

[4] See, for example, the analysis of existing transfer pricing simplification measures undertaken by the OECD available from http://www.oecd.org/tax/transfer-pricing/50517144.pdf

Spain

There could be several types of documentation compliance burdens depending on the characteristics of the parties involved. Relevant factors include a turnover of 8 ~~M~~million Euros or more, which may trigger a requirement to provide further and more thorough information. Another factor is whether transactions are undertaken with entities or individuals based in tax haven jurisdictions.

China

Under the new Public Notice 2016(42) China provides certain exceptions to documentation requirements that may apply to SMEs. The exceptions depend on the portion of the documentation in question. The local file is required if one of the following thresholds is exceeded for the year: (i) 200 million RMB of related party tangible asset transfers, (ii) 100 million RMB of related party financial asset transfers; (iii) 100 million RMB of related party intangible asset transfers; or (iv) 40 million RMB of other related party transfers. The local file is not required for transactions subject to an effective advance pricing agreement. The master file is required if the enterprise has conducted annual related party transactions exceeding 1 billion RMB. The country by country report is required if the MNE group has annual consolidated revenue exceeding 5.5 billion RMB. (d)

Korea

The method used and the reason for adopting that particular method ~~for an~~to comply with the arm's length principle ~~determination~~ must be disclosed to the tax authorities by a taxpayer in a report submitted along with the annual tax return. This is not the case, however, if the total value of cross-border transactions of goods and that of cross-border transactions of services of the taxpayer for the taxable year concerned is 5 ~~B~~billion KRW (Korean Won)~~e~~ or less and 500 ~~M~~million KRW~~Korean Won~~ or less, respectively. The above obligation is also exempt for the taxpayer whose inter-company transaction volume per an overseas related party is 1 ~~B~~billion KRW~~Korean Won~~ or less for goods and 100 ~~M~~million KRW or less for services. (e)

India

Taxpayers with international related-party transactions valued at not more than 10 ~~M~~million INR (Indian Rupees)~~f~~ are exempted from the obligation of contemporaneous transfer pricing documentation which must be ~~prepared prior to the filing of Indian annual tax returns and retained for eight years.~~ (f)

Brazil

As a general rule, documentation regarding to tax accounting (which includes Transfer Pricing documentation) must be kept with the taxpayer until the expiration of the statute of limitation for tax matters (five years). This documentation must be presented to the tax administration when the taxpayer is summoned to do so for tax auditing purposes. On the other hand, taxpayers must indicate in the tax return (electronic certified tax accounting) which Transfer Pricing method is used for each fiscal year, and detail the TP adjustments made. Failure to present the documentation allows the tax administration to choose the TP method for tax auditing purposes. There are three regimes for income tax for enterprises:

1) small enterprises (Simples);
2) presumed profit regime; and,
3) the common regime (based on actual profit).

Small enterprises are not subject to TP regulations (and companies subject to this regime cannot have an ownership relationship with foreigners). Those that opt for the presumed profit regime are subject to TP adjustments regarding to exports; however, only enterprises with annual revenue (turnover) up to BRL

78,000,000 (approx. USD 23,000,000) may opt for this system.

Footnotes:

a A company with annual turnover or gross balance sheet assets of less than EUR 400 ~~M~~million ~~Euro~~s, which does not belong to an economic group, is exempted from documentation requirements.

b A company with turnover in goods of less than EUR 5 ~~M~~million Euros or turnover in services of less than 500,000 Euros falls into this category.

c. One Euro was worth approximately USD 1.13 in September 2016~~1.29 US$ as of May 2013~~.

d. 6.67~~2~~ Yuan Renminbi (CNY) were worth approximately USD1 ~~US$~~ as of ~~May 2013~~ September 2016.

e. 1.1~~0~~1~~5~~5 Korean Won (KRW) were worth USD1 ~~US$~~ as of ~~May 2013~~ September 2016.

f. 66.69~~55~~ Indian Rupees (INR) were worth approximately USD1 ~~US$~~ as of ~~May 2013~~ September 2016.

~~7.~~C.2.4.4.3. In summary, some countries have particular legislative provisions that allow exemptions from the obligation ~~for~~to prepare transfer pricing documentation, or for submission of documents to tax authorities at the time of filing tax returns. However, some countries allow similar exceptions by an administrative measure notwithstanding the lack of any specific legislation granting such exceptions. In some countries, exemptions or mitigation of transfer pricing documentation obligations are directly targeted at SMEs. However, a number of countries operate such exemption or mitigation regimes mainly targeting taxpayers whose transaction volumes with overseas related parties are quite limited. Since many SMEs are not heavily involved in cross-border transactions with overseas related parties, they benefit from these exemptions in an indirect way.

~~7.~~C.2.4.5. Language to be Used for Transfer Pricing Documentation

~~7.~~C.2.4.5.1. The OECD / G20 BEPS Report notes that a requirement to provide transfer pricing in the local language can constitute a complicating factor for transfer pricing compliance since both time and cost may be involved in translating documents. The language in which transfer pricing documentation should be submitted should be established under local laws. Countries are encouraged in the BEPS Report to permit filing of transfer pricing documentation in commonly used languages where it will not compromise the usefulness of the documents. Where tax administrations believe that translation of documents is necessary~~,~~ they should make specific requests for translation and provide sufficient time to make such translation as comfortable a burden as possible.

~~7.~~C.2.4.5.2. Many countries require taxpayers to present transfer pricing documentation in their own language and require translation if the documentation was prepared in a different language. The Egyptian transfer pricing guidelines provide that if documents are provided in any language other than in Arabic, the taxpayer may be required to bear the cost of an official translation.[5] However, some countries such as France, Germany, Netherlands and Korea allow presentation of documentation in a language other than their own languages at least on an exceptional basis. It is particularly common to allow documentation to be provided in English.

[5]Further information available from http://www.us.kpmg.com/microsite/taxnewsflash/tp/2011/TNFTP11_02Egypt.html