UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

November 8, 2019

VIA EMAIL
Global Tax Platform
GlobalTaxPlatform@worldbank.org

Re: USCIB Comment Platform for Collaboration on Tax Toolkit on Transfer Pricing Documentation

For the attention of the members of the Global Tax Platform,

USCIB[1] appreciates the opportunity to comment on the draft toolkit (hereinafter "toolkit" or "discussion draft"). In our view, an open comment process is an important part of developing helpful guidance that will meet the needs of both tax administrators and taxpayers.

General Comments

USCIB believes the toolkit provides a useful framework for developing countries to develop appropriate transfer pricing documentation rules. The structure of the draft recognizes that one size does not fit all and that different countries, at different stages of development, may appropriately choose different approaches. For more advanced economies, the current stage of development of the arm's length pricing rules represents a decades long journey and countries at an earlier stage of development may need a different approach. However, we see this as an opportunity to standardize transfer pricing documentation/information provided across geographies. A lack of standardization adds costs to the system without any perceived benefit.

We note that more guidance in making these decisions might be appropriate. The toolkit contains a great deal of information and many options. We believe it would be useful to offer recommendations, along with explanations of why a particular approach would be recommended. For example, there are open options with no guidance in the section on local language versus foreign language. The toolkit states that "generally, countries require transfer pricing documentation in local languages" and then gives options for foreign language. It would be beneficial to state more directly what is the best practice. Another example is the discussion on materiality. The toolkit does not provide specific recommendations. It also might be useful to recommend that developing countries consult with the Platform partners in deciding how to implement transfer pricing documentation in particular circumstances.

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[1] USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide and works to facilitate international trade and investment.

In this context, we also suggest that the toolkit should note the importance of pairing the creation of the appropriate structure for transfer pricing documentation with an emphasize on capacity building. Proper enforcement of transfer pricing rules requires both access to necessary information and a tax administration that is properly trained and has the necessary internal resources to handle the information that has been provided. In addition to the toolkit on documentation, the Platform partners should focus on the training necessary to permit tax administrations to make appropriate use of the information that has been provided. For example, in Section 3.3.1: Functions of transfer pricing studies, there is not enough emphasis on understanding contributions to value. The ability of tax authorities to have a thorough understanding of assets and functions contributing to value is crucial to the identification and selection of reliable comparables.

Timing

The OECD Secretariat has issued a proposal that, if adopted, would have a profound impact on transfer pricing. New substantive rules might result in changes to what is considered appropriate transfer pricing documentation. Therefore, countries considering adopting or substantially revising their transfer pricing documentation requirements might consider waiting until any new substantive rules are finalized.

Primary Law vs. Secondary Law

USCIB believes that the more appropriate approach to deciding whether guidance should be provided in primary law or secondary law is to provide broad outlines in the primary law and leave the details to secondary law. Secondary law is usually easier to amend, so necessary adjustments would be easier to make if the detailed provisions are part of secondary law.

Burden of Proof

USCIB found the discussion on burden of proof confusing. This is an area where clear recommendations might be appropriate. USCIB has assumed that this discussion is taking place in the context of a country that has decided to adopt transfer pricing documentation rules.[2] USCIB believes that the following principles should be adhered to in determining the burden of proof:

- Taxpayer's should prepare, maintain and submit the transfer pricing documentation required to support their transfer prices. If they do, they should be considered to meet their burden of proof with respect to the prices for those transactions.

[2] Burden of proof might be different if there are no transfer pricing documentation rules in place.

- If the tax administration seeks to make any adjustment under such circumstances, the tax administration would have the burden of proving that its adjustment is correct.[3]

The Platform acknowledges that good transfer pricing documentation requires taxpayers to think carefully about their transactions and improves compliance. When taxpayers have performed this careful analysis, this ought to be acknowledged by a shift in the burden of proof to the tax administrations. It also makes sense for a party asserting an outcome to have the burden of proof on that issue. In addition, if it is not linked to mandatory binding arbitration it would be impractical. Many times, in developing countries there is no clear regulations to apply Mutual Agreement Procedures (MAP), and the process in local courts will support the local tax administration, leaving taxpayers with no options for relieving double taxation. Finally, disproving something is always difficult, taxpayers should not be obligated to disprove the tax administration's position if contrary to the proper transfer pricing documentation prepared by the taxpayer.

TPIR and Customs

The toolkit is silent on linking TPIRs with customs databases, a practice in some developing countries (China, India, Indonesia, Argentina). This should be discouraged as it many times drives confusion during audit.

Country-by-Country Reporting

USCIB is concerned that the discussion of country-by-country reporting may be misleading. The toolkit describes the country-by-country report as part of the group level transfer pricing documentation.[4] The lengthy discussion of country-by-country reporting describes the appropriate use standard, but the initial discussion describing the country-by-country report as transfer pricing documentation may encourage tax administrations to believe the report could be used to justify an adjustment, which of course is not permitted. This point should be clarified in the scope paragraph. Also, the Conclusions section mentions that country-by-country reporting will provide valuable information, but it is still not clear how this is being used in practice.

Transfer Pricing Questionnaires

The UN Manual recommends that tax payers fill out questionnaires in addition to Action Plan 13 and the TPIR. It would be good to have a clear explanation on why the UN recommended the questionnaire in addition to Action Plan 13. For example, what types of beneficial information are included in questionnaires and why is this information not included in local files. This could be mentioned at the beginning of the document and in section 3.5.1

[3] Burden of proof may be determined under generally applicable legal principles. If that is the case, then it should be clear that special burden of proof rules provided for under the tax legislation take precedence over contrary generally applicable rules.

[4] Toolkit, para. 1.3, page 10.

Privacy of Tax Return Information

The toolkit does address privacy of tax return information. USCIB believes, however, that this should be further emphasized. Transfer pricing studies may provide detailed information on some of the most valuable corporate assets. Publicizing this information may cause substantial financial harm. It should be emphasized, that confidentiality rules restrict all government access to confidential information. That is, this information cannot be made public, but also within government access is restricted in order to prevent the substantial harm that might result from inappropriate disclosure.

Simplified Methods and Materiality

The toolkit recommends simplified methods, which USCIB supports, but seems to limit the application of simplified methods to SMEs. USCIB believes that simplified methods should also be available to MNEs at least in some cases. MNEs may have many transactions with related parties and full-blown transfer pricing analysis will not be appropriate in every case. Both taxpayers and tax administrations benefit from the availability of simplified methods, especially if combined with materiality thresholds. This is an area that might be affected by the work that the OECD is currently doing on its Unified Approach.

Industry Specific Guidance

The Platform should consider industry specific guidance of documentation. The Platform has provided guidance on comparability and in particular on mineral pricing. It might be helpful to coordinate the substantive guidance with the guidance on documentation.

Penalties

Annex 6 contains sample primary legislation for transfer pricing documentation. A significant part of this sample legislation is devoted to penalties. The penalties are too onerous and penalize behavior that ought not to be penalized. Generally, penalties should be a reasonable fixed amount or a percentage of any sustained adjustment. There should generally be a reasonable cause exception. If taxpayers are engaging in fraud or willful disregard of rules, then penalties may be more onerous, however, even in those cases, there should be some limits that relate to the behavior. Penalties should never relate to the gross value of the transactions. Using gross value could result in multi-billion dollar fines that bear no relationship to the tax, if any, that might be due. USCIB believes these penalties are, in some cases so onerous, the risk they would create is so extreme, that they would negatively impact foreign direct investment.

These penalties should be substantially modified:

- Paragraph 5(1) provides for a penalty for failing to maintain documentation equal to 2% of the gross value of controlled transactions. This penalty should be a rational fixed

amount or a percentage of any sustained adjustment – with a reasonable cause exception.

- Paragraph 6(1) provides a penalty for failure to submit documentation or a CbyC report. These penalties are fixed dollar amounts (although there are no recommended dollar amounts). A reasonable cause exception should be included here. Paragraph 7(a)(1) penalizes "inappropriate" statements to tax officers. It is not clear what an inappropriate statement is and how it differs from an "incorrect" statement. Inappropriate statements should not be subject to tax penalties.[5]

An incorrect or inappropriate statement may be an oral statement.[6] USCIB believes that penalties should only be imposed when the factual predicate is clear. Relying on oral statements may devolve into "he said/she said" disputes, which should be avoided. If the tax authorities believe an oral statement is incorrect, then they should follow-up and ask for confirmation in writing. This would give the taxpayer the opportunity to correct any misstatement or clarify any misunderstanding. If the writing confirms the oral statement and establishes grounds for a penalty, then the factual predicate for any penalty would be clear.

Paragraphs 7(a)(2) and (3) provide methods for determining the amount of the penalties. Depending on the circumstances, penalties may be equal to 4% and 3% of the total value of controlled transactions. These are extremely high; these already highly extreme penalties would be doubled in the case of an MNE group. Penalties such as these may in many cases exceed expected return on investment and create real reluctance to invest in jurisdictions.

Paragraph 7(5) provides an exemption from the penalty imposed under subsection (2) if the taxpayer has a "reasonably arguable position" for its determination of the transfer price. First, it should be made clear that this exemption applies for both penalties under subsection (2) and (3). As drafted, this could be read to apply only to subsection (2), although the better reading should be if there would be no penalty under subsection (2), there is nothing to be doubled under subsection (3).

The definition of reasonably arguable position should be clearer; it should also take into the materiality of the transaction. Not every transaction should require the same level of due diligence. If the taxpayer has taken appropriate steps to determine the transfer price and provided the required documentation supporting the transfer price, then the burden should be on the tax administration to demonstrate that the taxpayer's position is not reasonably arguable.

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[5] USCIB thinks this may be intended to reach bribes offered by the taxpayer to the tax authority. We understand that bribery is a highly sensitive subject. Nevertheless, if this is intended to reach bribery, we think that should be clearly stated and penalties that the generally applicable penalties applicable to bribery should apply in these cases. If there are specific tax bribery offenses, they should be clearly set forth in a separate section, such that ordinary disputes about the adequacy of information are not conflated with bribery.

[6] Again, looking at oral statements may be a way of getting at bribery; bribes are very unlikely to be in writing. As stated above, any rules relating to bribery should be either be the generally applicable rules or broken out and treated separately. The concerns with bribery are very different than with ordinary disputes concerning documenting transfer prices.

The entire incorrect disclosure penalty paragraph 8 should be deleted. This penalty only applies if there is no tax liability or loss adjustment in respect of the statement or omission. It is debatable whether any penalty at all should apply in these circumstances let alone one as onerous as this. The draft language also fails to acknowledge that the CbyC report is supposed to be filed by the parent of the MNE Group and exchanged pursuant to treaty exchange of information provisions. Presumably if the MNE files with its home country, then the MNE will rely on that home country to exchange the CbyC report and should not be subject to this penalty. If a country is asking for local filing of the CbyC report is not entitled to it under the relevant treaty because of failure to comply with confidentiality or appropriate use standards, would they be able to ask for independently and impose substantial penalties if the taxpayer fails to file it locally because of concerns about appropriate use or lack of confidentiality?

The amount of penalty is incredibly high. If the taxpayer knowingly or recklessly fails to file a CbyC report, then the penalty could be 1% of the consolidated revenue of the MNE Group in the preceding year (or 10 million dollars for every billion in MNE Group revenue). If the local jurisdiction is not entitled to the report under the treaty exchange provisions, they should not be entitled to circumvent those provisions and use onerous penalties to force compliance.

Conclusions

The conclusions could emphasize how each element of the transfer pricing documentation meets the objectives: risk assessment, audit, encourage voluntary compliance. The conclusions could also emphasize how tax authorities can track the effectiveness of transfer pricing documentation to achieve the three objectives.

Sincerely,

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