February 23, 2014

By email
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Working Party No. 6 of the Committee on Fiscal Affairs
Organization for Economic Co-operation and Development (OECD)

Subject: Comments on the Discussion Draft on Transfer Pricing Documentation and CbC Reporting

We welcome the OECD's efforts at revisiting and developing guidelines for transfer pricing documentation.

After carefully reviewing the document, we do consider that the global approach regarding transfer pricing documentation of a multinational group must have to take into account the additional effort and costs that taxpayers at a local level would have to incur in order to fulfill this transfer pricing documentation global approach.

Below are the comments prepared by the Transfer Pricing Committee of the International Fiscal Association Mexican branch (IFA Grupo Mexicano, A.C.) in connection with the abovementioned public consultation draft.

Transfer pricing risk assessment

Comments are requested by the OECD as to whether work on BEPS Action 13 should include development of additional standard forms and questionnaires beyond the country-by-country reporting template. Comments are also requested regarding the circumstances in which it might be appropriate for tax authorities to share their risk assessment with taxpayers.

In this regard, BEPS Action 13 establishes that "*The actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business. Work to improve the effectiveness of the mutual agreement procedure (MAP) will be an important complement to the work on BEPS issues. The interpretation and application of novel rules resulting from the work described above could introduce elements of uncertainty that should be minimized as much as possible. Work will therefore be undertaken in order to*

examine and address obstacles that prevent countries from solving treaty-related disputes under the MAP. Consideration will also be given to supplementing the existing MAP provisions in tax treaties with a mandatory and binding arbitration provision."

If the taxpayers are required to produce information of other related parties, such as transactions carried out between different related parties, intangibles of other related parties, among other information that the local taxpayer is not obliged to have in its files by its domestic law, the effectiveness of the MAP would discouraged.

Improving the mechanism of exchange of information between tax authorities would be helpful in these processes.

Transfer pricing audit

Paragraph 14 states that *"…regardless of how comprehensive transfer pricing documentation requirements may be, situations will inevitable arise when tax administration wish to obtain information not included in the documentation package".*

Transfer pricing audits show that the information required by the tax authorities depends to a great extent on the characteristics of the case at hand. Even if a standardized format is used for documentation purposes, additional information requirements should be expected to take place frequently. The design of the master file and the local file should not result in demanding from the MNCs an over comprehensive documentation package, as it can result in a very high compliance burden which at the same is unlikely it will satisfy the transfer pricing enquiries of the tax authorities regardless of its level of detail.

Paragraph 15 provides that *"It may be often the case that the documents and other information required for a transfer pricing audit will be in the possession of members of the MNE group other than the local affiliate under examination. Often the necessary documents will be located outside the country whose tax administration is conducting the audit."*

Given the above, OECD is requesting comments regarding the appropriate scope and nature of possible rules relating to the production of information and documents in the possession of associated enterprises outside the jurisdiction requesting the information.

From local entities standpoint, relevant difficulties may arise in order to obtain information of other related parties to be provided to local tax administrations conducting an audit process.

In addition, it is very important to consider the obligations established for the taxpayers by its domestic laws, regarding documentation to be held in case of a tax audit. This should also have to be considered for the statute of limitations for the tax authorities in connection with the information they may request from the taxpayers.

Again, if the tax authorities require specific information from a different tax jurisdiction, it should be obtained through a mechanism for exchange of information between tax authorities.

Moreover, there are many subsidiaries from two or more different stockholders, which are not related parties between them; therefore confidentiality issues would arise for that subsidiary if requested by the tax authorities to provide information of their stockholders.

Master file

Paragraph 18 provides that *"The master file should contain common standardized information relevant for all MNE group members. Its purpose is to elicit a reasonable complete picture of the global business, financial reporting, debt structure, tax situation and the allocation of the MNE's income, economic activity and tax payments so as to assist tax administrations in evaluating the presence of significant transfer pricing risks. Tax payers should be able to prepare the master file either for the MNE group as a whole or by line of business, depending on which would provide the most relevant transfer pricing information to tax administrations."*

OECD is requesting comments as to whether preparation of the master file should be undertaken on a line of business or entity wide basis, stating that consideration should be given to the level of flexibility that can be accommodated in terms of sharing different business line information among relevant countries, and that consideration should also be given to how governments could ensure that the master file covers all MNE income and activities if line of business reporting is permitted.

Regarding the aforementioned, it is important to define at a first stage that local entities rarely have access to global information and usually take part of only a line of business or on a specific business or activity within the group. The aforementioned also occurs when a local company is a subsidiary of two or more different unrelated stockholders given that one of the stockholders would not share information to any other unrelated group.

Furthermore, when transactions are carried out between independent parties, it is not possible for an entity to provide the tax authorities, neither it is obliged to have information regarding other transactions carried out by the counterparty with its related parties. This should be considered as an arm's length behavior that should also be taken into consideration for related party transactions.

In addition, OECD is requesting comments regarding the following:

"• Should the country-by-country report be part of the master file or should it be a completely separate document?

• Should the country-by-country template be compiled using "bottom-up" reporting from local statutory accounts as in the current draft, or should it require (or permit) a "top-down" allocation of the MNE group's consolidated income among countries? What are the additional systems requirements and compliance costs, if any, that would need to be taken into account for either the "bottom-up" or "top-down" approach?

• Should the country-by-country template be prepared on an entity by entity basis as in the current draft or should it require separate individual country consolidations reporting one aggregate revenue and income number per country if the "bottom-up" approach is used? Those suggesting top-down reporting usually suggest reporting one aggregate revenue and income number per country. In responding, commenters should understand that it is the tentative view of WP6 that to be useful, top-down reporting would need to reflect revenue and earnings attributable to cross-border transactions between associated enterprises but eliminate revenue and transactions between group entities within the same country. Would a requirement for separate individual country consolidations impose significant additional burdens on taxpayers? What additional guidance would be required regarding source and characterization of income and allocation of costs to permit consistent country-by-country reporting under a top-down model?

• Should the country-by-country template require one aggregate number for corporate income tax paid on a cash or due basis per country? Should the country-by-country template require the reporting of withholding tax paid? Would a requirement for reporting withholding tax paid impose significant additional burdens on taxpayers?

• Should reporting of aggregate cross-border payments between associated enterprises be required? If so at what level of detail? Would a requirement for reporting intra-group payments of royalties, interest and service fees impose significant additional burdens on taxpayers?

• *Should the country-by-country template require reporting the nature of the business activities carried out in a jurisdiction? Are there any features of specialist sectors that would need to be accommodated in such an approach? Would a requirement for reporting the nature of the business activities carried out in a jurisdiction impose significant additional burdens on taxpayers? What other measures of economic activity should be reported?*"

The country-by-country report should be prepared on an entity by entity basis, since it would show the information required by local tax administrations without generating additional costs to taxpayers. This is, the information of the template should be only applicable for the local taxpayer with respect to its related party transactions.

Information from other countries and nonresidents should be requested or exchanged between tax authorities through an information exchange mechanism, informing the involved taxpayers that such request is in process. Once a request from a tax authority to the authority from the other country is in process, the local subsidiaries should collaborate with the local tax authorities in connection with the information and documentation it may be required at that local level.

Materiality

Paragraph 29 establishes that "*Not all transactions that occur between associated enterprises are sufficiently material to require full documentation. Obviously, tax administrations have an interest in seeing the most important information while at the same time they also have an interest in seeing that MNE's are not so overwhelmed with compliance demands that they fail to consider and document the most important items. Thus, transfer pricing documentation requirements should include specific materiality thresholds that take into account the size and nature of the local economy, the importance of the MNE group in that economy, and the size and nature of local operating entities, in addition to the overall size and nature of the MNE group.*"

OECD is requesting comments as to whether any more specific guideline or materiality could be provided and what form such materiality standards could be taken.

Certainly, a definition of materiality would derive in subjectivity regarding what is considered or not as material.

Although, there are some non-recurrent operations that are also non-significant, which may be considered as immaterial. This should be included in the contemporaneous transfer pricing documentation but the full analysis as determining method, comparable, among other information, should be optional.

Frequency of documentation updates

Paragraph 34 establishes that "*In order to simplify compliance burdens on taxpayers, tax administrations may determine, as long as the operating conditions remain unchanged, that the searches in databases for comparables supporting part of the local file to be updated every 3 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.*"

In this regard, OECD is requesting comments regarding reasonable measures that could be taken to simplify the documentation process.

Our comment is that this can only be applied on a case-by-case basis. This, considering that certain industries are quite stable and do not present significant changes every year, and certain industries with an opposite situation showing important changes every year. Other factor to be taken into consideration is whether the functions, assets and risks associated to the transaction under analysis change or remain stable from one year to the other.

Language

Paragraph 35 establishes that "*The necessity of providing documentation in local language may constitute a complicating factor with respect to transfer pricing compliance to the extent that substantial time and cost may be involved in translating documents. As a general matter the master file should be prepared and submitted to all tax administrations in English. However, transfer pricing documentation should be useful to local country tax administrations seeking to undertake a risk assessment, and therefore at least the local file should likely be prepared in the relevant local language. Where tax administrations believe that translation of relevant parts of the master file is necessary, they should make specific requests for translation and provide sufficient time to make such translation as comfortable a burden as possible.*"

OECD is requesting comments regarding the most appropriate approach to translation requirements, considering the need of both taxpayers and governments.

Information to be filed to the local tax authorities is usually mandatory to be filed in the local language, as established in the domestic law. Translations to English language should result in additional costs for MNE's.

Implementation

Comments are requested by the OECD regarding the most appropriate mechanism for making the master file and country-by-country reporting template available to relevant tax administrations. Possibilities include: The direct local filing of the information by MNE group members subject to tax in the jurisdiction; filing of information in the parent company's jurisdiction and sharing it under treaty information exchange provisions; some combination of the above.

We consider that information regarding local intercompany transactions should be directly filed before tax authorities, since this would represent simple compliance rules as well as it do not imply additional administrative charge and costs to taxpayers.

A master file may be prepared by the parent company, and if its domestic law requires that taxpayer to file transfer pricing information of all its subsidiaries and its related party transactions, then a master file should be useful for that tax administration. Other tax administrations should request this information from that tax authority considering information exchange provisions.

General comments

The two-tier approach to the transfer pricing documentation of a MNE must be a "second step" preceded by relevant modifications to existing local legislations that are needed to reduce the current differences among basic concepts that usually translate into obstacles for taxpayers to efficiently comply with transfer pricing regulations. Before requesting MNEs' for more information, it might be more useful to promote a consensus among countries on basic concepts such as the one for "related parties"; otherwise important differences would still exist among jurisdictions that would not permit achieving simplification and documentation effectiveness nor common understanding of facts. Thus, consistency needs to be achieved before suggesting the implementation of a two-tier approach; consistency that will allow and assure both tax administrations and taxpayers that information at hand will be properly interpreted and used. As currently no same or similar rules and concepts exist in every country, it is likely that an effort to produce a master file will not result in the anticipated outcome but will only translate into even more burdensome TP compliance and documentation processes. Important differences that need to be addressed as a "first step" are:

- **“Related party” definition:** When providing information of relevant transactions among members of the same Group, what are the legal entities that would need to be considered, based on which local regulations / definitions? Even within one country taxpayers find differences between what should be understood for “related parties” for transfer pricing, accounting principles and even for custom purposes. A “joint venture” might be a Related Party for Country A; whereas it might be deemed as a third party for Country B.

- **Arbitration Process:** An appropriate arbitration process on a global basis needs to be available for taxpayers; one that considers not only those countries with which a given country has entered into tax treaties to avoid double taxation but also any other with which the taxpayer has conducted intercompany transactions and has access to the master file. From a taxpayer standpoint, providing access to global documentation and/or tax positions of the MNEs to all tax administrations in which the MNEs conducts its business operations and considering the tax collection required by all tax administrations will most probably imply a significant increase in double taxation of the MNEs. On this regard, it is also critical to consider the appropriate use of said information by the tax authorities, which is a baseline assumption of the document but might not necessarily be the reality in all countries or by all tax administrations.

- **International Norms of Financial Information:** Currently there are different norms of financial information been used by each country. There has also been an attempt to unify the reporting norms by using the IFRS. However, current documentation regulations require taxpayers to conduct economic analyses based on the locally accepted norms of financial information, which in most cases, differ from one country to the other. Another fact that the document does not consider is the financial information used to conduct the analyses. Will it be the generally accepted accounting norms used in the host country of the parent company? Will it be accepted by each local tax authority?

- **Language**: A similar situation occurs with the language in which the global transfer pricing documentation must be written. Currently, some countries only accept documentation produced in local language. Therefore, in order for the documentation to be produced by each MNEs to be directly applicable to all tax jurisdictions, tax administrations must also agree to a given language (English is suggested in the proposed draft). Otherwise, global documentation would need to be translated into each and every language applicable in the tax jurisdictions in which the taxpayer conducts its business operations (and/or intercompany transactions).

- **Thresholds**: There are significant inconsistencies in the intercompany transactions that are required to be documented in each tax jurisdiction. In some jurisdictions all intercompany transactions (domestic and foreign) must be documented notwithstanding the amount of the intercompany transaction. In other countries either because the documentation requirement only applies to intercompany transactions exceeding certain amounts or given that the documentation provides penalty protection and the penalties are only imposed when adjustment exceeds specific amounts, transactions that do not exceed specific amounts are not necessarily documented. This might imply that not all intercompany transactions are documented in all tax jurisdictions.

- **Deadlines**: Different deadlines to meet local transfer pricing requirements need to be considered as well, moreover when it seems to be intended for taxpayers to provide global documentation to all tax authorities by the time annual tax returns are filed in each tax jurisdiction.

It might be reasonably concluded that the lack of consistency in the above mentioned concepts (which is not carefully discussed in the document) will not allow tax administrations to clearly understand how global documentation and available information relates to local taxpayer's activity.

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Should you have any question or comment in connection with the foregoing, please do not hesitate to contact us.

Sincerely,

IFA Grupo Mexicano A.C.
(International Fiscal Association, Mexican Branch)
Transfer pricing committee