give the third party an opportunity to intervene and take steps to protect the confidentiality of the information.

In some cases, CCRA may have information relevant to a taxpayer's case, but may not use it in reassessing the taxpayer. Sometimes, this is because the CCRA auditor may not even know that this information exists. In other cases, there may be a more conscious decision not to use the information. For example, your tax issue may relate to the deductibility of a royalty paid to a related person. Perhaps you know that there are third party licences of similar property, where CCRA has collected withholding taxes. If CCRA uses that information in a transfer pricing case, it will be covered by IC-87R2 as outlined above. But what if CCRA says that they did not use this information? You may nevertheless want to see it yourself in order to test the validity of CCRA's position.

This issue arose in *Smithkline Beecham Animal Health Inc.*, where there was a transfer pricing dispute in which the taxpayer requested profitability information from CCRA relating to other Canadian pharmaceutical companies. Even though the matter was in litigation, CCRA refused to provide the information, arguing that it did not form the basis of CCRA's reassessment. The taxpayer's motion to compel the information was refused by the Tax Court of Canada. On appeal, the Federal Court of Appeal indicated that the taxpayer might have had a basis for compelling disclosure of the information in order to strengthen its own case or weaken the Crown's case. However, it was held that the motion was correctly refused on procedural grounds.

The *Smithkline* case suggests that, in the appropriate circumstances, it may well be possible for taxpayers to obtain third-party taxpayer information from CCRA during the litigation process, even where the information did not form the basis of the reassessment being appealed. Of course, such information may do more harm than good and thus it may not always be in the taxpayer's interest to seek it.

III. Protecting Your Information from Disclosure

The foregoing deals with attempts by taxpayers and CCRA to obtain confidential information from third parties. What about protection afforded the third parties who provide information?

As mentioned above, any information provided to CCRA by a taxpayer is protected against disclosure to other taxpayers by the confidentiality provisions under the Act. This protection may be lost, however, once legal proceedings have commenced.

Where there is a concern about the confidentiality of information or documentation provided to CCRA, the best practice is to blank out information that does not relate to the CCRA inquiry and to put a clear notification on the disclosed materials that they are being provided in confidence on the understanding that CCRA will seek the owner's consent before disclosing them to any third party. This puts you in the best position to be able to control the dissemination of the information by seeking a confidentiality order to limit disclosure.

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Stop Press

GERMANY

Update on Transfer Pricing Documentation Rules

In the July 2003 issue of *Tax Planning International transfer pricing*, we reported on the transfer pricing documentation rules enacted by Germany in the spring of this year and on the June 2003 draft implementing regulations under the new law.[1] A modified version of the proposed regulations has since been released.[2] An Official Explanation of the proposed provisions is included with the July 2003 draft for the first time.

The new July 2003 draft regulations by and large make technical changes in the June 2003 draft. In several cases, sentences have been moved from one place in the draft to another for organisational purposes. The wording is improved or clarified in a few instances. The following is a summary of the principal material changes.

1. The July 2003 draft regulations would extend the qualified small business exemption[3] to

taxpayers earning non-business income, regardless of monetary limits.[4] This means that taxpayers earning lease and rental income, income from capital, income from dependent personal services, and so-called "other income" automatically qualify for the small-business exception.[5]

2. Both drafts require the taxpayer to state the reasons why the third party prices and financial data on which it relies are in fact comparable and document any adjusting calculations made to obtain comparability. However, this requirement has been moved from section 5 (Information Required in Certain Cases) in the June 2003 draft to section 4 (Information Required in All Cases) in the July 2003 draft. This is a material change that makes clear that the tax authorities intend to require third party data as a rule, not just by way of exception.[6]
3. Where section 1 (3) of the June draft required information showing that a taxpayer's business dealings conform to *normal third party practices*, the July 2003 draft requires information showing that the taxpayer's business dealings are in accordance with the *arm's length standard*. This is a change of substance, since normal third party practice and the arm's length standard are not the same thing. The former is a test for, not a definition of the latter.[7]
4. With regard to the aggregation of transactions, the July 2003 draft adds the requirement that aggregated transactions be comparable with respect to functions and risks. It also allows aggregation of transactions that are not of the same or an equivalent type where aggregation accords with customary third party practice.[8] While this is probably intended as a relaxation of the previous rule, it is not entirely clear how the "third party practice" exception would apply.
5. Under the July 2003 draft, the taxpayer would apparently no longer be entitled to present contracts and similar documents in the original language as an initial matter. Rather, it seems that these would have to be translated as a general rule and presented along with the rest of the documentation unless the tax authorities have agreed to accept the original document.[9]

The Official Explanation of the July 2003 draft of the proposed regulations states:

1. that the transactional nature of the required documentation means that documentation based on generalised profit comparison studies (*e.g.,* "worldwide benchmarking studies") without a focus on specific transactions will be rejected as inappropriate, thus exposing the taxpayer to penalties.[10] By implication, a transaction-based profit method, such as the transactional net margin method, may be acceptable.
2. that binding group transfer pricing guidelines can considerably simplify the taxpayer's compliance obligations by replacing individual documentation.[11]
3. that documentation that does not comprise both analytic documentation (arm's length documentation – *Angemessenheitsdokumentation*) and factual documenta-tion (*Sachverhaltsdokumentation*) will be rejected as unsatisfactory, thus exposing the taxpayer to sanctions.[12]

The July 2003 draft appears to have been prepared without knowledge of a scathing article on the transfer price documentation rules published by the Chief Justice of the 1st Chamber of the Federal Tax Court in mid-July 2003.[13] Litigation relating to the transfer pricing documentation rules is ultimately likely to come before the 1st Chamber at the appeals level.

Further changes in the proposed regulations remain probable.

1 Proposed Regulations of June 12 , 2003 on the Nature, Content, and Scope of Documentation under section 90 (3) AO (Tax Procedure Act). See *Tax Planning International transfer pricing*, Vol. 4, No.7, July 2003, p.3.

2 Proposed transfer pricing documentation regulations (Fn.1) draft of 11 July 2003, released on Aug. 7, 2003.

3 This exemption applies to businesses that do not exceed monetary limits of Euro 5 million for related party transactions in goods and Euro 500,000 for other related party transactions. The exemption is not absolute.

4 Proposed Regulations section 8 (1), July 2003 draft. Specifically, the July draft refers to taxpayers that do not earn so-called "profit-based income". Income from agriculture and forestry, independent personal services, or a commercial business is determined by the "profit" as a technical matter (*Gewinneinkunftsarten*). Income in the other four income categories (*Überschuß-einkunftsarten*) is defined as the excess of revenue over expenses.

5 Typically, only individuals earn non-business income. See, however, the *Equestrian Sport* decision of the Federal Tax Court (FTC, Nov. 7, 2001 *Equestrian Sport* – I R 14/01 – DStR 2002, 667).

6 Proposed Regulations (July 2003 draft) section 4 (4) (d); cf. June 2003 draft section 5 (b).

7 Cf. Proposed Regulations section 1 (3) first sentence, drafts June 2003 vs. July 2003.

8 Proposed Regulations (July 2003 draft) section 2 (2).

9 Proposed Regulations (July 2003 draft) section 2 (4).

10 Official Explanation of the July 2003 draft of the proposed regulations (Fn. 2 above), comments on section 2 (2) and section 6 (2) of the proposed regulations.

11 Official Explanation of the July 2003 draft of the proposed regulations (Fn. 2 above), comments on Proposed Regulations section 2 (1).

12 Official Explanation of the July 2003 draft of the proposed regulations (Fn. 2 above), comments on Proposed Regulations section 1 (1) and (2) and on section 6 (2).

13 *Wassermeyer* DB 2003, 1535.

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