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BEPS: A Transfer Pricing Documentation Survival Kit for Small and Medium-Sized Businesses

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The OECD's BEPS Action Plan may soon increase the compliance burden in terms of transfer pricing documentation on small and medium-sized companies all around the world, including Canada. The following articles briefly exposes the new rules and offers needed guidance.

I. Introduction

On September 16, 2014, the Organisation for Economic Co-operation and Development (OECD) released *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting* ("the Guidance").² This OECD report addresses the issues raised by Action 13 (Transfer Pricing Documentation) of the 15-point Action Plan on the Base Erosion and Profit Shifting initiative ("BEPS initiative").³ As clearly indicated in the executive summary, the Guidance "contains revised standards for transfer pricing documentation and a template for country-by-country reporting of income, earnings, taxes paid and certain measures of economic activity." In short, as

specified in the preamble of the document, it replaces Chapter V (Documentation) of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*⁴ ("OECD TP Guidelines").

II. The BEPS Transfer Pricing Documentation Era has Begun

The newly crafted "three tiered approach to transfer pricing documentation", as it has been labelled by the OECD, significantly extends the scope and the depth of information required from taxpayers involved in cross-border transactions with related parties all

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around the world. Welcome, we might say, to the BEPS transfer pricing documentation era which includes:

- the Master file;
- the Local file; and
- the Country-by-country report.

In light of these significant changes, which may have enduring effects on companies of every shape and size, a few words on these new rules are understandably included in order to delimit the scope of this paper.

Paragraphs 18-21 and Annex I of the Guidance detail the constituent parts of the Master file. In short, the Master file shall outline the organizational structure of the multinational enterprise (“MNE”) group.⁵ It should contain information on the MNE group, as indicated in paragraph 19, on the following:

- the organisational structure;
- a description of the main business lines;
- a description of the intangibles;
- a brief on the intercompany financial activities; and
- an overview of the financial and tax positions.⁶

According to the OECD, there shall be one Master file for the whole MNE group. The information therein may nonetheless be presented by business line if such a presentation is warranted by the way the MNE actually operates.⁷ It is expected that the transfer pricing documentation produced under the Master file will be made available to every tax administration where the MNE group operates or has potential or actual tax liabilities. The OECD webcast which took place on September 16, 2014 stated that: “[. . .] implementation and especially filing and dissemination mechanism for master file and CbC (Country-by-country) report [is] to be addressed over [the] coming months”.⁸ The Guidance offers no clear indication on the language of choice for the Master file. Paragraph 39 timidly suggests that local laws will apply on that matter. But “countries are encouraged to permit filing of transfer pricing documentation in commonly used languages where it will not compromise the usefulness of the documents.”⁹

Paragraphs 22-23 and Annex II of the Guidance contain the components of the Local file. In a specific country, the Local file is expected to provide more detailed information on the particular cross-border transactions of a company.¹⁰ Although not explicitly stated in the Guidance, there should evidently be at least one Local file per country where the MNE group operates or has tax liabilities. However, as indicated in the Guidance, the information required in the local file serves to complement the Master file. As such, “where a requirement of the local file can be fully satisfied by a specific cross-reference to information contained in the master file, such a cross-reference should suffice.”¹¹

As highlighted by Annex 2 of the Guidance, the Local file comprises information pertaining to the “management structure of the local entity”, a thorough OECD comparability analysis as it applies to the controlled transactions in a particular country and in-depth explanations on the “most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method”.¹² Methodological choices for the application of the se-

lected transfer pricing method must also be documented in great detail. The Local file also requires the inclusion of all “material intercompany agreements concluded by the local entity” and financial statements.¹³

Last but certainly not least, paragraphs 24-26 and Annex III of the Guidance outline the content of the Country-by-country report which “requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, and various indicators of the location of economic activity among tax jurisdictions in which the MNE group operates.”¹⁴ For greater certainty, the Country-by-country report consists of the presentation of information on a country-by-country basis instead of an entity-by-entity basis in a particular country for each country, as was originally envisioned by the OECD.¹⁵ Just like the Master file, the language of the Country-by-country report is not clearly defined at this time. As indicated in Annex 3 of the Guidance, the Country-by-country report covers information for each tax jurisdiction where the MNE group operates or has tax liabilities related to the following:

- revenues from sales, services, royalties, interest, premiums, etc., which involve related parties;
- revenues from any type of transactions with arm’s length parties;
- profit or loss before income tax, including all extraordinary income and expense items;
- income tax paid;
- income tax accrued for the current year;
- stated capital;
- accumulated earnings;
- number of employees; and
- tangible assets excluding cash and cash equivalents.

Additional information is also required, for each country, on the functions performed including:

- research and development;
- intellectual property;
- purchasing or procurement;
- manufacturing;
- sales, marketing or distribution;
- administrative, management or support services; and
- intragroup financing and insurance.

The heightened transfer pricing compliance burden is easily noticeable. The rest of this paper discusses some tools that may prove useful, especially to small and medium-sized businesses in Canada and everywhere around the world, that is, to businesses determined to succeed in their cross-border transactions in spite of these BEPS transfer pricing documentation rules.

III. Transfer Pricing Documentation Processes

Part D of the Guidance discusses “compliance issues” in relation to the new transfer pricing documentation rules. Paragraph 27 of the Guidance suggests that, more than ever, arm’s length prices should be determined “based upon information reasonably available at the time of the transaction”. If the transfer pricing documentation is indeed maintained contemporaneously, it may need to be periodically updated. Paragraph 37 suggests that the Master file, Local file and

Country-by-country report should be reviewed annually. Materiality will play a key role in these determination and revision processes. As indicated in paragraph 32 of the Guidance, “not all transactions that occur between associated enterprises are sufficiently material to require full documentation in the local file.” However, paragraph 34 clearly states that “the country-by-country report should include all tax jurisdictions in which the MNE group has an entity resident for tax purposes, regardless of the size of business operations in that tax jurisdiction.”

In the new era of BEPS transfer pricing documentation, taxpayers will thus be expected to accurately maintain and properly assemble high quality transfer pricing documentation in a timely manner. The era of the “cut and paste right down to the wire” transfer pricing documentation package may have abruptly come to an end as the new BEPS rules seemingly require extended business information coverage, highly transaction-specific content, country-by-country financial and business information and a much deeper degree of explanation on the transactions between related parties.

Understandably, such a high standard of transfer pricing documentation may be cause for apprehension. In short, companies will be expected to fully justify the nature and content of their transfer pricing documentation. But the challenges posited by the new BEPS transfer pricing documentation rules may fortunately be much more manageable than meets the eye by simply getting back to the nuts and bolts of transfer pricing.

In fact, a summary comparison of the information to include in the Master file, Local file and Country-by-country report with the content, for the most part, of Chapter I, II and III of the OECD TP Guidelines suffice to see that, after all, alignment with these latter directives shall facilitate the task at hand.

Part D of Chapter I of the OECD TP Guidelines pertains to the comparability analysis which involves the examination of:

- the characteristics of the property or service;
- the functions performed by the parties taking into account the assets used and risks assumed;
- the contractual terms;
- the economic circumstances of the parties and which surround the transaction; and
- the business strategies used by the parties.¹⁶

The analysis of these five comparability factors, provided it is not simply superficial and hurried, should prove more than adequate to achieve the appropriate level of detail required by the Master file and Local file with respect to most of the non-financial information. In fact, the taxpayer may find that an efficient course of action to address this apparent puzzle may simply reside in the joint use of the comparability factors and the components listed in the Master file and Local file to put together significant pieces of its transfer pricing documentation.

Supplementary information in regard to the Local file should thereafter stem from the selection of the most appropriate transfer method as per Chapter II of the OECD TP Guidelines and its application as per the specific directions provided in Chapter III of the OECD TP Guidelines. With respect to the selection of the most suitable transfer pricing method, Chapter II contains all the essential guidance to address issues included in the Local file such as the selection of the tested party¹⁷ and important assumptions made to apply the transfer pricing method.

As for Chapter III, it will greatly assist in addressing the relevance of a multi-year analysis, to justify the comparable transactions or prices selected (whether internal or external), to inform tax administrations of the comparability adjustments that may have been necessary, etc. It shall nonetheless be stated at this point that the accurate application of the transfer pricing method may demand technical skills somewhat not automatically in the realm of the typical company.

As for controlled transactions involving intangibles, they will unmistakably benefit from the guidance provided by the new Chapter VI of the OECD TP Guidelines titled *Guidance on Transfer Pricing Aspects of Intangibles*, although another revision is expected in 2015.¹⁸ The same can be said for controlled transactions pertaining to intragroup services discussed in

“Great TPPP will first and foremost focus on the transactions between the related parties.”

Chapter VII of the OECD TP Guidelines. However, let it be said that the OECD has recently released a public discussion draft titled *BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding intra-Group Services* which may render the current guidance included in chapter VII partially irrelevant in 2015.¹⁹

In short, whether it's through the comparability analysis or the transfer pricing method selection or application, the BEPS transfer pricing documentation rules can probably be met more easily than might seem. Nevertheless the transfer pricing compliance burden has indeed substantially increased in the burgeoning BEPS era.

IV. Transfer Pricing Policies and Procedures

Even though good transfer pricing documentation processes will undeniably help achieve compliance, more than ever before small and medium-sized businesses must also join the fray and adopt typical MNE-like behaviors with respect to their related party cross-border dealings. Transfer pricing policies and procedures (“TPPP”) should therefore be designed and implemented across the group, whatever its size may be.

Great TPPP will first and foremost focus on the transactions between the related parties. TPPP should

consequently be designed in order to address the five comparability factors of the OECD comparability analysis mentioned above. They must also include components in relation to the selection of a transfer pricing method and its application. As a starting point, written agreements between the related parties are mandatory. These agreements should reflect the terms and conditions that may be found in the dealings of arm's length parties.

In Canada, recent decisions rendered by the Tax Court of Canada have highlighted the fact that poor design or implementation of intragroup agreements which include unsubstantiated terms or conditions may lead to unexpected transfer pricing results and litigations with the tax authorities. In *McKesson Canada Corporation v. The Queen* and *Marzen Artistic Aluminum Ltd. v. The Queen*²⁰, both sets of taxpayer's agreements went under heavy fire during trial. Although the companies had both taken considerable time to draw up commercial agreements, insufficient efforts were carried out to ensure the arm's length viability of specific key provisions, that is, the comparability analysis was an unfinished business at best. Incomplete or ambiguous agreements can sometimes have long-lasting effects on the taxpayer. In *Canada v. Glaxo-SmithKline Inc.*, the company has been entangled in a transfer pricing dispute with the Canada Revenue Agency that relates to the relevance of some of its agreements since 2008 with no apparent end in sight.²¹ Arm's length commercial agreements are indeed worth their while.

Good TPPP will also greatly benefit the transfer pricing documentation processes. They should in fact work together since good design and efficient implementation of TPPP constitute one of the first lines of defence against tax administrations around the world. Systematic and successful implementation will obviously increase the likelihood of transfer pricing compliance and performance. As a corollary, good TPPP design and implementation will have the commercial operations in mind. TPPP will be designed in such a way to complement the operational and commercial procedures of a small or medium-sized business that are already in place. As such, implementation should be facilitated. There is in fact no point in designing highly complex TPPP if the implementation component is impractical or difficult to perform. TPPP design and implementation will for that reason usually be aligned with the enterprise resource planning ("ERP") systems already in place, that is, with the specificities of the business in order to create what is nowadays called successful operational transfer pricing. Some cases may require new ERP systems. But generally there will be no need to reinvent the wheel.

In other words, TPPP may provide an opportunity to review the existing value chain and non-tax busi-

ness processes to ensure that both the tax planning and the overall ability to generate business profits are optimized.

V. The Relevance of an Advance Pricing Agreement

In the BEPS era, which is now upon us, greater tax certainty may become more relevant than ever before to companies around the world. In fact, it is difficult to imagine that a unique interpretation of the information obtained through the new transfer pricing documentation rules will prevail. On the contrary, tax administrations will likely generate more and more double taxation cases. An advance pricing agreement or arrangement ("APA") may then become a viable tool for a small or medium business who wishes to acquire greater tax certainty in connection with its cross-border dealings with related parties. Most countries offer companies the opportunity of contracting an APA.

In Europe, the EU Joint Transfer Pricing Forum ("EU-JTPF") has already recognized the relevance of APA for small or medium-sized businesses directly quoting from paragraphs 4.158 [Costs of APA for the

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taxpayer] and 4.163 [Equitable access to APAs for all taxpayers] of the OECD TP Guidelines.²² The EU-JTPF explains “tax administrations should use their experience of the problems faced by SMEs to facilitate access to APAs for SMEs where APAs are useful for dispute avoidance or resolution. This wording is intended to encourage a flexible approach when accepting cases into an APA programme.”²³ Many European countries actually offer APA programs modelled on Part F of Chapter IV of the OECD TP Guidelines, including France²⁴, Germany²⁵, Ireland²⁶, and the United Kingdom²⁷.

In Asia-Oceania, Australia²⁸, China, Hong Kong²⁹, India³⁰, Japan³¹, New Zealand³², Singapore³³, among others³⁴, offer APA to companies. Both the United States and Canada also provide companies with comprehensive APA programs.

In the United States, *Notice 2013-79 Proposed Revision of Procedures for Advance Pricing Agreements*³⁵ provides a detailed account of the steps required to obtain an APA. The US program is indeed very similar to the Canadian APA program.

In Canada, the APA process is described in Information Circular *IC 94-4R International Transfer Pricing:*

Advance Pricing Arrangements (APAs).³⁶ Information Circular IC94-4RSR *Special Release—Advance Pricing Arrangements for Small Businesses*³⁷ highlights the Canadian APA program for taxpayers with gross revenues under 50 million Canadian dollars. However, the CRA's APA program for small and medium-sized businesses can only lead to a unilateral APA, which is of limited value as far as tax certainty is concerned. Bilateral and multilateral APAs allow companies greater tax certainty in every country where the parties to the controlled transaction may have potential or actual tax liabilities.

All around the world, the APA process generally starts with the pre-filing meeting, followed by the formal APA request by the taxpayer, the APA submission by the company, the case plan by the tax administrations, the review phase which usually includes site-visits and on-site interviews with personnel, the negotiations between the Competent Authorities involved in the APA, the drawing of the APA agreement, and the post-settlement meeting.

Each step of the APA process will entail an important amount of time and effort from the taxpayer. An APA is simply and exclusively fact-driven. It is an intensive process where the tax administrations involved will acquire access to a significant sum of commercial and financial information about the company. As such, it is a course of action that should be considered in cases where a company's needs for tax certainty clearly outweigh the disadvantages of heightened scrutiny by the tax administrations. It may also be measured against the potential consequences of a transfer pricing compliance audit in some situations.

Conclusion

The purpose of our account was to enable the small and medium-sized businesses to survive the new BEPS transfer pricing documentation rules. Good transfer pricing documentation processes properly aligned on the OECD TP Guidelines will clearly go a long way to smooth the entry in the BEPS transfer pricing documentation era. Combined with the smart design and efficient implementation of good transfer pricing policies and procedures, the transition into the new BEPS transfer pricing documentation era will be greatly facilitated. In some instances, an advance pricing arrangement may also offer significant advantages to the company who is wary of the risks of unforeseen tax liability.

These tools may be used independently or concurrently depending on the objectives and constraints with which the company must juggle in its dealing between related parties. Provided that they are accurately and professionally applied by specialists, it is our contention that they will in fact enable any small or medium-sized business to thrive in the BEPS era, not simply survive.

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² OECD (2014), *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing; online: http://www.oecd-ilibrary.org/taxation/guidance-on-transfer-pricing-documentation-and-country-by-country-reporting_9789264219236-en.

³ OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing; online: <http://www.oecd.org/tax/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm>.

⁴ OECD (2010), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, July 22, 2010; online: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2010_tpg-2010-en#page1.

⁵ *Ibid.*, par. 18.

⁶ See also Annex I of the Guidance for more detail.

⁷ *Op. cit.*, par. 20.

⁸ Online: <http://www.oecd.org/tax/beps-webcasts.htm>.

⁹ *Op. cit.*, par. 39.

¹⁰ *Ibid.*, par. 20.

¹¹ *Ibid.*, par. 22.

¹² *Ibid.*, par. 22.

¹³ See Annex II of the instructions for the comprehensive list of inclusions in the Local file.

¹⁴ *Op. cit.*, par. 24.

¹⁵ See *White Paper on Transfer Pricing Documentation*, released on July 30, 2013; online: <http://www.oecd.org/ctp/transfer-pricing/white-paper-transfer-pricing-documentation.pdf>; and *Discussion Draft on Transfer Pricing Documentation and CbC Reporting*, released on January 30, 2014; online: <http://www.oecd.org/ctp/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf>.

¹⁶ For more detail on the comparability factors, see online: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2010_tpg-2010-en#page1.

¹⁷ See also paragraphs 3.18-19 of the OECD TP Guidelines.

¹⁸ OECD (2014), *Guidance on Transfer Pricing Aspects of Intangibles*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing; online: http://www.oecd-ilibrary.org/taxation/guidance-on-transfer-pricing-aspects-of-intangibles_9789264219212-en.

¹⁹ OECD (2014), *BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services*, Public Discussion Draft, November 3, 2014; online: <http://www.oecd.org/ctp/transfer-pricing/discussion-draft-action-10-low-value-adding-intra-group-services.pdf>.

²⁰ *McKesson Canada Corporation v. The Queen*, 2013 TCC 404 (appeal filed at the Federal Court of Appeal on 10 January 2014; files A-48-14 and A-49-14) and *Marzen Artistic Aluminum Ltd. v. The Queen*, 2014 TCC 194 (appeal filed at the Federal Court of Appeal on 5 September 2014; file A-387-14).

²¹ See *GlaxoSmithKline Inc. v. The Queen*, 2008 TCC 324 (Tax Court of Canada); *GlaxoSmithKline Inc. v. Canada*, 2010 FCA 201 (Federal Court of Appeal); and *Canada v. GlaxoSmithKline Inc.*, 2012 SCC 52 (Supreme Court of Canada). The case has now been returned to the Tax Court of Canada and is still pending (see file 98-712(IT)G).

²² See European Commission, *Report on Small and Medium Enterprises and Transfer Pricing*, EU Joint Transfer Pricing Forum, COM(2012) 516 final, p. 11 (paragraph 24); online: http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf/2012/2012-09_com516_en.pdf.

²³ *Ibid.*

²⁴ France, *No. 171 of 17 September 1999, Instruction on the Advance Pricing Arrangement Procedure*, Ministry of the Economy, Finance and Industry, September 7, 1999; online: http://www.impots.gouv.fr/portail/deploiement/p1/fichedescriptive_2959/fichedescriptive_2959.pdf.

²⁵ Germany, *Information on bi- or multilateral mutual agreement procedures under double taxation agreements for reaching Advance Pricing Agreements ("APA") aimed at granting binding advance approval of transfer prices agreed between international associated enterprises*, Federal Ministry of Finance, October 5, 2006; online: <http://www.oecd.org/tax/transfer-pricing/47655669.pdf>.

²⁶ Ireland, *International Tax: Mutual Agreement Procedures (including Transfer Pricing/Corresponding Adjustments/ Advance Pricing Agreement issues)*, OECD Country Profiles; online: www.revenue.ie/en/business/oecd-country-profiles.pdf.

²⁷ United Kingdom, *INTM422150—Transfer pricing: methodologies: Advance Pricing Agreements: sample agreement*; HM Revenue & Customs; online: <http://www.hmrc.gov.uk/manuals/intmanual/INTM422150.htm>.

²⁸ Australia, *PS LA 2011/ATO's Advance Pricing Arrangement Program*, Australian Taxation Office, May 7, 2012; online: <http://law.ato.gov.au/atolaw/view.htm?Docid=PSR/PS20111/NAT/ATO/00001>.

²⁹ See online: http://www.ird.gov.hk/eng/tax/dta_apa.htm.

³⁰ India, *Notification No. 36 of 2012*, Ministry of Finance, August 30, 2012; online: <http://www.rbrt.ca/wp-content/uploads/2014/11/Notification-No.-36-of-2012-APA-Program.pdf>

³¹ Japan, *Commissioner's Directive on the Operation of Transfer Pricing*, National Tax Agency of Japan, June 28, 2013; online: https://www.nta.go.jp/foreign_language/07.pdf.

³² See online: <http://www.ird.govt.nz/transfer-pricing/practice/transfer-pricing-practice-apas.html>.

³³ Singapore, *IRAS Supplementary Circular – Supplementary Administrative Guidance on Advance Pricing*, Inland Revenue Authority of Singapore, October 20, 2008; online: http://www.iras.gov.sg/irasHome/uploadedFiles/Quick_Links/e-Tax_Guides/Business_and_employers/IRAS%20Supp%20Circular%20-%20Supp%20Admin%20Guidance%20on%20APAs.pdf.

³⁴ See also Thailand, *Guidance on APA Process*, The Revenue Department of Thailand; online: <http://www.rd.go.th/publish/fileadmin/download/GUIDANCE-ON-APA-PROCESS-EN.pdf>; and Fiji Islands, *Fiji Revenue & Customs Authority Transfer Pricing Guidelines (January 2012)*, Fiji Revenue & Customs Authority; online: http://www.rbrt.ca/wp-content/uploads/2014/11/Fiji_Transfer_Pricing_Guidelines.pdf.

³⁵ United States, *Notice 2013-79 Proposed Revision of Procedures for Advance Pricing Agreements*, Internal Revenue Service, Internal Revenue Bulletin: 2013-50, December 9, 2013; online: http://www.irs.gov/irb/2013-50_IRB/ar12.html.

³⁶ Canada, *IC 94-4R International Transfer Pricing: Advance Pricing Arrangements (APAs)*, Canada Revenue Agency, March 16, 2001; online: <http://www.cra-arc.gc.ca/E/pub/tp/ic94-4r/ic94-4r-e.html>.

³⁷ Canada, *IC94-4RSR Special Release - Advance Pricing Arrangements for Small Businesses*, Canada Revenue Agency, March 18, 2005; online: <http://www.cra-arc.gc.ca/E/pub/tp/ic94-4rsr/ic94-4rsr-e.html>.