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Transfer Pricing

—

the global divergences regarding the documentation
requirements

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Abbreviations

Art.	Article
Ch.	Chapter
CUP	Comparable uncontrolled price method
ECJ	European Court of Justice
EU	European Union
EU JTPF	European Union Joint Transfer Pricing Forum
EU TPD	European Union Transfer Pricing Documentation
MNEs	Multinational enterprises
OECD	Organization for Economic Co-operation and Development
PATA	Pacific Association of Tax Administrators
para.	Paragraph
PWC	PriceWaterhouseCoopers
STA	Swedish Tax Agency
SMEs	Small and medium sized multinational enterprises
TPG	Transfer Pricing Guidelines
Treas. Reg.	Treasure Regulation
US	United States

1 Introduction

Transfer pricing has grown to be the most important issue on the tax agenda of multinational enterprises. It deals with terms and conditions for transactions between related parties, i.e. in the absence of the open market as the regulator of those terms and conditions.¹

The globalization, the international trade and the number of multinational enterprises have continued to increase over the last decade and today over 70 percent of the cross-border transactions take place between related enterprises.² The growth of multinational enterprises (hereinafter referred to as a MNE) which are doing cross-boarder transactions, present increasingly complex taxation issues, both for the tax administrations and the companies themselves. International transfer pricing deals with those intra-group transactions where the open market regulator is absent.³ The determination of the correct transfer prices is likely to be the main determinant of how the tax base of MNEs is divided between the jurisdictions in which they operate. Transfer pricing is also important from the perspectives of managing an MNE. Without accurate transfer prices, an MNE would not be able to identify those parts of the enterprise performing well and those performing less so.⁴

There are many different reasons why enterprises charge transfer prices on goods and services, whether it be the allocation of sources between different segments, performance evaluation, or supply chain management.⁵ The legal issues arises when the affiliates are situated in different countries and an incentive for tax authorities occur to investigate whether the company is taxed on the right grounds in that country. For the MNEs there are several aspects to be considered in a cross-border transaction; such as taxes, customs, company or currency

¹ Oosterhoff, Danny, *Global Transfer Pricing Trends, International Transfer pricing journal*, p. 119

² Government Bill 2005/06:169, p. 87

³ R. Feinschreiber, *Practical Aspects of Transfer Pricing, 2001*, § 2- 1

⁴ Owens, Jeffery, *Should the Arm's length principle retire? International Transfer Pricing Journal*, p. 99

⁵ Horngren, Charles, Stratton, William and Sundem, Gary, *Introduction to Management Accounting*, p. 404

regulations, that could result in losses if not proper transfer pricing.⁶ The main aim for an MNE is however to maximize its overall profit and therefore it goes without saying that one should try to allocate profits to a low tax country and losses to a high tax country.⁷ However this tax planning aspect of transfer pricing is not what companies today mainly try to achieve, but instead just to be in accordance with the new regulations. The new attitude, approach, and legislation of the tax authorities affect the behavior of MNEs trying to predict risks and comply with the new expectations.⁸

Hence, the question arises is how the right to tax should be divided between the different countries. A fundamental principle has developed in this aspect through co-operation on taxation on MNEs, mainly under the institution of the Organization for economic co-operation and development (OECD).⁹ This states that each state shall tax companies operating within its jurisdiction, in spite of if it is part of a larger association.¹⁰

The issues on transfer pricing have attracted more attention during the last years, even though the first guidelines from the OECD dates back to 1995. Due to the increased focus on these issues almost all major economics now have some sort of transfer pricing regulations. They are all influenced of one or several of the big three main guidelines which are created by the OECD Transfer Pricing Guidelines, The Pacific Association of Tax Administration (tax organization consisting of the United States, Canada, Japan and Australia) Documentation Package and the European Union (EU) Transfer Pricing Documentation.

1.2 Purpose

My aim with this thesis is to do a comparative study of the guidelines on transfer pricing produced by the OECD, the Pacific Association of Tax Administrators (PATA) and the EU, in particular the requirements of documentation, the

⁶ Arvidsson, Richard, *Dolda vinstöverföringar*, p. 15, 41ff

⁷ Ibid p. 16

⁸ Ernst & Young GM Limited, *Precision under pressure, Global Transfer pricing survey 2007-2008* p. 3

⁹ OECD Model Tax Convention article 9

¹⁰ Arvidsson, Richard, *Dolda vinstöverföringar*, p. 16

different methods of arm's length principle and the penalties available. In this context I will also reflect over the new Swedish regulation. How does this correspond with the three guidelines and how have the Swedish regulators chosen to deal with the issues around documentation requirements and the principle of arm's length. When analysing the guidelines my purpose will be to identify their differences and if these divergences create any problems for the taxpayers or the revenue authorities? My final aim with this thesis will be to see if these eventual problems could be resolved in any way.

To some limited extent, the regulations of the United States will be considered and reflected over, mainly where they are apparently different. This because, as will be noted below,¹¹ the majority of the MNEs worldwide have some business conducted in the US market.

1.3 Disposition and Delimitations

The thesis will discuss the differences between the three guidelines on transfer pricing and how the Swedish regulations correspond with these. To be able to analyse this I will, as an introduction, synoptically describe the arm's length principle and the different methods used to fulfil this code. Thereafter I will point out the main problems with transfer pricing requirements; the increased costs, the burden of proof and the divergences between countries and regions. This could be seen as an introduction to why I have chosen four big issues to look more closely at when processing the guidelines and the Swedish regulation, before I finally compare them and try to give my conclusions on the issues being raised. The questions have been dealt with by assessing the problems and analyse how these have been addressed by the OECD Transfer Pricing Guidelines (TPG), the PATA Package, the EU Transfer Pricing Documentation (TPD) and the Swedish regulation on documentation requirements. As the OECD TPG is the most widespread guideline and because it has influenced almost all national regulations, including, to some extent, the other two guidelines, more facts about

¹¹ See chapter 3.2

this one is necessary and inevitable. Therefore does this thesis to some extent take a benchmark in the OECD TPG.

To not make this thesis stupendous, economical and technical aspect on transfer pricing will not be regarded. Neither will the problems of double taxation or the methods available to resolve such disputes between the tax authorities, be concerned.

1.4 Methods and materials

To get a wide picture of transfer pricing as possible I have, besides the regulations and guidelines, used doctrine on the subject. It has been quite hard to find relevant books on the subjects since it, in this shape at least, is relatively new and yet not many have wrote about these issues. I have therefore used several articles from international tax journals, mainly from the database IBFD.

My method has been to, from the above mentioned material, do a comparative study of the guidelines and the regulation, after doing a synoptically review regarding four main areas of each one of them.

2 The principles of Transfer Pricing

2.1 The OECD Transfer Pricing Guidelines

As above mentioned is The OECD Transfer Pricing Guidelines the benchmark of almost all transfer pricing regulation. It is therefore inevitable to talk about the principles of transfer pricing without talking about the OECD.

The OECD is an organisation that deals with tax issues on a multinational arena and was actually the first to address the problem with reports from its Committee on Fiscal Affairs. The genesis of arm's length as an international agreed principle dates back to 1933, when the Fiscal Affairs Committee of the League of Nations approved a "Draft Convention on the Allocation of Business Profits Between States for the Purposes of Taxation". The 1933 Draft Convention is based on the principle that permanent establishments must be treated in the same manner as independent enterprises operating under the same or similar conditions. The arm's length principle therefore sees the light in the field of intra-company dealings and it is only subsequently extended to transactions between separate legal entities.¹² Today the principle is to be found in Articles 9 of the OECD Model Tax Convention.¹³

It was not until 1995 that OECD issued the Guidelines on Transfer Pricing, after being feared that the harmonization on national rules and practices on transfer pricing among its Member States would be interrupted after the US in 1994 had released transfer pricing regulations.^{14 15} The main objective for the OECD when issuing the Guidelines was to restore a collateral view on transfer pricing, and once again underline the main transfer pricing principle adopted by the OECD, the arm's length principle.¹⁶

¹² Russo, Raffael, *Application of Arm's Length Principle to Intra-Company Dealings: Back to the Origins*, p. 7

¹³ OECD Model Tax Convention on Income and on Capital, art. 9

¹⁴ The Treasury Department of the IRS published the Code of Federal Regulations (CFR). The US transfer pricing Regulations can be found in CFR, Title 26, section 1.482

¹⁵ OECD, *Tax Aspects of Transfer Pricing Within Multinational Enterprises: The United States Proposed Regulations : A Report*, § 2

¹⁶ OECD TPG, Preface 14

2.2 The Arm's length principle

Consensus amongst tax practitioners worldwide is that the arm's length principle should carry the discussion about transfer pricing.¹⁷ The principle requires that, for tax purposes, the transfer prices of controlled transactions should be similar to those of comparable transactions between independent parties in comparable circumstances (uncontrolled transactions). (Controlled transactions in this context mean transactions between two enterprises that are associated with respect to each other.¹⁸) The main aim with the arm's length principle is to ensure that the right tax is paid in the right country and to avoid the risk of double taxation issues. The principle is based on a separate entity approach, i.e. each affiliated company in a group is for tax purposes treated as a separate entity and taxed individually on the basis that it conducts business with other group members at arm's length.¹⁹ The principle dates back a long time, but developments in the last decade have presented fundamental challenges to the application of arm's length in practice. As it is set out definitely in the OECD Model Tax Convention article 9, which forms the basis of many bilateral tax treaties it has become a benchmark in many countries. The principle is further developed in the OECD TPG on how it should be applied in practice. All the three other regulations dealt with in this thesis, base on this principle.²⁰

The implication of the principle is that related enterprises must set transfer prices for all inter-company transaction as they were unrelated entities but all other factors of the transaction were unchanged. That is, the transfer price should equal a price determined by reference to the interaction of unrelated parties in the marketplace.²¹ To be able to determine if the company have complied with the arm's length principle it is necessary to obtain information about identical or similar transactions. The OECD Guidelines have acknowledged that it could be difficult to acquire sufficient information to verify the application of the principle

¹⁷ Miesel, Victor, Higinbotham, Harlow, Chi, Chun, *International Transfer Pricing: Practical Solutions for Intercompany Pricing – Part II*, p. 1

¹⁸ OECD TPG glossary G-2

¹⁹ Owens, Jeffery, *Should the arm's length principle retire?*, p. 91

²⁰ The PATA Package para II a, COM (2005) 543 final, para 19, The Swedish Income Tax Act (1999:1229) §§ 14:19-20

²¹ OECD TPG 1.1-6

in practice but states that it is the best theory available to replicate the conditions of the open market.²²

2.3 Transfer pricing methods of the OECD

To determine arm's length, OECD TPG recommends various methods to establish whether conditions imposed by parties are consistent with the arm's length principle.²³ Five different methods that fall into two categories; traditional transactions methods and transaction-based profit methods, are recommended.

2.3.2 Traditional Transaction methods

There are three methods in this group; the comparable uncontrolled price method (CUP), the resale price method and the cost plus method. According to the OECD do these methods provide the most direct way to establish whether an arm's length has been used, and are therefore preferable to the others.²⁴

The CUP method compares the price charged for service or goods transferred in a controlled transaction to the same service or goods in an uncontrolled transaction, under comparable circumstances. An example is when a company is selling the same goods to an affiliate as to an independent entity, in the same geographic zone and under almost the same conditions. If the conditions are not identical the method can still be used if one of the two conditions is met: (i) none of the differences between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market; or (ii) reasonable accurate adjustments can be made to eliminate the material effects of such differences. This method is the most direct to use and therefore preferable to all other methods.²⁵

The resale price method compares the gross margins. This means that the method begins with the price at which a product has been purchased from an affiliated

²² OECD TPG 1.12

²³ OECD TPG 1.68

²⁴ OECD TPG 2.49

²⁵ OECD TPG 2.6-7

that is resold to an independent enterprise. The gross margin of the controlled transaction is compared with the gross margin of the uncontrolled transaction to see if the first transaction is covering its selling and other operating expenses and as well is making an appropriate profit. According to the OECD TPG the method is probably most useful when it is applied to marketing operations, i.e. the reseller does not add any substantially value to the product, and this because in these situations it is easy to determine an appropriate resale price margin.²⁶

The cost plus method commence with costs of a supplier of property sold to a related purchaser in a controlled transaction. An appropriate cost plus mark up is then added to this cost, to make an appropriate profit in the specific circumstances. This price is at arm's length and the method is probably most useful for example where semi-finished goods are sold between related parties.²⁷

2.3.2 Transaction-based profit methods

These methods are to be used when the traditional transaction methods are not applicable or as a supplement to them. The OECD TPG states that there are only two methods that satisfy the arm's length principle; the profit split method and the transactional net margin method. Other profit methods could be used only if they are consistent with the guidelines overall. Transactional profit methods examine the profits that arise from affiliates. The profit arising from a controlled transaction can be used as a relevant indicator of whether the transaction can be said to be made at arm's length.²⁸

According to the OECD TPG the profit split method is good to use where transactions are very interrelated, no comparables exists and therefore the traditional transaction methods can not be used. Firstly the method identify the profit to be split among the parties, secondly it splits the profit on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. One positive

²⁶ OECD TPG 2.14-15, 21-21

²⁷ OECD TPG 2.32-33

²⁸ OECD TPG 3.1-2

side of this method is that it does not directly rely on closely comparable transactions.²⁹

The transactional net margin method is based on comparison of the profitability of enterprises in a controlled transaction as to those in an uncontrolled. The amount of operating profit that one party to the controlled transaction would have earned in comparable transaction by independent enterprise is required to determine whether the transactions are comparable and what adjustments may be necessary to obtain reliable results. The strengths of this method are that the net margin is not affected by transactional differences and the net margins are often more tolerant to some functional differences between controlled and uncontrolled transactions.³⁰

2.4 Factors determining comparability

To be able to evaluate the controlled transactions, comparables therefore must be found in uncontrolled transactions. When determining if the transactions are comparable an analysis of the functions performed of the parties is essential. This analysis is performed to identify and compare the economic functions, risks and responsibilities taken by the separate entities. Particular attention should be paid to the structure and organisation of the group and the principal functions performed by each party.³¹

²⁹ OECD TPG 3.5-6

³⁰ OECD TPG 3.26-28

³¹ OECD TPG 1.19-27

3 Problems with the transfer pricing requirements

3.1 General

It has been mentioned in the introduction that almost all major economies have transfer pricing regulations these days, often as a documentation requirement. The formal requirements vary from country to country and the arm's length principle is differently applied among these jurisdictions. This creates a big burden for the tax payers as they have to do a different documentation for each country it operates in.³² In order to fully recognize the problems arising from documentation requirements, it is necessary to highlight the importance of documentation and the urge for compliance.

The guidelines and regulation examined in this thesis developed firstly with the OECD TPG in 1995. After the OECD TPG was introduced the PATA Transfer Pricing Package was released in 2003. This is an agreement between the United States, Canada, Japan and Australia to allow the taxpayers in these countries to set up just one set of transfer pricing documentation for an MNE that satisfies the documentary requirements for each respective jurisdiction.³³ For the European Union it took until 2006 before they issued a Code of conduct on transfer pricing to try to impose the countries to regulate in this area and it is in affiliation with this code that Sweden adopted their regulations.^{34 35}

For an MNE today it is important to be able to comply with the different regulations, because if it cannot satisfactory demonstrate that the transfer price used is adequate it may be unable to escape an adjustment as a result of an audit. This could result in a double taxation situation, and beside this implication penalties could be imposed for not following the regulations.³⁶ The imposition of penalty have been criticized as the assessment of the arm's length principle is a

³² Gommers, Edwin, Reyneveld, Jaap, Lund, Henrik, *Pan-European Comparables Searches: Enhancing Comparability Using Comparability Adjustments*, p. 126

³³ Andersen, Philips, *Asian-Pacific Tax bulletin, PATA Transfer Pricing Documents*, p. 199ff

³⁴ Transfer Pricing Database – Introduction to Transfer Pricing – EU code of conduct on Transfer Pricing Documentation, Ch. 16.4.1

³⁵ Governmental bill (prop.) 2005/06:169

³⁶ Miesel, Victor, Higinbotham, Harlow, Chi, Chun, *International Transfer Pricing: Practical Solutions for Intercompany Pricing – Part II*, p. 2

matter of judgments and based on evidence that could be sparse, difficult to interpret or even non-existent.³⁷

Not only the existence and the nature of penalty provisions differ between countries. What power the tax authorities have to obtain information about transfer pricing policies and profitability's of competitors and to use this at a tax audit, the provisions of confidentiality by the tax audits of information produced by a taxpayer and whether the burden of proof is upon the taxpayer or the authorities to prove that the transfer price is /not/ at arm's length range, are some examples of differences that may vary between the documentation requirements.³⁸ Other differences are to what extent a non-controlling taxpayer is obliged to produce information which is currently not in its possession when the affiliated is under control of a foreign company, the time limits for the taxpayer to hand in the documentation after requirements of the tax authorities and special treatment of small and medium-sized enterprises (SMEs).³⁹

The global increase in implementing regulations that creates a risk of economic sanctions if not complied has made the business aware of the importance of documentation.⁴⁰ These differences are especially undesirable within the EU as its goal is to create a single market.

3.2 Problems with assessing the arm's length principle

Although the arm's length principle is an international and old accepted standard, the underlying interpretation and practical application can diverge considerably from one jurisdiction to another which creates an important group of practical problems with the effective application.⁴¹ One big difficulty is that the arm's length principle is based on the notion that multinational companies operate in a free market competition, while the MNEs are often highly integrated companies.

³⁷ EU Joint Transfer Pricing Forum, Doc JTPF/014/BACK/2003/ENG, p. 13

³⁸ Miesel, Victor, Higinbotham, Harlow, Chi, Chun, *International Transfer Pricing: Practical Solutions for Intercompany Pricing – Part II*, p. 2

³⁹ *ibid*

⁴⁰ Ernst & Young GM Limited, *Precision under pressure, Global Transfer pricing survey 2007-2008* pp. 2, 4

⁴¹ Oosterhoff, Danny, *Global Transfer Pricing Trends*, p. 120

To be able to state whether an arm's length price is used, the companies need to find comparables. The MNEs are however so frequently integrated that the measures often cannot be duplicated in the context of arm's length, i.e. they cannot find independent parties performing the same or similar functions or selling the same or similar products. This is much due to the increased market integration, as well as the importance of intangible products, which makes it difficult to divide profits on a traditional transactional basis.⁴²

Another difficulty that may get in the way of the effective application of the arm's length principle is that multinationals often engage in transactions that independent parties would not participate in. This could be maintaining a new affiliate at a loss to create market share, transfer a valuable technology to an affiliate or entering into other specialized contractual transactions. These arrangements among controlled parties may differ and vary in important and fundamental ways from potentially comparable transactions among unrelated companies, which almost makes it impossible to find comparables that live up to the requirements of the arm's length standard.⁴³

The absence of comparables from independent parties, has led to a more consistent use of comparables from commercial databases, although these comparables might not be optimal to use. The reason for this is that the information might provide imprecise and incomplete trade descriptions that do not produce adequate information for a comparison.⁴⁴ Another problem is that the tax authorities seem to prefer local comparables when determining if the range is in line with the arm's length. (Local comparables are comparables found on the local market, i.e. maybe in the same country or region.)⁴⁵ The reason behind this preference of local comparables is that, in line with the OECD Guidelines, the comparability analysis should take into account market differences and focus on

⁴² Miesel, Victor, Higinbotham, Harlow, Chi, Chun, *International Transfer Pricing: Practical Solutions for Intercompany Pricing – Part II*, pp. 2f

⁴³ *ibid*

⁴⁴ Abdallah, Wagdy and Murtuza, Athar, *Transfer Pricing Strategies of Intangible Assets, E-Commerce and International Taxation of Multinationals*, p. 10

⁴⁵ Van Stappen, Dirk, *Pan-European versus country-specific searches and pan-European versus country-specific databases: Not a clear-cut issue*, p. 3

local markets whenever possible.⁴⁶ Naturally, compliance costs increase when an MNE must seek domestic comparables for every country in which it operates. Notwithstanding, providing acceptable comparables is almost a must to have an arm's length price approved of by a tax administration ruling under any of the three guidelines, to avoid the risk of adjustments, double taxation and penalties. As for example, OECD TPG states that "the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in a transaction between independent enterprises".⁴⁷

In other words, good comparables are vital to be able to determine arm's length price as well as the choice of transfer pricing method is to satisfy the documentation requirements. In view of the fact that different countries stipulate various demands on documentation, the multinational companies must be careful to ensure that the choice of method and comparables satisfies the demand of each involved tax administration.

The OECD have, when stating that the arm's length principle is the pre-eminent method, pointed out that the standard is not simple to apply and that it could be crucial to find good comparables. Both taxpayers and tax administrators therefore have to bear in mind that the principle is not an exact science but does require the exercise of judgment on both parties.⁴⁸

3.3 The prudent business management principle

Documentation obligations are affected by rules governing burden of proof in the relevant jurisdiction. In most jurisdictions in the Continental Europe, the tax administration bears the burden of proof and the prudent business management principle is followed. The last mentioned principle means that the arm's length principle should be determined based on what a reasonable business person would

⁴⁶ OECD TPG 1.30

⁴⁷ OECD TPG 1.15

⁴⁸ OECD TPG 1.12

do if there is a similar level of complexity and importance of the relevant business.⁴⁹

The OECD is in favor for this principle and states that according to the prudent business management principle the taxpayer should not be expected to incur disproportionately high costs and burdens to obtain comparable data from uncontrolled transactions, if the party reasonably believes that no comparable data exists or that the cost of location this data would be disproportionately high relative to the amounts at issue.⁵⁰ If a functional- and comparable analysis is made according to the prudent business management principle, the legislation itself should not require a taxpayer to motivate its choice of method to establish its arm's length prices.⁵¹

However, this principle is not used in all countries, for example not in the United States. The American rules of transfer pricing are considered to be the most stringed and comprehensive in the world.⁵² One major difference is that the US corporate tax system is a self-assessment system where the burden of proof is placed on the tax payer and it is an adversarial relationship between the tax authorities and the tax payer.⁵³ Instead of having the principle of prudent business management the US regulation stipulates "the best method rule" which stipulates that the taxpayer's compliance with the arm's length standard must be tested with the method that "under the facts and circumstances, provides the most reliable measure of an arm's length result".⁵⁴ The effects of the differences in the US regulations are unfortunately of great importance as this market is significant for that the majority of multinational enterprises have business conducted here.⁵⁵

⁴⁹SEC(2005) 1477, p. 9, OECD TPG 5.2-4

⁵⁰ OECD TPG 5.6

⁵¹ PriceWaterhouseCoopers, *International Transfer Pricing 2008*, pp. 244ff

⁵² PriceWaterhouseCoopers, *International Transfer Pricing 2008*, p. 121

⁵³ *ibid*

⁵⁴ ICR §1.482-1(c)(1)

⁵⁵ PriceWaterhouseCoopers, *International Transfer Pricing 2008*, p. 121

3.4 The effects on business

Transfer pricing continues to be the most important international tax issue that many MNEs face, according to the 2007-2008 Transfer Pricing Global Survey by Ernst & Young.⁵⁶ The big difficulties and costs for the companies are when the transfer pricing documentation requirements vary among the countries it operates in. The need to find comparables so that an arm's length price can be determined is one big burden and cost imposed by the transfer pricing regulations, as it may require the MNE to do things that it would otherwise not do (e.g. in searching for comparable transactions and documenting transactions in detail)⁵⁷.

⁵⁶ Ernst & Young GM Limited, *Precision under pressure, Global Transfer pricing survey 2007-2008* pp. 2, 4

⁵⁷ Owens, Jeffery, *Should the Arm's length principle retire?*, p. 100

4 The OECD Concept

4.1 The main points of the Guidelines

The first revised, with the look of today, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the OECD was published in 1995. Since then new chapters have been added and parts been revised. The Guidelines address transfer pricing and other related international tax issues with respect to multinational enterprises. The guidelines intend by giving suggestive ways of resolving transfer pricing issues, to help both tax administrations and taxpayers to minimize conflicts and costs between the parties and different countries. The main salient points of the Guidelines are to encourage the countries to regulate and the MNEs to adopt the arm's length principle in the way OECD interprets it. This is by expressing a strong preference for the traditional transaction-based methods, to set out the level of comparability that emphasise functions performed, risks assumed and assess employed. Furthermore the Member States should introduce a profit based method, the transactional net margin method, and to acknowledge the need for taxpayer documentation of the arm's length character of its intra-company transactions and the role played by penalties in encouraging compliance.⁵⁸

When assessing a situation of transfer pricing the Guidelines point out the essential of achieving a balance between the interests of the taxpayer and the interest of tax administrations in a way that is fair to all parties.⁵⁹ The Guidelines have served as a guide framework for the creation of the PATA Package and the EU TPD, as well as most countries legislations and regulations in the area of transfer pricing.⁶⁰

4.2 The compliance burden vs. the control interest

As above mentioned, the OECD TPG is based on the prudent business management principle, which means that the right for the tax authorities to obtain

⁵⁸ OECD preface 1-19

⁵⁹ OECD preface 18-19

⁶⁰ The PATA Package para I, COM (2005) 543 final para 3, Ernst & Young GM Limited, *Precision under pressure, Global Transfer pricing survey 2007-2008* p. 4

necessary information to ascertain if the transfer pricing is at arm's length, should be weighted against the compliance cost for the taxpayers to produce the documentation. The principle implies that on each side of a transaction there is a prudent business manager following economic principles on behalf of his company. The tax authorities must therefore ensure that their request when it comes to the documentation and the comparables are reasonable relative to the matter under enquiry.⁶¹ This is the most important standard when it comes to reflexion over the compliance burden. The practical application of the prudent business management principle is though difficult, but it makes it all the more important that the Member States adopt the same approach.⁶²

The Guidelines lists the types of documentation that might be relevant for the tax authorities to require, at the same time for the taxpayers to prepare and obtain. The common features asked for are a structure of the associated companies including the ownership linkages, an outline of business conducted, the nature of the transactions, and the basis on which the transactions is priced. Furthermore it could, depending on the situation, be useful with information about the functions being performed, information derived from independent enterprises engaged in similar transactions or businesses, the nature and terms of the transactions, economic conditions and property involved allocated risks and so on. It is clearly expressed in the Guidelines that the list of information to be requested is not a minimum, nor an exhaustive compliance requirement.⁶³

Worth mentioning is also that there could be a problem with companies not noticing that the above mentioned list is not exhaustive, i.e. even if following the wordings of the OECD Guidelines, problems could arise with the different authorities. Therefore can companies not blindly relay on the Guidelines but must seek the answers in the legislation in every country they are required to file documentation.

⁶¹ OECD TPG 5.6

⁶² Owens, Jeffery, *Should the Arm's length principle retire?*, p. 100

⁶³ OECD TPG 5.16-19

4.2.1 The effects of small multinational enterprises

As above mentioned, the requirements to prepare transfer pricing documentation impose comprehensive obligations on the taxpayers and by applying the prudent business management principle this may be an indication that there should be a simplification for SME. Even though there are no explicit statements about the burden imposed on SMEs, one should be able to predict, as the business management principle exists, that the SMEs should not be required to produce as much and as specific information as MNEs, i.e. tax administrations that want to be in accordance with the OECD TPG should not be able to require the same amount of information from SMEs as of MNEs.

4.3 The time aspects

According to the Guidelines the taxpayer shall make reasonable efforts to decide if the transfer price is in accordance with the arm's length principle and the documentation prepared should be handed to the tax authorities after request. The OECD states clearly that not all information about the intra-group transfers should be required when filing the tax return, but only information sufficient to allow the tax administration to determine approximately which taxpayers need further examination.⁶⁴ This is a result of the prudent business management principle.

The OECD does not however state anything about the time limits when the taxpayers have to hand in their documentations to the tax authorities after request. The tax administrations interest is considered to be satisfied if the necessary documentation is submitted in a timely manner when requested by the tax administration in case of an examination.⁶⁵ This is upon the different countries to determine in accordance with their domestic tax regulations. Considering the amount of documentation required the flexibility of time might not play any significant role for especially the taxpayers. For example do the American taxpayers have 60 days after request to file their documentation, but this could instead be 60 seconds as neither is enough to prepare a sufficient documentation. The documentation must therefore be done and in storage when filing tax return.

⁶⁴ OECD TPG 5.4,15

⁶⁵ OECD TPG 5.5

4.4 Assessment of the Arm's length price

As pointed out in chapter 2, there are two main groups of methods to use when assessing the arm's length principle. The traditional transactional-based methods (CUP, RPM and CP) are more preferable than the transactional net margin methods (the profit split method and TNMM). Among the three main ones there are no internal ranking, hence the method to be used is the one that best reflects the circumstances of the case at hand. The reason for this flexibility is that no method is good for all kind of transactions.⁶⁶

Besides just using the right method, the right comparables must be found for a company to be able to show that an arm's length price is used. Even in this matter the Guidelines are flexible to what comparables can be used and how they can be applied in the specific transaction. When an MNE applies a method which fits into the particular type of business, supported by a reasonable analysis of comparables under that method, the arm's length principle ought to be considered fulfilled.⁶⁷ It is though stated that different markets need different comparables, as the conditions usually diverse.⁶⁸ Nothing is expressly said about the use of comparables from other countries than the one where documentation required. The reason for this could be that the OECD has not seen any problem with this, but as long as the comparables are relevant to show arm's length price, they can be used. The OECD Guidelines could therefore be considered as very elastic when it comes to how the company can verify that an arm's length price is used.

4.6 Penalties

The OECD Guidelines include a cautious acknowledgement that penalties may play a legitimate role in improving compliance in the transfer pricing area, by making underpayments and other types of non-compliance more costly than compliance. The Guidelines encourage the member countries to administer any such penalty system in a manner that is fair and not unduly for the taxpayers.⁶⁹

⁶⁶ OECD TPG 1.16

⁶⁷ OECD TPG 1.6, 31

⁶⁸ OECD TPG 1.30

⁶⁹ OECD TPG 4.28

It is generally considered that the fairness of the penalty system should be measured against whether the penalties are proportionate to the offence. For example should a taxpayer that has made a reasonable effort in good faith to determine the arm's length price, not be imposed by a sizable penalty if the tax authorities find these transfer pricing default. It would be improperly harsh to impose a sizable "no-fault" penalty when efforts to compile with the regulations have been made in good faith. To do this consideration must be taken to the national tax system.⁷⁰

4.7 Salient points

The OECD Guidelines are a great framework, covering the wide spectrum of transfer pricing. With its great flexibility it is compliant with all different national regulations. As it is based on the prudent business management principle the information required by the tax authorities should be proportionate with the burden it imposes on the taxpayer. This is an important principle as there is nothing explicitly stated about lessening the burden for SMEs. Not to forget is that the guidelines are non compulsory, i.e. countries can chose to follow it or to adopt different rules. Hence, MNEs still have to prepare different documentation to each country they operate in to avoid the national penalties.

⁷⁰ OECD TPG 4.18-28

5 The PATA Documentation Package

5.1 Background

The United States, Canada, Japan and Australia are all members of the Pacific Association of Tax Administrators (PATA) which is an intergovernmental tax organization. The PATA member countries discuss tax-administrative issues of joint concern, including cross-border tax avoidance, tax evasion and other international tax matters.⁷¹

In 2003 PATA issued an agreement among its members concerning documentation of transfer pricing. The PATA Documentation Package allows taxpayers to prepare one set of uniform transfer pricing documentation that should meet the requirements of all four of the PATA member countries. This is intended to eliminate the need for taxpayers to prepare separate documentation for each PATA member country. The agreement states that MNEs will be deemed to satisfy each PATA member country's transfer pricing documentation requirements if they comply with the principles contained in the Package and will then not be subject to tax penalties in the four jurisdictions covered by the agreement. Compliance with the requirements of the PATA documentation package is voluntary.⁷² The document is an attempt to ease the burden imposed on taxpayers in seeking to comply with laws and administrative requirements in various jurisdictions. It is explicitly stated in the Package that it is in line with the general principles of the OECD TPG.⁷³

5.2 The operative principles

According to the Package an MNE will have to follow three operative principles to avoid transfer pricing penalties regarding a transaction, i.e. the MNE will have to (i) make reasonable efforts, as determined by the tax administration of each PATA member country, to establish transfer prices in accordance with the arm's length principle, (ii) maintain contemporaneous documentation of its efforts to

⁷¹ Internal Revenue Service, United States of the Treasury Department, Pacific Association of Tax Administrators Finalizes Transfer Pricing Documentation

⁷² *ibid*

⁷³ The Package para I

comply with the arm's length principle and (iii) produce the documentation in a timely manner when requested to do so by the tax administration of a PATA member country. The Package sets out the conditions under which each of the three operative principles will be deemed to have been satisfied. This includes a provision of 48 mandatory documents listed.⁷⁴

5.2.1 The first principle

The Package contains minimum requirements of what constitutes reasonable efforts to establish a transfer price according to the arm's length principle. This include; “analysis of controlled transactions, searches for comparable transactions between independent enterprises dealing at arm's length, and selection and application of transfer pricing methods that are reasonably concluded to produce arm's length results in accordance with applicable PATA member transfer pricing rules, consistent with the OECD Guidelines”.⁷⁵

The fact that the first principle include just minimum requirements could mean that the national tax administrations could demand more rigid requirements when deciding if enough efforts been taken. This could not be seen as in accordance with the main aim of being a waterproof paper that ensure of not giving penalties if complied. What the regulators could have had in mind when writing the Package though, could have been that the requirements should be more rigorous depending on the circumstances of the intra-group transactions. As the Package does not have any published preparatory work it could be a risk that the PATA member countries misinterpret this principle and impose a heavier burden on the taxpayer than intended.

5.2.2 The second principle.

To maintain contemporaneous documentation of the efforts to comply with the arm's length principle, the documentation needs to be of sufficient quality. This includes evidence where the taxpayer reasonably conclude that it selected and

⁷⁴ The Package para II

⁷⁵ The Package para IIa

applied a transfer pricing method that produced an arm's length result in accordance with applicable PATA member transfer pricing rules and consistent with the OECD Guidelines. This is done by complying with the 10 broad categories and 48 specific documents that the Package lists and requires.⁷⁶ An analysis under the arm's length principle is based on information about the associated enterprises involved in the controlled transactions, the transactions at issue, the relevant functions, assets and risks, and information derived from independent enterprises engaged in similar transactions or businesses. Additional information not listed on the attached schedule of the Package may be requested by a PATA member tax administration as necessary to examine an MNE's conclusions considering the arm's length nature of its arrangements. In evaluating the adequacy of an MNE's documentation, a PATA member tax administration may take into account the documentation guidelines and principles contained in Chapter V of the OECD Guidelines, for example considering what information was reasonably available at the time of the transfer pricing arrangement.⁷⁷

5.2.3 The third principle

The third operative principle is that taxpayers need to timely produce the foregoing documentation upon the request of the tax authorities in the PATA countries. The time limits for the documentation to be provided are determined upon each of the PATA member's respective legislation.⁷⁸

The Package has been exposed to criticism,⁷⁹ where the most fundamental issues will be dealt with in the following description. The aims of the Package are, firstly an attempt to reduce taxpayers' administrative burden in complying with different sets of documentation requirements and, secondly, to avoid the imposition of transfer pricing related penalties.⁸⁰ Unfortunately, the Package is at risk of falling short when it comes to both of its endeavours.

⁷⁶ The Package, Annex

⁷⁷ The Package para IIb

⁷⁸ The Package para IIc

⁷⁹ For example Anderson Philips, *PATA Transfer Pricing Documentation Package*, pp. 199-203, Hobster, John, Thibeault Crystal, Tomar, Rahul, Wright, Deloris, *Practical Implications of the PATA Transfer Pricing Package*, pp. 83-89

⁸⁰ Anderson, Philip, *PATA Transfer Pricing Documentation Package*, p. 199

6 The PATA Package concept

6.1 The compliance burden vs. the control interest

When it comes to the compliance burden three aspects have to be considered. Firstly, is the Package based on the Anglo-Saxon law where the focus is on cross-border tax avoidance with emphasis on external benchmarks. Secondly the Package explicitly states it is meant to reduce the administrative burden. A comparison with the mandatory requirements in the individual jurisdictions shows though that the Package, with its 48 specific items, impose more requirements than any of the four member countries' jurisdiction, including the United States. Note though that the comparison is only on the listed mandatory requirements and that a comparison covering all aspects is very difficult to do.⁸¹ In this context it should be reminded that the Package states that it is in line with the general principles of Chapter V of the OECD Guidelines. The mandatory production of 48 documents must, however, be in conflict with the OECD principles of prudent business management⁸² concerning the collection of documentation, as it leaves no flexibility to the taxpayer.

Thirdly, there is an aspect concerning the wording of the requirements. Some of the 48 documentation requirements are drafted in such a broad mode that it must be seen as onerous to obtain all necessary information.⁸³ An example is requirement no. 6 in the Annex of the Package, where it states that the company should prepare an "Analysis of the general economic factors effecting the business and industry". This example does not contain the wording "relevant to the related party transaction", which most requirements do, and therefore makes an impression that the taxpayer is required to provide details of any economic factors effecting the business and industry, although it might not have any material effect on the transaction.⁸⁴ The result is that the taxpayer is obliged to produce documentation that might be irrelevant to determine the transfer price. This, together with the lack of the prudent business management principle or any

⁸¹ Hobster, John, Thibeault Crystal, Tomar, Rahul, Wright, Deloris, *Practical Implications of the PATA Transfer Pricing Package*, pp. 86-88

⁸² OECD para 5.4

⁸³ Andersson, Philip, *PATA Transfer Pricing Documentation Package*, pp. 200f

⁸⁴ *ibid*

principle alike, does that the Package impose a greater burden to the taxpayer than the OECD Guidelines. It could also be seen as the sheer fact of having a set of compulsory documentation requirements excludes a proportionality aspect, why the compliance burden seem to be in conflict with the OECD Guidelines.

6.1.1 The effects of small multinational enterprises

The Package has no specific regulation about SMEs. As all documentation requirements are compulsory, a small business taxpayer, or one with a limited level of international dealings, will be required to produce a documentation set which is comparable in size to that of a company with an extensive level of international dealings. Compared to the OECD Guidelines this is the direct contrasting position as the Guideline states that “the information relevant to an individual transfer pricing enquiry depends upon the facts and circumstances of (each) case”⁸⁵ and “documentation requirements should not impose on taxpayers costs and burdens disproportionate to the circumstances”.⁸⁶ The Package is therefore more likely applicable to MNEs with substantial international related party transactions, which could actually reduce their burden if compliance.

6.2 The time aspects

As the third principle states the taxpayer should upon request hand in their documentation. The Package does not say anything on what the time limits should be, but this must be determined by the member countries. As mentioned under the OECD time aspects⁸⁷, are differences in this aspect of minor importance for the taxpayer as the need to produce the documentation continuously throughout the year. However, if the taxpayers should be able to follow only the Package and be safe in all the member jurisdictions, harmonization of the different administrative approaches should be a matter of course in every serious attempt to reduce the documentation burden within the PATA area.

⁸⁵ OECD 5.16

⁸⁶ OECD 5.28

⁸⁷ Chapter 4.3

6.3 The Assessment of the Arm's length price

To comply with the Package, the taxpayer must “reasonably document its reasonable efforts to establish their transfer pricing in accordance with the arm's length principle”.⁸⁸ As the Package does not include any provisions about what are “reasonable efforts” that are to be determined by the relevant tax authorities. To be able to fulfill these subjective measurements, knowledge of the different countries transfer pricing regulations is indispensable and the purpose of the Package to ease the burden and prevent penalty provisions must seem as undermined. An example is if an MNE uses a method or a comparable accepted in one country but not in another because here local comparables or methods are required to reach an arm's length price, the documentation in the other country might not be considered reasonable. In this point, it seems almost impossible to fulfill the arm's length principle in all Member States at the same time, and this must be seen as the weakest point of the Package.⁸⁹

In this context it is of interest to notice that both Australia's and Canada's transfer pricing legislations are based upon the OECD Guidelines, i.e. the prudent business management principle. This means that local comparables and methods of another country could be used and still be in compliance with the domestic regulations, if motivated in the documentation why the choice of method and comparables are appropriate.⁹⁰ Japan, on the other hand, only accepts comparables and methods that are explicitly stated in their regulations, which results in a method used in another PATA country might not be accepted in Japan because it does not fulfill the requirements of “reasonable document the efforts to comply with the arm's length principle”.⁹¹ The American regulations require a taxpayer to set transfer prices in a “reasonable manner”, which include the use of the most appropriate selection of data. When selecting a method, the MNE must show that the selected method is the best method applicable to show the arm's length price and why other methods are not used.⁹² As in Australia and Canada, a

⁸⁸ The Package, first principle

⁸⁹ Anderson, Philip, *PATA Transfer Pricing Documentation Package*, p. 201

⁹⁰ *ibid*

⁹¹ The Package, Chapter II b

⁹² IRC § 1.482-1(c), Misel, Victor, Higinbotham, Harlow and Yi, Chun, *International Transfer Pricing: Practical Solutions for intercompany pricing – Part II* pp. 2ff

foreign method or comparable can be used, but more rigorous documentation are needed to prove that the method is the most appropriate.⁹³

The effect of the lacking guidance of which comparables and methods that should be used makes the Package weak. Compliance with the arm's length principle will require, in many cases, local comparability and application of locally accepted methods, but to be able to comply with the Package the "reasonably"-requirement must be accomplished in every member country. To be able to solve this burden of complying with different jurisdictions, harmonization is required of the legal systems, statutes, regulations and administration approaches.

One positive side of the Package is that the guidelines are easy to maintain as they do not require extensive year to year updates. For the MNEs, this mean that while significant efforts may be required initially to create the documentation package, the yearly maintenance is manageable. Given the nature of the documents required, it is likely that when dealing with a transaction between a PATA country and a non-PATA country, the analysis and the documentation that satisfy the PATA country will most likely also meet the requirements of the non-PATA country.⁹⁴ Notable is though the importance that the taxpayers and the PATA member tax authorities use the PATA Package as a guideline and not as a checklist when preparing or evaluating documentation, otherwise the burden will be to extensive.

6.4 Penalties

One of the main aims with the Package is that if followed, the company will avoid the imposition of the documentation related penalties. To be noted is that the Package only applies to the imposition of transfer pricing penalties. It does not provide any guidance as to whether transfer pricing adjustments will be made by the relevant authority.⁹⁵ Another problem, not solved by the Package, is that the domestic authorities are the ones who determine whether there is a price at arm's

⁹³ Anderson, Philip, *PATA Transfer Pricing Documentation Package*, p. 202

⁹⁴ Hobster, John, Thibeault, Crystal, Tomar, Rahul, Wright, Deloris, *Practical implications of the PATA Documentation Package*, pp. 5ff

⁹⁵ The Package, Introduction

length, and therefore the company is still at risk of being exposed to transfer pricing penalties. Documentation is an important factor in showing that arm's length prices exist, but is not determinative by itself. If the taxpayer has not reached an arm's length result, no PATA country offers penalty reduction specifically because a significant documentation has been provided.⁹⁶ As the member countries do not have specific penalties regarding transfer pricing documentation, it is hard for the Package to be a real safe-harbour.

6.6 Salient points

The compliance with the three operative principles requires a taxpayer to undertake substantial documentation tasks, which even when completed, provide no certainty that the taxpayer will avoid the imposition of transfer pricing penalties. There is still a jurisdictional subjectivity in the judgment of the quality of documentation. Documentation in line with the Package is burdensome for the MNEs but the strict requirements ought to be sufficient to satisfy the requirements of most national regulations in the world, no matter how rigorous. Therefore the big burden of setting up documentation according to the Package will not be in futile.

As the guideline is optional for the taxpayers and as it does require a fulfilment of the 48 specific requirements it is very burdensome for SMEs and probably not an option for them. However it is important to bear in mind that the Package is a guideline and not a checklist.

⁹⁶ Anderson, Philip, *PATA Transfer Pricing Documentation Package*, p. 202

7 The EU Code of Conduct on Transfer Pricing Documentation

7.1 Background

As the OECD Guidelines on transfer pricing did not result in a common approach in its Member States and consequently not in all EU Member States, the EU Commission in 2002 set up a Joint Transfer Pricing Forum (JTPF). This forum consistent of experts from all Member States, works on the basis of consensus and aims at non-legislative improvements to practical transfer pricing problems, focusing on improvements of dispute resolution and on documentation requirements.⁹⁷ As different documentation requirements hamper the function of the EU internal market and cause additional compliance and operational costs for companies active in Europe and for tax authorities as well, it is of vital interest for the European Union to reduce this extra burden within the single market.

In May 2005 the EU JTPF published a EU-wide common approach called the EU Transfer Pricing Documentation (EU TPD) which combines one set of documentation containing common standardized information, relevant for all EU countries, called the masterfile, and sets of country-specific standardized documentation, i.e., a documentation set for a specific country should contain the masterfile and documentation specific to that country.⁹⁸ The EU TPD expects that standardized and, to a certain extent, centralized documentation could reduce taxpayers' compliance costs by fulfilling the documentation requirements in all EU Member States in a similar way. The code is optional for the MNEs to adopt.⁹⁹ The EU TPD is designed to establish a balance between the tax administrations' right to obtain from a taxpayer the information necessary to assess whether the taxpayer's transfer pricing is at arm's length and the compliance costs for the taxpayer. Thus it should enhance the transparency of the transfer pricing process in order to avoid and to simplify agreement procedures

⁹⁷ European Commission – Taxation and Customs Union / Transfer Pricing Forum, *homepage*

⁹⁸ Transfer Pricing Database – Introduction to Transfer Pricing – EU code of conduct on Transfer Pricing Documentation, Ch. 16.4.1

⁹⁹ Official Journal of European Union, 28.7.2006, (2006/C) p. 176/2

and reduce the risk of double taxation and the exposure to documentation related penalties.¹⁰⁰

The EU TPD is not legally binding and contains only recommendations to the Member States that intend to introduce transfer pricing documentation requirements or to amend the rules existing under their domestic laws. These Member States may implement the EU TPD by legislative action or by issuing administrative guidelines, provisions of which are compatible with the Code of Conduct. When doing this, the Member States should bear in mind that a reduction of compliance costs for MNEs doing business in the European Union should be achieved.¹⁰¹

The problems with the European internal market and the EU TPD are that MNEs operating in the EU, define the whole market as one single market and that within this market, there are different interpretations of the EU TPD in the different countries. This results in cross-border disputes which are damaging to the smooth functioning of the internal market and create large extra costs for the companies as well as the tax authorities in the EU.

7.2 The Masterfile

The masterfile should follow the economic reality of the business and provide a “blueprint” of the MNE and its transfer pricing system that would be relevant and available to all EU Member States concerned. This includes a description of the business, strategies, the group organizational structure, the transactions at issue, the performed functions and assumed risks. It should work both as a basic set of information for the judgment of the transfer pricing as well as a risk analysis tool for the MNEs to identify transactions that may require more detailed explanations and documentation. For the tax administrators it should work as a case selection tool. The masterfile should be handed in, after request, to all tax administrations

¹⁰⁰ Official Journal of European Union, 28.7.2006, (2006/C) p. 176/2

¹⁰¹ COM (2005) 543 final, para 25

involved, so they all access the same common documentation and information in the masterfile element.¹⁰²

7.3 The Country-specific documentation

The country-specific documentation is supposed to supplement the masterfile. It should contain the information about the specific transactions made by the specific taxpayer in each country. The documentation should be available to tax administrations that have a legitimate interest in the appropriate tax treatment of the transactions covered. The reason for a specific documentation is that the masterfile would not necessarily satisfy the documentation requirements in each Member State and tax administrations would therefore be entitled to request additional country- or transactional-specific information.¹⁰³

Together the masterfile and the country-specific documentation constitute the documentation file for the relevant Member State, i.e. the EU TPD.

¹⁰² COM (2005) 543 final, para 21-28, Official Journal of European Union, 28.7.2006, (2006/C) p. 176/3 para 4.1-4.2

¹⁰³ COM (2005) 543 final, para 23, Official Journal of European Union, 28.7.2006, (2006/C) p. 176/4 para 5.1-5.9

8 The EU TPD concept

8.1 The compliance burden vs. the control interest

There are no recent figures on the implementation rate of the EU TPD within the EU Member States. One source from 2006 states that only a few of the 25 Member States have implemented or were willing to implement the code into their domestic legislation in the future.¹⁰⁴ My own conclusion from reading through some European and International Tax papers¹⁰⁵ is though that quite many EU countries have chosen to adopt or amend their transfer pricing regulations mainly according to the EU TPD. This is essential for the effectiveness of the code, otherwise the burden would be greater for the MNEs as they would have yet another regulation to comply with, i.e. the EU TPD, as well as different domestic regulations.

The EU TPD is a lot about the aim at maintaining a balance between the tax administrations' right to obtain the "necessary and sufficient" information from the taxpayer and the compliance burden costs for the taxpayer. The importance of this balance is expressed several times in the EU TPD.¹⁰⁶ The question to ask is then how companies are to know what is necessary and sufficient documentation for the assessment of an MNE's transfer prices. According to the EU JTPF, good documentation is; "not a matter of whether a tax authority needs to ask for further information but rather if the administration has sufficient information to identify the relevant intercompany transactions, make an assessment of the transfer pricing risks and frame further enquiries into matters of detail".¹⁰⁷ Sufficient documentation in the context of the EU TPD is therefore about presenting risk judgment that should assist both tax administrators and taxpayers to evaluate what the transfer pricing risks are and what further action is required to investigate

¹⁰⁴ Beudeker, Janssen, *EU Transfer Pricing Documentation requirements: A critical analysis and comparison*, p. 241

¹⁰⁵ For example Transfer Pricing Journal, European Taxation Journal, Bulletin for International Taxation

¹⁰⁶ COM (2005) 543 final, para 19, 23

¹⁰⁷ EU Joint Transfer Pricing Forum – Business Representatives, Transfer Pricing Documentation Discussion Paper p. 2

those risks.¹⁰⁸ Necessary and sufficient documentation therefore seems to be a matter of whether it is possible to make a judgment out of the information given or if further enquiry is needed to conclude whether the transaction is within arm's length range.

By adopting the masterfile concept, the Member State should not impose unreasonable compliance costs or administrative burden on enterprises in requesting documentation to be created or obtained. It is not possible for the tax administrations to demand more documentation than necessary since this does not stand in balance with the costs it brings the taxpayer.¹⁰⁹ The documentation requirements should therefore be seen as a guideline to be used by both parts, as it provides an opportunity to rationalize the process for the MNEs when it comes to the difficulties with documentation on transfer pricing issues.

8.1.2 The effects of small multinational enterprises

The EU TPD expresses the importance of transfer pricing documentation requirements to be implemented flexibly and that recognition must be made to particular circumstances of the business concerned. This includes particular smaller and less complex businesses, i.e. the SMEs, which should not be expected to produce the same amount of documentation that might be expected from a larger and more complex business.¹¹⁰

The expressed concern about the SMEs is unique to the EU TPD compared to the OECD TPG and the PATA Package.

8.2 The time aspects

A Member State should not impose documentation related penalty where a taxpayer complies in “good faith”, in a “reasonable manner” and within a

¹⁰⁸ Beudeker, Janssen, *EU Transfer Pricing Documentation requirements: A critical analysis and comparison*, p. 240

¹⁰⁹ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *Proposal for a Code of Conduct on Transfer Pricing, Documentation for Associated Enterprises in the EU*, p. 37

¹¹⁰ COM (2005) 543 final, para 27

“reasonable time”.¹¹¹ The use of these wordings makes it hard for the taxpayers to know what is required, and when.

The masterfile concept is to be seen as a non-legislative solution within the frames of the OECD TPG. It is not a compulsory set of rules and the EU TPD is therefore to some extent quite vague in its formulations. This opens up a possibility for the Member States to interpret the TPD in different ways, which could undermine the whole idea of the documentation. Regarding the definition of reasonable time, the masterfile explicitly states that the amount of detail on the requested documentation must be taken into account when deciding the time limit. The meaning of this depends on the regulation in the country at hand and can also vary depending on the complexity of the transaction.¹¹² In this area differences between countries are not a big issue, as the documentation “must” be prepared and in storage when filing tax return.¹¹³

8.3 The Assessment of the Arm’s length price

The major issue that causes an additional administrative burden in the documentation of cross-border transactions is the different use of methods and comparables.¹¹⁴ Differences in the nature and type of available information following national documentation requirements, makes it sometimes difficult to obtain adequate data on third party transactions which fully meet the five comparability factors mentioned in chapter 2.2. The EU TPD explicitly stipulates that the use of non-domestic comparables from, for example pan-European databases should not be rejected automatically. (Pan-European databases are databases within the European Union.) The tax administrations should instead evaluate domestic and non-domestic comparables with respect to the specific facts and circumstances of the case, and the use of non-domestic comparables should not by itself subject the taxpayer to penalties.¹¹⁵ The reason for this is that the

¹¹¹ COM (2005) 543 final, para 7

¹¹² COM (2005) 543 final, para 19

¹¹³ If the reason for this is forgotten, see chapter 4.3

¹¹⁴ See chapter 2.2

¹¹⁵ COM (2005) final 543, para 3.1

differences between single country comparables and pan-European comparables are not likely to be substantial insignificant.¹¹⁶

The EU TPD does not express any preferred methods to use when establishing transfer prices in accordance with the arm's length principle. As mentioned above, the documentation requirements are more of a risk assessment tool than a fully completed documentation.¹¹⁷ The EU JTPF states that risk management is about what effort and costs that are appropriate in establishing what an arm's length result of a controlled transaction should be and how evidence should be kept to demonstrate that result. The forum further concludes that the more common understanding there is within businesses and tax administrations about the basis of risk assessment, the better.¹¹⁸ The absence of further guidance regarding methods it is established that the general principles of the OECD shall prevail.

The benefit of dealing with the comparable issues of transfer pricing within the EU TPD is clear compared to the Package. As explained in chapter 6.3, might the use of foreign comparables not be accepted in the other PATA Member States, hence the documentation in line with the Package in one country might not be considered correct in the other jurisdiction. This is not the case in EU TPD. The fact that the EU TPD explicitly states that pan-European databases could be used is of great importance since over 70 percent of all the global transactions are made between dependent parties. This makes it extremely hard to find comparable transactions between independent parties. Hence, one could think that you would have greater success with non-domestic comparables within EU TPD than within the PATA Package.

The wording "not automatically rejected" in the EU TPD is though subjective and gives the impression that Member States still have the possibility to decide whether to accept or reject external comparables from pan-European databases. If the MNEs are able to use pan-European databases it could ease the burden and

¹¹⁶ Fris, Pim, *The Transfer Pricing Agenda for Europe*, p. 2

¹¹⁷ COM (2005) 543 final, para 11

¹¹⁸ COM (2005) 543 final, para 16-18

costs, even though the use of databases in Europe is not as widespread as for example in the US. In Europe the results from databases are more used as complementary evidence to confirm that the methods used have proven an arm's length price, although the EU TPD does not say anything about how the databases should be used.¹¹⁹ One reason for differences in the use of databases between the US and Europe could be that the European market can not be seen as one market in the same way as the American market.¹²⁰ However, could it be of value to have more firm rules of when non-domestic comparables are not allowed, if that will ever be the case.

As the OECD TPG and the PATA Package, does the EU TPD leave a lot up to the Member States and their tax administrations to decide whether the documentation is set up in "good faith", in a "reasonable manner" and within a "reasonable time". The EU TPD states, as it is a basic set of rules, that a Member State should be entitled to require more and different information and documentation than are stipulated in the Documentation.¹²¹ It should though be kept in mind that the EU TPD relies on the OECD TPG and states that the information relevant to an individual transfer pricing enquiry is dependent on the facts and circumstances of the case.¹²² If the administrations would require too much information or a long specific list of documentation requirements for every transaction, it could be in breach of the spirit of the EU TPD as well as the OECD TPG.

8.4 Penalties

The EU TPD recommends, as mentioned in chapter 8.3, that Member States should not impose a documentation-related penalty where a taxpayer has complied in "good faith", in a "reasonable manner" and within a "reasonable time" with the masterfile concept or with the Member State's domestic requirements and that they also should accept comparables found in pan-European

¹¹⁹ EU Joint Transfer Pricing Forum, *Is Europe One Market? A Transfer Pricing Economic Analysis of Pan-European Comparables Sets*, Deloitte White Paper, p. 4

¹²⁰ Hobster, John, *Practical implications of the PATA Documentation Package*, p.5

¹²¹ COM (2005) 543 final, para 18

¹²² OECD TPG 5.16.

databases.¹²³ Moreover, the EU TPD does not encourage the Member States to use penalties as a means of solution if companies do not follow the guidelines. However, it is stated that there should exist documentation-related penalties for non-compliance with the EU TPD or the national documentation requirements.¹²⁴

The tax authorities remain entitled to request additional information, in particular during tax audits. The EU TPD stipulates yet another penalty that is recommended regarding this, the co-operation-related penalty. The taxpayers should be able to avoid this if they upon specific request from the tax authorities, in a "reasonable manner" and within a "reasonable time" provide additional information and documentation.¹²⁵

Keeping a good documentation will not in itself keep the taxpayer from the risk of being surcharged a fixed amount or a certain percentage of the transfer pricing adjustment, if determined that it has not complied with the arm's length principle. However a taxpayer that shows that its pricing has been made in good faith and with reasonable attempts to comply with the principle, should not be subject to this kind of penalty. In order to determine whether the documentation has been conducted in good faith there should be a case by case judgment on its own facts and merits.¹²⁶ The question then arises whether it is the taxpayer or the tax administrations that have the burden of proof. This is an issue that the EU JTPF says goes beyond transfer pricing and therefore a question that depends primarily on national law.¹²⁷ Briefly said, the question of being penalized is still a question that remains a domestic decision, with only brief guidance from the EU JTPF and the EU TPD.

¹²³ COM (2005) 543 final, para. 20, 25

¹²⁴ COM (2005) 543 final, para 21

¹²⁵ COM (2005) 543 final para 20

¹²⁶ EU Joint Transfer Pricing Forum, Draft Revised Secretariat Discussion Paper on documentation requirements, para 80

¹²⁷ EU Joint Transfer Pricing Forum, Draft Revised Secretariat Discussion Paper on documentation requirements, para 95

8.5 Salient Points

The main aim with the European Union is to create an internal market where obstacles that interfere with the free movements within the Union should be eradicated. Having different sets of transfer pricing regulations is a complication that hampers this goal as it creates greater costs for companies when they choose to act in different countries. The EU TPD is to some extent a solution to these problems. The pros with this guideline are that it does explicitly have expressed concern about the SMEs, one documentation set can be used in all European countries concerned supplemented with country-specific documentation and that penalty should not be imposed when a taxpayer has produced their documentation in good faith. However there are cons as well. As the Member States are allowed to have stricter or looser rules than the EU TPD, it does not completely have the effect intended. There are still many subjective wordings in the guideline that is up to the Member States' authorities to interpret, as they can not turn to the ECJ to ask for guidance.

9 The Swedish regulations about Transfer Pricing

9.1 Documentation Requirements

The Swedish thoughts on transfer pricing regulations date far back but it was not until 2003 when the Swedish Tax Agency (STA) published a report on “Information- and Documentation requirements regarding international enterprises’ transfer pricing on controlled transactions”, where the Tax Agency prescribes that new regulations are required.¹²⁸ Two years later, in 2005 a Government Bill¹²⁹ was produced and since the 1st January 2007 companies operating in Sweden are liable to document transaction with international related parties. The new legislation introduced formal transfer pricing documentation requirements in relation to cross-border transactions with MNEs.

The arm’s length principle has been part of the Swedish tax law for almost 80 years¹³⁰ and is as a general rule regulated in the Income Tax Act (1999:1229) chapter 14, section 19-20. The rules are created according to Article 9 in the OECD Model Convention and are, to some extent, almost a copy thereof. The Swedish transfer pricing legislation affects all Swedish entities having transactions with a related entity abroad. An entity is regarded to be related when the other company has direct, or indirect, management control over the entity or if the entity has an ownership interest in the other company’s share capital.¹³¹ Swedish transfer pricing case law has established a number of principles, for example the tax authorities have the burden of proof to show that the rules are applicable, however the taxpayer must still hand in the material and information asked for.¹³² The arm’s length principle is also a component in almost all Tax Conventions that Sweden is part of, i.e. over 80 conventions with, among others, all the EU Member States.¹³³

¹²⁸ RSV Rapport 2003:5

¹²⁹ Government Bill (prop.) 2005/06:169

¹³⁰ Grive, Magnus, Carendi, Isabel, *Internprissättning – Skatteverkets nya föreskrifter*, p. 1

¹³¹ The Swedish Income and Tax Act § 14:19-20

¹³² RÅ 1991 ref. 107

¹³³ Government Bill (prop.) 2005/06:169 p.90

The new regulations of the transfer pricing documentation requirements have been implemented in chapter 19, section 2a and 2b of the Tax Return and Statements of Income Act (2001:1227). These only prescribes the main features of what the documentation should include, more precise requirements are stated in the Swedish Tax Agency's *regulations* on documentation of transfer pricing between associated enterprises¹³⁴ and Swedish Tax Agency's *notice* on documentation of transfer pricing between associated enterprises.¹³⁵

9.1.1 Tax Return and Statements of Income Act

The documentation requirements are regulated in chapter 19, section 2a and 2b, which only constitute framework legislation. Here it is stated that controlled transactions should be presented in a transfer pricing documentation. The documentation should include a description of the company, the organisation and the business, information about the transactions, a function analysis, a description of the chosen pricing method and a comparable analysis. It stipulates as well, indirectly, that the Tax Agency has been given the authority to produce more detailed guidelines on what the taxpayer should include in their documentation.¹³⁶

9.1.2 The Tax Agency's regulation

As mentioned above, the Tax Return and Statement of Income Act declares the main features to include in the transfer pricing documentation. The Tax Agency's non-binding guideline states some further information that could be appropriate to incorporate.¹³⁷ One problem with the Swedish way to regulate within this area is that there are laws and two types of administrative guidelines; binding guidelines (SKVFS 2007:1) and non-binding guidelines (SKV M 2007:25). Only the first one is legally binding upon the taxpayer, but as the Tax Agency is the first instance to give verdict, the non-binding guidelines are of great importance as well. Unfortunately, the STA has given their guidelines many different headings and has not been totally clear of which ones are binding and which ones are just

¹³⁴ SKVFS 2007:1

¹³⁵ SKV M 2007:25

¹³⁶ Tax Return and Statements of Income Act § 19:2a-2b

¹³⁷ SKV M 2007:25 p. 6

recommendations. This have of course created great uncertainty and even a risk of undermining the rule of law.¹³⁸ These questions and problems, even though they are very interesting, are beyond the scope of this thesis, but should be bore in mind when reading the further information about the Swedish regulation on transfer pricing issues.

As the main rules about the documentation requirements in the Tax Return and Statements of Income Act are not very specific, more guidance is given in the Tax Agency's regulations. Here it is quite extensively described what shall be included in the documentation. It refers to the OECD Guidelines and states that documentation prepared according to the EU TPD shall be regarded as been set up in accordance with the Swedish regulations. The regulations do not state anything about which methods to use but only refers to the OECD Guideline's methods and that the comparability factors in Chapter I of the Guidelines are the ones to apply.¹³⁹ According to the Governmental Bill the Swedish regulations should be in harmony with both the OECD Guidelines as well as the EU TPD.¹⁴⁰

¹³⁸ Pålsson, Robert, *Skatteverkets styrsignaler- en ny blomma i regelrabatten*, pp. 401-418

¹³⁹ SKVFS 2007:1 section 1, 15

¹⁴⁰ Government Bill 2005/06:169 p. 103

10 The Swedish concept

10.1 The compliance burden vs. the control interest

One of the first things that the Tax Agency's regulation state is, that the information included in the documentation shall make it possible to assess whether pricing and other terms and conditions applied in a intra-group transaction are in accordance with the arm's length principle. The documentation only needs to contain information which is necessary to make a reasonable assessment in these respects.¹⁴¹ According to the Agency's non-binding guideline the proportionality principle should be regarded when reading all other regulations on transfer pricing in Sweden, including the OECD Guidelines and the EU TPD.¹⁴² This must be seen as a variant of the prudent business management principle.¹⁴³ One lack of the principle could be that it does not include any expressed notions on the administration costs, i.e. the burden should not be unduly costly, in contrast to the OECD TPG. This is instead dealt with in the not binding recommendations where it is said that the costs should be one main factor when determining if the compliance burden is too great.¹⁴⁴

For intra-group transactions of minor value, there is a specific notion, in contrast to all the three major guidelines and most other countries.¹⁴⁵ The documentation may contain a simplified report compared to what is required in chapter 19, section 2b of the Tax Return and Statements of Income Act.¹⁴⁶ Considered are transactions with goods where the total market value is below a certain amount. The simplified report is not available when the transactions involve sale and purchase of intangible property.¹⁴⁷ The fact that simplified requirements would be preferable when transactions are of minor value could most likely be referred from the proportion notions in the OECD TPG and the EU TPD, as countries otherwise would impose an unproportionate burden on the taxpayers. However it is important that bear in mind that Sweden is unique, compared to the OECD

¹⁴¹ SKVFS 2007:1 2

¹⁴² SKV M 2007:25 p. 6

¹⁴³ Se chapter 3.3

¹⁴⁴ SKV M 2007:25 p.8

¹⁴⁵ Grive, Magnus, Carendi, Isabel, *Internprissättning – Skatteverkets nya föreskrifter*, p. 2

¹⁴⁶ SKVFS 2007:1 section 10

¹⁴⁷ For further information; SKVFS 2007:1, section 10

TPG, the EU TPD, the PATA, and Norwegian legislation (comparison with the Norway is made as their legislation system is quite similar the Swedish system)¹⁴⁸ by having this kind of notion, which could mean that the same transactions must be documented more complete in another country and therefore the positive effect for the taxpayers will be lost.

10.1.1 SMEs

Before introducing the transfer pricing rules into Swedish law, several consultative bodies expressed their concern for SMEs. They thought that SMEs should be excluded from the documentation requirements because of the burden it would impose on the enterprises. However, the Government reckoned that since there would not be any information requirements in the income tax return, and that the SMEs would only have a limited amount of cross border transactions, it would not impose such a great burden that the consultative bodies feared.¹⁴⁹ Today there are no special regulations for the SMEs but instead they have to lean against the above mentioned proportionality principle, which might not give enough protection.

The STA has only briefly mentioned the SMEs in their non-binding guideline. Here it is stated that the SMEs documentation can be limited to the few transactions made,¹⁵⁰ which is quite self-explanatory and therefore almost a redundant sentence.

10.2 Time aspects

The Swedish rules are, according to the three regulations mentioned above, not requesting a filing of the documentation with the tax return, but first upon request of the tax authorities.¹⁵¹ Prominent is that neither the law nor the binding guideline from the STA specifies any time limits, but this is first mentioned in the non-binding guideline. Here it is stated that the enterprise should be given

¹⁴⁸ After studying several Norwegian laws, including their transfer pricing rules, I make this conclusion.

¹⁴⁹ Government Bill 2005/06:169 p. 109

¹⁵⁰ SKV M 2007:25 p. 8

¹⁵¹ SKVFS 2007:1, section 12

“reasonable” time to compile their documentation and therefore judgment must be done in each specific case. The benchmark is though stated to be 30 days after request. Notable is that even a shorter period can be used if the STA “knows” that the MNE has already prepared its documentation.¹⁵² This must be a result of the view that the MNEs continuously have to set up documentation. With these non-binding notions, it hardly matters how many days the tax authorities will give the taxpayer to file their documentation, as they could be given 30 days and that is not enough to set up a documentation, but they can be given even shorter time or longer, but as when and how this will be applied is not certain, the documentation need to be in place when filing tax return.

10.3 Assessment of the Arm’s length price

The Swedish regulations are quite specific about what is required to satisfy the documentation requirements. The Tax Return and Statements of Income Act 19:2a-2b states that documentation should be established regarding intra-group transactions and what this documentation should contain, synoptically. The MNEs are obligated to specify how they have used the pricing methods, as well as the internal and external comparables and how their intra-transactions are compatible with the arm’s length principle.¹⁵³ No specific methods are preferred compared to others, but the methods to be used are the ones stated in the OECD Guidelines. Therefore there are two main groups of methods to choose between when assessing the arm’s length principle. As the OECD Guidelines express that the list of methods is not exhaustive,¹⁵⁴ the Swedish taxpayers are allowed to use other methods as well, as long as they are in accordance with the arm’s length principle.¹⁵⁵

Regarding which comparables to use, again, there is a reference to the OECD guidelines.¹⁵⁶ In the non-binding guideline the STA has quite extensively described which comparables are preferable. Nothing is explicitly stated about

¹⁵² SKV M 2007:25 p. 36

¹⁵³ Tax Return and Statements of Income Act § 19:2b

¹⁵⁴ OECD TPG 1.68

¹⁵⁵ SKV M 2007:25 p. 20

¹⁵⁶ SKVFS 2007:1 section 1

non-domestic comparables, but a reference is done to the EU TPD about not automatically reject pan-European comparables.¹⁵⁷

10.4 Penalties

The transfer pricing regulations are not followed by any special transfer pricing penalty if non-compliance, but the normal tax penalties are to be used. Nothing is stated in the law or the STA guidelines about penalties. According to the Government Bill, the main condition for tax surcharges is that the taxpayer has given erroneous factual or misleading information, if not done by mistake.¹⁵⁸ If the tax authorities change a taxpayer's transfer price, the taxpayer can still be disburdened from the surcharges if correct or adequate information is available to the tax authorities. Although arbitrary assessments could be relevant if there is a serious shortage in the documentation when for example the taxpayer has applied a faulty transfer pricing method.¹⁵⁹

My point of view is that the whole transfer pricing area is quite vague and it sometimes seems difficult for the taxpayers to know when they are inline with the regulations and when enough documentation is made. Even though it sounds like the STA is quite reasonable with their penalties, it is still very important for the taxpayers in Sweden to be in accordance with the regulations, as the Nordic countries stand out in a global survey as it is most likely that transfer pricing examinations result in adjustments here (45% likelihood in Sweden). Sweden is as well number seven on a global list of the likelihood of a transfer pricing examination in the next two years (25% likelihood).¹⁶⁰

10.5 Salient Points

The Swedish Guidelines are unrealistically detailed about what is required in some parts, but more realistic in others. As a result, the outcome of their application could result in large problems for the MNEs. Since a lot of the actual

¹⁵⁷ SKV M 2007:25 pp. 28ff

¹⁵⁸ Government Bill 2005/06:169 p. 115

¹⁵⁹ *ibid*

¹⁶⁰ Oosterhoff, Danny, *Global Transfer Pricing Trends*, p. 122

regulations are to be found in the STA's non-binding guidelines, it creates a great uncertainty and the outcome of the rules are hard to predict. The administrative guidelines are binding for the taxpayers as long as there is no court decision going against the guidelines. It is therefore not yet possible to estimate the full extent of the Swedish legislation, as it still is untested by the courts.¹⁶¹ Not to have expressed any concern about SMEs is a let-down for the Swedish regulations that increase the burden upon the taxpayers. However, the notion about transactions of minor value plays a significant role in this aspect and must be of great importance especially for the SMEs. If the burden will be greater or lesser in Sweden than in other countries where specific notions on SMEs are to be found, but not on transaction of minor value, remains to see.

There are expressed opinions that the Swedish guidelines could and should be more simplified as it would reduce the administrative burden that is put on the companies, and the tax authorities would still get enough information to decide whether the arm's length principle is fulfilled or not.¹⁶²

¹⁶¹ Jonsson, Lars, Melz, Peter, *Sweden Branch Report*, p. 708

¹⁶² Leijonhufud, TNS Online, 3 december 2007, Advanced Seminar on Transfer Pricing, Stockholm

11 Comparison between the frameworks

11.1 Compliance burden vs. the control interest

The PATA has two features that stand out compared to the OECD TPG and the EU TPD. Firstly, it tries to be as complete as possible in its listing of issues to be addressed, and secondly it appears to underline the use of information provided primarily for purposes of outcome testing. The European market requires more weight on price setting which makes it different from the PATA Package which is formed on the purpose of outcome testing, i.e. more database comparables are used.¹⁶³

Regarding the compliance burden, the masterfile concept of the EU TPD follows the OECD TPG rather than the Package. The balance between costs and burdens for the taxpayers and the tax administration's need for information is stressed in the OECD TPG as a result of the prudent business management principle and in the EU TPD with the wordings "necessary and sufficient documentation". The advantages with these approaches are that they provide flexibility and save costs for the businesses when they do not have to provide documentation that might be irrelevant. For the tax authorities the advantage is that they do not have to sieve among irrelevant information. The Package with its list of 48 compulsory requirements is the opposite of proportion. The specified list doubtfully fulfils its purpose of lessening the compliance burden for the taxpayers regarding documentation, and critics consider the requirements to be more onerous than any single jurisdiction's requirements. Hence one has to be sceptical to its statement that it is in line with the OECD TPG as the mandatory list of the Package seems to be in conflict with the fundamental principle of proportionality stressed by the OECD.

A reason for the different approaches in this context is the different benchmarks in the Anglo-Saxon law and in the Continental European law. As the first one focus on cross-border tax avoidance and the second one that the application of

¹⁶³ Fris, Pim, *The Transfer Pricing Agenda for Europe*, p. 132

laws in this context must be economically justifiable, it is not strange that different requirements have developed within these different geographic areas.

To bear in mind is that with flexibility follows uncertainty. In this aspect the PATA Package at least in theory is in advantage of the OECD TPG and the EU TPD. However there are still a lot to decide by the different PATA member countries' tax administration and here there are still widely differing practical requirements.¹⁶⁴ These differences and the big flexibility within the OECD TPG and the EU TPD make all the regulations quite hard to interpret.

The Swedish regulations are very influenced by the OECD TPG and as well in accordance with the EU TPD. The prudent business management principles of balance and proportionality are used as a fundamental base. Neither the regulations nor the guidelines do completely cover all information a taxpayer might need to ensure being in accordance with laws and guidelines. Hence the rules must be considered to be flexible, as well as creating some uncertainty. The Swedish limitation of the burden of documentation of transactions of minor value, is something that goes beyond all the three guidelines, but is in accordance with the prudent business management principle. The standpoint here is a good step to fulfil the proportionate principles, but unfortunately will the value of these relieves be limited as many other countries do not have similar alleviations.¹⁶⁵ The effect of that one country creates "better" rules than implied by the OECD TPD could start a race to the top if the MNEs choose to establish in this country as a result of the rules and other countries therefore have to follow to attract the MNEs again. However, I hardly believe that a rule of this kind would have that effect on MNEs, unfortunately for the global regulation development.

11.1.1 The effects of small multinational enterprises

The EU TPD is the only guideline that has expressed concern about SMEs. The issue relies directly on the proportionality between compliance burden and the control interest, which is highly valued in OECD TPG and EU TPD, as well as in

¹⁶⁴ Interview with John Hobster, Transfer Pricing expert Ernst & Young London

¹⁶⁵ Grive, Magnus, Carendi, Isabel, *Internprissättning – Skatteverkets nya föreskrifter*, p. 2

the Swedish regulations. The PATA Package is furthest away from the EU TPD as it does not ease the burden at all for SMEs, but still requires the list of 48 specific documents. As all guidelines are voluntary, the extensive burden imposed in the Package will have the effect that no SMEs probably will consider to use it, which is a big failure for PATA.

11.2 Time aspects

None of the guidelines specify any specific time limit, why this is to be determined on a domestic level. Hence there are differences among the countries. However, these differences matter to a small extent as none of the time limits are enough for a company to prepare their documentation from scratch. The enterprises must nonetheless take notice of these differences within the different jurisdictions in which the MNE is operating, because many countries impose economical sanctions in case of delayed submission, irrespective of an adjustment is done further on.¹⁶⁶

Not even the Swedish regulations are precise about the time limits. 30 days is the benchmark, but this period can be extended or shortened depending on the circumstances, i.e. the documentation must be done and in storage when filing tax return.

11.3 Assessment of the Arm's length price

The quality of the documents is probably the most interesting but also difficult problem regarding transfer pricing documentation. What are reasonable efforts regarding the arm's lengths principle, differ widely between countries, and should therefore be the most regulated issue within the guidelines. This is however not the case.

The Package does not have a common view on what is required to fulfil "reasonable efforts" and "reasonable documentation". This is instead to be decided on a domestic level and each tax administration is to determine if the

¹⁶⁶ Fris, Pim, *The Transfer Pricing Agenda for Europe*, p. 133

MNEs fulfil the requirements, hence the whole Package itself. As there are very different views of preferred methods and comparables, it appears to be difficult with one set of documentation to comply with all the national requirements of “reasonable efforts and documentation”. The result is that an MNE has to prepare different sets of the Package for different Member States and the question arises if any taxpayer benefits from applying with the Package.

The EU TPD does not specify which methods are preferred when assessing the arm’s length principle. Instead should the methods of the OECD TPD be used or any other method that the national regulations require/permit. The OECD TPG recommends the use of the traditional transactional methods, but allows the traditional profit methods as a last resort, or even other methods if confirmative with the Guideline. The fundamental opinion of the OECD TPG approach is that there is no method that is useful in each situation but this must be determined in every specific case depending on the circumstances. This is a flexible approach that gives the taxpayer different methods to use when assessing their transfer prices. To be noted is that even though the traditional transactional methods are to be preferred, the traditional profit methods are the ones that are most commonly used, as there are often no comparables to be found which the traditional transactional methods need.

According to the OECD TPG it is not possible in any generalised way to define the precise extent and nature of evidence or documentation that would be reasonable for the tax administrations to require or for the businesses to produce for the purpose of an enquiry.¹⁶⁷ As a consequence, the EU JTPF argues that the Member States should avoid developing precise rules that are very prescriptive and specifying a long list of material to be produced by all companies regardless of the individual circumstances. This would prevent flexibility and individual circumstances and specific facts that otherwise would affect the evaluation of the

¹⁶⁷ OECD TPG, para 5.16

information given.¹⁶⁸ I.e. the EU JTPF has clearly disaffiliated itself from the PATA Package.

As the use of comparables is different depending on what method is used, the OECD TPG is flexible concerning which one to use. The OECD TPG prefers the use of internal comparables when such are available, compared to external. An MNE that performs a sound comparability analysis under a suitable method have good opportunities to have its arm's length price approved, no matter on which methods or comparables used. The EU TPD explicitly states that the use of non-domestic comparables from pan-European databases should not automatically be rejected. Compared to the OECD TPG, the EU TPD goes further when requiring the national tax administrations to accept non-domestic comparables. This is positive for the MNEs as it eases the burden, as it is problematic to find uncontrolled transactions to compare with due to the enlargement of cross-border intra-group trade. Worth mentioning is that both these guidelines are non-binding for its Member States and therefore it is doubtful whether national tax authorities will actually accept comparables from pan-European databases. Sweden has "resolved" the problem in the non-binding guidelines by cross-referring to the EU TPD about no automatically rejection of non-domestic comparables. What the result of this will be in practice is still hard to foresee as the STA has not written anything on the subject and there are still no verdicts from the tax authorities or the courts.

All the three guidelines use the wording "reasonable" when determination of the assessment of the arm's length principle, which is must be seen as too subjective to present any real guidance. Not even the national regulations in Sweden have specified what is required. This uncertainty creates a big burden on the MNEs as they have to do extensive and sometimes unnecessary documentation to be on the safe side. Continental Europe is however influenced by the prudent business management principle which ought to give taxpayers more discretion in establishing an arm's length price. Anglo-Saxon countries are controlled by a tax

¹⁶⁸ EU Joint Transfer Pricing Forum, Draft Revised Secretariat Discussion Paper on documentation requirements, p. 11

avoidance focus among tax authorities and therefore the MNEs doing business here must comply with more rigorous demands on what methods and comparables that can be used. As the assessment of the arm's length principle in the end is to be determined by each relevant tax authority, none of the guidelines eliminate the necessity to set up documentation with regard to the special conditions in every jurisdiction. Unfortunately, it seems like not even the specific jurisdictions are providing enough guidance on what is required and how an MNE can assess the principle to be safe of avoiding adjustments and penalties.

11.4 Penalties

Regarding penalties, the PATA Package seems to provide the most certainty in asserting avoidance of documentation-related penalties when complying with the Package. As the Package is quite precise about what is required, less is uncertain and therefore penalties should be easier to avoid. However, this is not the actual case as the Member States do not have specific documentation-related penalties and therefore compliance with the PATA Package can not guarantee avoidance of penalty. Regarding the other two guidelines, neither of them guarantees penalty avoidance, no matter how extensive the documentation is. As the guidelines are just guidelines, a sole recommendation to countries not to impose penalties when a taxpayer has tried to comply with the guidelines in good faith and with reasonable efforts, might be redundant and not followed by the Member States. Nevertheless it is still the best method to use, as when decided within the forum of the guidelines it is the common view of the countries representatives as well as it creates a benchmark of how the authorities should think.

The Swedish regulations do not include any specific transfer pricing penalties, but the normal tax penalties are to be used which requires erroneous factual or misleading information.

11.5 Salient points

The practical assessment of the arm's length principle presumes that companies in intra-group transactions know if the pricing of their transactions are at arm's

length compared to other companies. This is hardly ever the case and therefore does the whole transfer pricing documentation impose burden on MNEs. One should remember that transfer pricing is not an exact science but requires a high degree of judgement. Hence the tax authorities need to be just and reasonable in recognizing good faith efforts when deciding if compliance with the spirits of the guidelines is fulfilled, rather than focusing on the letter of them. The problem with differences among the three main guidelines will become even more visible in the different states as they implement and apply the rules. This could be very burdensome for the MNEs but if they keep a fair transfer pricing policy, great documentation could serve as a useful instrument to prove to the tax authorities that real business functions have motivated the chosen prices. Having a good documentation of the transfer pricing of intra-group transactions can as well be a great aid for the company to structure its business and get control and overview of its transactions.

It could be argued that Member States should avoid developing rules that are very prescriptive, specifying long lists of material to be produced by all companies affected by transfer pricing regardless of individual circumstances. This prevents flexibility that otherwise could take account of the specific facts and circumstances of a case. For the enterprises, the growing range of prescriptive transfer pricing rules may result in an onerous compliance burden which could be particularly frustrating within the European internal market.

A flexible approach taken by tax administrations also allows the taxpayer to avoid the preparation and collection of data that might not be necessary in the situation of the specific taxpayer. This leaves some uncertainty but gives a company the flexibility to make reasonable decisions on what is relevant under the facts and circumstances that prevail in their particular business. However, tax administrations have to assess whether the decisions taken by the taxpayer reflect the arm's length principle or not. A prescriptive approach might appear to offer greater clarity and certainty for both taxpayers and tax administrations but at a significant cost to companies and especially to those with relatively straightforward and transparent transfer pricing issues.

12 Final conclusions

Problems with different transfer pricing are not only an issue between different countries but as well between different blocks of countries, as for example between the EU and the PATA. As none of the guidelines are compulsory for the Member States to implement, an MNE operating in several different countries most likely must provide a specific documentation for each country. This is of course burdensome for the MNEs, but might be unavoidable. The need for transfer pricing documentation in the first place is a natural development of the internationalization and that countries wish to secure their tax base.

To do a comparison between the three guidelines and the Swedish regulation is hard as they are at three different levels of legislation. The OECD is an essential platform to create general rules that countries worldwide regard and often respect when creating their own domestic rules. It is unrealistic to hope for a development that OECD TPG ever will become compulsory. The EU TPD and the PATA Package are at the same international level and the Swedish regulation is an example of how a domestic legislation could be formed when taking the OECD TPG and the EU TPD in account.

The underlying problem with transfer pricing documentation is disagreement among countries of which methods and comparables that are preferable in establishing an arm's length price. The question is if the problem does not lay deeper than the documentation requirements alone. However the attempts of reaching consensus regarding documentation requirements and find an common alleviation of the burden on MNEs, are steps in the right direction. Finding transfer pricing solutions acceptable all over the world is dependent on developing realistic, workable and fair assessments of the arm's length principle. This is important for setting prices within MNEs and for testing the allocation of the outcomes amongst related parties.

The European Union discussed when creating their TPD if it should be inspired by the PATA Package, which is influenced a lot by American laws. Although Europe forms a market that is comparable in size to the United States, in contrast

to the United States it does not represent one jurisdiction, but rather many. As each jurisdiction has its own national tax authorities, all of those are interested in claiming “their” share of the profits generated by MNEs. If all of the various tax authorities would apply comprehensive and different comparable methods, it is evident that in order to keep them all happy, MNEs would be obligated to generate profits in excess of what they really earn. This is not a realistic approach in Europe as it would be too burdensome on the MNEs. This might as well be the main problem for the PATA Package, as the different countries have different solutions and interpretations of the extensive documentation requirements.

The EU TPD is a good solution with a masterfile and a country-specific documentation, as centralized documentation contains general description of the business strategy, structure, transactions flows, functions performed etc. and is available to all tax authorities in Europe that are concerned. The country-specific documentation, taking into account the differences in practice, interpretation and administrative approaches of the various jurisdictions, is then to be provided when the basic information is not sufficient to decide an arm’s length price in each country. This approach must be seen to have several advantages compared to the OECD TPD and the PATA Package as it provides flexibility together with a list that creates enough certainty. The major advantage is that all the Member States are to accept the masterfile concept, even though some differences still can be at hand, and when countries have the same information double taxation issues will be easier to solve. However, it is possible to find shortcomings with the EU TPD. The major one is that a request from one tax authority will result in them obtaining information about every detail of an MNE, even though some part of it would have been enough to prove that an arm’s length price was established. The burden could be compared with the compulsory list of the PATA Package, namely that documents that might be irrelevant will be provided and therefore could even the EU TPD be seen as in conflict with the proportionality principles of the OECD TPG.

Another problem with the EU TPD is that as long as it is not issued in a form of a Regulation or a Directive, there is nothing preventing the Member States from

imposing their own, stricter rules (within the masterfile concept). Furthermore as the guideline is not compulsory it is not possible to frame questions to the ECJ. The EU TPD must therefore be recognized and interpreted in the national jurisdictions and this is the same problem that is at hand regarding the PATA Package.

Despite all weaknesses pointed out about the PATA Documentation Package it could still, if it would be respected by taxpayers and authorities alike, be a good platform to work from. It is in many ways consistent with the regulations of the Member States, and with the broader sense of OECD TPD. Working according it will allow taxpayers, whether in PATA countries or not, to say legitimately that they have worked to the highest common denominator. But taxpayers should watch out for, and the authorities resist the temptation to further increasing requirements in another forum.

12.1 Possible solutions

The solution to all the problems of transfer pricing would be if all countries had uniform transfer pricing rules. In this way international double taxation would be avoided and the regulations would probably be more predictable. However, this will probably never be the case and therefore are small steps to make the rules more uniform the way to go. The three main guidelines are good platforms to get the countries to discuss the issues and to produce frameworks that helps them to approach each other.

One technique to ease the burden upon taxpayers could be to only permit the tax authorities to demand specific information to be submitted upon request, so that the documentation would not be available at the first stage of an enquiry. However this could be knocked back at the taxpayers themselves as the continuously prepared documentation probably helps the MNEs to ascertain that actual arm's length pricing is made. To even speak in these terms must be seen as outside the perception of reality as transfer pricing documentation requirements are here to stay.

The main problem, besides differences among the countries legislation, is that wordings like “reasonable” and “sufficient” are too vague and creates uncertainty. The transfer pricing area has therefore become similar to case law as the final outcome of the legislation is first to be determined after a court verdict. The OECD TPG has been criticized for being too broad but still its fundamental principles are vital and should be highly valued in every attempt to implement new guidelines. The OECD TPG is good as it represents flexibility and offers large possibilities to take the complexity of a particular transaction into account. The arm’s length principle is designed in such a way that the character of the group relationship will be taken into account. This could mean that the OECD TPG more or less is adequate when regulating these subjective issues, so that there is no actual need for an EU-harmonisation of transfer pricing. However it should be stated that the OECD TPG should be looked at by tax authorities around the world as the “ceiling” of what can be required by a taxpayer as far as documentation obligations are concerned rather than, as a majority of the states interpret them as the “floor”, i.e. the starting point of what enterprises have to submit. As long as the tax authorities do not see it as the ceiling, neither can the MNEs. In order to guarantee more certainty to taxpayers as to obtain proper compliance with the regulations, a more clear reference to the Guidelines would be welcomed in the Member States instead of as the Swedish regulators have done, produced an interpretation of the them. Not to forget is that the Guidelines have the value of mere recommendations for both the taxpayer and the tax authorities.

The EU, the PATA as well as the Swedish regulation are based upon the OECD TPG, but seek to specify the regulation. This is almost impossible as the fundamental idea is a case by case study regard the complexity of the transactions. As transfer pricing is not an exact science it seems difficult to decide exactly what is to be provided and by what methods. The PATA Package seems therefore almost impossible to apply in practice. The EU TPD and the Swedish regulations however pay regard to the complexity as a determinative factor, which makes them good solutions as it could simplify for both tax administrators and taxpayers.

The best approach would be if the EU TPD would become compulsory for all Member States and subject to ECJ's interpretation and control. This way the taxpayers would better know what is expected and the burden would be eased as the Member States would be forced to waive penalties in case of compliance. To find this solution, countries need to resign some of their sovereignty to legitimate the EU to impose compulsory rules. This is a major operation and hard to predict if the Member States are willing to do this sacrifice.

12.2 Race to the top?

The differences in countries transfer pricing documentation requirements could create a race to the top regarding effective and workable regulations. If a country could attract MNEs to establish within its jurisdiction because of their reasonable regulations, other countries would have to follow and implement similar rules. It is probably not likely that transfer pricing documentation requirements could have this effect on MNEs, but still this remains to see.

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The globalization, the international trade and the number of multinational enterprises have continued to increase over the last decade and today over 70 percent of the cross-border transactions take place between related enterprises. The growth of multinational enterprises which are doing cross-boarder transactions present increasingly complex taxation issues, both for the tax administrations and the companies themselves. International transfer pricing deals with those intra-group transactions where the open market regulator is absent. Transfer pricing has grown to be the most important issue on the tax agenda of multinational enterprises.

During the last decades fundamental principles have developed on different levels in the global environment and as the subject is international, differences among these guidelines and regulations are of great importance. This theises discuss the divergences of the three big guidelines produced by the Organization for economic co-operation and development (OECD), the Pacific Association of Tax Administrators (PATA) and the European Union (EU), in particular the requirements of documentation, the different methods of arm's length principle and the penalties available. With this background, the Swedish regulation will be regarded and examined. Mainly how this corresponds with the three guidelines and how have the Swedish regulators chosen to deal with the issues around documentation requirements and the principle of arm's length.