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February 2014

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Via e-mail

Re: Comments – Transfer Pricing Documentation / Country-by-Country Reporting

To Whom It May Concern:

On January 30, 2014, the OECD released for public consultation a *Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (Discussion Draft). In connection with that release, the OECD requested comments on the Discussion Draft generally, and also identified specific areas where stakeholder comments might be particularly illuminating. This letter is submitted in response to that invitation.

Although the substance of our comments below has been informed through thoughtful dialogue with colleagues in private practice, industry and civil society, the views expressed herein are ours alone. We have neither been engaged by an organization to provide, nor expressed a commitment to any person to advance, the viewpoints expressed below.

General comments

As a preliminary matter, we would like to express our gratitude to the OECD for its efforts in advancing the public dialogue regarding the important topics of transfer pricing documentation (TPD) standardization and tax transparency. Without question these two items weigh heavily on the minds of tax executives and administrators alike, as optimization in the area carries with it the promise of increased efficiency and certainty for both.

That joint interest is prominently recognized in Action 13 of the BEPS Action Plan, which speaks in explicit terms of balancing the informational needs of tax administrators against the compliance costs to taxpayers. Implicit in this language is the notion that successful implementation of a global TPD standardization or tax transparency initiative requires cooperation amongst stakeholders and a sense of mutual benefit.

Unfortunately, the Discussion Draft appears to tip the scales significantly in favor of tax administrators, and leaves open to question what material improvements to the status quo (whether in terms of cost or controversy mitigation) the adoption of this framework would produce for taxpayers. While Action 13 necessarily contemplated an increase in the volume of taxpayer information disclosed, the proposed (and theoretically attractive) two-tier approach, as presently crafted, seems to magnify compliance burdens without clearly delivering workable solutions to the expanding problem of fragmented local reporting requirements.

Further still, and perhaps most importantly, the Discussion Draft's proposal to merge the country-by-country template with the master file will amplify controversy risk (i.e., uncertainty) for compliant taxpayers. Because the country-by-country template can be interpreted to support formula-based pricing, its inclusion within a framework of data that is focused on arm's length pricing (i.e., the master file) can only give rise to confusion, mischief and controversy. As a general principle, efforts to enhance "big picture" awareness, or to supply sufficient data to ensure the proper application of arm's length principles, should not operate to expand the risk of intractable tax controversy nor promote the incidence of double taxation.

With this background, our comments to the Discussion Draft are offered below.

Country-by-country reporting should be dislodged from the master file

The OECD's July 2013 release of its *White Paper on Transfer Pricing Documentation* (White Paper) generated a substantial level of stakeholder commentary, and one issue that emerges forcefully from the commentary is the concern that the master file's purpose may be too broadly construed. The Discussion Draft similarly appears to contemplate a broad role for the master file – e.g., for use as a tool in making high-level tax risk assessments and for use in transmitting enterprise-wide data and analytics that are relevant in determining whether a proper arm's length price has been charged – which may result in the master file itself (as presently drafted) frustrating other important policy objectives such as simplification and utility (from a risk assessment perspective) and clarity (from a pricing perspective). As presently structured, the master file errs on the side of supplying more data than is necessary (or perhaps even quickly digestible) for making an initial tax-risk evaluation and, more importantly, provides this data in a context that seemingly opens the door for potential misinterpretation and mischief.

In particular, the merging of the country-by-country reporting template into the master file structure has the potential to generate significant misunderstanding and controversy given the country-by-country template's factual presentation of formulary apportionment factors while the focus of the master file itself is on data and analyses directed at deriving the proper (arm's length) related-party pricing. Although this potential for misunderstanding and controversy presumably is unintended, the merging

of the country-by-country template with the master file may increase the risk that wide-scale implementation of any Action 13 output will be harder to achieve.

As suggested earlier, it is not unreasonable to expect that taxpayers may be averse to the existence of the country-by-country template elements within the master file, in light of the strong message that this may convey to countries inclined to raise formula-based challenges to related-party pricing matters. However, we also believe that administrators that champion the arm's length standard may be similarly reluctant to support a merging of the country-by-country template and the master file, given the potential competent authority burdens that may ensue. Further, administrators from countries that employ foreign tax credit regimes may find the combination undesirable, particularly if it could be perceived as lending support to arguments that generate otherwise unintended consequences (e.g., a perception that the pursuit of competent authority relief is futile).

In light of the foregoing considerations, we recommend that the OECD separate the country-by-country template from the master file. We believe this separation will reiterate the OECD's previously-articulated commitment to arm's length principles, mitigate concerns associated with the structure of the master file, and make the country-by-country template available for potential utilization as a high-level tax-risk assessment vehicle. While we recognize that additional work will be necessary to assess the practical utility of the resulting multi-tiered approach, we believe it is desirable to separate from the master file data that might be interpreted as implying support for formulary apportionment.

Only a government-to-government exchange of information should be promoted

The Discussion Draft embraces TPD standardization efficiencies by relying significantly on an integrated relationship between the master and local files. To implement this approach, however, the Discussion Draft contemplates that a MNE group parent would prepare the master file and distribute it to group entities so that the file "could then be obtained by local taxing authorities directly from local affiliates."

While this approach endeavors to promote certainty and efficiency for local tax administrators, it generates material security concerns for taxpayers by placing potentially sensitive business data and secrets in the hands of remote employees. Further, this mechanism does not constitute a pragmatic solution even for tax administrators, if local legislative or judicial bodies refuse to compel the production of data not otherwise in the possession or control of local taxpaying entities.

We believe that taxpayer security concerns in this area are valid, and we have ourselves witnessed situations where highly-sensitive strategic, technologically-relevant or pricing-competitive data has been subjected to protracted internal vetting processes before receiving general counsel or executive-suite clearance for release to the tax department. We also have witnessed situations where data that is accessible by one core MNE team (e.g., the head office tax or treasury group) is restricted from wider internal dissemination (e.g., to local country teams), particularly where such data is associated with business strategy (e.g., intellectual property development and exploitation) or business realignments. Accordingly, we believe the Discussion Draft's proposed master file exchange mechanism is untenable – particularly in an era of enhanced labor market mobility and an increased proliferation of private/public data infringement – regardless of whether the master file's primary function is to facilitate high-level tax risk assessment.

Despite these shortcomings, a tiered approach to TPD standardization could be viable where the master file exchange is predicated on information exchange provisions already available in established treaty networks. In our opinion, a system based on government-to-government exchange mechanisms would be attractive in that it should (a) allay many taxpayer concerns associated with the wider internal dissemination of sensitive company data (particularly where the local finance team does not manage local tax controversy), (b) ensure that the most secure channels (i.e., those developed through deliberative processes that take privacy considerations into account) are utilized for any transmission of sensitive information to foreign governments,[1] (c) place taxpayers in a pre-audit posture of compliance (rather than creating a perception of non-compliance, which could occur if a private exchange mechanism were adopted and a taxpayer declined to transmit the master file to a local affiliate for valid reasons), (d) provide more appropriate avenues of recourse should transmitted data be misused or mishandled, and (e) foster a more regular dialogue amongst tax administrators.

Although the timeline for securing relevant data under this system may be lengthened, reasonable measures can be taken to improve the timing of any desired information exchange. Further, even modest delays should be tolerable, except perhaps where the primary function of such data is to facilitate a high-level tax risk assessment.

We strongly recommend that the OECD abandon the private exchange approach to sharing master file data, and instead adopt a government-to-government mechanism for exchange. In addition, we believe that it may be prudent to relegate the master file's tax-risk assessment function to another vehicle – so long as this may be accomplished in a way that mitigates burdens and promotes simplicity – in order to optimize timing and relevance considerations for tax administrators.

Finally, we believe that a MNE's "home country" (i.e., the country in which the group parent is tax resident) should play the central role in architecting, collecting and transmitting any master file information. The MNE's home country presumably is in the best position to know what (and in what format) information is available, how it is best presented to treaty partners, and what measures are appropriate to adequately protect sensitive business information.

It should be noted that the system described above could be applied with equal vigor to various tax transparency initiatives, as relevant (e.g., should a separate vehicle – such as the country-by-country template – be selected to function as a high-level tax-risk assessment tool).

Any inclusion of data regarding ad hoc arrangements should be voluntary

The Discussion Draft contemplates that a MNE's master file will include certain descriptive information regarding the group's collection of ad hoc tax arrangements. More specifically, it mandates that a MNE identify and describe all APAs and similar advance rulings, all transfer pricing matters currently pending or recently resolved in MAP, and all other tax rulings that may relate to the

[1] The United States government, for example, takes a deliberate approach to matters involving taxpayer privacy and disclosure. *See, e.g.*, U.S. DEPARTMENT OF THE TREASURY, OFFICE OF TAX POLICY, REPORT TO THE CONGRESS ON SCOPE AND USE OF TAXPAYER CONFIDENTIALITY AND DISCLOSURE PROVISIONS, VOLUME I: STUDY OF GENERAL PROVISIONS (2000), available at http://www.treasury.gov/resource-center/tax-policy/Documents/confide.pdf.

allocation of income to particular jurisdictions. This proposal, while perhaps well-intentioned, is misguided.

If the master file's primary function is to convey data that is relevant in determining whether a proper arm's length price has been charged, then it is questionable whether the MNE's ad hoc arrangements are relevant to that purpose. It is difficult to imagine a compelling rationale for why an ad hoc arrangement, which is formulated in reference to discrete facts and circumstances germane to a specific undertaking involving identified group members, should be presented in a manner that suggests it is of probative value for purposes of determining a proper arm's length price between affiliates that are not the subject of the arrangement.

These arrangements are typically predicated on robust negotiations involving at least one non-market participant, and therefore often reflect trade-offs (e.g., to achieve certainty) that would not otherwise influence an agreement between two market participants. As a result, taxpayers and tax administrators often have a mutual interest in ensuring that the details of these arrangements remain private.[2] While tax administrators arguably have an interest in (and presumably will be familiar with) ad hoc arrangements involving local affiliates, other ad hoc arrangements of a MNE group would have little relevance in assessing local pricing matters between related parties.

Even under an expansive view of the master file (i.e., that it also functions as a tax-risk assessment tool), the case for specifically disclosing ad hoc arrangements is unpersuasive. One problem with mandatory disclosure in this context is that it perpetuates a misconception that these arrangements imply aggressive taxpayer behavior, when in truth they are often the product of pragmatic decision-making by taxpayers and tax administrators. Thus, mandatory approaches seem to unnecessarily impair a taxpayer's initial standing with tax administrators.

Mandatory disclosure would also demand a tremendous commitment of taxpayer resources to summarize arrangements (which may be exceedingly complex) and respond to inquiries. Here, it is the level and continuous nature of the resource commitment that is troubling, since a superficial presentation of all arrangements is required – even those not specifically relevant to local taxation – and this is certain to lead to some level of confusion, and invite frequent, and possibly even superfluous, inquiries.

Finally, the Discussion Draft approach is troubling in that it essentially directs all MNEs to divulge to every tax administrator extremely sensitive proprietary data (e.g., strategic insight into the group's tolerance for tax risk, its global approach to negotiating or resolving tax matters, etc.), by mandating that all group arrangements be summarized in a single data array (i.e., the master file). The obvious concern here is that this information may then be used for improper purposes (e.g., to exploit local affiliates). Voluntary (or narrowly-crafted quasi-voluntary) disclosure regimes would avoid all or most of the problems noted above, yet presumably could be tailored to sensibly contribute to "big picture" awareness.

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[2] In the United States, APAs and MAP-related closing agreements are deemed confidential and disclosure restrictions are meticulously observed. See U.S. Internal Revenue Code Sec. 6103.

We recommend that the OECD eliminate the requirement that a MNE list and describe its ad hoc arrangements as part of a master file or other record. These arrangements are the product of unique sets of facts, circumstances, and trade-offs that are unique to those facts and circumstances, and therefore have little bearing on the question of whether a proper arm's length price has been charged in transactions between affiliates that are not covered by the particular arrangement.

Further, even where the reporting rationale is predicated on assessing tax risk, we are not persuaded that the probative value of information obtained by administrators is sufficient to justify the burdens and inequities to which taxpayers may be subjected. Because ad hoc arrangements play a central role in ensuring that the global matrix of tax systems operates efficiently (e.g., tax positions can be settled, certainty can be attained), there is genuine risk that any mandatory reporting model could deter taxpayers from pursuing these helpful instruments.

If the OECD nevertheless concludes that this reporting is essential to its Action 13 mandate, then we recommend that any such disclosure must be narrowly-focused and that alternative disclosure formats (e.g., check-the-box) be considered. Further, we also recommend that the OECD articulate with specificity how each reported item is relevant to and furthers the goals of proper tax administration (e.g., it should describe the role of MAP settlements in tax-risk analysis).

Concluding remarks

We recognize that the OECD's work in respect of Action 13 (and BEPS generally) is necessarily iterative and incremental, and appreciate that the Discussion Draft is reflective of early-stage thinking rather than broad consensus. As a result, and in light of timing constraints, we purposefully limited our comments above to certain key issues that require early resolution in order for this project to successfully advance. However, we believe the Discussion Draft raises other significant issues that also merit further consideration.

Despite the limited scope of our letter, we also recognize that nuanced issues or implications often arise in projects or as a result of recommendations or comments. Therefore, we believe there are a few additional observations (identified below) that may be helpful to the OECD as it advances its work in this area.

- Purpose of master file – If the country-by-country template is separated from the master file, it will be necessary to reconsider its purpose in the overall scheme of TPD standardization and simplification. One possibility is that it might be merged with the local file. Another possibility is that the master file might be presented as a "best practices" (internal) approach to generating proper TPD.

- Contours of the country-by-country template – For reasons set forth in our comments above, the country-by-country template should be separated from the master file. While this separation would permit the country-by-country template to function as a tax-transparency/risk-assessment vehicle, relevant reporting contours (e.g., the items to be identified and the method of display) will continue to be a central issue just as they are today. For instance, the issues associated with fiscal transparency (e.g., how a partnership or other transparent entity should be treated for reporting purposes, vis-à-vis its owners) will

continue to be relevant, and the OECD will still need to establish clear guidelines as to how reporting in this area will operate (e.g., to avoid increasing compliance burdens for MNEs and to assist administrators in interpreting reported data). Similarly, if reporting of ad hoc arrangements is deemed essential to the Action 13 mandate, then the method for reporting such information will remain open for debate.

- Practical considerations – To facilitate the adoption of any Action 13 output, the OECD might consider whether it would be prudent to publish an extensive, granular and on-the-record benefits / burdens analysis.[3] The OECD might also consider whether its Action 13 timeframe dovetails appropriately with timelines associated with other potentially-relevant BEPS initiatives (e.g., Action 4, Action 12).

Thank you for the opportunity to share our views on the Discussion Draft. We hope that our thoughts and suggestions are helpful to the OECD's work in this area, and we look forward to participating further in the public dialogue on transfer pricing and BEPS, as appropriate.

Please do not hesitate to contact us if you have questions or if we can be of further assistance.

Sincerely,

J. Brian Davis

Patrick J. Smith

Douglas M. Andre

[3] This foundation may be of assistance to countries later seeking to implement OECD proposals. In the United States, for instance, administrative agencies may not promulgate regulations without first engaging in a cost-benefit analysis and concluding that the rules are tailored so as to impose the least burden to society (taking into account various factors, including burdens to business). *See* Executive Order 12866 (Sept. 30, 1993).