

## Transfer pricing documentation: the master file and local file



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**The master file and local file approach was supposed to bring some consistency to transfer pricing compliance and documentation; however, I am finding that there are still local requirements that need to be adhered to. Is a holistic approach to documentation still possible or must we continue to reinvent the wheel in each location that departs from the OECD guidance?**

Yes, a global approach is possible, but this has been a source of frustration for many businesses. It is important to recognise that transfer pricing regimes fall into the following categories:

- those in which a master file and standard local file will be acceptable under domestic regulations;
- those in which separate local regulations have been enacted departing from the OECD documentation requirements; and
- those in which the OECD approach is acceptable but local tax authorities/inspectors prefer to see a more localised approach when conducting their audits.

Multinational businesses need to ascertain which category their operating jurisdictions fall into and adopt a tiered approach to documentation based upon that category. In this way, they will not need to 'reinvent' the wheel and can adopt the holistic approach referred to above (for the most part), whilst respecting local nuances.

### Examples of key operating locations and approach

#### Category 1: OECD master file and local file accepted

Around 35 jurisdictions have adopted the OECD format. Documentation submitted in accordance with the prescribed templates will be acceptable in these locations.

Note that whilst certain jurisdictions (including the UK) have not expressly adopted the Action 13 master file/local file format into local law, this format will be accepted as transfer pricing documentation in these locations without any further localisation. Such jurisdictions have opted to provide multinationals with some flexibility to depart from Action 13, where appropriate to do so in specific circumstances. It is only possible to divine a list of these jurisdictions through on the

ground experience through the annual tax reporting process. (It is advisable for multinationals to collate a database of their operating locations and track this going forward.)

#### Category 2: OECD master file and local file not accepted without 'localisation' and additional analysis

Documentation in English will only be acceptable in less than half of the 35 jurisdictions referred to above. In addition to language requirements, many jurisdictions have enacted specific requirements that build upon/depart from the OECD standard. The most notable examples include Australia, China, Germany, India, Italy, Poland, Russia and South Africa.

The recommended approach in many of the above jurisdictions is to begin with the local file template and make the required changes. (There are some exceptions that require a fresh local file to be built due to significant departures, e.g. Brazil; however, once a local file framework has been agreed this can then be applied going forward.) In the above jurisdictions, there is often a broader review of transactions, e.g. exchange controls, which necessitate a consideration of items beyond Action 13 when assessing compliance.

#### Category 3: local preferences

This final category is concerned with minimising the overall transfer pricing adjustment risk by recognising that local tax jurisdictions and inspectors prefer to see documentation set out in a specific manner with specific elements (despite the fact that there may be no legislative requirement to consider these items). The most common form of this can be seen in relation to the selection of comparable groups to form a range of potential arm's length outcomes. Many local jurisdictions have a number of (often local) comparables

in mind that will be required to make a sample 'significant'. In addition, there may be a local preference to remove loss makers from a sample set. This goes against the DNA of transfer pricing practitioners; however, running sets with and without these nuances and adopting a price in the intersection may prevent audit issues. Another example is with methodology selection: whilst the OECD guidance has moved away from hierarchy of methods, there are local jurisdictions that will wish to understand why a comparable uncontrolled transaction or a basic cost-plus method are not being applied (being the most common forms of method that they come across).

In such jurisdictions, and where a multinational has a more complex global transfer pricing policy (e.g. profit split, option pricing model, franchise fee arrangement), we recommend that a parallel (simpler) transfer pricing method is calculated at the local level to demonstrate that there is no material departure from the overall transfer prices under each method. Again, this will prevent audit issues from arising when the documentation is reviewed by the local jurisdiction.

### A small amount of localisation now will save a great deal of resource at a later date

#### In conclusion

Multinationals should separate out their operating locations into three categories and adopt a separate local file template for each of these categories to ensure that the next few years are harmonious and free from ongoing transfer pricing disputes. A small amount of localisation now will save a great deal of resource at a later date. ■



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