

## Documentation of Transfer Pricing: A New Global Approach

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### Abstract

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This research paper investigates two important tax issues: (a) an investigation of global documentation of transfer pricing around the world and suggests a new approach for managing transfer pricing documentation and (b) a comparison between the Organization for Economic Cooperation and Development (OECD) guidelines and the documentation requirements of selected countries. Multinational companies (MNCs) should design a well workable transfer pricing systems to comply with documentation tax rules of all countries, otherwise; huge penalties will be imposed. This paper suggests the use of a three-tiered approach, which is called a regional documentation file, for transfer pricing. The suggested approach is a modification of the ones suggested by the OECD. It will include information about regional business and economic conditions of the region, a description of the intangibles used for this specific area, and consolidated financial statements by region and tax documents. Moreover, it will make a significant cost reduction for MNCs in the preparation of transfer pricing documentation.

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**Keywords:** Tax rules, contemporaneous documentation, master file, regional file, documentation management

### I. Introduction

Global transfer pricing must achieve certain objectives for multinational companies (MNCs) while adapting to local and international trade policies and tax rules. Operating in the global environment makes the rules and strategies of transfer pricing systems dynamic. As many governments incorporate new tax regulations and more rigorously enforce current transfer price requirements, the need to develop a responsive documented transfer pricing system becomes an essential one.

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Decision-makers of MNCs must continually update and refine components of their transfer pricing systems to reflect current and potential environmental changes. A MNC is expected to have sufficient transfer pricing documentation of transfer pricing transactions including e-commerce to support and prove compliance with the arm's-length standard and to avoid the risk of transfer pricing audits and penalties. In addition, it has to maintain updated and convincing documents about their e-commerce or industry practice and current market conditions of all countries involved. To prove a consistent compliance with multiple jurisdictions, a global transfer pricing documentation system may be the best choice for a MNC (Abdallah; 2002).

The purpose of this paper is twofold: (1) to discuss how the corporate financial officers (CFO) of MNCs can manage transfer pricing documentation to avoid tax audits of local tax authorities and reduce the cost of transfer pricing documentation for their companies and (2) to compare documentation of transfer pricing of selected countries and the OECD as a basis for MNCs to justify that their transfer pricing strategies are consistent with the arm's-length standard. In the final section, conclusion and recommendation of the research paper and suggestions for future research will be discussed.

## **II Managing Transfer pricing Documentation**

For local governments, the common features of a transfer pricing regulation include adoption of the arm's-length pricing principle, requirement of extensive documentation in support of the transfer pricing methods to determine prices, and imposition of stringent penalties for noncompliance. Moreover, with the globalization of MNCs and rapid expansion in the cross-border flow of digitized goods, services, technology, and other intangible assets, national tax authorities have been addressing transfer-pricing issues with increasing scrutiny, documentation and penalties. Today, transfer pricing reports have tended to be lengthy and to contain general information sections in order to meet formal documentation requirements for tax authorities. One of the most important reasons for this trend has to do with the OECD guidelines that suggest a certain detailed structure of the transfer pricing reports starting with an industry and company analysis, followed by a function and risk analysis before the report actually examines the core matter-the transfer pricing transactions and methods.

Due to the difficulties both MNCs and tax authorities face, it is suggested that transfer pricing reports can be condensed to focus on the core issues but still meet the expectations of local tax authorities. For example, an extensive industry analysis need be included in the documentation only if it contributes to an understanding of how international income allocation in the group is affected by specific market trends or if it is known that the reader is not familiar with the industry at all.

Above all, there are three elements have drastically increased the burden and complexity of transfer pricing issues; they include: (1) the 1994 revision of the regulations under Section 482 of the IRC, (2) complementary measures such as the penalties in Code Section 6662 set forth in 1994, and (3) parallel initiatives by foreign tax authorities and the OECD since 1995. They also dramatically pushing MNCs to establish or declare their intercompany transfer pricing methods at the time a return are filed (contemporaneous documentation) (Miesel et.al; 2002.)

In fact, transfer pricing issues are considered as the most important concern for corporate financial officers (CEO) in multinational companies for the following reasons: (a) local tax authorities have increased transfer pricing documentation requirements, (b) most of transfer pricing tax audits have focused on reviewing and disputing transfer pricing issues, and (c) the escalating number and volume of transfer pricing transactions in MNCs (Scholz and Kohl, 2011).

Transfer pricing tax regulations in every country are based on the assumption that related party transactions should be done on an arm's-length basis. The significant differences in tax regulations, including penalties and documentation requirements, among countries in the application of the arm's-length price have made managing transfer pricing documentations a mission impossible.

At the international level, the US and the Pacific Association of Tax Administrators (PATA), including Australia, Canada, and Japan, as its members, issued a proposal to harmonize transfer pricing documentation requirements. PATA members have agreed on principles under which taxpayers can create uniform transfer pricing documentation so that one set of documentation can meet their respective transfer pricing documentation provisions and thus eliminate the need to prepare different documentation for each country.

The PATA documentation package is a voluntary procedure that, if satisfied, will protect taxpayers in each of the four PATA jurisdictions from otherwise applicable transfer pricing documentation penalties. The objectives of the proposal are: (a) to reduce transfer pricing compliance costs and burdens; (b) to promote the efficient and equitable operation of the tax systems; (c) to facilitate the efficient preparation and maintenance of transfer pricing documentation thereby enabling the timely production of such information upon request by tax auditors; (d) to develop a uniform, multilateral guidance for taxpayers and tax administrators; and (e) to create and maintain a single package of transfer pricing records and documentation in order to satisfy the transfer pricing documentation of all PATA members.

In general, there are specific problems in the PATA documentation package that should be considered before its implementation including the inability of MNCs to comply with all the principles discussed in the package, the open-ended list of documentation required, and the difficulty of subsidiaries' producing a world-wide group structure. First of all, the PATA should coordinate its proposal with the OECD guidelines related to uniform and consistent multilateral guidance in respect of transfer-pricing rules, documentation requirements, and penalty standards. Secondly, the development of cost-effective standards that MNCs can comply with will, as with the OECD's efforts, require a careful balance among the needs of MNCs and tax administrators.

Finally; the scope and amount of information required, under the PATA documentation package, to be produced and maintained is more detailed and extensive than that required under either section 6662 of the U.S. or section 247 of the Canadian transfer pricing tax rules. Thus, in resolving a transfer pricing tax issue involving controlled third party transactions between a U.S. and a Canadian subsidiary of a MNC, the PATA documentation package guidelines may be neither be relevant nor applicable in establishing that the taxpayer has undertaken reasonable steps to comply with the arm's-length standard, maintained adequate documentation in support of the arm's-length price of its controlled third-party transactions, or whether a documentation huge penalty should be imposed by tax authorities. In November 2014, the OECD met in Paris and discussed the transformation of transfer pricing documentation requirements on a global basis. The prevailed them at the meeting was driven by two issues: (a) for governmental tax authorities, they believed the transfer pricing documentation don't include useful information, and (b) for MNCs, current tax requirements are costly and time consuming (Clauser, 2014).

When a tax authority asks a MNC about its transfer pricing system, the taxpayer should be able to explain why the documentation it provided was appropriate, instead of having to begin by discrediting its own documentation. For MNCs, transfer-pricing documentation is a significant issue. Four important questions should be answered by MNCs' CFOs; accountants; and lawyers as they prepare transfer pricing documentation:

1. Can MNCs' documentation satisfy the IRS without creating exposure with other foreign governments?
2. Do MNCs have to produce separate documents for each country? If separate documents are necessary, are competent authority proceeding or treaty requests likely to mean that each government will see the documentation prepared for the other?
3. Can any government use any differences to reject the documentation produced for its use?
4. Does one set of documentation fit all or specific facts and circumstances prevail for every country?

With respect to the second question listed above, transfer pricing documentation process may be done either on a centralized or decentralized basis. In the 2014 white paper of the OECD, a two-tiered approach was suggested to be used for transfer pricing documentation (Clauser, 2014). The first tier is based on the preparation of a master file document to minimize compliance costs for compliant MNCs and provide governmental tax authorities with information necessary to assure the meeting of transfer pricing tax requirements.

In this case, compliance costs should decrease because a master file minimizes duplication across countries. It also aids governmental tax authorities because it contains information about a company's global business activities that is of interest to all governments (Ibid.) In general, the following five factors should be included in the master files:

1. An overview of the MNC business's ownership, local and regional location of principal entities, and management structure and location of key management members;

2. A detailed description of the MNC's major business line of the past five years;
3. A description of intangibles;
4. Intercompany financial activities; and
5. Financial statements by country and tax documents.

The second tier of the proposed approach is the decentralized one which is based on local country documentation. In this process, it is recommended that taxpayers identify all material transfer pricing transactions involving both local companies and foreign subsidiaries or affiliates. Then, taxpayers are encouraged to analyze any of these transfer pricing transactions that exceed a materiality threshold in a manner that is consistent with local country tax rules.

A three-tiered approach is suggested here by the author of this research paper. It adds a new file to be prepared in between the first and second tiers. It is a middle stage between the centralized and the decentralized approached which is called a regional file document. Under this approach, a MNC may prepare a regional file based on geographic regions (or by product applicability). The information in this regional file should include the industry and economic conditions of the region. This approach will help MNCs to reduce the compliance cost and at the same time, it will help to make a faster response to request of the local governmental tax authorities. The suggested approach may avoid the advantages of the other two approaches and alleviate the cost of documentation of transfer pricing for MNCs at both the local and headquarters levels.

### **III-Documentation of Transfer pricing in selected countries**

Transfer pricing documentation regimes in the U.S and European countries differ from one another in key respects, including whether penalties apply and who bears the burden of proof. The countries covered in this research have varying provisions on whether documentation must be contemporaneous, whether documentation prepared under the OECD transfer pricing guidelines is acceptable, whether the documentation may be in English, the definition of associated enterprises, which enterprises are covered by the documentation rules, and the actual documentation required (Bell 2011).

This section covers the transfer pricing documentation guidelines of the OECD and the documentation requirements of selected countries including Canada, France, Germany, Japan, Mexico, Netherlands, the United Kingdom, and the United States.

## **1The Organization for Economic Cooperation and Development (OECD)**

The 1995 guidelines provide extensive discussion on the documentation to be obtained from MNCs in connection with a transfer pricing system. The OECD guidelines suggest that MNCs should make reasonable efforts when establishing their transfer pricing policies to determine whether their transfer pricing results meet the arm's-length standard. The OECD also recognizes that tax authorities should have the right to obtain the documentation to verify compliance with the arm's-length price. The 1995 guidelines encourage member countries to administer penalty systems in a manner that is fair and not unduly onerous for MNCs.

MNCs will be challenged by materially increased compliance burdens as a result of the strongly debated proposals to report to tax administrations, country by country, extensive details of their taxes, income, and international business activities. Significant changes to the current requirements for transfer pricing documentation reporting will also be an additional burden. These are the broad consequences of the proposals that the OECD made its Discussion Draft on Transfer Pricing Documentation and Reporting in January 2014.

The intention of the guidance from the discussion draft is to replace the transfer pricing documentation guidance in Chapter V (Documentation) of the OECD's current Transfer Pricing Guidelines for MNCs and Tax Administrations, which was adopted in 1995. Different from the current version of Chapter V, the discussion draft requires a required list of documents to be included in a transfer pricing documentation package. The OECD will be giving more consideration to whether information relevant to other aspects of its Action Plan on Base Erosion and Profit Shifting should also be included (Anonymous. 2014.) The OECD is doing its best to help governments around the world collect more taxes. It is doing so by issuing a series of recommendations for tightening up corporate and personal tax measures. Individual governments are then likely to enact and/or implement such measures.

On February 6, 2015, the OECD announced a requirement of MNCs with a turnover above EUR750 million stating that they must start country by country reporting in their countries of residence in 2016. This simple procedural requirement is sending shock waves round the international business community (Harris 2015).

## **2 Canada**

The most significant change on the T106 of the Canadian regulations on transfer pricing is that taxpayers can no longer maintain a "wait and see" attitude concerning transfer-pricing documentation. For the first time, they must specifically indicate whether up to date documentation has been prepared for non-arm's-length transactions with each non-resident. Obviously, a "no" response is likely to invite closer scrutiny by Revenue Canada. (Zorzi, 1999) For MNCs, it is important to review their current transfer pricing methods and documentation to ensure they are in line with the Canadian regulations. If there are gaps, certain tax planning strategies should be implemented to help them to avoid lengthy tax audits, large reassessments and costly penalties for their companies. The implemented legislation introduced a requirement for contemporaneous documentation. Under the new rules, all taxpayers that conduct a minimum of \$1 million in cross-border business transactions are required to have specified contemporaneous documentation. This documentation consists of six categories of information including (Swaneveld et al.; March 2002).

1. Descriptions of the products or services sold
2. Terms and conditions of the transaction
3. All of the organizations involved in the transaction and their relationships
4. An assessment of the risks assumed by each party; the functions performed; any intangibles involved; and the capital employed in the transaction.
5. A description of the pricing policy established between the non-resident and the Canadian party.
6. Assumptions, strategies and policies that influenced the determination of the transfer price

The specific amount and type of contemporaneous documentation expected depends on the size of the MNCs involved, the sizes and types of business transactions, and the transfer pricing method selected. The documentation must be available at the same time when tax returns are due (Ibid.)

### 3. France

The goal of the French documentation rules is to provide clarity for both the French tax administration and for taxpayers and whether the rules will work in practice will depend on whether both the French government and taxpayers comply with the spirit of the regulations (Bell 2011). The French tax authorities, in the context of a tax audit, have the right to ask the taxpayer for information on its transfer pricing policy. If the tax authorities have gathered the evidence giving rise to the presumption that the enterprise made an indirect transfer of profit, the audited taxpayer is obligated to keep substantial documentation, while at the same time limiting the scope of the tax authorities' investigation to the following specific list of issues (Sporken et al. 2001): (a) the relations between the French and foreign MNCs; (b) the method of determining the transfer prices between the companies – the company must be able to justify the method used and provide adequate documentation in support of its choice. The methods included in the OECD guidelines are recognized by the French tax authorities; (c) the nature of the activities carried out by the associated foreign enterprise; and (d) the local tax treatment applied to the related or associated company, where the French company owns more than a 50% of its stocks or runs it directly.

If the enterprise's replies are considered inadequate, it mainly runs the risk of the tax authorities evaluating the amount of the transfers on the basis of the information in its possession, as well as imposing a fine per financial year covered by the request (Ibid.). The recent focus of the OECD on Base Erosion and Profit Shifting has already impacted the French tax Regulations. In order to combat transfer pricing more efficiently, the French tax authorities have recently got the right to obtain more power to get information for carrying on transfer pricing tax audits: taxpayers that establish analytical and consolidated accounts now have to provide them to the French tax authorities; in addition, large MNCs have, for the first time at the latest in November 2014, to compulsorily file every year a specific form describing their own transfer pricing policy, and they have to include in their transfer pricing documentation information on foreign rulings (Gouthière 2014).

#### 4. Germany

In Germany, no legal basis exists for field tax officers to ask for special transfer pricing documentation. However, the Ministry of Finance tries to establish a legal basis for the documentation requirement. Since August 2000, there are proposed regulations requiring transfer-pricing documentation following the OECD guidelines. Under the current regulation, there is no specific penalties exist for specific documentation to justify the use of transfer pricing; however, tax authorities may impose severe penalties in the case of fraud (Felgran & Yamada 2001). In August 2000, the tax authorities scored a judicial victory on a related, but distinct, transfer pricing documentation issue. The Monster Tax Court upheld fines assessed by the tax authorities to compel taxpayer production of cost accounting documents for transfer pricing tax audit purposes.

In general, the documentation requirements are derived from the obligation of German taxpayers to cooperate with the tax authorities' when determining the conditions that might be of importance for examining the case of income allocation. An important extended obligation is to provide appropriate documents exists in cases of business transactions with foreign related entities. The documentation should include information about group structure, products and services, markets, existing agreements and transfer-pricing method. As contemporaneous documentation is required, documents will have to be up-dated on a continual basis.

All documents should provide the tax authorities with an understanding of the mechanism and decision process for establishing transfer prices. If a company fails to provide adequate documentation, the tax authorities can make estimation the profit of the German company (Schmitz and Korner 2000)

In May 2001, a ruling handed down by the Federal Tax Court indicates that German tax law provides no basis for the documentation creation obligations stipulated in the draft Procedural AR. The ruling also states that the German subsidiaries of foreign parents are generally not required to produce parent company transfer pricing documentation. However, German parents may have such an obligation with regard to their foreign subsidiaries.

## 5. Japan

Generally, the National Tax Administration (NTA) has adhered generally to the OECD guidelines of documentation in creating its regulations. Although Japanese taxpayers are not required to maintain documentation, a penalty of 10 percent of the additional tax due may be imposed if an adjustment is made, and the penalty is increased to 15 percent if the additional tax due is more than 500,000 yen or more than the amount of tax paid on the original return whichever is greater. Moreover, in fraud cases, a 35 percent penalty may be charged separately. It's expected that the regulations will become stricter in the next few years as the government reviews current regulations to possibly make Japanese transfer pricing taxation to be in line with other countries' transfer pricing rules (Felgran and Yamada; 2001).

The Pacific Association of Tax Administrators (PATA) developed a proposed uniform transfer pricing documentation requirements. PATA members include Japan, U.S., Australia and Canada. PATA members are seeking comments on the proposal. PATA members have agreed on principles under which taxpayers can create uniform transfer pricing documentation so that one set of documentation can meet their respective transfer pricing documentation provisions and thus eliminate the need to prepare different documentation for each country. Unfortunately, the proposal does not achieve its goal of reducing the compliance burden.

In 2010, Japan has stepped up its transfer pricing enforcement since the introduction of new documentation requirements; therefore, advance pricing agreements may hold greater appeal for the taxpayers and practitioners. Unfortunately, it is expected to have more and more APA cases because of the uncertainty of transfer pricing debates (Gregory2012).

In Japan, transfer pricing audits typically have been conducted separately from general corporate audits, however, taxpayers have been asked for transfer pricing documentation as part of the corporate audit itself. Moreover, taxpayers are being asked to provide other information not covered on Schedule 17-4 of the Japanese corporate tax return, such as year-end transfer pricing adjustments on a year-by-year basis (Ibid.).

## 6. Mexico

At the time Mexican taxpayers file their tax return, they must have the transfer pricing documentation ready. Moreover, the MNC will need to conduct a transfer pricing study and provide an opinion by its certified public accountants that the taxpayer has complied with the formal requirements of the transfer pricing regulations. Unfortunately, Mexico's transfer pricing documentation requirements are among the most restricted ones in the world. Two important issues must be considered: (a) which international intercompany transactions must be documented, and (b) the potential conflict between taxpayers and their outside accountants that is caused by the documentation requirements (Valdes et.al. 1999).

In general, the Mexican transfer pricing documentation rules have achieved their objective of providing tax authorities with an effective way to closely monitor those transactions undertaken by Mexican MNCs with their foreign-related parties. Provided the Mexican tax authorities take all necessary steps to make sure that their transfer pricing regulations covers most of the unpredictable needs of MNCs operating in Mexico. In contrast to the countries that have adopted formal transfer pricing rules, Mexico is one of the few countries in the world that requires taxpayers to satisfy certain documentation requirements with regards to transactions undertaken by their residents with foreign-related parties. In other words, Business intercompany transactions among Mexican residents do not have to be documented, although all transactions (whether with foreign or domestic related parties) are to be determined based on the arm's-length standard (Ibid.)

Mexican tax authorities should consider adopting certain rules that will make the transfer pricing rules in Mexico more flexible such as eliminating the need for transfer pricing documentation for transactions with foreign-related parties that are below a certain threshold amount, especially for smaller taxpayers.

Furthermore, the tax authorities may provide taxpayers with further guidance as to other matters including the method in determining an arm's-length standard for transactions involving intangible property, the use of non-Mexican databases in order to identify comparable entities, and the use of an unspecified method in cases where the use of any of the other specified methods does not result in an arm's-length standard (Valdes et.al. 1999).

In Mexico, taxpayers need to know that formality is of the essence. It is noted that determined that documentation that misses any of the formal requirements is a valid reason to deny otherwise valid taxpayer tax deductions (Wright2007). While Mexican law has no clear rules on what kinds of documentation is considered privileged, a taxpayer's failure to provide discovery in violation of Mexican tax laws is a criminal offense (Ibid.).

## **7. Netherlands**

In the Netherlands, taxpayers are required to prepare their transfer pricing documentation at the start of a tax audit (Bell 2011). The Dutch Ministry of Finance published the transfer pricing regulations effective April 1 2001, also with the objective of codifying the arm's-length principle later in 2001. Documentation requirements were expected to be introduced before the end of 2001. The latter wish is primarily driven by the fact that the Dutch tax authorities have lately not been too successful in the Dutch courts in winning most of transfer pricing cases. (Sporken et al. 2001)

Section 86 of the Corporate Income Tax Act requires taxpayers to have available sufficient information to show how the transfer prices were established and from which it can be determined whether the prices satisfy the arm's-length price. Part of the objective behind this provision is to ensure that information concerning the transfer pricing system will become available in the Netherlands to enable the Dutch tax authorities to test the transactions by reference to the arm's-length standard (Rutges et.al. 2002). If a transfer pricing correction is made, it is the taxable profit in the Netherlands that will be primarily increased. Moreover, interest for late payment will always be due, albeit at a very low interest rate. Penalties may be charged on any additional tax due.

In the Netherlands audit process, the tax authorities have broad powers to collect all tax information it deems important and taxpayers normally cooperate with the tax authorities on documentation issues. If a taxpayer doesn't produce the required documents, the burden of proof shifts to the taxpayer to prove that its transfer pricing is correct. It is noted that within the past ten years, the traditional outcome of a court case is that "the party with the burden of proof loses."

However, recent Dutch legislation will improve taxpayers' ability to fight specific document requirements (Wright2007).

## **8. The United Kingdom**

In the U.K., Supporting documentation for transfer pricing systems needs to be prepared and preserved in accordance with the OECD Guidelines of prudent business management. The Inland Revenue has issued guidance as to the required level of documentation. In addition, the OECD Guidelines documentation standard, as detailed in Chapter V of the Guidelines, is to be used in interpreting the UK documentation requirements for transfer pricing. Under the new regime, taxpayers are expected to keep a level of documentation commensurate with the requirement of prudent business management. (Sporken et al. 2001)

The Inland Revenue issued guidance on documentation requirements stating that the extent of the documentation needs to be reasonable, given the complexity of the relevant transaction and should cover, at least, the following items:

- Information on relevant commercial or financial relations falling within the scope of the new regulations;
- The nature and terms of relevant transactions (including transfer prices and related party transaction);
- The method(s) by which the nature and terms of relevant business intercompany transactions were arrived at, including any study of comparable and any functional analysis undertaken;
- How the selected method has resulted in arm's-length prices.

The new statutory arrangements do not require additional documentation to be prepared provided the existing documentation is sufficient to enable the company to make a complete return under corporate tax self-assessment.

Documentation should exist at the time that a tax return is made and should be retained for at least six years (Sporken et al. 2001)

## 9. The United States

Recent trend of tax authorities around the world have caused the tax executive to take an increasingly multinational approach to the problem of international transfer pricing. Gradually, countries around the world are developing more uniform approaches to transfer pricing documentation. However, there remains substantial variation in transfer pricing documentation and practices among countries. Therefore, MNCs must design their transfer pricing policies and documentation to fit the unique international operating structure and tax enforcement and the specific rules and enforcement practices of the countries in which they conduct business.

Under the provisions of Section 6662(e) applicable to 1990 through 1992, the years under consideration in DHL, a taxpayer could avoid the penalty if it showed that there was a reasonable cause for the taxpayer's determination of such price and that the taxpayer acted in good faith as to such price. Section 6662(e) was amended effective for tax years beginning after 1993, but only for transfer pricing cases. The amendments provide that a taxpayer can avoid the penalty only if it shows that it "reasonably" determined its transfer prices, contemporaneously documented its transfer pricing determinations, and provided that documentation to the IRS within 30 days of request. Outside of transfer pricing cases, the general reasonable cause or good faith rule still applies (Levy et.al. 2002.)

The need for globally designed transfer pricing policies and its documentation places great demands on MNCs and their advisers to achieve the goal of simultaneously addressing transfer pricing needs in several countries, while at the same time keeping compliance costs within acceptable limits, will hold a large and justifiable competitive advantage. Development of core global documentation, coupled with tax planning suited to the substance of the MNC's operations, are the key tools that can allow MNCs to harness the new international environment to their advantage (Durst; 1999).

In the US, section 482 of the IRC was amended in 1986 to promulgate the "super royalty" provisions through the statutory matching-with-income standard. This was in response to ideas that foreign MNCs were not paying their fair share of US tax and certain U.S. Tax Court decisions where MNCs were perceived to be allocating most of their income to affiliates in tax heaven countries.

Since that time, regulatory projects started to define this standard in terms of an arm's-length result, member countries of the OECD simulated these rules in their respective tax regulations, documentation rules became the global norm, and tax audits of a MNC's transfer pricing policy dominated tax controversies among most foreign tax authorities worldwide (Levy; 2001).

In 2002, the IRS (news release IR-2002-77) and the Pacific Association of Tax Administrators (PATA) announced a joint proposal to simplify transfer-pricing documentation. PATA members include Australia, Canada, Japan and the US. PATA members have agreed on principles under which taxpayers can create uniform transfer pricing documentation so that one set of documentation can meet their respective transfer pricing documentation provisions (PATA documentation package) and thus eliminate the need to prepare different documentation for each country. The PATA documentation package is a voluntary procedure that, if satisfied, will protect taxpayers in each of the four PATA jurisdictions from otherwise applicable transfer pricing documentation penalties. The Tax Executive Committee strongly supported the proposed harmonization changes and encouraged the Service to open dialogues with other international governmental entities to expand simplification efforts (Purcell; 2002). A copy of the proposed multilateral transfer pricing documentation requirements may be obtained at the IRS website.

#### **Iv. Concluding Remarks**

This research paper examined, analyzed, and discussed the most two important issues of transfer pricing documentation: managing the transfer pricing documentation process and comparison of different global tax rules of transfer pricing documentation. For the 2014 OECD white paper, a three-tiered approach is suggested here. It adds a new file to be prepared in between the first and second tiers. Under this approach, a MNC may prepare a regional file based on geographic regions (or by product applicability). The information in this regional file should include the industry and economic conditions of the region. This approach will help MNCs to reduce the compliance cost and at the same time, it will help to make a faster response to request of the local governmental tax authorities.

The suggested approach may avoid the advantages of the other two approaches and alleviate the cost of documentation of transfer pricing for MNCs at both the local and headquarters levels.

The second part of the research included a comparison of 8 countries. It is concluded that all eight countries require taxpayers to document related party transfer pricing transactions; however, half of them, Canada, Mexico, the U.K. and the U.S., have formal specific documentation regulations of transfer pricing, as can be seen from Table (1).

The other four countries either do not have formal rules for documentation or try to adhere to the OECD guidelines. In France, transfer pricing documentation is required only in case if the tax authorities have gathered the evidence giving rise to a violation of transfer pricing tax rules, Germany has no legal basis for field tax officers to ask for special transfer pricing documentation, Japan have adhered generally to the OECD guidelines of documentation, and the Dutch tax authorities require taxpayers to have available sufficient information in their administration to indicate how the transfer prices were established and from which it can be determined whether the prices satisfy the arm's-length standard. It is critical that a MNC's documentation show compliance with both U.S. and foreign transfer pricing tax rules. Without a well-designed and workable transfer pricing system enabling MNCs to create and receive the right transfer pricing data, there would be no way for a MNC to avoid penalties imposed by tax authorities.

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**Table 1: Transfer Pricing Tax Issues of Selected Countries**

<b>Transfer Pricing Tax Issues/Countries</b>	<b>Follow OECD Guidelines</b>	<b>Arm's Length Standard</b>	<b>Formal Documentation</b>
Canada	Yes	Yes	Yes
France	Yes	No	No
Germany	Yes	No	No
Japan	Yes	No	No
Mexico	Yes	No	Yes
Netherlands	Yes	Yes with ranges	No
United Kingdom	Yes	Yes	Yes
United States	No	Yes	Yes