

Chapter 7 Documentation

7.1. Introduction

- 7.1.1.** Adequate documentation will make it easier for tax authorities to review a taxpayer’s transfer pricing analysis and thereby contribute to avoiding a dispute or to a timely resolution of any transfer pricing disputes that may arise. Adequate documentation is characterised by (i) the sufficiency of the details demonstrating the taxpayers’ compliance with the arm’s length principle, as well as (ii) the timely manner in which such details are prepared and submitted to tax authorities upon their request.
- 7.1.2.** A taxpayer should make reasonable efforts to undertake an adequate transfer pricing analysis to ascertain the arm’s length pricing, as well as to show clearly that such analysis has been actually conducted. Activities undertaken to prepare and maintain appropriate documents with a view to conforming to the arm’s length principle can be referred to as the “arm’s length documentation”.
- 7.1.3.** This Chapter first introduces some existing international guidelines on transfer pricing documentation, which will be helpful in browsing general issues on documentation. It is then followed by a more in-depth discussion on several topical issues frequently raised in the process of transfer pricing documentation, with the goal of providing practical guidance on such issues. An annex to this Chapter will set forth selected countries’ legislation examples on transfer pricing documentation and a sample transfer pricing study.

7.2. International Guidelines on Transfer Pricing Documentation

7.2.1. OECD Transfer Pricing Guidelines (2010)

- 7.2.1.1 The OECD’s guidance on documentation is well summarized in the following paragraphs of the 2010 version of the OECD Transfer Pricing Guidelines:¹

“5.28 Taxpayers should make reasonable efforts at the time transfer pricing is established to determine whether the transfer pricing is appropriate for tax purposes in accordance with the arm’s length principle. Tax administrations should have the right to obtain the documentation prepared or referred to in this process as a means of verifying compliance with the arm’s length principle. However, the extensiveness of this process should be determined in accordance with the same prudent business management principles that would govern the process of evaluating a business decision of a similar level of complexity and importance. Moreover, the need for the documents should be balanced by the costs and administrative burdens, particularly where this process suggests the creation of documents that would not otherwise be prepared or referred to in the absence of tax considerations. Documentation requirements should not impose on taxpayers costs and burdens disproportionate to the circumstances. Taxpayers should

¹ The 2010 OECD Transfer Pricing Guidelines reproduces the 1995 OECD Transfer Pricing Guidelines on the documentation issues.

nonetheless recognize that adequate record-keeping practices and voluntary production of documents facilitate examinations and the resolution of transfer pricing issues that arise.

5.29 Tax administrations and taxpayers alike should commit themselves to a greater level of cooperation in addressing documentation issues, in order to avoid excessive documentation requirements while at the same time providing for adequate information to apply the arm's length principle reliably. Taxpayers should be forthcoming with relevant information in their possession, and tax administrations should recognize that they can avail themselves of exchange of information articles in certain cases so that less need be asked of the taxpayer in the context of an examination." [...]

7.2.1.2. The key points from this guidance can be summarised as follows:

- (i) Taxpayers should make **reasonable efforts** at the time of the transfer pricing to prepare and maintain transfer pricing documentation – this is not to say that they need to *provide* the information to tax authorities at the time, however – this ultimately depends on domestic law.
- (ii) Tax administrations **should have the right to obtain taxpayers' documentation** prepared in the process of the taxpayers' establishment of transfer pricing.
- (iii) However, the governing principle for the transfer pricing documentation should be "**prudent business management**" principles. Therefore, a tax administration should have due regard for the extent to which that information reasonably could have been available to the taxpayer at the time transfer pricing was established.
- (iv) A tax administration's **need for documents should be balanced by the costs** and administrative burdens of providing such documentation by a taxpayer.
- (v) Tax administrations and taxpayers should **try to cooperate with each other** for maintaining effective operation of the transfer pricing documentation regime.
- (vi) Tax administrations should try to avail themselves of **exchange of information provisions** of tax treaties to the extent possible, especially in relation to information not readily available to the taxpayer.

7.2.1.3. It is of course recognised that most non-OECD countries do not have the extensive treaty networks of OECD countries and there will often have to be more reliance upon taxpayer provided information for this reason.

7.2.1.4. Under the OECD Guidelines, the following types of information among other things should be made available through documentation, although it is neither a minimum compliance list nor an exclusive list of information:

- Information about the **associated enterprises** involved in the controlled transactions and independent enterprises engaged in similar transactions;
- Information regarding the **nature and terms of the controlled transactions**, economic conditions and property involved in such transactions, product or service flows and changes in trading conditions or renegotiations of existing arrangements;
- Description of the circumstances of any known **transactions between the taxpayer and an unrelated party** that are similar to the transaction with the foreign associated enterprise, and therefore might be an arm's length comparison;

- Outline of the **business structure** of the organization, including the associated enterprises and ownership linkages within the MNE group;
- Information about the amount of **sales and operating results** of the associated enterprises from the last few years preceding the transaction; and
- Information on **pricing**, including business strategies and special circumstances that may be relevant, such as a “set-off” arrangement with the buyer providing the seller some services as part of the transaction.

Such information will help evaluate the **functions** performed by the associated enterprises, the **assets** used in doing this, and the **risks assumed** by the parties to the transaction, all of which will be important to a functional analysis of the type discussed in Chapter 5 of this Manual.

7.2.2. Documentation Rules of Pacific Association of Tax Administrators (2003)

7.2.2.1. In 2003, the Pacific Association of Tax Administrators (“PATA”), which is comprised of tax administrations from Australia, Canada, Japan and the U.S., announced its “Transfer Pricing Documentation Package” (the “Package”). The Package² provides for a harmonized documentation procedure among PATA member states. Taxpayers that choose to use the Package, which is voluntary and aimed at avoiding penalties for documentation, must meet the following three requirements in order to avoid penalties:

- Make reasonable efforts to establish arm’s length prices;
- Maintain contemporaneous documentation of their efforts to comply with the arm’s length principle, and
- Produce, in a timely manner, documentation upon request by a PATA member tax administrator.

The Package seeks to respond to the potential difficulties that MNEs face in complying with the laws and administrative requirements of multiple tax jurisdictions. It is intended to be consistent with the general documentation principles of the 1995 (and now 2010) OECD Guidelines.

7.2.2.2. While the Package is meant to give greater certainty to taxpayers, it has been criticised as doing so at the expense of expanding the required documentation. The PATA guidelines state that they should not impose higher documentation requirements than those set forth in any PATA member’s laws. The Package is however considered to impose significant requirements, which are perceived to be greater than those in any particular member country.³ It essentially requires compliance with the domestic laws of all the PATA countries to ensure that a penalty will not be applicable in one particular PATA jurisdiction.

7.2.2.3. The PATA guidelines should not therefore be seen as a template for other countries’ documentation requirements. Their greatest usefulness is perhaps that they form a

² Available at <http://www.irs.gov/businesses/international/article/0,,id=156266,00.html>

³ For example, in Australia, there is no apparent requirement to keep transfer pricing documentation in its tax law or regulations. However, taxation ruling TR98/11 recommends contemporaneous documentation to evidence compliance with arm’s length principle to reduce the risk of an audit and to mitigate penalties in the event of an audit adjustment.

compendium of local documentation requirements in the four PATA countries that may be a useful reference point for countries setting up a transfer pricing system.

- 7.2.2.4. The Package has also been criticised in that it contains no guidance as to the nature of the comparable transactions (which would depend on the law of the PATA countries). In other words, no guidance is provided as to whether local comparables must be used, or whether some form of blended (foreign with local elements) comparable is required. As noted in Chapter 5 in Comparability, however, the reality is that for most developing countries, there will be no local comparables, and some form of adjustment to foreign comparables will often be necessary. As many developing countries do not have access to databases that allow identification of foreign comparables, and may have limited analytical resources to adjust those comparables for local conditions, it will be very important that the comparables relied on by a taxpayer are well documented, with strong legal incentives (including strong penalty provisions to discourage provision of inaccurate information).
- 7.2.2.5. Further, the Package requires extensive documentation on organizational structure, nature of business (industry) and market conditions, controlled transactions, assumptions, strategies or policies, comparability, functional and risk analysis, selection and application of the transfer pricing method, details on cost contribution arrangements, background documents and an index to documents.

7.2.3. The European Union Code of Conduct on Transfer Pricing Documentation (2006)

- 7.2.3.1. In 2006, the European Council adopted a Code of Conduct on TP documentation for associated enterprises in the EU (the “Code”) in order to reduce the compliance costs of having to comply with different rules in each individual country. According to the Code,⁴ taxpayers can avoid transfer pricing documentation penalties imposed by EU member countries if they maintain (i) a “master file” of standardized information and (ii) a country-specific file of standardized information for each EU member country in which the taxpayer has related-party transactions.
- 7.2.3.2. Centralizing and standardizing documentation for centralized MNE groups is very likely to reduce their compliance burdens. The Code itself does not require contemporaneous documentation but, in practice, files should be prepared contemporaneously if a national law mandates contemporaneous documentation.
- 7.2.3.3. An EU Member State may decide not to require TP documentation at all or to require a shorter version of the EU transfer pricing documentation, i.e. require fewer items in the master file or the country specific documentation. However, a Member State should not require *more* items in the master file or the country specific documentation.
- 7.2.3.4. The Code also provides that translation to other languages would only be provided upon request and translation should not be required unless necessary in the circumstances. The Code seems particularly to deter countries from seeking translation of the Master File. The Code also provides that EU member countries should not automatically reject comparables found in pan-European databases. Therefore, the use of non-domestic comparables by itself should not subject the taxpayer to penalties for non-compliance.

⁴ Available at <http://register.consilium.europa.eu/pdf/en/06/st09/st09738.en06.pdf>

7.2.3.5. The “Master file” provides a “blue print” of the company and its transfer pricing system that would be relevant for all EU Member States concerned. The Master file should contain general descriptions of the group’s business strategy, organizational structure, general description of the controlled transactions involving associated enterprises in the EU, functions performed and risks assumed by enterprises, ownership of intangibles, group’s inter-company transfer pricing policy and a list of cost contribution agreements, APAs and TP rulings, etc.

7.2.3.6. The country specific documentation, on the other hand should contain a detailed description of the taxpayer’s business strategy, information on country specific controlled transactions, a comparability analysis, selection and application of the transfer pricing method, internal or external comparables, etc. However, the basic set of information for the assessment of a multinational enterprise group’s transfer prices is optional for the MNE.

7.2.4. Possible Lessons from Existing International Guidelines on Documentation

7.2.4.1. The international Guidelines above were designed by developed countries in the context of their own transfer pricing legislation, priorities and capabilities, and therefore cannot automatically be assumed to be in every respect practical for developing countries. It is worthwhile to examine these guidelines from the perspective of how they may work in practice in a developing country context., bearing in mind the information, analytical (including IT) and skills gaps that may exist between the tax administration and the MNE.

7.2.4.2. The essence of the 2010 OECD TP Guidelines with regard to transfer pricing documentation can be described as follows:

- Taxpayers are required to prepare or obtain documents necessary to allow a reasonable assessment of whether they have complied with the arm’s length principle.
- The extensiveness of TP documentation should be balanced between the need for the taxpayer to demonstrate compliance with the arm’s length principle and the additional costs to be incurred to prepare the required documentation.
- Taxpayers should thus not be expected to go to such lengths that compliance costs for the preparation of documentation are disproportionate to the amount of tax revenues at risk or to the complexity of the transactions.

7.2.4.3. Documentation rules of the PATA and the EU’s code of conduct on TP documentation have common features in that both were intended to respond to difficulties taxpayers faced in complying with the laws and administrative requirements of multiple tax jurisdictions. As a result, both provide taxpayers in their jurisdictions with a documentation list so that taxpayers can avoid penalties as long as they prepare and maintain documents included in those lists.

7.2.4.4. In order for such a list to be useful for taxpayers, it should not inflict excessive burdens on taxpayers or unduly raise their compliance costs. At the same time, however, in order for such a list to be useful for tax authorities’ reasonable assessment of a transfer pricing case, it should not be too superficial. In short, a balance between the tax authorities’ needs and taxpayers’ costs should be maintained in determining the scope and the extent of the information to be included in a mandatory documentation list, whether it is a country list or an international list adopted by a group of countries. Careful consideration must be given to striking such a balance in the design of the documentation regime, especially penalty rules, as an enforcement measure.

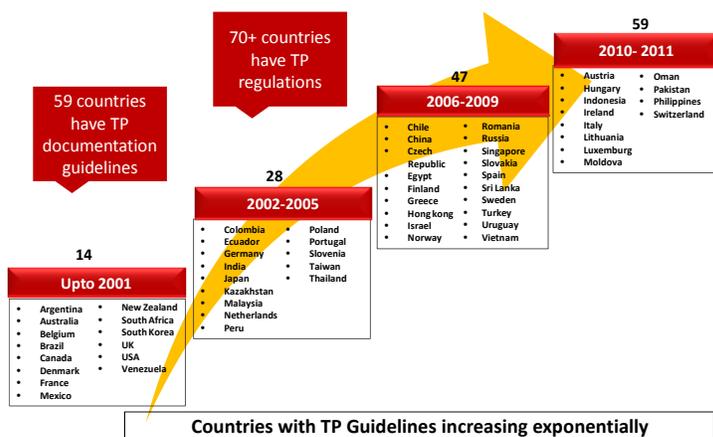
7.2.4.5. Instead of a list of required documentation an alternative could be developed in the form of a kind of disclosure form. The disclosure form should be based on the same assumptions as mentioned above and strike a balance between the effort required by a taxpayer to obtain information and its usefulness for tax authorities to make a proper assessment. The form should only be completed in relation to significant intercompany transactions. Completing the form should be sufficient to comply with transfer pricing documentation requirements as a full transfer pricing analysis is required to complete the form. However only upon request a further detailed transfer pricing report may need to be produced but this should not be required on a contemporaneous basis. By introducing such a form the compliance burden and compliance costs for MNE's may be reduced while not compromising on the available information for tax authorities. An example of a form is attached in Annex A.

7.2.4.6. Developing countries that consider the introduction of TP documentation rules should note that European MNEs, due to the EU's code of conduct on TP documentation, may have a master file in their parent companies (or headquarters) and a country-specific information file containing a detailed description of the business and the business strategy, information on country-specific controlled transactions, a comparability analysis and the motivation for the choice for a specific transfer pricing method. They should also note that the code of conduct is aimed at simplifying transfer pricing for cross-border activities within the EU, relieving unreasonable costs or administrative burdens on enterprises when requesting documentation, and ensuring that there is no public disclosure of confidential information contained in the documentation.

7.3. Experiences from an MNE perspective on existing Guidelines of Transfer Pricing documentation

7.3.1. 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 and with even more countries still introducing new documentation rules. Unfortunately countries introduce transfer pricing documentation requirements that may significantly differ per country resulting in a significant increase in compliance costs for MNEs.

TP compliance landscape



7.3.2. MNEs welcome initiatives to reduce the compliance burden and the relating compliance costs by introducing standards of required information that are relevant for multiple countries. The above mentioned International Guidelines are a good starting point but with so many countries not covered further harmonization is required to avoid a situation where the preparation of transfer pricing documentation becomes a business in itself instead of a support to the MNEs business.

7.3.3. 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 the businesses do not change every year it could be questioned what the added value of an annual transfer pricing report may be. From an MNE perspective an annual report should not be necessary as long as the relevant analysis is performed. The outcome of that transfer pricing analysis should be made available for example in a disclosure form as described in paragraph 7.2.4.5. Also the need for annual searches and local comparables is questionable. In many cases there is no real value added but it is time consuming and requires expensive database subscriptions, or outsourcing of the work resulting in significant costs.

7.3.4. Instead of having very detailed transfer pricing documentation requirements differing per country a general disclosure form may be developed as mentioned in paragraph 7.2.4.5. 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.

7.4. Practical Guidance on Documentation Rules and Procedures

7.4.1. Burden of proof

7.4.1.1. In most countries, the tax administration bears the burden of proof with respect to tax assessments unless a tax law specifically provides otherwise. It means that, in general situations, taxpayers need not prove the correctness of their transfer pricing or transactional margin unless the tax administration challenges taxpayers with concrete and clear grounds for such challenges. See further Chapter 3, para 3.6.

7.4.1.2. However, if one country has a set of specific documentation rules in its tax law or regulations, it is generally understood that the burden of proof for the transfer price at which a taxpayer transfers goods or services with his/her 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 still require the taxpayer to provide documentation about its transfer pricing, because without adequate documentation, the tax administration cannot assess the case properly. In fact, where the taxpayer does not provide adequate documentation, there may be a shifting of the burden of proof in some countries in the manner of a rebuttable presumption in favour of the adjustment proposed by the tax administration.

7.4.1.3. In countries where the burden of proof rests generally on the taxpayer, the burden of proof shifts to the tax administration in most cases 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, if specific documentation rules are already in place in such countries, the burden of

proof shifts to the tax administration if a taxpayer has fulfilled a reasonable level of obligations required by such documentation rules.

7.4.1.4. It is therefore important that the documentation rules are broad enough to give a true picture of the related party transaction, without being excessively burdensome on the chance, though unlikely, that a particular piece of information may be relevant.

7.4.1.5. The burden of proof should not be misused by the tax administration or taxpayers as a justification for making assertions which may be very difficult to substantiate through an ordinary level of TP documentation. In other words, both the tax administration and the taxpayer should make a good faith showing 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.

7.4.2. Timeframe to produce TP documentation

7.4.2.1. In general, countries have different types of documentation *timing* requirements, involving one or more of the following requirements:

- Prepare information at the time of the transactions, to be submitted at the time of the 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 the filing;
- Prepare information only if requested upon audit; or
- No documentation requirement.

7.4.2.2. As paragraphs 3.69-3.71 of the 2010 OECD TP Guidelines state, 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 "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 other instances, taxpayers might 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 "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.

7.4.2.3. A country that wishes to establish a TP documentation rule, especially so-called "contemporaneous documentation requirements", in its TP regime should take into account the existence of the two pricing approaches mentioned in the previous paragraph and that, when a taxpayer opts for the arm's length *outcome*-testing approach, data for external comparables are often not readily available by the year-end or by the due date of the tax return filing.

7.4.2.4. Perhaps for this reason, and because the tax authorities will not be seeking such documentation at the time the pricing is determined or the tax return is filed, the OECD TP Guidelines do not require contemporaneous *presentation* of documentation to the tax authorities. Since the tax

administration's interest is satisfied if the necessary documents were submitted in a timely manner when requested in the course of a tax assessment, the document storage process is therefore left to the taxpayer's discretion under the OECD TP Guidelines.⁵

7.4.2.5. Further, the OECD TP Guidelines provide some guidance on the amount of information to be submitted to the tax administration at the time of tax return filing. Paragraph 5.15 of OECD TP Guidelines recommends limiting the amount of information requested by a tax administration at the stage of tax return filing.

7.4.2.6. The basis for this is that at the time of filing, no particular transaction has been identified for transfer pricing review and that all that is needed at that stage is enough information to know if a further examination is needed of particular taxpayers.

7.4.2.7. The OECD TP Guidelines note that it would be quite burdensome if detailed documentation were required at this stage 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.

7.4.2.8. In practice, most countries *either* do not require the submission of transfer pricing related information at all *or* require only a minimum level of information at the tax return filing stage.

7.4.2.9. The **PATA Documentation Package** noted above indirectly encourages contemporaneous documentation by establishing a rule that a taxpayer that voluntarily uses the PATA Documentation Package must maintain contemporaneous documentation if they wish to avoid penalties. A number of countries have adopted provisions in their tax legislation similar to those of the PATA Package, providing that the tax administration cannot impose any penalty if a taxpayer complies with documentation obligations contemporaneously – adjustments can still be made and interest charged on those adjustments, of course.

7.4.2.10. The **EU Code of Conduct** itself does not require contemporaneous documentation but, in practice, files should be prepared contemporaneously if a relevant national law requires contemporaneous documentation.

7.4.3. Penalties

7.4.3.1. A country that requires its taxpayers to keep a certain level of TP documentation may operate a penalty system to ensure proper operation of its TP documentation system. Penalties in relation to TP regime can be generally divided into two groups based on the reason for imposing them: for underpayment of tax that is due and for non-compliance with documentation requirements.

⁵ Ultimately the storage issue 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 in a magnetic tape, disk or any other electronic storage.

- 7.4.3.2. However, a number of countries also have incentive measures exempting penalties against underpayment of taxes in cases where obligations for proper documentation (frequently contemporaneous documentation) have been fulfilled by taxpayers even in cases where the amount of taxable income turns out to be increased as a result of a tax audit. The principle governing these incentive measures is often called the “no-fault, no-penalty principle”.
- 7.4.3.3. In general, penalties can entail civil (or administrative) or criminal sanctions. Penalties imposed for failure to meet TP documentation requirements are usually monetary sanctions of a civil or administrative, rather than a criminal, nature. Tax audit or discretionary application of TP methods⁶ by tax authorities using a secret comparable or so-called “deemed income”⁷, are sometimes seen as a type of penalty for noncompliance with TP documentation rules. These cases are more closely scrutinized, and can equally be seen as resulting in greater risks of non-compliance in such cases.
- 7.4.3.4. It would be unfair to impose sizable penalties on taxpayers that exerted reasonable efforts in good faith to undertake a sound transfer analysis to ascertain arm’s length pricing, even if, they did not fully satisfy TP documentation requirements. In particular, it would appear harsh to impose penalties on taxpayers for failing to submit data to which they did not have access, or for failure to apply a transfer pricing method that would have required the use of data unavailable to the taxpayer. However, this does not mean that an adjustment cannot be made in such cases, with interest accruing on that amount.
- 7.4.3.5. Some countries consider that a penalty imposed as a consequence of lack of proper TP documentation can be dealt with through the mutual agreement procedure between competent authorities because it is covered by the taxes to which a relevant tax 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.
- 7.4.3.6. 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. 7.4.3.7. 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.

7.4.4. Special considerations for small and medium-sized enterprises (SMEs)

- 7.4.4.1. Comprehensive documentation requirements and subsequent penalties imposed on non-compliant taxpayers in a country may cause significant burdens on taxpayers, especially on SME taxpayers who engage in cross-border transactions with overseas related parties. A number of countries have introduced certain special considerations in their TP documentation rules, based

⁶ “Presumptive taxation” in Japan can be an example under this category.

⁷ Calculated using a formula stipulated in the tax law

on which SME taxpayers or taxpayers without heavy involvement in international transactions can be exempted from the TP documentation requirements.

7.4.4.2. The following countries have been selected as samples to demonstrate special considerations for TP documentation in the case of SMEs⁸:

France

France has issued guidance for SMEs, with the effect that the mandatory TP documentation requirements in the legislative proposal will only apply to large enterprises. Thus, SMEs should only undertake TP 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 TP documentation.

Germany

SMEs do not have a duty to issue TP documentation. However, they are obliged to provide further information and documents about the foreign business transactions when requested by tax authorities. In this case, issuance of TP documentation less detailed than that required for larger companies is provided for.

Netherlands

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

Poland

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

- EUR 100,000⁹ – if the value of the transaction does not exceed 20% 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.

Spain

⁸ The following examples of practice are largely quoted from a transfer pricing documentation survey conducted by Salans Vox Tax in 2009. Refer to www.salans.com. However, for China, please refer to the periodical of Beijing, Hong Kong, Shanghai offices in Baker & McKenzie (“Transfer Pricing”, January 2009). For Korea, please refer to materials from the website of National Tax Service in Korea ((www.nts.go.kr/eng/data/KOREANTAXATION2010.pdf)).

⁹ A Euro was worth approximately 1.4 USD as of May 2011.

There could be several types of documentation compliance burdens depending on the characteristics of the parties involved. Relevant factors include a turnover of EUR 8 million 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

There are three kinds of enterprises that are exempt from the contemporaneous documentation obligation:

- Entities with annual related party sales and purchases of less than 200 million RMB¹⁰ and other related party transactions of less than 40 million RMB;
- Entities within the coverage period of an APA; or
- Entities with less than 50% foreign invested shares that only have transactions with domestic related parties.

Korea

The method used and the reason for adopting that particular method for an 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 Korean Won (KRW¹¹) 5 billion or less and KRW 500 million or less, respectively. The above obligation is also exempt for the taxpayer whose inter-company transaction volume per an overseas related party is KRW 1 billion or less for goods and KRW 100 million or less for services.

India

Taxpayers with international related-party transactions valued at not more than INR 10 million 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.

7.4.4.3. In summary, some countries have particular legislative provisions that allow exemptions from the obligation for TP documentation or 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 TP documentation obligations are targeted to SMEs directly. However, a number of countries operate such exemption or mitigation regime mainly targeting taxpayers whose transaction volumes with overseas related parties are quite limited. Since most SMEs are in general not heavily involved in cross-border transactions with overseas related parties, they often enjoy benefits of these exemptions in an indirect way.

7.4.5. Language to be used for TP documentation

7.4.5.1. The guidance provided by the EU Code of Conduct on TP documentation regarding the language issue may be very useful for a country that wishes to establish its own TP documentation rule. As

¹⁰ 6.5RMB were worth approximately 1USD as of May 2011.

¹¹ 1000 KRW were worth approximately 1USD as of May 2011.

one of the basic principles to be applied to the EU Transfer Pricing Documentation, the Code states in Paragraph 6 of the Annex that the country-specific documentation should be prepared in a language prescribed by the Member State concerned, even if the MNE has opted to keep the country-specific documentation in the “master file”.

7.4.5.2. However, in Paragraph 23 of that same annex prescribing the general application rules and requirements for Member States, the Code states that it may not always be necessary for documents to be translated into a local language and that, in order to minimize costs and delays caused by translation, Member States should accept documents in a foreign language as far as possible. Further, the Code recommends that, as far as the EU Transfer Pricing Documentation is concerned, tax administrations be prepared to accept the master file in a commonly understood language in the Member States concerned and that translations of the master file be made available only if strictly necessary and upon specific request.

7.4.5.3. According to a country survey,¹² most countries require taxpayers to present TP documentation in their own languages and require translation if the TP documentation was prepared in a different language. However, some countries such as France, Germany, Netherlands and Korea allow presentation of TP documentation in a language other than their own languages at least on an exceptional basis. It is particularly common in practice to allow documentation to be provided in English.

7.4.5.4. The recent Egyptian TP guidelines¹³ provide that if documents are provided other than in Arabic, the taxpayer may be required to bear the cost of an official translation.

7.4.6. Information to be included in the TP documentation

7.4.6.1. In preparing TP documentation, MNEs must decide the type and scope of documentation and information that should be provided to tax authorities to meet various documentation requirements and avoid any tax adjustments and penalties, while at the same time minimizing added burdens and potential tax exposure in the event of a tax controversy.

7.4.6.2. The main objective of preparing and maintaining documentation is to place the taxpayer in a position where it can readily demonstrate that it has exerted reasonable efforts to ensure that its transfer prices are consistent with the arm’s length principle. As indicated in the previous sections, international TP documentation guidelines of OECD, PATA and the EU contain rather detailed TP documentation lists, respectively. Likewise, a number of countries have mandatory or illustrative lists of TP documentation in their tax laws or regulations.

7.4.6.3. However, it would not be possible to specify a comprehensive list of documentation requirements that would meet the needs of all taxpayers or tax administrations because the documentation required depends on the specific facts and circumstances of each case and the TP regime applicable in a country. Nevertheless, it would be useful to check common items or features that are included in TP documentation. An example of this can be found in “a Sample of TP Study” included in Appendix 2 to this Manual, which was prepared by a business grouping, the International Chamber of Commerce.

¹² Refer to the survey conducted by Salans Vox Tax in 2009.

¹³ Available at <http://www.us.kpmg.com/microsite/taxnewsflash/tp/2011/English%20Final.pdf>

- 7.4.6.4. First of all, information as to the related parties that are involved in the controlled transactions at issue needs to be documented. Such information includes *i)* an outline of business with transaction parties, *ii)* the structure of the organization, *iii)* ownership linkage within the MNE group, *iv)* the amount of sales and operation outcome from the last few years preceding the transaction; *v)* the level of the taxpayer's transactions with foreign related parties, for example the amount of inventory sales, value of services rendered, rent for tangible assets, the use and transfer of intangible property, and interest on loans, etc.. Information about functions performed, assets employed and risks assumed would be important items for TP documentation.
- 7.4.6.5. The current business environment and forecasted changes or commercial and industry conditions affecting the taxpayer, such as market scale, competitive conditions, regulatory framework, technological progress, foreign exchange market, also may need to be documented.
- 7.4.6.6. An explanation of the selection, application, and consistency with the arm's length principle of the transfer pricing method used for the establishment of the transfer pricing is also needed. Information on factors influencing the setting of prices or the establishment of any pricing policies for the taxpayer and the whole MNE group would be also useful.
- 7.4.6.7. If the documentation is designed to allow the evaluation of comparables used in a transfer pricing study, it would not be sufficient merely to provide a list of "comparables." In cases where internal or third-party comparables are used by a taxpayer to support its transfer pricing policy, supporting documentation should be provided explaining the process followed to arrive at a particular list of comparables and the arm's length range of those comparables. Comparables are dealt with in detail in Chapter 5 of this Manual.
- 7.4.6.8. The 2010 OECD TP Guidelines contain a description of a typical process used to identify comparable transactions and utilize the data so obtained through comparability analysis. Where a transfer pricing study relies on comparable information which has been obtained following such a process, it would be reasonable to expect each of the steps to be documented in order to make it possible for the tax administration conducting an audit to assess the quality of the analysis.
- 7.4.6.9. For example, if a taxpayer uses multiple-year data on the ground that its transactions are affected by business cycles, it would be reasonable for the taxpayer to provide some documentation explaining why a business cycle is a factor to be considered, the type (e.g., business cycle, product cycle) and duration of the cycle and placement of the controlled enterprise in the cycle. Based on this analysis, the qualitative and quantitative criteria used to select or reject comparables should be carefully documented.
- 7.4.6.10. Where a taxpayer concludes that no comparable data exists or that the cost of locating the comparable data would be disproportionately high relative to the amount at issue, reasons for such conclusion should be duly explained together with supporting documentation.
- 7.4.6.11. Special circumstances would include details concerning any intentional set-off transactions that have an effect on determining the arm's length price. In such a case, documentation may be necessary to help describe the relevant facts, the qualitative connection between the transactions, and the quantification of the set-off arrangement. In this situation, contemporaneous documentation helps minimize the use of hindsight, and the possible suggestion of manipulation based on that hindsight.

7.4.6.12. TP documentation for intra-group services is vitally important to allow tax authorities to satisfy themselves as to the legitimacy of intra-group service charges, including management fees. When TP documentation is prepared for intra-group services, it should be focused on whether intra-group services have in fact been provided and what the intra-group charge should be for such services for tax purposes. Once the relevant intra-group services have been identified, the documentation of such intra-group services performed by the service provider and the benefits received by the service recipient should be thoroughly prepared.

7.4.6.13. A cost contribution arrangement (CCA) is a framework agreed among business enterprises to share the costs and risks of developing, producing or obtaining assets, services, or rights, and to determine the nature and extent of the interests of each participant in those assets, services, or rights. Documentation is crucial for the proper operation and tax treatment of a CCA because the form and value of each participant's contribution cannot be properly obtained without proper documentation. The prudent business management principles espoused in the OECD Guidelines would lead the participants to a CCA to prepare or obtain materials regarding the nature of the subject activity, the terms of the arrangement, and its consistency with the arm's length principle.

7.4.6.14. Over the duration of the CCA's term, the following information could be particularly useful:

- Terms, participants, subject activity and conditions of initial arrangements and any change to the arrangement;
- The manner in which participants' proportionate shares of expected benefits are measured, and any projections used in this determination;
- The form and value of each participant's initial contributions, and a detailed description of how the value of initial and ongoing contributions is determined;
- Any provisions for balancing payments or for adjusting the terms of the arrangements to reflect changes in economic circumstances;
- A comparison between projections used to determine expected benefits from CCA activity with the actual results; and
- The annual expenditure incurred in conducting the CCA activity, the form and value of each participant's contributions made during the CCA's terms, and a detailed description of how the value of contributions is determined and how accounting principles are applied consistently to all participants.