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**Code of Conduct (business taxation)**  
**Subgroup A**  
**Transfer Pricing – Transparency and Exchange of Information**

**DRAFT**

**Introduction**

1. The ECOFIN Council at its meeting the 26-27 November 2000 approved the conclusions in Presidency Note of 20 November to the ECOFIN Council (13555/00 FISC 190).

2. In the context of transfer pricing the Presidency Note includes the following statement:

*The Presidency accordingly proposes that the Council:*

....

*(6) ask the Group to look into the question of transparency and the exchange of information on transfer pricing as referred to in paragraph 17 of Annex I to the report 13563/00 FISC 193.*

3. Paragraph 17 of Annex I to 13563/00 FISC 193 (hereinafter referred to as Paragraph 17) has the following wording:

*17. In relation to transparency and the provision and exchange of information concerning transfer pricing, regard should also be had, in accordance with paragraph B4 of the Code to the OECD's Transfer Pricing Guidelines and, in particular, to Chapter 4 ("Administrative approaches to avoiding and resolving transfer pricing disputes"). Member States shall inform each other yearly about the use of the transfer pricing guidelines in practice and the number and kind of Advance Pricing Arrangements concerning transfer pricing. Information on procedures regarding Advance Pricing Arrangements should be exchanged as well among Member States. If a Member State has agreed to an Advance*

*Pricing Arrangement, ruling or any other advance agreement concerning transfer pricing, it should automatically notify all other Member States concerned and provide them with all necessary information. The same principle should apply to Member States when after either an application or on examination they become aware that a company has used a transfer pricing method that is outside the OECD transfer pricing Guidelines. Member States should inform the Member States concerned of any such discrepancies.*

4. Paragraph 17 establishes a framework for the Code of Conduct group to continue its work in the transfer pricing area. The framework clearly identifies some specific elements of possible improvements with respect to transparency and exchange of information within the transfer pricing area. These elements are the so-called “agreed elements” as mentioned in the document 5670/01 FISC 11.

5. The services of the Commission find that these elements generally are well chosen being specific areas where (tax authorities of) Member States do not, or only very rarely, provide public available information or exchange information with other Member States. There might be other elements as well – and a few of these has been included in the note - but generally these specific elements listed in Paragraph 17 provide for a solid starting point.

6. In that context it should also be mentioned that the agreed elements in Paragraph 17 generally are in line with the OECD’s draft application notes on transfer pricing<sup>1</sup> and rulings<sup>2</sup> which were discussed at the meeting of the Forum on Harmful Tax Practices the 6-9 February 2001.

### **Objective for the Subgroup**

7. Whilst the agreed elements, as mentioned, are quite specific in their wording, they to a certain extent require some interpretation to establish the precise content. It may also – in more procedural/practical terms – be necessary to decide how the exchange of information etc. should be structured. The main objective for the

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<sup>1</sup> DAF/FE/CFA/FHP/(2001)1/CONF.

Subgroup A will be to suggest to the main Code Group the precise content of the agreed elements including how to apply these in more practical terms.

8. Paragraph 17 makes a general distinction between yearly exchange of information among all Member States and ad hoc exchange of information to concerned Member States. In both cases exchange of information will take place automatically. Below is outlined the structure of the transparency and exchange of information including points of interpretation.

### **Yearly information system**

9. This part requires automatic exchange of information among all Member States. To streamline the process it may be feasible to develop some kind of standard reporting scheme including a checklist. The question of when and how the information should be exchanged must also be explored further.

#### *Practical application of the OECD Transfer Pricing Guidelines*

10. Given the high importance of transfer pricing in the international tax area in general, and for the harmful tax competition area in particular, it will be useful that each Member State in general describes its “transfer pricing system”, including how the OECD Transfer Pricing Guidelines are applied. For Member States that have not issued regulations, circulars or any other kind of guidance describing how the guidelines are applied such material may also serve as a basis for information for the public. This will secure transparency of Member States’ transfer pricing systems.

11. It has to be developed further what pieces of information (and in what detail) should be included. The information naturally should focus on some of the specific features of transfer pricing that generally are of interest in the context of harmful tax practices. A non-exhaustive illustrative list could include:

- An introduction including a description of the legal framework;
- [Description of areas (if any) where the OECD Transfer Pricing Guidelines are not applied];

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<sup>2</sup> DAF/FE/CFA/FHP/(2001)3/CONF.

- Application on transfer pricing methods (including but not limited to the practical use of the cost-plus method and the resale-minus method);
- General rulings;
- Safe harbours;
- Documentation requirements;
- Administrative aspects including for instance audit aspects (performed audits, audit capabilities, the “depth” of the audits, the use of simultaneous audits).

The Subgroup may find it useful to discuss further which information should be included (and circulated amongst Member States).

*The number and kind of Advance Pricing Arrangements*

12. Whereas the *number* of APAs seems to be pretty straight forward, the *kind* of APAs may need some further thoughts. The OECD Transfer Pricing Guidelines make a distinction between unilateral, bilateral and multilateral APAs; the information should cover all these three types of APAs.

13. It might be useful if the information on the bilateral and multilateral APAs included the names of the other countries (including non-EU countries) that are parties to them. A disclosure of the identity of the tax payer involved in APAs will be important as it would enable other tax administrations, which, within their jurisdictions host affiliated companies to ask for further information. In case of a unilateral APA, disclosure will also be required according to the ad hoc information system (see below). Whether the ad hoc information system – in the case of a bilateral or multilateral APA – will also require disclosure to tax authorities hosting affiliated companies not directly engaged in the transaction(s) covered by the APA, depends on the whether such companies are considered to be “concerned” (see this discussion below). Whether or not such affiliated companies are “concerned” or not, it might still be important to include tax payer identities in the yearly reporting system in order for Member States to gain an overview.

14. It may also be useful to have information about the business areas covered by the APA (e.g. banking, insurance, manufacturing etc.) and about the nature of the

transaction covered by the APA (i.e. sale of goods, services, cost contributions agreement etc).

15. [The question of disclosure of taxpayers identity, business area etc. does not seem to cause confidentiality problems, as the information would only include statistical material not detailed enough to reveal any business secrets. Furthermore, as exchange of information is not required until after the APA is concluded, there will not be a problem of revealing investments decisions.]

16. The wording of Paragraph 17 does not cover ATRs. However, there would be good reasons to also include ATRs in the yearly information system. An ATR covering transfer pricing aspects, is in principle very like a unilateral APA and in relation to harmful tax practices it has the same problematic features. Furthermore, in practice the distinction between a unilateral APA and an ATR may be difficult to apply. It would therefore make sense to extend the yearly information system also to cover ATRs.

The Subgroup may find it useful to discuss further which information should be included (and circulated amongst Member States).

#### *Procedures for Advance Pricing Arrangements*

17. In order to improve transparency and provide equal treatment to taxpayers, countries should publish the procedures for APAs. Some Member States have already done so and for these Member States this information would serve as a basis for the information that should be exchanged with other Member States. Other Member States, which enter into APAs, but have not published the APA procedures, should be invited to do this. In this context, regard should be had for the 1999 Annex to OECD's Transfer Pricing Guidelines which includes detailed guidance on how countries should establish their APA procedures. In describing their APA procedures, Member States should in general pay close attention to this guidance.

However, the Subgroup may find it useful to discuss further which information should be included in the description of APA procedures (circulated amongst Member States).

## **Ad hoc information system**

18. This part will require a Member State automatically to notify “concerned” Member States about certain agreed elements and to provide such Member States with any necessary information. Whereas it seems less relevant with a standard reporting scheme, it might still be useful to try to develop a checklist and some guidelines of when and how information should be exchanged. These issues should be explored further.

19. A general question is when a Member State qualifies as “concerned”. Concerned can naturally be interpreted as “affected by”. There seem to be 2 different approaches to take. The tax authorities of the other affiliated company (or companies) directly engaged in a transaction (or transactions) which is covered by a (unilateral) APA or ATR is “affected by” the APA, and notification including necessary information will therefore be required. (Obviously, there is no need for notification among tax authorities engaged in the same bilateral or multilateral APA).

20. However, the tax authorities of any affiliated company to the company (or companies) concluding an (unilateral, bilateral or multilateral) APA/ATR, might also be “affected by” the APA/ATR. This is most obvious if such company (or companies) engage in identical or similar transactions (as those covered by the APA/ATR), as the MNE in practice often will apply the transfer prices covered by the APA as a basis for the transfer prices to the remaining affiliated (EU) companies. In this context it should also be mentioned that transfer pricing documentation requirements often will request the tax payer to provide information of any APA/ATR that affiliated companies have concluded with other tax authorities.

21. The need for automatic notification to tax authorities of affiliated companies not directly engaged in the transaction covered by an APA/ATR will also depend on which information is disclosed under the yearly information system. If the identity of the taxpayer is disclosed it will enable (other) tax authorities wishing so to submit a request for exchange information; thus reducing the need for a automatic notification including submitting necessary information.

*Notification of APAs, rulings or any other advance agreement covering transfer pricing<sup>3</sup>*

22. This element requires that a Member State having concluded an APA, ruling or any other advance agreement covering transfer pricing, notify other “concerned” and provide them with all necessary information. The precise scope of this element depends as discussed above on how “concerned” is to be interpreted.

23. Apart from identification of the taxpayer, “necessary” information is information required to establish whether the APA etc. is in line with the OECD Transfer Pricing Guidelines including the arms length principle. Although, the level of information necessarily will vary from case to case, it should generally include all the relevant information elements required for a proper arms length evaluation.

The Subgroup may consider in more detail which information it will be necessary to provide.

*Notification of MNEs application of method not in line with the OECD Transfer Pricing Guidelines*

24. This element requires a Member State to notify and provide necessary information to other concerned Member States in all cases where the Member States discover that a MNE has used a transfer pricing method “not in line” with the OECD Transfer Pricing Guidelines. A Member State could discover such a discrepancy after an audit or where a request for APA/ATR does not lead to conclusion of an APA. The scope of this element depends as discussed above on how “concerned” is to be interpreted.

25. The issue of whether a transfer pricing method is not in line with the OECD Transfer Pricing Guidelines, covers quite clearly the features that led to a positive evaluation of potential harmful measures in the Member States against criteria B4 in the Code, e.g. inappropriate use of the cost-plus method or the resale-price method.

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<sup>3</sup> A similar notification requirement is proposed in the OECD draft application note on rulings (for ATRs see paragraph 50; for APAs see paragraph 55). However, it should be noted that provision of further information is not automatically required but subject to a request.

However, in principle it could also cover other cases where a MNE has used a method – which according to facts and circumstances of the case – is not the appropriate transfer pricing method.

26. It's difficult to foresee the information burden that such a requirement would impose on Member States, but it could be substantial. Furthermore, there could be some overlapping to cases where the tax authorities – having discovered such a discrepancy – make an income adjustment. It could therefore be considered whether to limit the procedure to certain business areas (e.g. the financial and service sector) and/or to certain thresholds (e.g. only transactions over a certain amount), and not to include other cases where a tax authority makes an income adjustment. Other differentiations could also be considered.

The Subgroup may find it useful to consider the scope of this element and which information it will be necessary to provide.

### **Further elements**

27. This section describes one further element, already covered by the OECD Transfer Pricing Guidelines and the OECD Applications Note on Rulings, which also could be included in the ad hoc information system. However, it should be noted that there are likely to be other elements, which it could also be useful to include.

28. According to the OECD Transfer Pricing Guidelines<sup>4</sup> and the Application Note on Transfer Pricing<sup>5</sup>, unilateral APAs should whenever possible be either avoided or converted into bilateral or multilateral APAs. Where unilateral APAs are permitted (competent) tax authorities of other interested jurisdictions should therefore be informed about the procedure as early as possible to determine whether they are willing and able to conclude a bilateral APA. The same issue arises with ATRs covering transfer pricing issues.

The Subgroup might discuss whether it would be useful to include a rule which requires Member States not to enter into bilateral APAs (or ATRs) before having

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<sup>4</sup> Chapter 4, Paragraph 4.13.

invited interested competent tax authorities to conclude a bilateral (or multilateral) APA, or whether they would consider including any other element in the information systems.

### **Evidence on agreed elements**

29. As mentioned in paragraph 11 in the Chair's note to the Code of Conduct meeting on 1<sup>st</sup> February 2000 (5670/01 FISC 11), the Commission is responsible for providing evidence of the agreed elements to the main Code Group. This is also reflected in Point 2 iii) of the minutes to this meeting (6078/01 FISC 21).

To enable the Commission to meet this responsibility, members of the Subgroup are invited to provide information to the Commission on the current status with respect to transparency and exchange of information on each of the (5) agreed elements in Paragraph 17.

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<sup>5</sup> E.g. paragraph 50 and 55.