

The Platform for Collaboration on Tax

COMMENTS RECEIVED ON PUBLIC DISCUSSION DRAFT:

A Toolkit for Addressing Difficulties in Accessing
Comparables Data for Transfer Pricing Analyses

May 2017

International Monetary Fund (IMF)
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Platform for Collaboration on Tax
A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

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April 2017

Alexandra Readhead welcomes the opportunity to comment on the draft OECD Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses (“Toolkit”). Alexandra is an independent advisor on international taxation and the extractive industries. Her work focuses on issues of tax avoidance and other forms of illicit financial flows by multinational extractive companies in Africa. Alexandra has authored and co-authored a range of policy reports and guidelines, including the first reference book for tax practitioners on transfer pricing in mining. She has advised a number of African tax authorities, Parliamentary Committees, and regional assemblies on strengthening legal frameworks against abusive transfer pricing in the mining sector.

1. Transfer Pricing Issues in Commodity Transactions

The Toolkit refers to the OECD Mineral Product Pricing Guidance, which is a vital contribution to the knowledge base of resource-rich developing country tax authorities seeking to tackle underpricing of related party mineral sales. However, the Toolkit diminishes this practical contribution by reasserting the need for comparability adjustments to quoted prices (e.g. adjustments for quality, contractual terms, transportation, and insurance.) Such adjustments may not be possible for developing country tax authorities that lack the facilities to test mineral grade and quality, and the power to prevail upon offshore related parties to provide the necessary documentation.

Verifying the quality of mineral exports is difficult for many developing country tax authorities: it requires a laboratory with sufficient technical and financial capacity. In a recent study of transfer pricing challenges in the mining sector in Africa, Tanzania was found to be the only country out of five to have the full equipment needed to assess the quality and grade of mineral exports.¹ Consequently, tax authorities are unable to verify adjustments made by companies to the quoted price. This may result in significant loss of revenue. To assess adjustments for contractual terms, tax authorities may need to compare the mine offtake agreement against third party supply contracts usually held offshore by a related party marketing hub. Many developing country tax authorities find it difficult to reach into the group structure of multinationals to insist on this level of information.² These are some of the basic challenges that developing country tax authorities encounter when trying to conduct comparability analyses to benchmark related party mineral sales.

Therefore, the Toolkit should give more weight to exploring the “sixth method” as an alternative approach to pricing commodity transactions. The experience of Latin American countries would be particularly instructive here. Zambia is the only African country to have adopted the sixth method. A

¹ Alexandra Readhead. *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector*. Natural Resource Governance Institute. 2016. pg.33.

² *ibid.* pp 29-32.

new study indicates that both the Zambian Revenue Authority (ZRA), and mining companies, have had a positive experience of the sixth method. Company representatives referred to it as a “pragmatic approach” which has made ZRA’s tax treatment of sales revenue more predictable.³

The Toolkit proposes the ‘netback approach’ as another method for adjusting the quoted price of an intermediate product, where a known arm’s length price is available for the refined version of the product. To apply the netback approach, it may be necessary to evaluate treatment and refining costs (TC/RCs) paid to related smelters and refineries. To avoid the need for complex comparability analyses, the Toolkit should flag the option of benchmarking TC/RCs, and legislating simple percentage deductions. TC/RCs are generally small and consistent, and there is reasonable price transparency. This approach would reduce the need for comparability analyses by capping refining and treatment charges that may otherwise be used to reduce the tax base.

Recommendations:

- 1.1 **Prescriptive approaches to pricing commodities should be covered in more detail in the Toolkit, or in follow up materials.** The Latin American experience of the sixth method should be explored so that developing countries can weigh the pros and cons of such an approach. The OECD should use the Mineral Product Pricing Guidance work to inform the development of specific pricing formulas to be included in domestic legislation.
- 1.2 **The Toolkit should call on international partners to support resource-rich developing countries to establish mineral testing facilities, collaborate with existing regional facilities, or contract private assaying firms.**
- 1.3 **Further work is required to benchmark treatment and refining costs in the case of intermediate mineral products.** This would be a useful addition to the Mineral Product Pricing Guidance.

2. Addressing the Difficulties in Performing Comparability Analyses

In the current environment where the OECD guidelines govern international transfer pricing arrangements, developing countries have had to establish the legal rules, capacities, and institutions required to implement the arm’s length principle as best as possible. Therefore, it is appropriate that the Toolkit explore how developing countries can strengthen comparability analyses to apply transfer pricing rules. There are many pragmatic proposals in the Toolkit that developing country tax authorities should consider adopting. There are three that are worth specific mention:

- **Tax authorities may use information from local tax filings to inform risk assessment, and potentially audits, as well as the development of safe harbours.** This is particularly appropriate given the prohibitively high cost of commercial transfer pricing databases, as well as the geographic relevance of the available data. The recommendation to set up an international

³ Alexandra Readhead. *Special Rules for Commodity Sales: Zambia’s Use of the Sixth Method*. Natural Resource Governance Institute. 2017.

database derived from information collected by tax administrations should be carried out by regional bodies such as ATAF with support from partners. Thorough anonymization of taxpayer data should alleviate concerns about potential commercial sensitivity of disclosing taxpayer information used to inform risk assessment and audit. Alternatively, there is sufficient precedent for tax authorities not to make this information public at all.

- **Legislating the arm's length range.** It is not uncommon for taxpayers to present such a wide arm's length range that different points along it have vastly different implications for tax revenue. Capping the arm's length range means that tax authorities can focus on determining the appropriate point along the range, rather than testing the range itself.
- **Where there are independent minority shareholders involved in related party transactions, tax authorities may treat data from these transactions as a source of comparables.** This suggestion is particularly relevant in the mining sector where companies are often required to have a certain percentage of local ownership (for example 26% in South Africa), or where state participation is required. However, tax authorities should be mindful that there is still a chance that minority shareholders may collude or be ignored by the majority.

But even with the new proposals put forward in the Toolkit, the comparability analyses are still too resource intensive and complex for developing countries to implement. This is proven by OECD country experiences outlined in the Toolkit, let alone developing country experiences which receive little mention. For example, Box 12 states that a 'number of countries reported that they hesitate to make comparability adjustments because they believe they lack the experience or knowledge to apply them and to fully understand the ramifications.' Further support for this position is found in a recent study into implementation of transfer pricing rules in Tanzania, where the tax authority finds comparability adjustments information and resource intensive; the Head of the International Taxation Unit said that "any adjustment can be debatable, leading to complaints from taxpayers."⁴

Options for limiting comparability analyses in Part 3 are a positive step, but have significant drawbacks.

- **Safe harbours are regarded as inappropriate in the case of complex, high-risk related party transactions.** According to the Toolkit, safe harbours should be restricted to related party transactions that do not involve valuable intangibles or significant risk. Whilst it is more difficult to design appropriate safe harbours for complex transactions, these are precisely the types of transactions that present the greatest risk to revenue, and where developing country tax authorities struggle the most. Safe harbours for low-risk related party transactions are a useful way for tax authorities to prioritize limited audit resources. However, where possible, the OECD should lead the development of similar measures for more challenging transactions (e.g. the Australian Tax Office's informal safe harbor for offshore marketing arrangements.)
- **The Transactional profit split method requires hard-to-get information from foreign related parties.** This is something developing countries find hard to get.

⁴ Alexandra Readhead. *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector*. Natural Resource Governance Institute. 2016. pg.16.

- **Advance Pricing Agreements (APA) are resisted by developing country tax authorities due to fears of getting locked into bad deals.** APAs may simplify administration of the arm's length principle. However, very few developing countries have entered into one due to concerns about being "outgunned" in negotiations with sophisticated taxpayers.⁵ These concerns must be addressed if APAs are to become a feasible option for developing countries. Donors should consider providing support to developing countries to design and negotiate APAs.

The best option for developing countries is to introduce prescriptive rules that reduce reliance on the arm's length principle and limit the ability of foreign multinationals to avoid paying taxes. The Toolkit recognizes that such anti-avoidance rules represent a valid response by developing countries to BEPS. However, there is limited space afforded to exploring these measures in any real depth. Developing countries must be supported to find context-relevant and innovative ways to stop multinationals from using cross-border transactions to avoid tax. BEPS Action 4, which proposes a hard cut-off for interest deductions, is an example of the pragmatic response required. Research has shown positive experiences in South Africa and Zambia in implementing alternative tax policy rules. For example, the tax authority in Zambia reports that use of the "sixth method" makes it harder for companies to distort their mineral sale price to avoid tax. "It removes a free kick for companies," says one Zambian tax official. Developing countries do not have the resources to audit all transfer pricing practices of multinationals. So, they must avoid getting into unwinnable battles by introducing clear, objectively verifiable and easy to administer tax rules.

Recommendations:

2.1 The Toolkit should explore in more detail the experience of countries that have chosen to use non-public information in comparability analyses (e.g. China, Turkey, Mexico). This approach seems appropriate for developing countries given the cost and relevance of commercial databases.

2.2 Recommendation #7 in the Toolkit (safe harbours) should explicitly include work on designing safe harbours for hard-to-value transactions. There could be a more specific recommendation for the OECD Mineral Product Pricing workstream to also cover development of safe harbours for high-risk related party transactions in mining (e.g. an industry specific safe harbour for interest deductions).

2.3 The Toolkit should call on international partners to support developing countries to design and implement APAs. This might be an area where Tax Inspectors Without Borders could assist.

2.4 For reasons outlined above, Recommendations #8 (use of quoted prices) and #9 (prescriptive, anti-avoidance measures) should receive significant time and effort in future work by the OECD.

⁵ Alexandra Readhead. *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector*. Natural Resource Governance Institute. 2016. pg.17

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**Comments on the Discussion Draft
“A Toolkit for Addressing Difficulties in Accessing Comparables Data
for Transfer Pricing Analyses”**

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VIA E-MAIL

To the Attention of

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The Platform for Collaboration on Tax,

GlobalTaxPlatform@worldbank.org,

Re: Comments on the Discussion Draft "A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses"

Dear Mrs. Brown, Dear Sir / Madam,

ArcelorMittal is the world's leading steel and mining company. Guided by a philosophy to produce safe, sustainable steel, it is the leading supplier of quality steel products in all major markets including automotive, construction, household appliances and packaging. ArcelorMittal is present in 60 countries and has an industrial footprint in 19 countries.

ArcelorMittal appreciates the opportunity to provide input to the Platform for Collaboration on Tax with respect to Draft of a Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analysis and would be pleased to respond to any questions or to provide further input as the work of the Platform for Collaboration on Tax on this item continues.

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Executive Summary

The “Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses” (“Toolkit”) provides with a comprehensive summary of the main principles for performing comparability analysis for transfer pricing purposes. Under Part I, II, and III the Toolkit describes broadly the current transfer pricing rules, comparability methods as well as alternative solutions addressing therefore all currently prescribed and applied approaches covered by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“OECD Guidelines”) and the United Nations Practical Manual on Transfer Pricing for Developing Countries (“UN Transfer Pricing Manual”).

The Toolkit confirms clearly the arm’s length principle as the general standard for Transfer Pricing. It emphasizes the need of sufficient level of comparability of data used for Transfer Pricing Analyses and it recognizes several difficulties that may arise when performing Transfer Pricing Analyses.

However, the Toolkit is providing only limited guidance on ways to improve comparability and remains reserved towards clear recommendations for situations where sufficient comparability cannot be achieved.

Instead the Toolkit does highlight the possibility to use so called “Prescriptive Methods”, notwithstanding the fact that such methods are contradictory to the arm’s length principle and are likely suited to create substantial disputes, including the risk of double taxation, on transactions between jurisdictions which do not allow the use of “Prescriptive Methods” and Jurisdiction which request the use of such methods.

The Toolkit indeed addresses many of the challenges associated with comparability analyses. With the published draft of the Toolkit The Platform for Collaboration on Tax nevertheless lags behind the potential to pave the way towards a universally applicable set of methods for Transfer Pricing Analyses based on the arm’s length standard.

Consistency with existing guidance and the arm’s length standard

In general, a large part of the Toolkit may be used as practical guidebook given in addition to the theoretical guidelines of the OECD, as well as the UN TP Manual and as such does not raise specific comments of a critical nature to its content. In that sense the document indeed could be seen as a “toolkit” for Tax Authorities and Transfer Pricing professionals. In addition, it shows that principally the arm’s length standard should be applied based on the same matrix solutions in all countries and differences in Transfer Pricing

are driven by objective difficulties, and not per se by differences in methodological approaches between developed and developing countries.

According to the Toolkit, the focus needs to be put on “accurately delineating” the controlled transactions, and that is dictated by the nature of the transactions (e.g. characteristics of asset or service, functions and risk undertaken), economic condition (e.g. market of operations, business strategies), and/or factual circumstances (e.g. lack of data source). Again, from such perspective the Toolkit should be viewed as a helpful and welcomed document.

In particular, the reflections on importance of the functional and risk profile of the entities involved in all transactions, including commodities transactions, should be seen as very positive. This follows the OECD guidelines and current BEPS approach with focus on risks analysis, including financial capacity to assume risk, as well as encountering for upside and downside consequences of risk outcomes. Also worthy are comments about the importance of choosing the tested party, and the potentially significant differences the in outcome of the analysis depending on that.

Secret Comparables and customs data

As for developing countries the use of information collected by Tax or Customs Authorities seems to be more relevant than for developed countries, it would have been helpful to underline in the Toolkit that there is not only the question whether information is available to taxpayers or not, but also when this information is available. Information collected by authorities could be disclosed, if disclosed at all, only with a likely significant time lag and can therefore not be used for setting transfer prices in the moment when transactions take place. A clear statement should be made that the use of secret comparables by Tax Authorities is contradicting with the arm’s length standard and can create considerable uncertainty for the taxpayer.

Access to Commercial Databases

The Toolkit aims to address the difficulties in using commercial databases. Among others two main constraints have been identified, the lack of local comparables and the limited access of Tax Authorities to databases. In our view the latter point has nothing to do with Transfer Pricing. It is pure matter of having appropriate resources available at the level of the local Tax Authorities. It should be noted that the argument that Transfer Pricing analyses and the extensive documentation requirements are very costly and

burdensome for the taxpayers was repeatedly ignored by the OECD. So, budgetary constraints or lack of resources cannot be used as argument why Tax Authorities should not perform a proper Transfer Pricing analysis using commercial database, if such approach would be the most appropriate one.

The limited availability of local comparables however is indeed a critical point that may impact the use of commercial databases, and may then require the choice of a less appropriate transfer pricing method leading to unreliable outcome. On this point the Toolkit could have provided with more guidance and practical recommendations (please see below).

Comparability adjustments

Considering that the Toolkit aims to address the issues of comparability analyses one could have expected that this topic is discussed in a more comprehensive manner. The Toolkit rightly recognizes that finding ideal comparables is difficult and rather exceptional. However, limited comparability, restrictions in transparency, as well as the need to use projections and estimations is something that unrelated parties must deal with in all their business activities. Consequently, Transfer Pricing standards based on the arm's length principle should provide with a framework that allows to deal with limitations in comparability. Such framework for comparability adjustments is probably even more required for Transfer Pricing analyses of transactions with developing countries. In this context, the guidance provided on determining the arm's length range and adjusting or narrowing it via financial ratios is undeniably helpful. However, missing out the opportunity to transpose the conceptual framework on comparability as provided in the OECD guidelines into a practical guide for Tax Authorities in developing countries is a weaknesses of the Toolkit.

Prescriptive Methods

The Toolkit, in its attempt to bridge views of developed and developing countries on Transfer Pricing, places the prescriptive method among "other methods", or "sixth method" in OECD terminology, regardless the potential contradictions with the strong message on the necessity of a proper functional and risk analysis given as basic considerations of the Toolkit.

It is crucial to point out that the Toolkit on one side is noticing the over-simplification of the prescriptive methods however it quite fiercely defends this approach as de facto sort of CUP method as far as proper comparability adjustments are applied. Arguments given by the Toolkit pro prescriptive method, as: "... *clear application of criteria*...,...*quoted prices are likely to be most reliable and transparent basis for determine*

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arm's length prices.....approach on line with industry practices ..." are definitely far too general and in a straightforward way are not compliant with complex reality of business which operates not only on spot-based contract but in equal manner on long-term agreements whereas the index prices can't be use as a the sole reference.

Moreover the recommendation made by the Toolkit : *"toolkit proposes that work (on prescriptive methods) should be carried out to determine the feasibility of further developing these types of method to increase their reliability, ... in particular by incorporating a framework for adjustments such as those based in netback approaches."* would lead to the conclusion that prescriptive methods with adjustments as proposed by the Toolkit, in particular netback adjustments for commodities, is at the end close to the CUP method. If this is the case we believe there is no need to arrive to a traditional CUP method via a back door named prescriptive methods. Moreover, in practice the developing countries limit the application of adjustments and therefore the Transfer Pricing governed by prescriptive methods could be often lead to an outcome that is not in line with the practice in the open market.

Conclusion

This Toolkit is remarkable step forward in providing with more clarity and centrality regarding Transfer Pricing for Tax Authorities and taxpayers in developing countries. We appreciate this imitative and in particular the fact that we had the opportunity to provide our views already in the preparation of this draft. While in our comments above we have mainly focused on points where we believe some improvement is required we acknowledge that the draft of the Toolkit is a very comprehensive and practical guidance. We would be very happy to explain our views and comments in more detail in a meeting or in a telephone conference.

Comments on draft comparability toolkit

Thank you for the invitation to comment on the draft toolkit addressing difficulties in accessing comparables data. This is important and valuable work by the Platform for Collaboration on Tax, and I offer comments on one or two points relating to broadening the typical search process, reference to profit splits, and safe harbour design. The comments are intended to help support the objectives of making better use of available data, as well as developing alternatives when comparables are not useful or when the reliance on a comparability exercise can be lifted. In so doing the comments partly respond to some of the questions raised, but disjointedly and not in a comprehensive manner. These comments reflect my personal views and have not been prepared on behalf of or at the request of any other person or organisation.

A. Broadening the Search Process

1. Broadening the typical search criteria, as discussed in section 4.2 and Box 10 on page 33, represents a key improvement in allowing data to be used rather than unnecessarily discarded. The prominence of geographic screening may lead to erroneous conclusions that there are no useful comparables, and the focus on narrow industry classification codes may serve to diminish comparability. Broadening the search criteria is an approach already adopted in practice, but the discussion in the draft toolkit may be interpreted as expressing caution about broadening the selection criteria and may, pending the further work recommended in the draft toolkit, seem to discourage exploration of how to make best use of available data. Since the potential comparables resulting from a broadened approach may appear to be very different to those that may be perceived to be expected, endorsement of the specifics of a broadened approach by the Platform for Collaboration on Tax is necessary in order to provide greater confidence that the approach can be relied upon.
2. One of the problems encountered in effectively performing a search for potential comparables using a commercial database is largely self-inflicted; it is caused by the elevation of geographical market in the order of screening criteria (as Box 7 on page 28 shows and seemingly supports, geography is typically the second screening criterion). The elevation of geographical market immediately reduces the numbers of potential comparables simply because of data limitations by country: as Appendix 4 tellingly summarises, there are over 150 countries that are unlikely to have sufficient data to provide comparables relating to their country, yet there are tens of thousands of data points for over 30 countries. Elevating geography as a screening criteria tends to emphasise the paucity of data for particular countries, ignores the wealth of data that could be utilised, encourages a perception that geographic comparability overrides other comparability factors, and perpetuates the perception that useful comparables do not exist. In turn, this puts pressure on the arm's length principle.
3. The typical elevation over other comparability factors of geographic comparability as a screening factor is difficult to justify on technical grounds. It seems more likely that the use of geography as an initial screening factor has developed as a practice for dealing with large volumes of potential data points in those countries that are data-rich. In any event, there are many comparability factors

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for the potential comparables about which very little or nothing is known (for examples, contractual terms, components of pricing, risk profile, business strategy, product or services mix, markets of customers), yet we are content to assert approximate comparability. It may seem odd that the one factor we do know about, country of incorporation, is treated more uncompromisingly.

4. Further focus on geographic comparability will arise when tax administrations have access to CbC data and perceive the margins reported by a MNE around the world for apparently the same routine functions. If geographic comparability continues to be elevated in the screening process, there may seem to be something wrong about a MNE reporting consistent rates of return for similar low-risk activities around the globe, and tax jurisdictions that seem to be systematically disadvantaged through the vagaries of geographic screening may turn to different approaches. Both outcomes would be unfortunate.

5. My suggestion is that even without further research work being undertaken it is not sensible to elevate geography as a screening factor above other comparability factors, particularly for those countries included in those 150 or so listed in Appendix 4 that will have very few data points anyway. If there were something important for comparability about the particular country, then this might be adjusted for in the comparable data derived from other geographies, as the draft toolkit indicates. This seems to be a better approach than continuing to use a geographical screening criterion but extending it to other countries in the region on the dubious assumptions that countries are comparable since they are near each other, and that countries far away are not comparable. *Therefore, I suggest that consideration is given to provide guidance in the toolkit that initial geographic screening in a typical search process is useful only when the tested party operates in a country for which there is an abundance of relevant data points that provide an adequate sample for further refinement.*

6. In addition, when the local function is relatively low-risk, and therefore somewhat insulated from market conditions, and with limited exposure to its working capital (which may itself be limited), it is less likely that the local function needs to be adjusted for country risk factors that are effectively assumed by the other party to the transaction. *I suggest that consideration is given to provide guidance in the toolkit that the impact of potential country features on the rate of return for low-risk activities is likely to be limited.*

7. *I suggest that consideration is given to provide guidance in the toolkit that economically significant financial ratios should be elevated in the typical screening criteria.* Box 10 hints at this when it refers to finding potential comparables in other geographies and in other sectors, and the guidance should be developed in order to encourage such an approach. In addition, I suggest that any further work on reliability of comparables from other geographic markets should also consider the impact of potentially greater comparability provided by alignment of economically significant financial ratios. In other words, the work should not just examine, for example, manufacturing returns by industry classification across different countries, but should look at manufacturers in different

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countries with similar ratios, such as fixed assets to total costs or employee costs to total costs. *I suggest that consideration is given to focusing any further research not on whether the search process starts with homogeneity in rates of return for activities with the same industry classification across countries, but whether the process after making comparability adjustments including alignment of economically significant financial ratios ends with homogeneity for parties in different markets.*

8. Economically significant financial ratios are much the same concept as the diagnostic ratios discussed in section 6.3.1, but the stage at which they are used is different. Such diagnostic ratios are very useful in identifying the more comparable enterprises in the final set. However, they are also useful as a screening criterion early in the process of selecting comparables and before other criteria are used which may unnecessarily limit the data available or which may screen out potentially useful comparables.

9. Concern about the elevation of geography in the screening criteria can extend to the elevation of industrial classification codes. Where there is a large amount of data to filter, such codes can be useful. But where there is a small amount of data, such codes, if used narrowly to focus on product rather than on activity, can remove potentially useful comparables. This is particularly the case when the search criteria are not aligned with the accurate delineation of the actual transaction, which, as the draft toolkit correctly emphasises, is often much more important than the mechanics of benchmarking. For example, the accurate delineation of the transaction involving a controlled pharmaceutical distributor may show that it markets a small range of specialised drugs, it outsources box-shifting to a third-party logistics provider, it assumes no inventory or credit risks, and employs a large sales force. To then turn to a database and begin with an industry classification filter relating to pharmaceutical goods importer (wholesale) is unlikely to retain alignment with the accurate delineation of the controlled transaction. If the resulting supposed potential comparables are those of aspirin-to-zimmer wholesalers with large warehouses and distribution infrastructure, significant inventory and credit risks, and a relatively small sales force, then probably the only thing in common with the tested party is a shared industry classification. The economics of the two businesses are far from comparable. Applying diagnostic ratios to such an inappropriately filtered set in order to find potential comparables with, say, lower fixed asset ratios, lower inventory ratios, and employee to cost ratios aligned with the tested party is like looking for a banana in a box of apples, and pretending the most yellow apples are bananas. Starting with a box of bananas is better. The accurate delineation of the transaction suggests that the activity is that of marketing, and rather than try to turn an aspirin-to-zimmer wholesaler into a marketer, it may be more useful to start with marketing activities across all products and to screen at the initial stage for significant financial ratios (for example, the tested party may have a low ratio of assets to total costs, and a high ratio of employee costs to total costs, both of which may be relevant screening ratios when searching for comparable marketing activities). *I suggest that consideration is given to provide guidance in the toolkit that financial screening ratios can be used to filter data to achieve greater comparability with the tested party than can be achieved by narrowing industry classification codes that may in practice diminish comparability.*

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10. It would be helpful if the Platform for Collaboration on Tax could be very clear on the ordering of screening criteria, and in particular whether it is necessary to elevate geographic screening or use narrow industry classification codes, since the results from a broadened approach will look very different to some current expectations of typical benchmarking. For example, instead of wholesalers of after-market car parts being used as apparent comparables for national marketing subsidiaries of global car manufacturers, one may propose more reliably under a broadened approach a set of comparables including marketing activities involving mobile telecommunications products or kitchen appliances that show relevance to the economics of the delineated functions, assets, and risks; instead of computer assemblers being used as apparent comparables for chip manufacturers, one may propose more reliably under a broadened approach a set of comparables that include food manufacturing and which demonstrate similar key financial ratios; and instead of comparables from the same country or region, one may propose more reliably relevant comparables from other countries. The direction suggested by Box 10 is that comparables for the distributor of mining machinery in Country A could be a distributor of building materials in Countries X, Y, and Z. All these scenarios are not only possible to envisage, but are being explored and adopted in practice so as to make the best use of data. It is not helpful if readers interpret the draft toolkit as not endorsing such approaches, and *it would be a considerable improvement if the draft toolkit made specific recommendations about flexibly substituting broader functional comparability and financial screening ratios for narrow industry classifications and geographical market screening.* To utilise the wealth of potential comparables available in this manner and strengthen application of the arm's length principle, endorsement from the Platform for Collaboration on Tax will be valuable.

B. Profit Splits

11. The discussion of profit splits in Section 5 of Part III is likely to touch on some sensitive and strongly-held views about whether, and if so to what extent, profit splits open a valve to release pressure on the arm's length principle based on comparability. On the one hand, profit splits, coupled with valuation techniques, can be used to value royalties in the absence of comparables, but on the other hand profit splits are a highly specialised method that can be reliably applied only in very specific arrangements. As the draft toolkit indicates, a lack of comparables alone is insufficient to warrant the use of a profit split under the arm's length principle.
12. Nevertheless, a profit split does have a potential advantage, at least in some types of its application, in that it starts with an actual profit rather than a benchmarked profit, although it is true that the profit on the transaction accruing to the parties may not be readily computed. Also, when it is difficult to bring reliable comparables to bear, experience suggests that practitioners and tax officials do try to evaluate a sharing of total profits, taking into account the contributions of the parties as best they can. However, the sensitivity arises because this is not an application of the profit split as set out in Chapter II of the Guidelines, the bar determining whether there are reliable comparables is not capable of objective measurement and may be set too low, and there are no ground rules about what principles should apply in evaluating the appropriateness of each party's

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share. There is likely to be additional focus on the evaluation of how profit is shared when tax administrations review CbC data.

13. The appetite for using some kind of profit allocation approach is not likely to diminish, and so the development of ground rules would be helpful while maintaining a distinction between such an approach and the profit split method described in Chapter II of the Guidelines. *The following paragraphs offer some suggestions that might prove stimulating in considering potential guidance for using profit allocations in the absence of comparables.*

14. *One way of verifying the allocation of profit in the absence of comparables might be termed a comparable allocation method.* (Seeds of this approach may be seen to be planted in some aspects of the discussion of profit splits in chapter II of the OECD Guidelines, but they have not germinated.) For example, suppose there are reliable comparables for an MNE's controlled transactions in the European market and that these determine the arm's length profit for the European distributors and production entities; suppose also that these benchmarked profits result in an allocation of total profit for the European market of 35% to distribution, 25% to manufacturing, and the balance to services and intangibles contributed by the global head office. In the absence of comparables for the distribution and production entities in Latin America, for example, or in order to support the reliability of potentially inaccurate comparables, the allocation determined for Europe could be applied to the total profit for the LatAm market. In this scenario, it is assumed that the same functions are performed by the distribution and manufacturing entities in both regions, or that accurate adjustments to the allocation of profits could be made for any differences in functions, and that the functions are entrepreneurial and involve the assumption of risk. If the functions were low risk, it is less likely that reasonably accurate benchmarking of the LatAm entities could not be performed, or that their results would be significantly influenced by potential differences in local market conditions.

15. *Another way might be to draw a not unreasonable conclusion from the inability to find anything usefully comparable in the open market for the controlled transaction: the controlled transaction with no open market reference should be regarded as an internal arrangement.* There are ground rules for evaluating internal arrangements set out in the 2008 and 2010 OECD Reports on the attribution of profits to permanent establishments. Under this suggested approach one would deem the transaction between the associated enterprises for which comparables cannot be found to be conducted for the purposes of evaluation within a single enterprise. There would still be no comparables available to price the "dealing" but the focus on the location of significant people functions, and the attribution of risks and assets, may prove a useful framework for attributing the shares of the combined profit to the parties. Sanity checks on profit allocations that are currently used are probably closer to an attribution of profit approach than to a formal profit split as set out in Chapter II of the Guidelines, and so acknowledging the approach would at least introduce some agreed rules. If for no other reason, the potential complexities involved in deeming the transaction for which it seems there is nothing usefully comparable in the open market to be an internal arrangement may serve to encourage a more intensive examination of what might be available to use as comparables.

Comments on draft comparability toolkit

C. Safe Harbours

16. Safe harbours can in principle reduce the reliance on benchmarking studies and can be designed to align with a country's fiscal policy objectives and sources of economic activity. However, eligibility criteria can be difficult to determine, and tax administrations may tend to design narrow entry definitions that can reduce effectiveness. As an aside, descriptive eligibility criteria can be difficult to draft and interpret; instead, just like the use of economically significant financial ratios in the context of screening for comparability, financial ratios could also be used to determine eligibility appropriately and clearly (for example, marketing spend above a certain ratio to total costs would lead to non-eligibility). Nevertheless, improvements to eligibility criteria may not improve the effectiveness of the safe harbour so much as a safe harbour which is more universal in design, but with specific exemptions. Such an approach, for example as outlined below, may be feasible.
17. It is noticeable that the examples of transactions for which safe harbours may be appropriate on page 55 all have in common the absence of significant risk. In turn, the absence of significant risk means that the expected profitability across a wide range of activities is likely to be predictable and stable within a narrow range, and may be less affected by any market differences between countries, leading to greater prospects of the adoption of common approaches across countries. *It may be worthwhile considering harnessing this common feature to provide guidance on designing an effective safe harbour that covers all intra-group activities where control of economically significant risks is not exercised in the country, with the exception of certain specified sectors which may be important for the country's economy or which present other policy concerns or risks factors (e.g. mining, software, insurance, as the case may be).* This safe harbour would likely require the taxpayer to provide supporting material which could include contract terms and a risk statement modelled on the principles of Chapter I of the OECD Guidelines. One could spend resources on defining appropriate profit level indicators and various profit levels, but such an approach brings complexity. If one of the key reasons for turning to safe harbours reflects the difficulty in finding reliable comparables, or indeed any comparables, it may be sensible to adopt one-size-fits-all: that is one profit level indicator (I suggest mark-up on total costs), and a fixed mark-up rate.

Thank you for considering these comments. I should be happy to discuss further any points you think may merit development.

With best wishes

Andrew Hickman



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February 21, 2017

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**Re: TPWG Comments on Discussion Draft of A Toolkit for Addressing Difficulties
in Accessing Comparables Data for Transfer Pricing Analyses**

Dear Sirs and Madam:

We are writing to share the comments of the Treaty Policy Working Group (TPWG) on the draft *Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses*, which was prepared by the Platform for Collaboration on Tax in response to a request from the Development Working Group of the G20 and released on January 27, 2017 for public comment.

The TPWG is an informal association of large global companies that represent a spectrum of industry sectors.¹ The TPWG has been working since 2005 with the

¹ The membership of the Treaty Policy Working Group is currently comprised of the following companies: Amazon.com, Inc.; BP plc; Cisco Systems, Inc.; Procter & Gamble Co.; Salesforce.com Inc.; and Tupperware Brands Corporation.

OECD and since 2010 with the UN to analyze proposals and provide constructive comments on tax policy and administration concerns regarding transfer pricing and other issues. The development of a broad international consensus that minimizes tax uncertainty, prevents double taxation, avoids interpretive disputes, and reduces compliance burdens is critical to the ability of our member companies to create growth and employment through international trade and investment around the world.

The TPWG is pleased to have an opportunity to comment on the Draft, which addresses issues of great practical importance to our member companies. Given timing constraints, our comments necessarily focus more on the key issues for business than on specific drafting points and we have not attempted to comment on industry-specific issues. We first share some general comments and then offer some specific recommendations on the Draft.

I. General Comments

We applaud and support the goal of the “toolkits” initiative, which is, according to the Platform statement accompanying the Draft, “designed to help countries that may have limitations in their capacity to design or administer strong tax systems.” If well designed and properly implemented, the toolkits will facilitate the orderly determination and collection of taxes due. As a result, they have great potential to promote sustainable development by reducing the tax uncertainty and compliance burdens that currently discourage investment in many countries. This will not only improve current revenue collection and make more efficient use of tax administration resources, but also encourage additional investment and the resulting economic growth.

This Draft is an excellent start in many respects. Its recommendations are helpfully presented in a broad, practical context, with step-by-step advice and supporting documentation on many key aspects of conducting a transfer pricing analysis. This approach is sure to be more useful for tax administrations and less likely to create confusion than an isolated discussion of comparables data. The Draft is also generally well balanced in its analysis and recommendations and is very clearly written and well organized without being oversimplified.

We commend the Draft’s analysis of limitations on comparables data and its constructive consideration of potential remedies. Unlike many discussions of this subject, the Draft distinguishes clearly between issues regarding the availability of data and issues regarding the capacity of tax administrations to obtain and analyze data. It correctly acknowledges that some data availability issues are structural in nature, such as those related to financial reporting requirements, the prevalence of state-owned enterprises, the existence of a limited number of taxpayers in-country, and the need to protect taxpayer confidentiality. The Draft then offers a series of practical remedies designed to accommodate these limitations.

We particularly appreciate this uncommonly pragmatic approach. The Draft’s recommendations are generally practical and accompanied by a number of helpful cautions. For example, after acknowledging that “[i]n many cases, comparability data provides information that can only

approximate an arm's-length measure of price," the Draft concludes that "[t]his reality means that all parties need to be realistic about the use of comparability data and avoid the misperception that comparability analyses always result in a well-defined and definitive answer." It is refreshing to see guidance that calls for a realistic approach and resists the temptation to jump to the conclusion that such imperfections make comparability analyses impossible.

This approach is clear in the Draft's discussion of one-sided methods such as the Transactional Net Margin Method. Instead of concluding that the TNMM is not a viable method because of comparables data limitations, the Draft generally supports its use where it is the most appropriate method. It advises against the increasingly common practice of defaulting to other methods such as profit splits simply because perfect comparables are not available, and cautions strongly that "the selection of a profit-split method purely on the basis of a lack of data . . . risks leading to a significant departure from the arm's-length outcome." We believe that this advice is principled, pragmatic, and necessary to prevent wholesale deviations from the internationally accepted arm's length principle endorsed by both the OECD and the UN and incorporated in virtually all bilateral income tax treaties.

In addition, we especially welcome the release of this Draft for public comment. We understand that seven other toolkits or reports have been requested by the G20 for delivery by 2018, and that work on at least some of these has been underway for some time within the international organizations participating in the Platform and has even been completed in some instances.² This Draft (together with its supplementary material on minerals pricing) is the first of the series to be released for public comment. We submit that stakeholder input would strengthen these toolkits and reports, especially where they relate to practical tax compliance and administration matters on which global businesses have a unique breadth of experience. It also seems more appropriate, in this era of increased tax transparency, to permit stakeholders to comment on guidance under development. We hope that the Platform will release future toolkits and reports in draft form (ideally with more time for comment) and will make public the texts of any others that have already been finalized.

II. General Recommendations

Despite its considerable virtues, we believe that the Draft could be further improved with additional or modified guidance on certain issues. We summarize these points below:

² The G20 Development Working Group has also requested the following toolkits or reports: Report on Tax Incentives; Report on Indirect Transfers of Assets; Toolkit on Transfer Pricing Documentation requirements; Toolkit on Tax Treaty Negotiation; Toolkit on Base Erosion Payments; Toolkit on Supply Chain Restructuring; and Toolkit on Assessment of BEPS Risks. Of these, only the Report on Tax Incentives has been published to date, and it was prepared and finalized without opportunity for public comment. The current status of the remaining documents is not publicly known.

A. Enhancing the Utility of the Case Studies

We commend the inclusion of numerous case studies and examples in the Draft. We anticipate that many tax administrations will readily and frequently refer to these to provide education and practical guidance to their transfer pricing risk assessment and examination efforts. In fact, since the need for such examples and guidance is so great, we think the Case Studies have the ability to become a key resource for tax administrations. With that in mind, we believe the Case Studies could be further improved with some additional consideration, structuring, and expansion.

We believe that tax administrations would benefit more from a series of carefully crafted Case Studies that methodically develop across a series of common fact patterns. We recommend that the first installment of each Case Study focus on a relatively straightforward set of facts that leads to a relatively straightforward application of a specific transfer pricing method, perhaps with TNMM prominently featured, given the frequency with which that method is used and its emphasis elsewhere in the Draft. In addition, the first installment of each Case Study could be based on the premise that the tax administration reviewed the taxpayer's documentation, validated the key facts and suitability of the method and comparables analysis, and concurred that the taxpayer's transfer pricing was reasonable. Subsequent installments could complicate the case by altering the key facts and/or the selection and application of the method, including challenging the suitability of the comparables used by the taxpayer. Such an approach would seem far more instructive than the Cases Studies in their current format, particularly for tax authorities that have relatively little experience with transfer pricing matters, but also for taxpayers seeking to apply reasonable transfer pricing analyses.

Moreover, we are concerned that the Case Studies as they now stand miss an important opportunity to reinforce the lessons and messages of the Draft. They do not provide any insight into the question of how to select, interpret or evaluate comparables. Instead, the case studies largely focus on recharacterizing the transactions.

B. Clarifying the References to Recharacterization

It is also important for the Draft to clarify and provide appropriate context for its references to recharacterization. It is striking that, although recharacterization is universally recognized as a rare measure reserved for very limited circumstances, every one of the Case Studies involves recharacterization of the taxpayer's transaction by the tax administration, with little or no insight into the basis for this action.

This seems to signal more latitude for recharacterization than international transfer pricing guidance permits. The Draft should provide a more realistic balance, to avoid any inference that it is intended to encourage broad use of recharacterization by tax administrations. If examples involving recharacterization are to be included in the Draft, they should explain the factual circumstances and technical analysis supporting the recharacterization. The Draft should also

specifically note the limitations on recharacterization agreed in the BEPS work instead of just providing a cross-reference to an OECD document in a footnote.

C. Refining the Safe Harbor Recommendations

The Draft contains a very interesting and potentially very important discussion of the role that safe harbors can play in transfer pricing. We strongly support the provision of safe harbors in principle, and believe that they can ease burdens and provide needed certainty for both tax administrations and taxpayers. However, we also recognize that they need to be carefully designed to operate properly within the arm's length principle.

We agree with the Draft that bilaterally or regionally agreed safe harbors are generally preferable to unilateral approaches, both because they are more efficient and provide greater certainty and because they are less likely to create double taxation (or double non-taxation). However, the Draft raises a couple of concerns that first need to be addressed.

First, while the Draft acknowledges that safe harbors may be voluntary, it signals a preference for the use of mandatory safe harbors with a taxpayer opt-out. While the requirement of an opt-out option is appropriate in our view, the Draft further suggests that the burden of proof should be borne by the taxpayer if it chooses to opt out. This would be a major departure from the way the transfer pricing regimes and other laws of many countries operate, and it would limit the practical availability of the opt-out option in many cases. Without an effective opt-out option, a mandatory safe harbor becomes difficult to distinguish from the Brazilian fixed margin method, which is widely regarded as inconsistent with the arm's length principle.

This concern is heightened by the Draft's suggestion that tax administrations may use confidential "secret comparables" data reported to tax administrations by unrelated taxpayers to set safe harbor margins. We question whether it would be appropriate to create mandatory safe harbors based solely on tax return data, because those data do not provide all of the facts relevant to a transfer pricing analysis. In addition, we are concerned that, although the Draft appropriately cautions that secret comparables data may not be used as the basis for a transfer pricing adjustment, it recommends that the creation of an "international database" of such data be considered as the basis for tax administrations to set safe harbors. The Draft hints that this database would "potentially" be accessible to taxpayers, but there is no indication of how this would be accomplished given the Draft's appropriate insistence on the protection of taxpayer confidentiality. If mandatory safe harbors were created without transparency or true opportunity for input, it would, again, be difficult to distinguish them from the fixed margins used under the widely questioned Brazilian method.

We believe that all of these issues could probably be resolved by simply making the safe harbor regime voluntary or including a true opt-out option, without a major deterrent such as a shift of the burden of proof. If designed and administered in this manner, so that the safe harbor is not

effectively mandatory and does not become the baseline in practice for examination adjustments, we would support the expanded use of safe harbors as a practical administrative measure.

D. Clarifying the Discussion of Profit Splits and Other Methods

The Draft's discussion of transactional profit split methods should be updated to reflect last year's BEPS Project discussions, which widely acknowledged two important points:

- That highly integrated operations are neither necessary nor sufficient for the application of a profit split method, and
- That a value chain analysis should not be regarded as justification for the use of a profit split method as opposed to other transfer pricing methods.

We believe it should also be noted that even the existence of unique and valuable intangibles on both sides of a transaction should not require the use of a profit split method if the transaction or either party to the transaction is benchmarkable.

In addition, although most of the discussion in the Draft regarding transfer pricing methods is very strong, the short section regarding profit split methods based on contribution or value chain analyses fails to adequately discuss their strengths and weaknesses and the conditions in which they may be applied and thus lacks appropriate context and cautions. Similarly, the description of Brazil's fixed margin method and the call for further work on the application of "Sixth Methods" for commodities pricing should be accompanied an analytical discussion and an acknowledgment of their relatively limited international acceptance, so that the Draft is not misunderstood as implicitly endorsing these non-arm's length approaches for broader use.³

E. Addressing the Discussion of Anti-Avoidance Provisions

Finally, we note that the Draft contains a very brief but broad statement at the end that "anti-avoidance measures and other tax base protection measures" may be used in "categories of cases" where there is a "significant, systemic risk of tax loss, and data is not available or capacity is insufficient to apply one of the methods discussed." There is no indication of how it would be determined whether a "significant, systemic risk of tax loss" or one of the other specified conditions exists. The Draft specifically identifies several options available in these

³ We appreciate that the 2017 edition of the UN Practical Transfer Pricing Manual for Developing Countries will contain a discussion of Sixth Methods but note that that discussion does not acknowledge such Methods as arm's length in nature. While it is helpful for the Toolkit to include references to provisions of the UN Practical Manual for information and for the UN Practical Manual to provide practice advice, it should be recalled that the Manual represents the views of the 25 members of the UN Committee of Experts on International Cooperation in Taxation, who serve in their personal capacities. The UN Practical Manual therefore should not be taken as grounds for departing from the post-BEPS international transfer pricing standards set forth in the OECD Transfer Pricing Guidelines, which all members of the Inclusive Framework have committed to implement.

circumstances, including a cap on royalty deductions and limits on interest deductions in addition to those provided under BEPS Action 4.

We respectfully submit that the discussion of anti-avoidance provisions and “other tax base protection measures” is, as the Draft acknowledges, beyond the scope of the Toolkit. We believe that this section needs to be removed from the Toolkit, so that it is not interpreted as a green light for the use of such provisions in lieu of appropriate transfer pricing analyses. It might otherwise be read as a “self-help” exception available to any tax administration that believes that it *either* has a “significant, systemic risk of tax loss” *or* “data” is “not available” *or* the administration has insufficient capacity to apply a transfer pricing method. The unavailability of data due to limited public financial reporting, for example, has already been cited by some major emerging economies as justification for increased reliance on profit split methods. We are also troubled by the fact that the discussion endorses options that go beyond the scope of the recently agreed BEPS measures.

III. Specific Drafting Points

A. Unitary Taxation and Formulary Apportionment

Unitary taxation and formulary apportionment are addressed briefly in the Introduction to the Draft as follows:

“Unitary taxation or formulary apportionment approaches are sometimes proposed as alternatives to the arm’s length principle, which need not rely on comparables. While the merits and disadvantages of such approaches can be debated, including whether or not they would benefit developing countries, they are unlikely to be implemented at global level in the foreseeable future. This toolkit, therefore, focuses on practical measures that can be implemented in the short to medium term. The issue of a lack of comparables data for transfer pricing analyses was highlighted in the *Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries*, which was the catalyst for this toolkit.” (Page 6, citations omitted.)

As result of the way it is drafted, the statement appears to imply that unitary taxation or formulary apportionment is superior to the arm’s length principle because it does not require a comparability analysis, and even perhaps that the arm’s length principle is merely an interim approach. We assume this implication was not intended, as OECD and UN guidance has long eschewed these approaches in favor of the arm’s length principle, the Introduction confirms the centrality of the arm’s length principle just a few paragraphs earlier, and the paragraph footnotes an IMF Policy Paper questioning the suitability of formulary apportion for developing countries. To avoid any confusion, however, we respectfully recommend that the Draft revise its language to more clearly confirm its support for the arm’s length standard over alternatives such as unitary taxation and formulary apportionment.

B. Working Capital Adjustments

Section 5.2 of the Draft includes a discussion on working capital adjustments (WCA). While this is certainly a relevant component of transfer pricing practice and guidance, we find the Draft sends mixed messages that could be confusing to a less experienced tax administrator. TPWG members support the use of reliable working capital adjustments, because, almost certainly, there will be differences among the comparables, as well as between the tested party and at least some of the comparables, with regard to their levels of working capital, and these differences can affect the arm's length measure of profitability. We feel a more consistent and balanced message should be conveyed by the Draft, perhaps providing more insight into when working capital adjustments may and may not enhance the reliability of the analysis.

For example, a situation in which an adjustment for differences in inventory holding periods is relevant could arise if the tested party takes title to goods from its related party supplier when the goods leave the foreign port, but the comparables all take title at the port of importation. An adjustment to reflect that the related party holds inventory longer, measured by the average number of days in ocean transit, would be appropriate, and most likely could be calculated with reference to verifiable evidence. Such an adjustment would add reliability to the transfer pricing analysis.

By contrast, imagine a tested party held levels of inventory and/or accounts payable well in excess of those of any of the comparable companies. Before making adjustments for these differences, which could substantially alter the measure of the arm's length range, it would be appropriate to inquire what caused such high balances to be held. It could be that obsolete inventory had not been written off or written down, or it could be that the related party had forced the tested party to accept excess inventories beyond what could be sold or paid for. Excessive accounts payable could effectively be equity disguised as debt. While these are just examples, they illustrate that a reliable analysis should not apply working capital adjustments in an unexamined manner.

We believe that the Draft seeks to convey exactly this message – that certain working capital adjustments can add reliability, but that they should not be applied without due consideration. The TPWG agrees that this is the right message, but believes that some redrafting of this section would help to clarify this. Currently, the Draft has superficially conflicting language, on the one hand noting that WCA are the most commonly applied comparability adjustments (page 36), but then further noting, “WCA may give rise to additional costs and complexity out of proportion to any increase in reliability or accuracy of data” (page 37).

In addition, we note that the discipline of looking at working capital balances and ratios is important to understanding corporate business models and behavior, and signaling potentially important differences (*e.g.*, levels of risks) among companies. We believe the Draft should encourage tax authorities to analyze this information, along with other balance sheet data. We also note that the magnitude of working capital balances and differences among companies can

vary depending on the profit ratio used. Thus, inspecting these balances and ratios is an important part of a careful transfer pricing analysis.

Section 5.2.1 of the Draft further observes that a working capital adjustment may be used as a proxy for a functional adjustment. While we believe that a reasonable review should first be conducted to determine whether a more traditional comparability adjustment would work, the TPWG supports the use of this approach where an alternative is needed, as a reasonable and practical way to enhance comparability in the absence of reliable arm's length comparables. Such an approach, when applied reasonably and reliably, can enhance the applicability of various methods.

C. Analysis of Financial Data

The Draft acknowledges that analysis of financial data is part of the transfer pricing and comparables selection process. Yet TPWG members believe that careful analysis of the financial data of the tested party and each of the comparables is more important and more central to the transfer pricing process than the Draft currently suggests. Careful analysis of the data for the tested party is essential to gaining an understanding of the nature and scope of operations and how those align with the legal arrangements and functional analysis. Similarly, a careful review of the data for each potential comparable will reveal similarities and differences from the tested party and amongst the comparables. It must then be determined whether these differences are significant enough to require the application of certain adjustments, or possibly, the rejection of a potential comparable.

For example, in some companies and some industries, outsourcing and subcontracting are a substantial part of the business model. Some companies that employ subcontractors report the reimbursement for subcontracting as "Revenue" and the payments to the subcontractors as "Costs." Other companies in the same industry do not record these amounts as Revenue or Costs, but instead, report the net amount received on subcontracted work as "Revenue." Without a careful review of the data for the tested party and each comparable, these reporting differences will not be identified. However, with a careful review, the companies' data can be adjusted to a consistent basis, by either converting all companies to reporting in Revenue the net receipts from subcontracting, or by grossing up Revenues and Costs to include the subcontracted amounts to ensure consistency. These kinds of considerations are critical to a meaningful and accurate transfer pricing analysis, and also strongly affect the selection and application of the PLI. Very different results will be obtained, and incorrect conclusions will be drawn, if the financial data of the parties is not carefully analyzed, understood, and conformed. We further note that Case Study 2, if it were extended, could be a vehicle for illustrating this, particularly as it relates to the construction engineering business, which typically involves a substantial amount of subcontracting.

Understanding the financial data permits a more meaningful selection of the PLI, as well, because some PLIs naturally tend to correct or adjust for differences across the tested party and

the comparables better than others. The above example demonstrates that a cost-based PLI or a revenue-based PLI will not be a consistent or meaningful metric if costs and revenues are not measured consistently across the tested party and the comparables. Similarly, if differences are observed in balance sheet ratios, an asset-based PLI may be a better choice, because by scaling profit to assets, differences in the composition of assets is essentially controlled for. An income statement-based PLI may not adequately reflect balance sheet differences (unless the observed differences can be adequately addressed through a WCA). In fact, the Draft could reflect the notion that the application of more than one PLI should lead to broadly consistent conclusions. If the choice of the PLI yields conflicting conclusions about the transfer prices, this should direct the analyst to look more deeply at the financial data of the tested party and the comparables.

D. Foreign Comparables

The Draft comments in various sections on the use of data for companies located outside the jurisdiction of the tested party. On balance, it seems to conclude that it is unclear whether such data can be reliably used for transfer pricing analyses.

TPWG members believe that such data has much more utility than the Draft suggests. As the Draft notes, numerous tax authorities already accept comparables data on companies located outside their jurisdiction. In addition to the examples cited in the Draft, including Europe, China, Australia and New Zealand, we would point to Canada, Mexico and other Latin American countries, and the United States, as jurisdictions where it is common for many (and in some cases, all) of the potential and accepted comparables to be from non-local jurisdictions. Due to factors such as the small size of certain markets, the lack of reporting requirements for non-public companies, and the lack of diversity in publicly traded companies, it has become common practice for taxpayers and tax authorities alike to rely on non-local comparables. This is a practical approach to transfer pricing with an established track record; it provides taxpayers with a sound basis to comply with documentation requirements; and it provides tax authorities a basis on which to avoid or resolve controversies and double taxation.

Given the globalization of business, any assertion that profitability for a given product or function in a given geographic market should be materially different from profitability earned in other geographic markets needs to be substantiated by reference to documentable barriers to entry, regulatory requirements, or other demonstrable factors. Otherwise, basic economic concepts suggest that geographic profitability differences will not persist as more competitors enter the market and bid away these differences. This is consistent with our collective experience: we find that regional or even global comparables are normally in line with local comparables and are routinely used by taxpayers and accepted by tax administrations.

We would add that the understanding of data from “other markets” could usefully be further examined. If a company under consideration as a comparable is a consolidated, publicly-traded company, its jurisdiction may be identified in a database based on where its shares are traded and/or where its headquarters is located. However, it may not be the case that all or most of the

company's economic activity is located in that jurisdiction. An advantage of considering publicly-traded companies as comparables is that their level of financial and factual disclosure is enhanced. Often a review of an annual report or other filing document will reveal details about the geographic spread of the company's activities. This information also may describe certain sub-segments of the company's business, some of which may be more comparable to the tested party than others. Thus, the headquarters/listing jurisdiction may not be the location of much or most of the relevant economic activity, and these details should be reviewed before assigning a company's geographic location (or relying on the assignment designated by a database).

The same is true for private companies whose data may be available in certain databases. Even though details on their geographic activity may not be as readily available, it is worthwhile to research this before rejecting an otherwise comparable company, simply because of its reporting jurisdiction.

E. Profit Splits and Comparables

Certain language in the Draft states or implies that profit split methods can be applied without any reference to comparables. TPWG members respectfully disagree with this view.

Specifically, in section 2.4.1, the Draft states,

“In most cases, the transactional profit split method is applied by splitting the actual combined profits between the associated enterprises on an economically valid basis (for example, based on the relative contributions of each party). As pointed out in Part III, *this is a method that can be applied in the absence of comparables.*” (Emphasis added.)

In addition, section 5 of the Draft provides,

“ . . . profit splits may be made on another economically valid basis, such as an analysis of economic and business processes that are employed to determine the respective contributions to profit of each of the parties to the transaction. *Such analyses do not necessarily apply or require data from comparable uncontrolled transactions.*” (Emphasis added.)

TPWG members are concerned that readers will mistake these comments as a license to resort to profit splits when they perceive comparables to be hard to come by. Given that the entire Toolkit is directed at circumstances in which comparables are difficult to obtain, statements such as these may appear to inappropriately favor profit splits.

Moreover, we do not believe it is accurate to indicate that profit splits are or can be applied without reference to comparables. The OECD Guidelines provide, “[w]here comparables data are available, they can be relevant in the profit split analysis to support the division of profits that would have been achieved between independent parties in comparable circumstances” (para.

2.110). The Guidelines go on to set out at least two ways in which data from independent parties that are comparable to all or part of the subject transaction may be used in a profit split.

The first relates to a contribution analysis, in which the way that independent parties have split profit between themselves is used as the basis for splitting profits between related parties. (OECD Guidelines, para 2.119.) Thus, one or more independent transactions can be comparables for a split of profits. Such circumstances can arise in the context of joint ventures, licensing, and the purchase/sale of rights or part or all of a business, as well as in certain other situations.

The second way in which comparables are relevant to profit splits is in the context of a residual analysis, in which the first stage of the analysis involves remunerating the contributions made by the related parties that can be reasonably benchmarked by reference to comparables – either comparable transactions or comparable companies. The Guidelines indicate that, “[o]rdinarily this initial remuneration would be determined by applying one of the traditional transaction methods or a transactional net margin method, *by reference to the remuneration of comparable transactions between independent enterprises.*” (Guidelines, para 2.121 (emphasis added).) Only the profits in excess of these benchmarkable amounts are then subject to a profit split in the second stage.

TPWG members recommend that the language in the Draft be modified to reflect the useful guidance of the OECD Guidelines on this issue. We also believe that the cautious sentiment expressed in the following statement from the Guidelines should be reflected in the Draft for the benefit of tax administrations:

“On first review, the transactional profit split method may appear readily accessible to both taxpayers and tax administrations because it tends to rely less on information about independent enterprises. However, associated enterprises and tax administrations alike may have difficulty accessing information from foreign affiliates. In addition, it may be difficult to measure combined revenue and costs for all the associated enterprises participating in the controlled transactions, which would require stating books and records on a common basis and making adjustments in accounting practices and currencies. Further, when the transactional profit split method is applied to operating profit, it may be difficult to identify the appropriate operating expenses associated with the transactions and to allocate costs between the transactions and the associated enterprises’ other activities.” (Para. 2.114.)

More generally, although the last paragraph of section 2.4.1 acknowledges that a method should not be “easily dismissed” due to “imperfect” comparables, this proposition is stated in the negative. By phrasing this in the negative (referencing the dismissal rather than the acceptance of a method), and by referencing “imperfect” comparables (as though “perfect comparables” were the norm), TPWG members are concerned that the wrong message will be conveyed,

particularly to less experienced practitioners of transfer pricing. We believe it would be preferable to have affirmative guidance that emphasizes that tax authorities and taxpayers should make every reasonable effort to identify the best (even though imperfect) comparables and make reasonable adjustments, before abandoning what otherwise would be the most appropriate method in pursuit of a level of perfection or precision that does not exist. We are pleased to see that the Draft notes the various adjustments that might be made, and we believe that positive, practical guidance should acknowledge that, in most cases, taxpayers and tax authorities are in equivalent positions, with only so much potentially comparable data available. It is far preferable to make best efforts to apply the most appropriate method using the available data, making reasonable adjustments where possible and/or necessary, provided that significant deviations from the operation of the TNMM or other methods are not institutionalized or used for procedural advantage (*e.g.*, to effectively shift the burden of proof with respect to a proposed adjustment). The alternative is to lose transfer pricing discipline altogether by deviating from the most appropriate method. This is a far inferior result that will increase disputes, rather than resolve them.

F. Box 3 Example

We appreciate that the Draft has created numerous examples to guide the reader in some of the practical issues arising in the application of transfer pricing analysis. However, we submit that it is important to be attuned to both the stated and unstated messages that might be derived from these examples. In the Box 3 example, we find a number of concerning messages that could be corrected with some minor changes to the facts and language.

The discussion in Box 3 sets out to illustrate that one can obtain different results when a different TNMM analysis is applied to each party to a transaction. While this is undoubtedly true, the specifics of the example could be improved. First, we note that the example posits a line of business that generates a 30% operating margin on a consolidated basis. While not impossible, we note that businesses that generate 30% operating margins are relatively rare. When margins as high as 30% are observed on a sustained basis, it is appropriate to ask what circumstances afford the company to sustain such high profits. There may be unique intangibles or market circumstances that produce this result. Box 3 does not address this sufficiently or note that a thorough and careful transfer pricing analysis should elucidate the relevant facts and consider those in the selection of the method, selection of the tested party, selection of comparables, and application of these. Because the complexities associated with addressing the presence and creation of intangibles or other factors generating very high profit margins likely extend beyond the intent of the example, we suggest modifying the example to focus on a more typical and modest profit margin, such that “excess profits” do not arise or appear to be unexplained. Even with a more modest system profit margin, it would be possible to illustrate that the transfer price may not be identical if the manufacturer is remunerated as opposed to the distributor. At the same time, however, the example could be extended to show that if ranges of TNMM profits are

used, the ranges may overlap such that there is a narrower range of transfer prices that leaves each party with a defensible level of profit.

We also recommend conforming the language in the last sentence of Box 3. That is, just as Scenario 1 “is more likely to be appropriate” when PenCo Manufacturing undertakes routine manufacturing activities; Scenario 2 is also “more likely to be appropriate” if PenCo Sales undertakes routine distribution and sales activities. The current language, indicating only that Scenario 2 “*may* be more appropriate” (emphasis added) suggests different and weaker guidance than that provided immediately above for Scenario 1.

Similarly, we recommend using more consistent and parallel language in the text immediately below Box 3. It contains a sentence that states, “[f]or instance, where an enterprise assumes *the economically significant risks*, including those associated with a unique and valuable intangible, it is unlikely to be possible to identify a reliable comparable for it, and a one-sided method that tests the return to that enterprise *will not be appropriate*” (emphasis added). We have some difficulty agreeing with the very strong statement that simply because a party assumes economically significant risks, a one-sided method *will not* be appropriate. Virtually every independent company assumes certain economically significant risks, within the context of its business model and industry. As a result, many economically significant risks are capable of being benchmarked through external comparables, and a one-sided method is likely to be appropriate. Where independent comparables cannot be identified that are sufficiently comparable, a one-sided method applied to that party is less likely to be appropriate, but may be in some cases. We, therefore, recommend modifying the language to replace the phrase “will not be” with “is less likely to be.”

G. Specific Comments on Case Studies

We have discussed several general recommendations regarding the Case Studies above. We would also like to offer the following specific drafting suggestions:

- In each Case Study, it would be appropriate to start by indicating the evidence the taxpayer relied on to establish the existing transfer prices. This evidence could then be evaluated in the Case Study. However, as currently written, none of the Case Studies encourages the tax administration to review the taxpayer’s documentation or indicates that such a review has occurred. In fact, the taxpayer’s own transfer pricing documentation is only mentioned once, in Case Study 1, and only in passing. In none of the case studies are the taxpayer’s transfer pricing method and comparables presented or analyzed.

We would encourage further illustration and discussion of the ways in which the taxpayer’s transfer pricing analysis can provide valuable assistance to tax administrations and help them conduct their transfer pricing analyses more efficiently and effectively. This recognition is presumably what has inspired the global proliferation of

documentation requirements in recent years and the focus in the recent BEPS work on further improving the usefulness of documentation for risk assessments and examinations. The taxpayer has already had to carefully evaluate, analyze, and document its functions and assets and the risk profiles of the entities involved in order to be select what it believes to be the most appropriate transfer pricing method to test the arm's length nature of each transaction. For example, where the TNMM is applied, the benchmark search steps outlined in deriving the final set of comparable companies can provide a tax administrator with vital information relevant to its evaluation of the reasonableness of the taxpayer's comparable company benchmark set. The information already prepared by the taxpayer can thus provide a useful starting point and source of information. The taxpayer's documentation and responses to any additional information requests can assist in the quick and efficient identification of points for further discussion. While the ability to leverage the taxpayer's initial information and analysis can benefit any tax administration, it seems particularly valuable for tax administrations with relatively limited resources and experience. The Draft should encourage this more affirmatively.

Of course, tax authorities should be expected to retain an appropriate degree of independent skepticism about taxpayer positions, and the Case Studies appropriately advocate independent review and fact development by the tax authorities. The Case Studies should also emphasize the importance and utility of reviewing taxpayer documentation where provided.

- The Case Studies focus on delineating the transactions and, ultimately, on recharacterizing the transactions. However, they do this without considering whether the taxpayer's transfer pricing method and comparables correctly capture the features of the transaction. For example, in Case Study 3, B Co. is remunerated through a 5.4% handling fee plus any gain or loss in the price of gold. The taxpayer's basis for selecting this transfer price is never presented. The Case Study merely remarks that B Co. is found to be earning "substantial profits" and appears to be performing routine functions, and therefore its profits should be tested via the TNMM. We believe it would be far more instructive if the Case Study first presented the market and benchmark data that the taxpayer used to establish the handling fee. It is possible that in the market, this magnitude of handling fee is fully consistent with arm's length dealings. Even if the transfer pricing can be challenged, presenting the taxpayer's approach and evidence would provide a basis to illustrate numerous other considerations raised in the body of the Draft.
- The Case Studies are relatively complex, but nonetheless miss opportunities to provide guidance and clarification on some important points. For example, the Case Studies do not recommend careful analysis of the financial performance of the companies or of the drivers of profit performance, even though they suggest that the observed level of profit can or should be a factor in selecting a tested party, a method and a transfer price. Case

Study 1, for instance, states that A Co. has been in operation for 6 years, and that the tax audit covers 5 of these 6 years. The facts do not, however, address the possibility of A Co. having substantial upfront start-up costs, or other similar considerations that could affect its reported profitability. Case Study 2 has a similar gap. The Case Study introduces the statement that XYZ (M) earned significant losses over the life of the contract. However, the example does not address whether those losses are solely arising from the transfer price paid to XYZ (S), or whether the losses exist regardless of the transfer price. This matters because if there are losses beyond the transfer price, then an understanding of what drove those losses must be developed to assess the situation. That understanding should be added to the factors assessed in evaluating the appropriateness of the transfer pricing method and result. For example, if the losses arose because XYZ (M), in its capacity of providing local office and IT support, contracted for excessive real estate and IT facilities and resources well in excess of what was needed, then it may be appropriate for XYZ (M) to bear the financial consequences of these poor decisions. However, the solution offered by the Case Study is likely to result in shifting losses to XYZ(S) and the basis for and appropriateness of this result also needs to be discussed.

* * *

We would like to reiterate our appreciation for the opportunity to comment on the Draft of this Toolkit. We believe that this is an important project that stands to provide benefits to all stakeholders, and the Draft provides an excellent starting point for this. We hope that our comments and recommendations are taken in the constructive spirit in which they are offered. The TPWG would be pleased to discuss these points further if it would be helpful.

Sincerely,

On behalf of the Treaty Policy Working Group



Carol A. Dunahoo



Holly E. Glenn



Gary D. Sprague

The BEPS Monitoring Group

COMMENTS ON

Discussion Draft: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

These comments have been prepared by the [BEPS Monitoring Group](#) (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. They have been drafted by Tommaso Faccio and Jeffery Kadet, with comments from Sol Picciotto.

We are very grateful for the opportunity to submit comments on the discussion draft “A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses” prepared by The Platform for Collaboration on Tax.

SUMMARY

The existing international tax rules are interpreted to require taxation of multinational enterprises (“MNEs”) as if their various constituent entities are independent of each other and dealing at “arm’s length”. This independent entity concept generates a perverse incentive to create complex and fragmented corporate structures, locating affiliates in convenient jurisdictions to minimise tax. MNEs have increasingly taken advantage of this, and now consist of often complex corporate structures with hundreds of such entities. In practice, MNEs conduct centrally directed and managed operations that have been intentionally apportioned amongst various legal entities not due to compelling operational reasons or legal concerns, but rather primarily for tax-motivated planning purposes.

A typical tax efficient group structure will ensure that affiliates located in high-tax jurisdictions are contractually responsible for performing “routine” activities and thus should be remunerated by reference to “comparable” firms which have relatively low returns, with the entrepreneurial return allocated to affiliates located in zero- and low-tax jurisdictions. Comparability analyses are often used by MNEs to support the low returns earned by their “routine” affiliates. The contractual allocation of risks, functions and assets which delineate the local affiliate in a high-tax jurisdiction as a “routine” entity often gives rise to base erosion and profit shifting.

The Discussion Draft (DD) Toolkit is based on the flawed assumptions that a local entity often conducts only “routine” activities, has no unique and valuable contributions, and should not be entitled to any portion of the entrepreneurial profit. It also accepts the fiction that the various business units of a multinational enterprise should be considered to be independently

managed, albeit with common ownership and some top-level management that limits itself to overseeing policy and direction.

In contrast, most MNEs operate as centrally-managed unitary businesses performing core functions and using intangible property in multiple countries. For most MNEs, the characterisation of a member entity as one performing merely “routine” activities with no unique and valuable contributions will therefore often be wrong. The business operations of the associated enterprises are typically highly integrated, and the entities each make their own contributions to the synergy of the group as a whole. We consider that the examples in the Discussion Draft (e.g. boxes 5 and 6) should be amended to reflect this and therefore reject the use of routine activity comparable analyses as an appropriate approach to determine the return earned by the local affiliate in such cases.

In our submission¹ to the latest OECD Working Party 6’s Discussion Draft “*Revised Guidance on Profits Splits*”, we recommended a wider use of the profit-split method by applying it to a number of common business models adopted by MNEs. Such application would use concrete allocation keys and weightings for each common business model. Using such concrete keys and weightings would provide a true simplification for both taxpayers and tax authorities. This method also reflects our view that, for most MNEs, it is wrong to assume that their member entities perform merely “routine” activities. Further, given the subjectivity of transfer pricing analyses, which is only increased by the lack of comparables in many countries, such concrete keys and weightings for common business models would go a long way toward establishing transfer prices that are fair to the countries and taxpayers concerned. The results should virtually always be within the wide pricing ranges found in traditional transfer pricing analysis that tries to identify comparables for all the assets, functions, and risks.²

The work on profit splits is not yet concluded. We hope that final OECD guidance will widen the scope for the profit split method, thereby significantly reducing the need for traditional transfer pricing comparability analyses. Finalisation of this Toolkit should be delayed until agreement has been reached on a better approach to transfer pricing.

Hence, we oppose the widespread use of comparability analyses from both the theoretical and practical perspectives. We appreciate that the Discussion Draft points out the many flaws associated with this approach that make it so subjective and create such wide transfer pricing ranges.

The Discussion Draft clearly outlines why both from a theoretical and practical perspective, comparability analyses are not a feasible and cost-effective approach for allocating profits (and thus taxes) between associated enterprises, particularly for developing countries. We strongly recommend that the Discussion Draft be amended to provide guidance for expanded use of the profit split method using concrete allocation keys and weightings for each common business model used by MNEs.

¹ <https://bepsmonitoringgroup.files.wordpress.com/2016/08/profit-split.pdf>

² To illustrate briefly how wide and subjective the transfer pricing analysis can be, and focusing just on a group member treated as performing routine functions (i.e. ignoring any non-routine functions that we believe will commonly exist in reality), a traditional analysis generally produces a wide range of profit margins. For example, the comparables analysis will find a 1% to 14% range of results, with an interquartile range between 3%-8% and a median of 6%. Probably none of the comparables identified will have perfect alignment with the assets, functions, and risks of the group member being analysed. It is also a matter of judgement deciding which potential comparables to include in the analysis. The whole process is simply very subjective.

The lack of comparable data available in a significant number of countries, the subjectivity and room for opportunistic behavior of MNE taxpayers in the comparable search process, and the lack of experience and resources faced by developing countries' tax administrations show that this approach is inherently flawed.

GENERAL REMARKS

The approach adopted

The Discussion Draft identifies a number of key challenges in conducting comparability analyses by tax administrations, such as the lack of appropriate data, challenges and costs associated in accessing databases, and the inability of tax administrations to effectively audit the comparability analyses prepared by taxpayers.

These pose major challenges for tax authorities, in particular in developing countries. These countries face special problems of lack of data, the low quality of such data available to perform comparability analyses, and the use of comparability adjustments. The Discussion Draft reports that for more than 164 countries in 2013 there was not sufficient comparable data. In our view this is a key flaw in the use of this method as the basis to allocate profits to an associated enterprise.

The problem is not just a lack of data, but because true comparables generally do not exist. This is due to the real competitive advantages enjoyed by MNEs resulting from their economies of scale and scope and the synergy resulting from their internationally integrated operations.

The Discussion Draft also identifies a number of areas in which the comparability analysis process allows for subjectivity and opportunistic behavior by taxpayers, thereby undermining the validity of the approach. In each step of the comparability analysis, there are opportunities for taxpayers to ensure that comparability analyses support BEPS structures.

Most tax optimization planning strategies start with the identification of the expected remuneration for a "routine" entity, and intra-group pricing is then set to achieve that specific return and to ensure that any additional "entrepreneurial" profit is allocated to zero- or low-taxed entities within the group.

Comparability analyses are therefore prepared with a view to identify an arm's length range that supports the preferred tax optimal return, rather than with the view to identify what an arm's length return should be. In practice, the comparability analysis is one of trial and error, and search criteria can be changed in order to find a suitable arm's length range. While transfer pricing analyses may appear to be objective and scientific, they are anything but that.

It is often the case that the comparability analysis will be undertaken to support the results of a local affiliate. The Discussion Draft fails to mention that, in most cases, tax authorities will be presented with only the comparability analysis which supports the pricing used by the local MNE's affiliate(s).

The Discussion Draft outlines a number of steps in the process, such as inclusion of additional screening for functional comparability, adjustments for the cost of working capital, and adjusting for country risk. All these allow taxpayers to influence the results of the comparability analysis to ensure that the return earned by the local MNE's affiliate is within the desired arm's length range of results.

Changes to search criteria and adjustments to comparable companies can result in very different arm's length ranges. Unless tax authorities are in a position to replicate the taxpayer's comparability analysis and fully understand the impact of the criteria used and

choices made by the taxpayer, it is very challenging for tax authorities to determine whether this analysis has identified a reasonable range of arm's length results.

Furthermore, a significant number of countries do not have access to relevant databases, while others do not have the skills and experience to effectively use the databases. They therefore face an uphill struggle against the legions of accountants/lawyers that prepare transfer pricing documentation for MNEs.

The Discussion Draft correctly identifies a number of critical flaws in the argument that using comparable searches is likely to result in the determination of an arm's length return in many countries. Such countries generally have little or no comparable data and their tax authorities have little ability to effectively audit transfer pricing analyses prepared by specialists for MNE taxpayers due to lack of experience, access to comparable databases, and lack of resources.

At the same time, some of the recommendations included in the Discussion Draft to address the difficulties in accessing comparables, particularly those in relation to making optimal use of the data, determination of and making comparability adjustments, and determining arm's length remuneration, lack any clear evidence that such recommendations are likely to lead to sustainable improvements.

Whilst we agree with the flaws identified in the report, it seems to us counter-productive to try to address such significant problems by suggesting a number of potential changes to the comparable search process where there is no clear evidence that such changes are likely to lead to a more accurate representation of what local affiliates' remuneration should be. It is a waste of scarce resources to try to build capacity for poor countries to try to administer a system which is fundamentally flawed, as shown by the experience of developed countries. Just recall that even the U.S. tax authorities were reported to have spent \$2 million hiring outside experts to help them pursue one transfer pricing case.

We consider that the Discussion Draft should refrain from suggesting ways to improve the comparability analyses' process, since there is no clear evidence to support such suggestions, and put more emphasis on the potential alternatives available, outlined in Part III of the Discussion Draft, as well as others.

Proposed solutions

The Discussion Draft outlines a number of actions that could be taken to address situations where there is a lack of data.

We consider that only some of the actions identified in the Discussion Draft address the immediate need of tax authorities, and particularly those of developing countries, to have a system in place that is workable, cost effective, and that leads to an appropriate determination of an affiliate's tax base.

We suggest that a more fruitful way forward would be the use of safe harbour prices or margins, particularly if these are based on information available to tax authorities through taxpayer-lodged information. The experience of countries which have created safe harbours is positive, as it provides certainty of revenue and simplifies and reduces compliance and auditing costs. Having said this, though, we believe that the Discussion Draft should emphasise that safe harbours that assume only routine activities should not apply to MNE situations where each member uses group IP and contributes to the profitability of the group. In such cases, safe harbours encourage BEPS planning. Rather, the profit split approach as earlier described herein will provide a more appropriate transfer pricing result.

Brazil's prescriptive rules in this area (described in Box 22 of the DD) are a useful example of a system that works. It fixes the gross profit margins for a number of types of transactions and ensures that interest and royalty payments to overseas tax residents are subject to high withholding taxes. This has effectively reduced BEPS opportunities for MNEs in Brazil. Most importantly for many developing countries, Brazil's approach provides a system which is predictable and easy to administer, and creates few conflicts.

A refinement of Brazil's approach would be to develop an industry specific Advanced Pricing Agreements ("APA") program. Such an approach has been successful in relation to the package holiday industry in the Dominican Republic. This program set out a general framework for companies in the all-inclusive hotel sector, on the basis of which to establish individual APAs including the selection of the transfer pricing method and based on different rates depending on the category and geographic location of the taxpayer.³

An alternative approach to safe harbours, which also dispenses with the need to search for comparables, has recently been suggested by Michael Durst.⁴ Under this approach, local affiliates would be required to earn profit margins equal to 25 per cent of the global group's consolidated margin (based on earnings before tax). Such a benchmarking approach would provide a simple and clear method to ensure that the local affiliates earn an appropriate remuneration which reflects their contribution to the total income generated by the MNE. We suggest that this alternative approach should be included in the discussion draft.

In view of the fundamental flaws of comparability analyses, we strongly doubt the recommendation for more capacity building in this area. Investing government or donor funding toward this end, including the purchase of access to commercial databases, will not produce a sustainable improvement. Of course, any increase in the resources of tax authorities will quickly produce some additional revenues, as tax advisers rein in some of their more aggressive practices. However, it is also likely to create conflicts due to the inherently subjective nature of the decisions involved in comparability analysis. It would be far more cost-effective to reform the rules and establish simple methods that produce fair results which are easy to administer, than to invest substantial resources to boost highly specialist skills to operate a defective system.

There are better and more practical ways to determine the appropriate return earned by a local affiliate which do not need to rely on a flawed search for comparables. There is no evidence that investing in this area would be a good use of developing countries' resources or donor funds and as such this recommendation should be removed.

An increased use of the profit-split method and safe harbours/fixed margins would significantly obviate the need to rely on a method which is proven to be highly subjective, difficult to implement and which facilitates opportunistic behaviours by taxpayers.

³ For further detail on both these approaches see CIAT, *The Control of Transfer Pricing Manipulation in Latin America and the Caribbean* (2013), pp. 63-70, available from <http://biblioteca.ciat.org/opac/?v=5377>

⁴ M. Durst, *Developing Country Revenue Mobilisation: A Proposal to Modify the 'Transactional Net Margin' Transfer Pricing Method* (2016), ICTD Working Paper 44, available at <http://www.ictd.ac/publication/2-working-papers/96-developing-country-revenue-mobilisation-a-proposal-to-modify-the-transactional-net-margin-transfer-pricing-method>

SPECIFIC COMMENTS

Pages 6-7: *“While ‘perfect’ or ideal comparables may only rarely be available, commonly the data that is available will still allow a reasonably reliable analysis to be performed and a satisfactory approximation of an arm’s length outcome to be determined.”* This statement seems incompatible with the evidence provided on page 23, which states that for 164 countries, fewer than 1,000 local observations were available in 2013. A “satisfactory approximation” in such cases of limited data will often result in a very broad range of potential prices based on highly limited comparability.

Page 7 *“where comparables local to the tested party are scarce or unavailable, data from other geographic markets (potential ‘foreign comparables’) can be considered. In such cases, it will be important to examine whether differences in markets are likely to make a material difference to the condition being examined. Where the transaction occurs in a truly global market, geography may not make a material difference [.]”*

The Discussion Draft provides good and simple examples and explanations, but it tends to make light of the necessary sophistication, extensive work, and time and resources required in practice to make and/or evaluate functional and comparability analyses.

A more realistic comment on this issue is provided on page 43: *“In sum, the use of foreign data—though fairly extensive in practice given the lack of local comparables—has not been studied sufficiently to draw definitive conclusions about its reliability.”*

The available evidence is at best inconclusive and the report should refrain from recommending solutions to key problems where there is no sufficient evidence of their appropriateness. Indeed, a close examination of the available studies, some of which are cited, suggests that using foreign data is unsuitable, not least due to the complex techniques needed to perform adjustments, and the wide ranges of the resulting so-called comparables.

Pages 51-52: *“... all parties need to be realistic about the use of comparability data and avoid the misperception that comparability analyses always result in a well-defined and definitive answer. It is often necessary to recognise that a comparability analysis provides only an approximate answer and that some flexibility is needed to determine a principled answer in many cases. Some countries, particularly those that are more experienced in transfer pricing seek to mitigate this issue by negotiating with taxpayers to arrive at a sensible, arm’s length result, however others, particularly many developing countries, prefer to avoid settlement of cases in this manner. Further, many developing countries report that they do not have the capacity to negotiate in this way. However, where tax administrations do negotiate with taxpayers, the available data will inform the negotiations. [Footnote omitted.]”*

This emphasizes the subjectivity of the decisions involved, and the resulting need for negotiations that might be little more than horse-trading over many millions/billions of tax dollars. Again, the Discussion Draft seems to fail to recognise and address the fact that there is no level playing field between tax authorities in many countries, and in particular developing countries, and the legions of paid accountants/lawyers that prepare transfer pricing documentation for MNEs.

Page 66, Part IV. 2. Conclusions, 2.3 *“A framework for the selection and application of the most appropriate method, 3: For transactions in which the analysis concludes that a profit split approach is most appropriate, data on comparable transactions may not be required”.*

In our submission⁵ to the latest OECD Working Party 6's Discussion Draft "*Revised Guidance on Profits Splits*" we have recommended a wider use of the profit-split method to cover a number of common business models adopted by MNE, with concrete allocation keys and weightings for these common business models, which could provide a true simplification for both taxpayers and tax authorities.

The work in this area is not concluded and we hope that, ultimately, this will result in a widening of the scope for the profit split method to apply, which will significantly restrict the need for comparability analyses.

Part III, Section 8 concerns "Anti-avoidance and other tax base protection measures". There is one important tax base protection measure that we consider should be added to this section. That is the finding of a permanent establishment (PE) or dependent agent PE (DAPE) that is directly taxable in the host country.

A PE or DAPE may be found in two business circumstances:

- The first and most common, which was also a principal focus of BEPS Action 6, is the finding of a PE or DAPE when a foreign seller or service provider is earning income from selling products or services to customers within a country through commissionaire or other arrangements that avoid the criteria required for a PE.
- The second, and seemingly ignored circumstance, involves a group that conducts a domestically-run business that has structured inter-company contracts with zero- and low-taxed foreign group members causing those foreign group members to earn significant profits from that business.

Given the significant difficulties, resource requirements, and subjectivity of a transfer pricing audit, where the circumstances support it, factually finding a PE or DAPE and taxing the foreign taxpayer on the profits attributable to the PE or DAPE may be significantly easier than a full transfer pricing investigation in some cases.

The first business circumstance is one that is currently being explored as part of the further post-BEPS work that is being done in connection with Article 7 and the attribution of profits to a PE or DAPE.

We will only make one practical point here. In a situation in which a foreign company, say from Country A, sells products or provides services to customers in Country B and has a DAPE through a related-party commissionaire or agent in Country B, there is normally little or no practical need for the Country B tax authorities to conduct a transfer pricing investigation to determine the relative shares of profits between the foreign company and the commissionaire or agent. Where income is being taxed by Country B either in the hands of the domestic commissionaire or agent or in the hands of the foreign company, it will often make little difference to the overall tax collected by Country B.

We suggest that Part III, Section 8, includes this point that taxation of both the DAPE and the local commissionaire or agent may in some cases be an alternative mechanism that avoids a full transfer pricing investigation.

Regarding the second business circumstance, the inclusion in this discussion draft of Case Study 1 shows the importance of this second circumstance. Many multinational companies manage and operate major portions of their business within one country, say Country A. However, using common profit-shifting structures, such multinationals often create entrepreneur companies located in some low- or zero-tax Country B, that record significant

⁵ <https://bepsmonitoringgroup.files.wordpress.com/2016/08/profit-split.pdf>

profits. These entrepreneur companies often have few employees and conduct few direct business activities, relying instead on related party service agreements under which related parties in Country A perform the crucial business functions that really earn the entrepreneur companies their profits.

In such cases, the facts that Country A's tax authority learn will often support the existence of a PE or DAPE of the entrepreneur in Country A. Where this is the case, there is no need for any transfer pricing investigation to determine the proper level of profits within the Country B entrepreneur and the Country A related party service providers. Rather, the Country A tax authority can accept the transfer pricing used and simply tax the PE or DAPE of the entrepreneur. The aggressiveness of many profit-shifting structures will mean that most or all of the income earned within the entrepreneur results from a business that is conducted within Country A and is appropriately taxed by Country A.

We consider that brief mention of this could be included in Part IV, Section 3, Paragraph 9 of the Discussion Draft.

Page 71, Case Study 1: Case Study 1 should be supplemented to make clear that there are two practical approaches available under this case study that the tax authority of Country A could pursue. One, of course, is the delineation of the transaction in the manner provided in the case study for applying Country A's transfer pricing rules.

A second approach that will likely be available under the specific, but not uncommon, facts of Case Study 1 is that Country A's tax authority could accept the transfer pricing used by A Co and B Co and recognize that A Co's services create a DAPE in Country A for B Co. (See OECD Model Tax Convention Article 5 as modified by the BEPS Final Report dated 5 October 2015 for Action 6). As such, the Country A tax authority could impose direct tax on B Co. Depending on Country A's tax laws, most or all of B Co's profits would be taxable in Country A.

A particularly important practical point is that the work to delineate the actual transaction is, for the most part, all that will be necessary to establish B Co's tax obligation to Country A. There is no need to go through the further time consuming and subjective steps in a transfer pricing audit to conduct a search for comparables and the difficult analyses that accompany this process. Thus, from a practical perspective, application of direct taxation on B Co will result in a much lower expenditure of time and effort by the Country A tax authorities and for the taxpayer as well.

Another practical point is that if A Co were the U.S., for example, it is likely that 100% of B Co's profits would be taxable in the U.S. Further, with the branch profits tax within the U.S. tax law, there would be an additional up to 30% tax on the branch profits tax base, which is B Co's taxable income less the normal 35% corporate tax payable to the U.S. on the taxable income of the dependent agent PE. That gives an effective tax rate of up to 54.5% of taxable profit ($35\% + 30\% \times (100\% - 35\%)$). Some number of other countries would have similar tax rules that apply to the DAPes of foreign corporations, including the branch profits tax.

The difference should be noted in the case study discussion that where the Country A tax authority applies the first approach (i.e. applying transfer pricing rules), then the taxpayer paying the additional tax is A Co, a domestic taxpayer within Country A. In this case, no branch profits tax will apply.

On the other hand, where the Country A's tax authority decides to apply the second approach (i.e. the DAPE), then the taxpayer is B Co. Where Country A's tax law includes a branch profits tax, then that tax will apply in addition to the normal Country A's corporate tax.

Applicable comments about this “choice” facing Country A’s tax authority should be included in Parts III and IV of the discussion draft.

William Morris
Chair, BIAC Tax Committee
13/15, Chaussée de la Muette, 75016 Paris
France

The Platform for Collaboration on Tax

Submitted by email: [GlobalTaxPlatform@worldbank.org]

February 21, 2017

Ref: DISCUSSION DRAFT: A TOOLKIT FOR ADDRESSING DIFFICULTIES IN ACCESSING COMPARABLES DATA FOR TRANSFER PRICING ANALYSES

Dear Members of the Platform for Collaboration on Tax,

Thank you for the opportunity to comment on the Discussion Draft: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses (the "Discussion Draft") issued on 24 January 2017. We acknowledge and thank the Platform for Collaboration on Tax (the "Platform") for the time and effort put into this comprehensive draft.

BIAC strongly supports the Platform in its role of coordinating of efforts between international organisations on tax matters, and greatly welcomes the work done by the Platform to create a toolkit (the "Toolkit") that will address the difficulties in accessing and effectively utilising comparables data. Specifically, BIAC recognises the usefulness of the initiative in seeking to address transfer pricing disputes and controversies. We believe this will be of benefit to both tax authorities and taxpayers in developing countries, and can therefore act as a catalyst for investment, jobs, growth and development.

The Toolkit represents a very thorough review of Transfer Pricing issues, summarising general questions and common practices, which should be used as a valuable reference tool in tandem with OECD guidelines and other supranational / local regulations. However, BIAC believes that it is of great utmost importance, given these multiple resources, that the Toolkit recommends a priority rule to ensure the greatest possible clarity for tax authorities and taxpayers in the event of any differences. We have included further discussion on this point, in addition to other more specific comments, below for your consideration.

Again, we thank you for the opportunity to comment on this Discussion Draft, and look forward to working with you further on this project.

Sincerely,
Will Morris, Chair
BIAC Tax Committee

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General Comments

1. BIAC strongly believes that the effectiveness and value of the Toolkit is entirely linked to the ability for taxpayers and tax authorities to interpret the Toolkit in conjunction with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“TPG”), the United Nations Practical Manual on Transfer Pricing for Developing Countries (“UNM”), and local regulations. Therefore, we would recommend the addition of clear guidance at the beginning of the Toolkit which would allow taxpayers and tax authorities to understand which guidance should be relied on in the event of a discrepancy between the Toolkit and those documents. While the Toolkit provides valuable guidance in addressing transfer pricing questions, BIAC believes that deference should be given to the TPG and UNM in such instances, considering the wide support these documents have worldwide and the general acceptance and validity given by Tax Administrations and taxpayers to them as a reference for completing transfer pricing analyses.
2. BIAC continues to support the application of the arm’s length principle (“ALP”). We believe it would be appropriate to include some brief upfront comments on how to apply functional/asset/risk analyses (in line with the TPG and UNM) to ensure the main body of the text on comparables is read with this perspective. Without this guidance, a country may feel it is appropriate to seek recharacterisation where comparables are not immediately visible.
3. BIAC observes that a comparison between controlled and uncontrolled transactions is a critical element of the ALP and as such, it is necessary to establish clear, comprehensive independence criteria as search processes seek to eliminate transactions that have been entered into by entities that belong to a multinational group. However, BIAC believes that less rigid independence criteria when conducting benchmarking analysis could be a simplified option as long as it is applied uniformly. This simplified approach may also assist with improving the number of potential comparables (and thus may be of particular use where there are scarce comparables for a given transaction). In addition, in order to ensure that appropriate comparables are not overlooked or excluded, we would recommend broadening the independence criteria in Appendix 7 beyond the *Bureau van Dijk* indicators alone. On the sensitive issue of independence, it would seem appropriate to ensure that the indicators come from a range of sources.
4. A concern remains over the possibility of tax administrations making use of data collected to obtain comparables or to populate internal databases that are not generally available and/or not easily verified from publicly available data (often known as “secret comparables”). BIAC notes that certain countries specifically prohibit the use of secret comparables or generally refrain from using them in practice. However, this prohibition is not comprehensive. Secret comparables can penalise small local companies that will struggle to find acceptable comparables, and damage countries’ capabilities to attract foreign business as a result of the uncertainty they create.
5. Appreciating that it may be difficult to completely eliminate the use of secret comparables, BIAC strongly recommends that full transparency into the use of such information is

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encouraged. At the very least, a detailed description of the analysis behind such comparables should be made publicly available. For example, this could include creating ranges of industry average Profit Level Indicators, or mark ups for common services, in a useful, searchable, anonymous and publishable format. Additionally, it is essential that taxpayers and tax authorities have access to the same tools and information available to allow each party to adequately defend their respective positions in a balanced way, and (even more importantly) this could avoid disputes arising in the first place. Given the scarcity of resources in some Tax Administrations, the adoption of measures for avoiding future litigation should be a common goal.

6. The Toolkit recommends the use of the Profit Split Method (“PSM”) as an alternative where there is a lack of comparables. Although there is recognition that the selection of a profit split method based purely on the lack of data risks leading to a significant departure from the ALP, BIAC is concerned that this recommendation in the Toolkit will still result in tax authorities quickly defaulting to a PSM in scenarios where it may be inappropriate. Additionally, the application of the residual profit split method still requires comparables data in order to allocate the routine return as the first step. Similarly, the application of the PSM using a contribution analysis is often dependent on comparable data. As such, BIAC would welcome further qualifications within the Toolkit recommendations to ensure that the use of the profit split method is limited to cases where more appropriate methods are not available and that further guidance on appropriate allocation keys is provided so that it is not used as a tool to apportion profits arbitrarily.
7. BIAC welcomes the case studies included in the Toolkit and believes these examples will provide taxpayers and tax authorities with valuable guidance. However, BIAC notes that each case study results in a recharacterisation of the respective transactions, which is not representative of the very small number of actual transactions that will require recharacterisation. BIAC recommends that a statement to this effect be added, as well as additional case studies be included to demonstrate examples where transfer pricing adjustments are made but the transactions remain respected. Ideally, these would be more prominent than the examples that result in recharacterisation, to re-enforce the OECD position that recharacterisation is only appropriate in exceptional circumstances.
8. BIAC strongly supports the efforts of the Platform to encourage the use of safe harbours. In particular, BIAC agrees that the establishment of bilateral safe harbours significantly reduces the risk (and limits the quantum) of double taxation and we believe that such safe harbours are therefore a very useful tool in achieving tax certainty for taxpayers and tax authorities. BIAC stresses, however, that such safe harbours must be consistent with the facts and circumstances of all cross-border transactions within groups, and should therefore be elective and based on the ALP. The risk of double taxation will arise where safe harbours are not based on ALP.
9. BIAC believes that the use of “comparability adjustments” is a valuable tool, especially in scenarios where there may be a lack of quality data, and agrees with the Platform’s assertion that such adjustments should only be used after careful consideration of the applicable facts and circumstances. Cooperation between taxpayers and tax authorities will be paramount to using comparability adjustments to increase the reliability of results given the high degree of subjectivity that can be involved. Additionally, technical difficulties may



arise in the application of such adjustments due to the complexity and required industry specificity of the calculations. To that end, BIAC recommends a program of training for tax authorities as part of capacity building initiatives to ensure effective and consistent application in line with the ALP and economic reality.

10. BIAC encourages the Platform to further analyse the use of “foreign comparables” so that definitive conclusions may be drawn as to their reliability. Faced with a lack of local comparables, the use of foreign comparables, while not without its challenges, may provide the best solution. This is especially true in the context of margin-based methods. BIAC observes, however, that sufficient studies have not been undertaken as of yet to gauge the degree of reliability and agrees with the Platform that this is an issue that would benefit from further study.

11. BIAC supports the use of anti-avoidance measures where they are implemented in a way that is appropriately targeted and do not result in undue compliance burdens. BIAC encourages the Platform to provide additional guidance in this area because such measures should only be applied to high-risk issues and not used as a means for arbitrary collection. However, we do not consider that anti avoidance is an appropriate topic for a toolkit discussing transfer pricing comparables (which appears to be recognised in the Toolkit itself; *“the topic of anti-avoidance measures is extremely broad, and thus beyond the scope of this toolkit”*). Accordingly, we believe that section 3.7 should be removed, and addressed more comprehensively in a separate toolkit. In particular, the suggestion that royalties should be capped as a percentage of EBITDA seems misplaced in a discussion of transfer pricing comparables, and is out of line with the international consensus (intangibles are fundamentally different to monetary capital, which itself was the scope of a significant amount of discussion and work in relation to BEPS Action 4 before that recommendation was finalised).

20th February 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: Request for comments on a draft toolkit from the Platform for Collaboration on Tax

Please see the following comments from side BMZ/GIZ (Germany) to the proposed draft toolkit on Transfer Pricing:

- In our impression, the toolkit contains many practical elements that can be of use to practitioners (e.g. commonly used profit level indicators for particular types of businesses, step-by-step templates for screening purposes, a number of country practices, sample legislation or regulations). It is also useful that the toolkit provides educational content, such as case studies, overview of methods etc.
- We also welcome that the appendix includes practical documents such as a questionnaire for functional analysis or ratios that can be used to analyse enterprises. Even though these appendices are not new but derived from existing sources, it is nevertheless useful to have these sources gathered in one document. However, the order of the appendices could be better structured in a more systematic way. Some of the individual appendices could be merged, e.g. Appendix 16 (“Financial ratios and acronyms”, Appendix 17 (“Common acronyms”) and Appendix 18 (“Ratios measuring functions, assets and risks”).
- It appears that a reference to business restructurings and international pricing methods besides database analyses is missing (“hypothetical arm’s length method”).
- An issue is whether developing countries can cope with the costs of commercial databases that can be used to access comparables data. These databases are often quite costly. We propose that Appendix 3, which contains examples of commercial databases, should also provide information on their costs. However, in this regard we welcome that the toolkit also places some emphasis on approaches to implementing transfer pricing rules that reduce the reliance on such databases.
- The issue of relying on data to determine the arm’s length price of a transaction in developing economies cannot be underestimated (lack of (IT-) infrastructure, human capacity, substantial informal sector, missing publication requirements for financial statements, lack of comparable businesses). Even in developed economies, the correct determination of transfer prices is a science. Risk of non-compliance might rise due to the complexity of filing a return with transfer prices determined according to complicated data analyses and comparison and using costly commercial databases.

Kind regards from Bonn,
Marion Fleuth-Leferink

April 7, 2017

Platform for Collaboration on Tax:
International Monetary Fund (IMF)
Organisation for Economic Co-operation and Development (OECD)
United Nations (UN)
World Bank Group (WBG)

(delivered via email)

The Platform for Collaboration on Tax, *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* (Discussion Draft issued January 2017)

Comments by Pat Breslin and Linda Fernandez

Dear members of the Platform for Collaboration on Tax:

Breslin Consulting would like to thank the Platform for Collaboration on Tax (“PCT”) and its participating organizations—including the IMF, OECD, UN, and World Bank Group—for their joint leadership in developing the draft Toolkit,¹ and for the opportunity to comment on this very important project.

Below, we offer feedback and observations on this important topic based on decades of experience in transfer pricing and comparable data analysis across many country jurisdictions. These experiences have enabled us to face many challenges cited by the PCT with respect to comparable data and analysis more generally. Indeed, many such challenges were once encountered in some form within what are now more experienced country jurisdictions. Other such challenges persist within countries that are among the earliest adopters of transfer pricing regulations and procedures. Further, we recognize that additional challenges are more common today in countries that have more recently adopted transfer pricing rules and enforcement procedures, or that seek to further develop such processes. In all cases, we hope to lend insight based upon our years of experience in many relevant contexts.

¹ The Platform for Collaboration on Tax, DISCUSSION DRAFT: *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses*, Feedback period: 24 January 2017 to 7 April 2017 (as extended); as requested jointly by the International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), and World Bank Group (WBG). Hereinafter, this document will be referred to as the “Toolkit” or “the draft.”

The authors would also like to note our relevant experience participating in the OECD efforts to address tax base erosion and profit shifting (“BEPS”), by contributing written and oral public commentary on multiple occasions at the OECD. The BEPS project culminated in revised OECD transfer pricing guidelines to which the Toolkit makes references.²

We applaud the draft and the very concise and coherent direction the Toolkit has taken thus far. Indeed, in many transfer pricing contexts it is a challenge to communicate the many complex issues undertaken by this draft in a brief manner. Often, the need for clarity and nuanced distinctions among the subject’s key concepts requires and justifies lengthier explication.

In this regard, the draft succeeds in covering an ambitious array of complex subject matter in a relatively brief yet comprehensive manner. Its reliance upon and references to more comprehensive guidance and documents—for example, the transfer pricing guidelines and manual produced by the OECD and the UN, respectively—is appropriate, and enables the Toolkit to effectively serve as a more concise reference document while leveraging these complementary efforts.

Comments on Part I

General comments

The Introduction to the Toolkit sets out a clear and direct explanation of transfer pricing and explains different approaches tax administrations may use to determine whether the transfer prices they examine are appropriate. The Toolkit properly recognizes that “transfer pricing” is necessary and legitimate practice for multinational companies, while it proposes useful and practical ways to measure transfer prices by: a) the use of comparable data (which are never perfect, but often reliable), and b) prescriptive methods that do not rely on comparables.

The following comments focus on the second paragraph of page 5, which properly notes that transfer prices *per se* are not necessarily problematic as they are inherent to the normal operations of any related group of companies to the extent such companies must transact with each other. Thus, transfer prices are an unavoidable fact of most related groups and they cannot alone be considered improper as is sometimes suggested in public statements that criticize “transfer pricing” itself as inappropriate.

However, when transfer prices have the effect, whether intentional or not, of distorting the allocation of profits among the group companies in different jurisdictions, this may be problematic. The above-mentioned paragraph in the Toolkit concisely captures important consequences when transfer pricing “artificially shifts profits” and thus undermines the efficacy and fairness of tax systems on a domestic, international and increasingly global level.

However, the authors would caution, or at least query, a portion of the second sentence of this

² For example, the Toolkit has a number of references to the OECD Transfer Pricing Guidelines (2016) which incorporates amendments set out in the 2015 BEPS Final Reports on Actions 8-10, *Aligning Transfer Pricing Outcomes with Value Creation*. For further information on contributions that professionals of Breslin Consulting have provided to this process, please see: <http://breslinconsulting.com/publications.html> for written commentary and <http://breslinconsulting.com/events.html> for oral commentary and presentations at OECD public consultations at the invitation of the OECD Committee on Fiscal Affairs and country delegates.

paragraph: that is, in reference to whether “transfer prices used do not accord with internationally applicable norms **or** with the arm’s length principle (emphasis added).” This use of “or” here raises questions about what other “internationally applicable norms” are meant as part of this statement, and whether or not such norms would produce outcomes that are consistent with the arm’s length principle, as discussed further below.

The concerns here remain relevant even if a reader might infer from the draft discussion of potential “internationally applicable norms” through its later discussion of prescriptive approaches, safe harbours, and the like.

From an economics perspective, the arm’s length principle has a conceptual and practical benefit over prescriptive approaches in that, if properly applied, it achieves internal consistency from the vantagepoint of both parties to a transaction—notwithstanding the common use of “one sided” methods. However, in practice, application of the arm’s length principle is often subject to different and inconsistent interpretation, resulting in different transfer pricing outcomes from the perspectives of two or more MNC affiliates and the taxing authorities within relevant jurisdictions.

It may be relevant to consider whether or not the co-existence of the arm’s length standard in some jurisdictions with other “applicable international norms” in other jurisdictions invites or exacerbates further inconsistencies in outcomes—over and above those experienced when both relevant jurisdictions follow the arm’s length principle.

Specific comments

In the fourth paragraph of page 5, second sentence, it may be better to describe most country transfer pricing rules as seeking “*prices that are consistent with prices that would be seen between independent enterprises in comparable transactions and circumstances*” rather than “the *same prices* (and other conditions)...in comparable circumstances (emphasis added).”

This revision could avoid potential confusion—which the draft effectively avoids elsewhere with respect to this same issue. For example, the draft properly recognizes that arm’s length results are unlikely to arrive at “the same price” as any *actual* price(s) observed between independent parties. In this regard, the first paragraph on page 6 states, “It is important to emphasise that comparability analyses are not always primarily focused on the actual price of the transaction.”

Further, as this same paragraph properly notes, “It is important to also stress that comparability analyses are not always based directly on prices found in the market. More often, a comparability analysis utilises data on profit margins.”

However, even when a comparability analysis is focused on prices or transactions found in the market, rather than profit margins, there are further practical and conceptual reasons for pursuing the goal of *consistency* between related-party and comparable results, rather than the *same results*.

For example, as well-addressed in Part II, Section 5, applications of the arm’s length principle will often observe important differences between the best available comparable data—whether transactional or from financial statements—and the subject related party transaction and data. To the extent these differences would have a material effect on prices or profits, it may be necessary to

make adjustments to improve the reliability of the comparables analysis in order to reach an arm's length result. The aforementioned section of the draft provides useful discussion on "Determination of and making comparability adjustments where appropriate," including with respect to pitfalls and misuses of such adjustments.

Furthermore, the often imperfect nature of benchmark or comparable data explains the common use of ranges and statistical analysis to determine acceptable prices or results between related enterprises. For example, often an arm's length result must be consistent with, or fall within, a range of results for independent transactions or companies.

Finally, it worth recognizing that when independent parties negotiate under competitive market conditions, each party is likely to weigh its different options, including the prices, other costs and benefits, and expected returns associated with these options. In this sense, each independent party would naturally consider a potential range of acceptable arm's length prices and anticipated outcomes. At arm's length, a deal may be struck within a "range of agreement" where overlap exists between each party's separate range of acceptable prices. Thus, in positing these arm's length conditions, the arm's length principle is not necessarily a quest for any single (or *same* or identical) actual price or observation.

This concept is reflected at least in part in paragraph 1.1.8 of the UN Practical Manual on Transfer Pricing, which states,

Rationally, an entity [acting independently and] having a view to its own interests...would only acquire products or services...if the purchase price was equal to, or cheaper than, prices being charged by unrelated suppliers. This principle applies, conversely, in relation to an entity providing a product or service; it would rationally only sell products or services to an associated entity if the sale price was equal to, or higher than, prices paid by unrelated purchasers. Prices should on this basis gravitate towards the so-called "arm's length price", the transaction price to which two unrelated parties would agree.

Additionally, Part I of the draft properly recognizes that,

While some of the illustrations included in this toolkit conclude that the local associated enterprise conducts 'routine' activities and thus should be remunerated by reference to comparables which have relatively low (and stable) returns, this is far from a presumption and each case must be analysed on its own facts.

In effect, there is a potential correspondence between the term "presumption" as used here with respect to "routine...and relatively low (and stable) returns" and the term "prescriptive." The latter term is properly used to describe approaches the Toolkit recognizes as alternatives when sufficient comparable data are unavailable. But in practice, all too often the term "prescriptive" could also be applied to incomplete comparability analyses that produce an overly routine approach and conclusion—and thus fail to realize arm's length results. This critique may apply to transfer pricing analyses that, in practice, employ a "prescriptive" approach that is overly reliant on a rote interpretation "accepted" transfer pricing methods without sufficient analysis—making a routine out of applying routine markups.

Such generic approaches fail to utilize the full potential of the arm's length principle, and often yield inconsistent interpretations and outcomes that would not be agreeable between independent parties operating at arm's length.

In this manner, both tax practitioners and taxing authorities can sometimes reduce well-intentioned guidance on the application of the arm's length principle to a prescriptive approach. The Toolkit, however, has the potential to reinforce a proper application of the arm's length principle along with its valuable predecessor guidelines noted earlier. For example, Part I concludes by noting,

Indeed, the Toolkit emphasizes the importance of determining the most appropriate method according to the facts of the relevant transaction, with the result that the local associated enterprise may or may not be determined to be due all or part of the entrepreneurial profit or loss. As an example, see Case Study 1 which concludes that the local enterprise in fact assumes all the economically significant risks associated with the transactions. In this case, comparables need to be sought to benchmark an arm's length return for the foreign enterprise, with the local entity being entitled to the remaining profits.

Comments on Part II

Part II of the Toolkit provides very helpful and cogent guidance in a concise manner. A common challenge in articulating a proper use of the arm's length principle is the tendency for any textual description of the process to appear more linear or formulaic than the analysis itself would be in practice. On the other hand, certain critical steps must be performed before others in order to properly apply the arm's length principle—so a degree of order must be maintained.

Despite these challenges, in many respects the draft succeeds in properly conveying the frequent need for a multi-dimensional analytical approach while emphasizing the need for a logical ordering of steps where necessary. Nevertheless, some suggestions are offered below to help avoid a mistakenly rote interpretation of the Toolkit and the potential for inconsistent interpretation of its text.

For example, the second paragraph on page 9 properly captures critical initial steps in applying the arm's length principle in stating,

In order to apply the arm's length principle to controlled transactions it is necessary to thoroughly understand the commercial or financial relations between the associated enterprises and, specifically, the features of the controlled transaction(s) to be compared. The process of doing this is referred to below as "accurately delineating" the controlled transaction.

The paragraph continues,

Once [the accurate delineation of the controlled transaction] is understood, it is necessary to select the most appropriate transfer pricing method and identify one or more potential uncontrolled transactions that may be considered comparable.

Items in the first quote above are essential starting points in an arm's length analysis, along with a broad understanding of the overall business, facts and circumstances of the related group and the parties to the transaction. These and other key steps are more fully described later in the side-by-side

comparison of a “typical process for performing a comparability analysis”—which itself is also a very helpful reference.

However, the second quote above could potentially be interpreted to suggest a more linear step-wise approach than would be advisable or even feasible. These steps—*i.e.* 1) selecting the most appropriate transfer pricing method and 2) identifying potential comparables—may need to proceed in a non-linear, iterative or parallel fashion.

Indeed, it usually will not be possible to select the most appropriate transfer pricing method without first considering “one or more potential uncontrolled transactions” that may be available, and then assessing whether or not these potential comparables meet with comparability criteria discussed elsewhere in the draft. It is also possible that available comparable data would include data types that are suitable to more than one method—and such available data should be given full consideration before selecting any one method. In short, one must ascertain the best available comparable data in conjunction with selecting an appropriate transfer pricing method.

Additionally, the first sentence of this same paragraph may also be interpreted to suggest an unintended sequential ordering of steps. It could also be subject to other misinterpretation, as it states,

The conditions of a controlled transaction are established, or tested, by reference to the conditions observed in comparable uncontrolled transactions.

First, it is not entirely clear what “conditions” are being referred to in the phrase “conditions of a controlled transaction.” Possible interpretations include:

- 1) A broader reference to conditions surrounding the “accurate delineation” of the related party transaction—as described in the text’s very next sentence—including reference to the facts and circumstances of the associated enterprises, and their functions, assets and risks, as well as other “conditions” faced by the transacting parties more generally, such as “market conditions;” or
- 2) A narrower reference to the “terms and conditions” of the controlled transaction to include its pricing terms, payment terms and structure, and other rights and obligations embodied as “conditions” of the contract itself. (Note that the accurate delineation of the controlled transaction—*i.e.* item 1 above—must also take this narrower reference to contractual conditions into account.)

If the broader interpretation of “conditions” in item 1 were intended, then such conditions would pertain to the facts and circumstances of the related parties and their transaction. In that case, these conditions would exist *a priori* and must be understood as a starting point for the analysis. Here, a potential for inconsistent interpretation arises in that it does not seem that “the conditions of a controlled transaction” could necessarily be “established, or tested, by reference to the conditions observed in comparable uncontrolled transactions” as described in the full sentence. At least, this could imply that transactions comparable to the related party transaction could be identified and observed before accurately delineating the subject related party transaction itself.

An article addressing such issues is attached along with this submission. Entitled “*Altera and the Arm’s Length Standard: The Case for Considering Stock Options*,” this analysis of a case in U.S. Tax Court was recently published by one of the authors in Bloomberg BNA, *Tax Management Transfer Pricing Report*. The article illustrates some of the consequences that arise when an analysis relies upon “reference to the conditions observed in comparable uncontrolled transactions” without first accurately delineating the subject related party transaction, and without a complete comparability analysis and application of the arm’s length principle.

Meanwhile, if the narrower interpretation in item 2 is intended, then a potential for inconsistent interpretation arises primarily from multiple connotations of the word “conditions” having meaningful relevance to the subject of the text—an issue that might also translate into other languages that have such connotations as well.

While these last comments may seem semantic, in the authors’ view it is best to revise any avoidable potential for inconsistent interpretation of the text. The underlying subject and issues themselves are often subject to different interpretation even with a clear text—which, in large part, the draft achieves. Thus, for example, if the intended meaning of “conditions” in the first sentence is the narrower transactional form, clarifying language would be helpful.

Additional comments

The draft conveys that the arm’s length principle is a case-specific and fact-intensive process, one that must take as its starting point an understanding of the specific facts and circumstances of the tested controlled transaction and the related parties involved, as well as their functions, assets, and risks. It is from this basis that comparability analysis proceeds in pursuit of potential comparables.

In light of this and related comments above, the authors suggest a slight revision to the language in the fourth paragraph on page 9 to say,

The OECD Transfer Pricing Guidelines¹¹ and the UN Practical Manual on Transfer Pricing each set out a framework of five economically relevant characteristics or comparability factors to be kept in mind when considering whether an uncontrolled transaction is comparable to a controlled transaction.

As noted above, the summary of a “typical process for performing a comparability analysis” (on page 10) is quite helpful in cross-referencing other guidance, while it also demonstrates welcome consistency between the guidance offered by the OECD and the UN.

Here, the sequence of steps properly includes the need for a broad-based analysis of the taxpayer’s circumstances. The necessary interplay between “initial review of possible sources of comparable information” and the step to “select the most appropriate transfer pricing method” is iteratively expressed en route to identification of potential comparables—conveying a degree of “back and forth” that often must take place in applying such steps.

Page 11 reinforces that comparability analysis follows from and depends upon:

- The background and context of the related party transaction;

- Verifying the contractual terms *and* the conduct of the parties in the related party transaction;
- Accurate delineation of the actual controlled transaction with a focus on the economically significant characteristics that “allow for the accurate identification of the features of a controlled transaction that will be the starting point for comparability analysis;”
- Analysis of “all important features of a controlled transaction”—including with respect to the parties’ functions, assets and assumption of economically significant risks; and
- The crucial considerations regarding the assumption of risks by the parties in performing a functional analysis and the process of delineating a transaction.

On this point, the draft notes:

The accurately delineated transaction should be priced taking into account the financial consequences of risk assumption, as appropriately reallocated (if necessary), and appropriately compensating risk management functions, as understood in OECD Transfer Pricing Guidelines.

Without offering much further detail here, the authors also commend the quality of the illustrations and examples provided in the draft. In particular, Box 3. Stylised Case is very useful in itself as a “simplified example [that] illustrates the impact of the choice of the tested party when using a one-sided method.” Furthermore, this example could provide a useful basis for variations that further illustrate other relevant issues and concepts discussed in the draft.

For example, in Box 3 the draft already offers three scenarios represented by the table and subsequent text to numerically illustrate the importance of an accurate delineation of the controlled transaction and understanding the parties’ contributions of functions, assets and risks assumed—in addition to the choice of tested party and transfer pricing method in each case. In the two scenarios applying the TNMM to one tested party, the residual profits realized the party not chosen as the tested party are also noteworthy and offer further opportunity for useful illustration.

For example, one might consider another scenario that could further illustrate the potential effects of a frequent use of “routine” profit margin calculations throughout the same supply chain—that is, by applying the TNMM not only to one but to *both* parties as separate tested parties.

In such a case, the illustration could show the manufacturer earning 85 in profit, the distributor 75—both using a TNMM—and a residual profit of 290 representing 64 percent of the total profits of 450. If this were a realistic scenario for a given taxpayer, it would reveal a need for further inquiry to understand more about other parties in the value chain, including their contributions in terms of functions, assets, risks assumed, their financial capacity to bear risks associated with the business, and other capabilities. Presumably, these contributions would be substantial if they were to justify the corresponding returns that arise outside of the manufacturing and sales entities.

Once again, we greatly appreciate the opportunity to comment on the draft Toolkit and commend the clear progress reflected in the draft.

Sincerely,

Pat Breslin
Washington, DC
April 7, 2017

Linda Fernandez
Indianapolis, IN
April 7, 2017

(Delivered via email)



BUREAU VAN DIJK

6 April 2017

Platform for Collaboration on Tax

International Monetary Fund (IMF)

Organisation for Economic Co-operation and Development (OECD)

United Nations (UN)

World Bank (WB)

Submitted by email: GlobalTaxPlatform@worldbank.org

Ref: Discussion draft – A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

Bureau van Dijk welcomes the opportunity to comment on the Platform for Collaboration on Tax (the Platform)'s Discussion Draft titled "A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses" (the Discussion Draft).

General Comments:

Bureau van Dijk commends the work of the Platform in addressing the issue of "accessing comparable data", particularly in the context of developing countries.

As a firm specializing in business intelligence, and as a leading provider of external, independent data used for arm's length analysis, Bureau van Dijk is pleased with the objectivity and thoroughness of the work performed by the Platform. We hope that the findings outlined in this Toolkit help ensure the continued reliance on the Arm's Length Principle (ALP) as the basis for Transfer Pricing analysis, to ensure that profits are allocated fairly across multinational groups.

The reliability of any arm's length analysis is based on the availability and the quality of the information used. At the core of the Toolkit's concern is the lack of thoroughly enforced information disclosure requirements for companies in most countries (especially developing countries), which significantly limit the availability and quality of information for arm's length analysis. Fomenting the adoption of legislation requiring companies to disclose qualitative, quantitative and ownership information in the public domain would go a long way in increasing the availability and quality of external, independent data for arm's length analysis. Moreover, it would have an important impact in mitigating corruption and financial crime by increasing transparency, which is in line with the broader goal of assisting countries protect their tax bases.

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Observations:

Part II, Section 2.4 – Select the most appropriate transfer pricing method

The description in the Discussion Draft of the application of the Transfer Pricing Methods outlined in the OECD Transfer Pricing Guidelines could benefit from clarification:

- The Discussion Draft states that the Resale Price and the Cost Plus Methods are primarily applicable in limited-risk routine situations. However, as transactional methods (that should rely primarily on internal comparables), both the Resale Price and Cost Plus Methods can be – and in their text-book form are often – applied to full-fledged operations. In fact, one could argue that limited-risk, routine functions (like contract manufacturing) seldom lend themselves to transaction-based methods because most multinational enterprises do not enter into comparable, limited-risk relationships with unrelated third parties (for fear of creating unnecessary competition vis-à-vis its other related parties, or for fear of infringement of their intangible property by unrelated third parties), and hence offer no internal comparables with which to apply these transaction-based methods.
- The discussion on the Cost Plus Method, and the cost base that should be included in the calculation of the cost mark-up, should make clearer the distinction between the Cost Plus Method and the Full-Cost Mark-Up (commonly referred to as the “Net Cost Plus” or the “Return on Total Operating Costs”, which is a profit level indicator specific to the Transactional Net Margin Method).
- The Discussion Draft states that the Transaction Net Margin Method (TNMM) bears some similarities to the Resale Price and Cost Plus Methods. Although the Discussion Draft does make clear that the TNMM tests the arm’s length nature of the controlled transaction at the net profit level of the P&L, and that the Resale Price and Cost Plus Methods test it at the gross profit level of the P&L, the Discussion Draft should make a clearer distinction between the TNMM and the Resale Price and Cost Plus Methods. The TNMM is a profit-based method that relies primarily on external comparables. The Resale Price and Cost Plus Methods are transaction-based methods that rely primarily on internal comparables.
- The discussion on the Tested Party in Part II, Section 2.4.1(d) paragraph 2 could also benefit from further clarification.
 - Whilst it is true that the TNMM and the Resale Price and Cost Plus Methods are one-sided methods, the concept of the Tested Party is unique to the TNMM.
 - The TNMM is testing the arm’s length nature of the controlled transaction by reference to the net margins earned *by independent companies* engaged in comparable uncontrolled transactions (i.e., we

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are testing the net profitability of one or another of the parties involved in the controlled transaction).

- In contrast, the Resale Price and Cost Plus Methods test the arm's length nature of the controlled transaction by reference to the gross profitability earned *in comparable uncontrolled transactions* (i.e., we are testing the controlled transaction, not any one of the parties involved in the transaction).
- The TNMM is a zero-sum method where one party (typically the Tested Party) earns a routine profit, and any excess profits (or losses) are attributable to the non-routine, risk-taking counter-party in the controlled transaction.
- The Resale Price and Cost Plus Methods (as well as the CUP Method) can yield net operating losses for either or both of the counter-parties in the controlled transaction, yet still be consistent with an arm's length standard. This is because these methods test the arm's length nature of the controlled transaction at the gross profit level of the controlled transaction (or the revenue or cost of goods/services level in the case of the CUP Method), and they do not consider operational inefficiencies below the gross-profit level of the P&L account.

Part II, Section 3.3 – Commercial Databases

The Discussion Draft states that commercial databases offer a universe of approximately five million global records with revenue and operating profits, and which meet the basic independence criteria. Bureau van Dijk finds that this figure is significantly understated. As show in Figure 1, below, the approximate number of global records that meet the Discussion Draft's basic criteria is nearly 10.5 million.

Figure 1: Number of Global Records that Meet Basic Arm's Length Analysis Criteria

SEARCH STRATEGY		Save	Print	Clear all steps
X	<input checked="" type="checkbox"/> 1. Status: Active, Active (rescue plan), Active (default of payment), Active (reorganization)			170,072,637
X	<input checked="" type="checkbox"/> 2. Operating revenue (Turnover): All companies with a known value, Last available year, Last year -1, Last year -2, for at least 2 of the 3 selected periods			25,040,325
X	<input checked="" type="checkbox"/> 3. P/L before tax: All companies with a known value, Last available year, Last year -1, Last year -2, for at least 2 of the 3 selected periods			17,916,203
X	<input checked="" type="checkbox"/> 4. Cos owned by at least one shareh.: of one of the following types: Industrial companies, Foundations/Research Institutes, Public authorities, States, Governments, owning between 50.01% and 100%			5,557,826
X	<input checked="" type="checkbox"/> 5. No of subs.: None			210,770,406
Boolean search 1 And 2 And 3 And 5 And Not 4				TOTAL : 10,433,687
Refresh				

Source: Bureau van Dijk's Orbis database, update 5 April 2017

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Appendix 3 – Examples of Commercial Databases Used for Transfer Pricing

Appendix 3 of the Discussion Draft provides examples of commercial databases used for transfer pricing analysis. The following provides a more accurate overview of the available information for Transfer Pricing analysis from Bureau van Dijk.

Figure 2: Number of Global Records with Detailed Financials by Geography

World regions/countries	Availability of financial data			
	Companies with detailed financials	Total	of which publicly listed companies	of which branches
North America	35,026	28,548,782	13,567	3,932,770
Western Europe	10,512,010	60,967,215	10,093	7,201,367
Eastern Europe	6,051,028	33,024,218	7,444	1,500,072
Middle East	3,439	1,987,186	1,859	108,979
Far East and Central Asia	2,337,472	34,768,527	26,258	2,143,192
South and Central America	1,168,672	32,832,108	3,724	1,336,063
Africa	245,960	2,944,023	1,349	74,795
Oceania	23,587	16,888,123	2,298	4,494,608
Supranational	32	49	0	0
No country specified	306	2,477,393	0	226
Total	20,377,532	214,437,624	66,592	20,792,072

Source: Bureau van Dijk's Orbis database, update 5 April 2017

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Figure 3: Number of Global Records with Specific Information

Total number of companies ▾ 214,437,624
Number of countries covered ▾ 227

	Active companies	Inactive companies	Unknown status	Total
Total	170,515,433	37,192,754	6,729,437	214,437,624
Number of companies with specific information				
with				
Directors	94,519,587	25,520,123	2,663,280	122,702,990
Ownership	54,040,363	727,007	224,886	54,992,256
Shareholders	49,983,312	701,184	193,018	50,877,514
Subsidiaries	6,787,470	57,710	43,592	6,888,772
News*	762,450	148,496	11,109	922,055
Overview information	2,430,943	336,313	36,918	2,804,174
Original documents	21,260,315	9,896,092	324,577	31,480,984
MarketLine company reports	12,520	148	19	12,687

* Note that we receive a continuous feed of company news, hence these figures may slightly change.

Source: Bureau van Dijk's Orbis database, update 5 April 2017

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Figure 4: Bureau van Dijk Company Databases Used for Transfer Pricing Analysis

	Geographic Coverage	Detailed Ownership Structures	Company Overviews	Standardised Financial Data	Localised Financial Data	Original Scanned Documents	IP Profiles	Financial Stability Profiles	M&A Activity Overviews	Industry Overviews
International Databases										
Orbis	Global (listed & private companies)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Osiris	Global (listed companies only)	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Amadeus	European (listed & private companies)	Yes	Yes	Yes	No	Yes	No	Yes	Yes	No
Oriana	Asian (listed & private companies)	Yes	Yes	Yes	No	No	No	Yes	Yes	No
Orbis Bank Focus	Global (financial institutions only)	Yes	Yes	Yes	No	Yes	No	No	Yes	No
Orbis Insurance Focus	Global (insurance companies only)	Yes	Yes	Yes	No	Yes	No	No	Yes	No
Domestic Databases										
Fame	UK & Ireland (listed & private companies)	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Diane	French (listed & private companies)	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Aida	Italian (listed & private companies)	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Sabi	Spanish & Portuguese (listed & private companies)	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Bel-First	Belgium & Luxembourg (listed & private companies)	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Dafne	German (listed & private companies)	Yes	Yes	Yes	Yes	No	No	No	Yes	No
Odin	Scandinavian (listed & private companies)	Yes	Yes	Yes	Yes	No	No	No	Yes	No
Reach	Dutch (listed & private companies)	Yes	Yes	Yes	Yes	No	No	No	Yes	No
Ruslana	Russian & Ukrainian (listed & private companies)	Yes	Yes	Yes	Yes	No	No	No	Yes	No

Source: Bureau van Dijk's Orbis database, update 5 April 2017

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Figure 5: Bureau van Dijk CUP Modules Used for Transfer Pricing Analysis

	Geographic Coverage	Type of data	Links to Company Reports	Standardised Information	Original Scanned Documents	Links to Original Sources	Source
External CUP Databases							
Royalty Rates Module	Global	Royalty rates and license agreements	Yes	Yes	Yes	No	US Securities & Exchange Commission
Lending Margin Module	US only	Lending margins, debt-capacity ratios and credit agreements	Yes	Yes	Yes	No	US Securities & Exchange Commission
Zephyr	Global	M&A deals with values and multiples	Yes	Yes	No	Yes	Bureau van Dijk research
Commodities Module	Global	Daily, historical commodity prices	No	Yes	Yes	Yes	Various commodity exchanges worldwide

Source: Bureau van Dijk's Orbis database, update 5 April 2017

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Appendix 7 – Independence Criteria

For the past 20 years, Bureau van Dijk has been developing an Ownership Database. The Ownership Database is a database of links. A link establishes an ownership relationship between 2 entities, a shareholder and a subsidiary. A shareholder might be a corporation, a private individual, a government or a collectively described entity (such as the "public" for listed companies). The subsidiary, however, is always a corporation.

For this reason, the Bureau van Dijk Independence Indicators should be used with caution. A company with Independence Indicator D (a company with one or more shareholders owning more than 50% of the shares) could be considered as an independent comparable for transfer pricing purposes if the company is own by a private individual. As a result, most transfer pricing analyses relying on external comparables will apply the Bureau van Dijk Independence Indicators, but include companies that are owned by private individuals, managers or employees.



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Questions:

- 1. Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit?**

The Discussion Draft offers practical solutions to the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis.

Though the Discussion Draft places emphasis on other approaches, such as safe harbours, benefit tests, profit splits and other protective measures, the risk of overstating or understating the transfer price is greater with these approaches than with the use of foreign comparables. Moreover, whilst many emerging economies lack information on local comparables, Bureau van Dijk's coverage of information across emerging economies exceeds 3 million companies (see Figure 2, above).

This is a vast sample of potential comparables from which tax administrations in emerging economies can draw to establish more reliable arm's length results. The reality is that tax administrations in emerging economies, today, do not need to rely on foreign comparables from developed countries, which would make geographic comparability more of an issue and could have greater effect on the results. Today, tax administrations in emerging economies can draw from this universe companies from similar economies that offer greater comparability for the arm's length analysis.

The combination of the greater availability of company data from emerging economies, and the application of time-tested, reliable geographic comparability adjustments described in the Discussion Draft make a stronger case for the use of foreign comparables by tax administrations in developing countries. The use of safe harbours, formulary apportionments or other tools that stray from undertaking an arm's length analysis are more likely to result in double taxation for the multinational group and more controversy with other tax administrations.

As the Discussion Draft points out, what will help tax administrations the most with the lack of local comparable data (especially those in developing countries) is to take steps requiring the central registration of financial accounts by public and private companies in their respective countries. Taking this steps will, not only increase the universe of potential local comparables, but also improve transparency and help mitigate corruption and financial crime.

- 2. How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level?**

No comment provided.

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3. How could the reliability of potential comparables from other geographic markets be tested?

Bureau van Dijk encourages the Platform to run empirical analyses based on companies that meet basic transfer pricing criteria, and which are located in emerging economies. We suspect that, when empirical samples from select emerging economies are run, one may be able to draw clearer conclusions about the reliability of foreign comparables that are located in countries with economic similarities.

We ran a rudimentary analysis of companies in all manufacturing industries (using NACE Rev. 2 industry classification codes). We separated the samples based on geographic regions and analysed the respective companies' 2015 unadjusted EBIT margins. Figure 6, below, shows the results.

Figure 6: Unadjusted Interquartile Range of 2015 EBIT Margins for Manufacturing

	Latin America	Africa	Asia Pacific
Upper quartile	14.21%	12.82%	12.30%
Median	6.23%	8.10%	6.52%
Lower quartile	-1.10%	3.84%	2.07%

Source: Bureau van Dijk's Orbis database, update 5 April 2017

As shown above, though the ranges differ slightly from one region to another, the disparity between the respective regional ranges is not dramatic. There is a natural convergence in the rates of return to the function of manufacturing. A more in-depth analysis based on a more specific breakdown of industries might yield clearer results that further support the use of foreign comparables from countries with similar economic conditions (i.e., emerging economies).

4. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft?

The Discussion Draft did touch briefly on the idea of having emerging economies take steps toward greater disclosure of financial accounts onto national company registries. This is likely to be the best approach, and the one more likely to ensure the proliferation of the ALP. The Discussion Draft, however, seemed to place more emphasis on approaches that lend themselves to double taxation (like safe harbours, formulary apportionment, pre-defined margins, etc.).

The Toolkit would benefit from more emphasis on the creation of local, company information by fomenting the notion of mandatory disclosures of financial accounts by companies onto the public domain.

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- 5. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?**

No comment provided.

- 6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?**

No comment provided.



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Conclusion:

We thank the Platform again for inviting our comments. We hope the Platform will find our comments useful. We look forward to the Platform's finalised Transfer Pricing Toolkit. Should you wish to further discuss or clarify any of the points outlined in this document, please contact Luis Carrillo, Director of Tax & Transfer Pricing Solutions, via email at luis.carrillo@bvdinfo.com.

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1st February 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: Feedback - Request for comments on a draft toolkit from the Platform for Collaboration on Tax

Thank you for bringing the toolkit consultation to my attention, indeed I'm interested in commenting and we were already asked our views on TP Week, and I'll make a more detailed response. I'll also spread the consultation to different networks, both NGOs working directly on WB / IMF related issues and the tax specific NGOs in the Financial Transparency Coalition, Global Alliance for Tax Justice, and the Tax Justice Network, to publicise this opportunity to comment on the toolkit, which I find timely.

The initial comments are already below, I think the toolkit asks the right question of localised adaptation of transfer pricing guidelines, and looking at comparable databases is a good start. However, it could also look at other adaptations of TP rules in developing countries as practiced for instance by China, and Brazil, as well as how extractive sector and agricultural export sectors are being taxed through simplified regimes and adapting to local market conditions. So there are many practices to report in developing countries in the section where adaptations and adjustments are discussed.

Public accountability may be weak in the proposed greater use of safe harbours, and so we propose public transparency on country-by-country reporting and beneficial ownership registres as key parts of greater public accountability. In case of spillover analysis, we're also starting to propose accountability over tax rulings (e.g. Ireland), and granting of safe harbours and APAs in the developing country context, e.g. a Finnish-Swedish forestry giant Stora Enso (also an IFC investee) had an APA in the Netherlands that reduced tax liabilities in Brazil as reported in the recent edition of the Bretton Woods Observer, below: <http://www.brettonwoodsproject.org/2017/01/ifc-investment-stora-enso-need-responsible-ifc-tax-policy/>

TP weekly story is here:

<http://www.tpweek.com/Article/3656986/How-to-help-developing-countries-with-transfer-pricing-The-Platform-for-Collaboration-on-Tax-wants-to-hear-from-you.html>

Best regards,

Dr. Matti Kohonen

Principal Adviser – Private Sector

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7 April 2017

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Platform for Collaboration on Tax

By email to: GlobalTaxPlatform@worldbank.org

Dear Sir/Madam

A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

Thank you for the opportunity to comment on the draft *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* ("the draft toolkit").

International trade is greatly enhanced by an international tax system that can provide relief from trading profits being taxed in two (or more) countries, and where possible where there is some certainty of treatment. It is important that transfer pricing guidance is consistently applied by countries in order to achieve this, in line with the principles agreed by international consensus and set out in the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. The toolkit will need to be updated in future to take account of updates to the OECD's Guidelines as part of continuing work by governments to improve the consistency and practice of transfer pricing. Low income countries may also need help in implementing the toolkit.

Detailed comments on the paragraphs on the validity of relying on foreign market data for comparables are set out in the attached appendix to this letter. In particular, these focus on Appendix 12 of the draft toolkit and the summary of the economic work updating the 2004 study *Is Europe One Market? A transfer pricing economic analysis of Pan-European Comparables Sets* by Meenan et al in relation to the European market.

Please do not hesitate to contact André Schaffers (aschaffers@deloitte.com), Alison Lobb (alobb@deloitte.co.uk) or me if you would like to discuss further.

Yours faithfully



W J I Dodwell
Deloitte LLP

Appendix

1. Draft Toolkit Appendix 12

Section 5.5 dealing with a lack of (local) comparables data includes a repetition of the exercise using the same approach as Meenan et al. in 2004¹, but with more recent company data from 2008 – 2014. The details on the approach used and the conclusions of the findings are available in Appendix 12 of the draft toolkit.

Based on the findings of the updated study, the draft toolkit concludes that notable heterogeneity may exist in profitability ratios even in the European context.

Upon analysis of the approach and conclusions, several differences have been identified between the draft toolkit and the original approach used by Meenan et al. Each of these differences may have had an impact on the findings and the conclusions drawn.

2. Key differences in approaches applied

- **NACE codes:** The 2004 study uses NACE Rev.1 codes. The classification of companies has been updated since, with the use of NACE Rev.2 codes. Some of the selected NACE Rev.2 codes in the draft toolkit are not related to the industry tested, jeopardising the representativeness of conclusions. For instance, for Automotive Manufacturing, the 2004 study only focuses on automotive vehicles & accessories. The draft toolkit also includes the manufacture of office and shop furniture, the manufacture of machinery for mining, quarrying and a few other codes.
- **Statistical testing:** the lack of details on the actual hypothesis tests being carried out makes it impossible to directly compare with Meenan et al.'s 2004 study. In particular the null hypothesis in the draft toolkit is not clearly defined. If the studies have not been performed robustly and in similar fashions, comparing the outcomes will not be appropriate.²

¹ Meenan et al. 2004. Is Europe One Market? A transfer pricing economic analysis of Pan-European Comparables Sets.
http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/forum7/europe_one_market_white_paper_feb18.pdf

² Further detailed questions on this point are:

- What quantities are being compared across countries – Interquartile range, P25 alone, P75 alone, P25 or P75, P25 and P75?
- If the “2N” degree-of-freedom test that is being used, how are single countries being identified as violating the null hypothesis? We understand that further country-by-country tests are being carried out for this, though again the precise test is not stated in the draft toolkit.

Additionally, the following technical issues and differences with Meenan et al. are identified:

- The author's convention for testing samples with an even number of observations is not explained (See footnote 52 on page 29 of Meenan et al.)
- End of section 2: it is not clear whether the authors of the draft toolkit mean chi-squared tests with 2N-1 and N-1 degrees of freedom. A miscounting will cause an error in the p-value being reported.
- Meenan et al. explain the preparation of their data to make it suitable for chi-squared testing on page 30 of the 2004 study i.e. splitting the dataset in two equally-sized, ordered subsets around the median, and then considering the 1st and 3rd quartiles as the medians of these two halves. It is not clear whether the draft toolkit uses the same methodology or how they set up the chi-squared tests was done.
- the draft toolkit does not provide a cross-check of its results using other methods, whereas the 2004 study of Meenan et al does.
- The authors of the draft toolkit do not mention how they take care of contingency tables with cells that contain small entries, which can render the results of chi-squared tests unreliable.

- **Outliers:** Footnote 128 in section 3 of the draft toolkit states the revised convention for removal of outliers in profitability ratios. The table below provides an overview of the different ranges used per profit level indicator (PLI) to identify and remove outliers.

PLI used	2004 study	Draft toolkit
Return On Assets (Manufacturing industry)	Min: -10% Max: 20%	Min: -2% Max: 24%
Operating Profit Margin (Distribution industry)	Min: -5% Max: 15%	Min: -4% Max: 18%

Different boundaries have been applied in the 2004 study and the 2016 update. The definition of outliers should be contrasted with the equivalent process in Meenan et al. so that a comparison can be made.

In addition, it appears that the draft toolkit removes outliers on the full sample of companies, irrespective of the industry and sector to be tested. The 2004 study verifies and removes outliers depending on the PLI to be tested per industry.

- **Date of incorporation:** The 2004 study uses an extra criterion for the search strategy: all companies that are incorporated less than 5 years ago are excluded from the set. This step is performed to remove start-up companies. The draft toolkit does not make reference to this step.
- **Region:** The definition of the region under review is not clearly specified. The Meenan et al. study considered the then 16 members of the European Union.

3. Deloitte study for the European Commission in 2016

A full update of the 2004 study has been prepared by Deloitte in 2016 with the use of the most recent data available. That study follows closely the approach of 2004 and is available on the website of the European Commission³. This study also includes additional testing to validate the conclusions reached. It does not, however, cover the 2008 – 2009 crisis period now covered by the draft toolkit that possibly showed higher volatility in the observations.

³ A copy of the study and findings is available at:
<https://bookshop.europa.eu/en/study-on-comparable-data-used-for-transfer-pricing-in-the-eu-pbKP0116144/>
http://ec.europa.eu/taxation_customs/publications/studies-made-commission_en



The Platform for Collaboration on Tax
Organisation for Economic Co-operation and Development
By e-mail: GlobalTaxPlatform@worldbank.org

21 February 2017

EY comments on the Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

Dear Madam/Sir,

Ernst & Young (EY) welcomes the opportunity provided to comment on the discussion draft titled *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* (the Toolkit), as published on the OECD's website on 24 January 2017. We appreciate the opportunity to contribute to the discussions about this topic. This letter presents the collective view of EY's global international tax network.

General comments

The Toolkit seems to address more topics than just the difficulties in accessing comparability data. The Toolkit provides guidance on a broader range of transfer pricing issues and the guidance seems practical as well as helpful for practitioners that do not have extensive transfer pricing experience.

Accordingly, we believe it would be helpful if the Toolkit would clarify how this document relates to other transfer pricing guidance issued by the various parties to the "Platform for Collaboration on Tax" (the Platform), specifically in the case of differences between the various other sources of guidance/regulations and the guidance included in the Toolkit. We also believe it would be helpful to clarify the purpose of the various country practices included in the boxes throughout the document. Does the fact they are being mentioned in the Toolkit transform these techniques into a best practice in emerging countries? In our view, some of the practices may be controversial or even not desirable. Clarification of the purpose of the inclusion of country practices is likely to prevent such practices spreading to other jurisdictions without careful consideration.

We also believe that the Toolkit strongly focuses on the challenges and limitations experienced by tax authorities when conducting transfer pricing audits. In order to reach a more balanced approach to transfer pricing in emerging countries, it would be beneficial if the challenges faced by taxpayers be studied and described as well (e.g., weak institutional environment, tax administration's lack of capacity). Once a tax authority decides to adopt the arm's length principle as part of its tax policy, we believe it should also take into

consideration the cost of the proper infrastructure to support the tax audits in such specialty areas.

In our view, the Toolkit provides a good description of the various challenges arising as the result of difficulties in accessing comparables data. In addition, we believe the Toolkit demonstrates that there is not one clear solution. We therefore recommend that the Platform emphasize that flexibility and reasonableness from tax administrations is required when taxpayers make a reasonable effort to address some of the challenges encountered, e.g., by means of comparability adjustments.

We welcome the repeated statement that the selection of the most appropriate transfer pricing method, on the basis of a detailed factual analysis, is central to the application of the arm's length principle, and in many cases, is likely to have a greater impact on the outcome than the accuracy of the data used in the method's application. However, inclusion of the profit split method in Part III (approaches in the absence of comparables), notwithstanding the caveats made, might be interpreted as the profit split being acceptable because of the lack of comparables. Therefore, we strongly recommend clarification of this point.

Finally, we note that a lack of international consensus about (potential) solutions for the challenges in accessing comparability data could lead to additional disputes and additional cases of double taxation. We therefore support the ongoing work of the Platform in this respect.

Making use of available data

Section 3.2 of the Toolkit states that, in practice, application of the arm's length principle is heavily reliant on external comparables (i.e., transactions between two independent parties, neither of which is a party to the controlled transaction). Although we believe this is generally correct, in our experience internal comparables (i.e., comparable transactions between one party to the controlled transaction and an independent party) are used more often than this conclusion suggests. Specifically when dealing with developing markets and smaller markets, multinational enterprises sometimes use third party distributors. Such arrangements might be used to support the transfer pricing.

Other sources of comparability data that are often overlooked or rejected by tax administrations are quotes and price offers. While we acknowledge that in principle such information is theoretically not ideal, it would be helpful to provide guidance on the use of such data, e.g., on the circumstances in which they may be used to support the transfer pricing. In our experience, there can be cases in which such data is practically speaking the best data available.

Another way to potentially expand the amount of comparables data, is to use the full range instead of the interquartile range. We agree with the prevailing view that the interquartile range can be used to account for unidentifiable and unquantifiable comparability differences. However, it would be helpful if guidance were provided about the trade-off between being conservative regarding such unknown differences and the

need for a sufficiently sizeable set of comparables. In our view, it can be appropriate to consider the full range in certain circumstances, where the set of comparables is reasonably reliable, and not to 'routinely' rely on statistical approaches. This may be particularly relevant when using internal comparables. While this view finds support in the current guidance, a stronger statement in this regard would be helpful as, in our experience, the use of the interquartile range seems to be the standard and default practice for many tax administrations. For similar reasons, we believe the suggestion included in par 6.1, to limit the application of the range concept to relatively small ranges is not correct and we recommend it be deleted.

In some (developing) countries, transfer pricing legislation also covers transactions with third parties, for instance if they involve commodities. It may also include transactions with joint ventures (JVs) which effectively transact on an independent basis. This adds a challenge to the overall issue of finding reliable comparables, especially where external comparable uncontrolled prices (CUPs) are not available or not reliable unless adjusted. In these cases, profitability may be tested only on one side of a transaction, which party is not necessarily the least complex entity. It would be helpful to elaborate on these cases. First, we believe transfer pricing legislation should not cover such transactions with third parties or JVs. Second, if nevertheless such transactions are included, we recommend practical guidance on finding comparables for these transactions be included in the final report. In our view, it can be helpful in these instances to focus on price setting processes and negotiation procedures, and less on the outcome as such, to support the transaction has taken place under arm's length circumstances.

Making comparability adjustments

The Toolkit mentions that many countries take a very cautious approach in the application of comparability adjustments and notes the "comparability adjustment paradox" - that small adjustments will not materially alter the resulting arm's length range of outcomes and large adjustments may in fact mask more fundamental differences in comparability with the controlled transaction. While this may be true, we note that there are cases where: a) it is fairly clear that an adjustment would probably enhance comparability, and b) the direction of the adjustment is known. The question arises whether in these instances it is better to make no adjustment, merely because the reliability of the adjustment cannot be fully guaranteed.

In practice, there are many cases in which it may be appropriate to consider a foreign exchange (forex) risk adjustment, e.g., when testing a local distributor which assumes a forex risk. In practice, a benchmarking study would often yield a set of "second tier distributors" which are likely to buy from first tier importers and sell further. Limitations with respect to the amount of information available regarding the comparables would make it difficult to irrefutably demonstrate that those comparables do not assume forex risk, even when such an assumption is very reasonable.

We believe it may be helpful to include some guidance on additional specific comparability adjustments, for example, the acceptability of adjustments for volume, specifically in

relation to commodities. In our experience, there is controversy around this kind of comparability adjustments in practice.

Use of foreign comparables

The proposal of country risk premium does, in our view, not take into account experiences in certain countries (e.g., in Latin America). The proposal in the Toolkit seems conceptually flawed where it seems to suggest that a higher risk profile should necessarily lead to a higher actual return. In our view, it would be helpful to clarify that higher returns will be expected *a priori* from riskier activities and assets. On an *ex post* basis, the financial results in riskier environments (e.g., emerging countries) are more volatile, not just higher.

Some developing countries with no local comparables may have access to financial data regarding independent comparables in neighboring markets. Even though such countries may show similarities, there may also be significant differences. Comparability factors to consider include whether those companies derive the majority of their revenue from sales in markets other than the one where they are headquartered, local tariffs, local government protectionist policies towards certain sectors/industries, number of players/competitors in such market, recessions, inflation, and foreign exchange risks.

Finally, the way companies operate in developing countries is often different from their operations in developed countries. Therefore, it should not lightly be assumed that the functions performed are similar to those of group entities in developed countries. Therefore, the accurate delineation of the transaction, including the functional analysis, is very important, and may be even more important than focusing on availability of local data.

Safe harbors

The Toolkit mentions that for the purpose of identifying data on comparables suitable for setting a safe harbor margin, a solution would be to use data already in the hands of the tax administration, sourced primarily from tax return information. We agree that this could be a potential solution in the absence of sufficient comparability data (available to taxpayers), in particular when combined with an “opt-out” or “opt-in” mechanism. However, if a taxpayer does not want to make use of the safe harbor rule, it may be very difficult to provide a robust alternative analysis, in particular if the lack of comparability data was the main reason for the existence of the safe harbor rule in the first place. Practically, this could seriously impede the effectiveness of the opt-out rules and make the safe harbor rules, *de facto*, mandatory. Therefore, we recommend the use of opt-in rules, instead of opt-out rules. Furthermore, we believe that a stronger statement should be made with respect to the transparency and fairness of the approach used by the tax administration to determine the safe harbor. The Toolkit refers to the transparency as a good practice. We recommend that this transparency be mandatory.

The Toolkit also mentions bilateral safe harbors. In our view, the use of bilateral or even multilateral agreements has the potential to significantly decrease the number of transfer pricing disputes and help overcome the problem of lack of comparables. A mechanism

similar to the Multilateral Instrument as per OECD BEPS Action 15 may help introducing multilateral safe harbors on a large scale.

Secret comparables

We recommend the Platform provide additional guidance and take a firmer position towards the use of secret comparables. The Toolkit includes some examples of countries that allow the use of secret comparables by the tax administration. In our view, tax administrations should not be allowed to use secret comparables to adjust the transfer pricing of taxpayers that have taken a reasonable position. Also for that reason, we believe that it is very important that detailed guidance be provided regarding the standards to be applied and procedures to be followed (and documented) by tax administrations when compiling sets of comparables, for whatever purposes, based on information that is only accessible to them.

We recommend that the Toolkit encourage tax administrations to disclose, on a no-name basis, comparables data for certain functional profiles, obtained from the tax returns, to guide taxpayers, possibly as an intermediary step towards the implementation of an obligation for the disclosure of companies' financial information.

Commodities

Section 2.4.2 of the Toolkit addresses "Commodity pricing and prescriptive approaches" and, among others, touches upon the issue of using quoted prices for controlled transactions involving an intermediary company. We would like to point out that when an intermediary is involved, it is not always required to make an adjustment to the CUPs to establish an intermediary's margin. In some industries it is predetermined that a third party sale may involve an intermediary too, and that therefore an adjustment to external CUPs would arguably not be required. It would be helpful if this scenario would be included in the Toolkit.

Furthermore, it would be helpful if guidance were included regarding some more specific comparability adjustments, for example, on volume differences. We refer to our comments above.

Anti-avoidance measures

As the Toolkit acknowledges, the topic of anti-avoidance measures is very broad. The examples described seem to be generic (relevant to intra-group transactions), and not limited to the lack of comparables data. We question whether the Toolkit should address such general anti-avoidance measures, specifically since the OECD BEPS project has already covered these.

The approach described with respect to the deduction of royalties is of particular concern. It is suggested that countries could introduce a cap on royalty deductions, based on the ratio of royalties payable to EBITDA, or similar. The amended OECD guidance (par. 6.144) strongly rejects a rule of thumb approach. Furthermore, the analogy of such cap with the approach recommended in the BEPS Action 4 report is not correct. Where a multinational

enterprise may have certain freedom to choose between the use of capital or debt, such freedom is not present when dealing with intangibles. The tax authorities of an entity providing the right to use an intangible to an associated entity will require an arm's length compensation. When the receiving country would restrict the deduction of the royalty payment, this will inevitably lead to double taxation.

Examples

In our view, the inclusion of examples is helpful. In general, we believe the Toolkit could be enhanced by including more examples where the practical approach used by the taxpayer is accepted, as opposed to being challenged by the tax administration. The examples throughout the Toolkit seem to be extremely simplified. It would be helpful if the Toolkit more explicitly mentions this and if it were clarified that these examples are merely to illustrate the concept or issue discussed.

Without being exhaustive, we have commented below on some of the examples provided.

In our view, the example in Box 2, Sugar Producer, is not complete. The conclusion seems to rely on product comparability, and not based on an analysis of the functions performed.

Section 5.4.3 in part II discusses netback approaches. When a netback adjustment is discussed for the transportation cost, it would be helpful to clarify that the tax authorities should consider the same transportation route as chosen/ used by a taxpayer and not to suggest any alternative route which, in the view of the tax authority, may be more economically justifiable, as we have seen in practice. Moreover, we believe that netback approaches require a deep functional analysis that was not provided in examples described in the Toolkit (i.e. box 15 and box 16).

If you have any comments or questions, please contact:

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Yours sincerely,

On behalf of EY

Peter Griffin

Ronald van den Brekel

11th February 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: **Our feedback about the toolkit of global platform**

Dear Julia:

I hope everything is great over there.

I have been sharing your request with many colleagues from different sectors to achieve enough comments to fortify the toolkit proposed.

I'm also doing good at the university with my colleagues. We have created GIFID (Grupo de investigación en Fscalidad internacional y desarrollo) to share our point of views in meetings like IMF-WB in october 2016. My colleague Juan Carlos Campuzano (JC) met with Mrs Victoria Perry too, in december 2016 at meeting organized by UN.

JC and I were analyzing the toolkit proposed and I want to share you the points written below:

1. Legal national framework of each country is limited to be possible the application of many procedures or to make possible many of your suggestions. It could be logical but not possible, because the laws of national bodies haven't been developed including these scenarios. Harmonization of laws along all these countries must be applied and the role of this platform could be focused in the coordination of this achievement in mid-long term.
2. Lack of transparency is not only about Tax Administration (TA). Companies' superintendence must be included in capacity building aid programs trying to reinforce their activities, empowering the transparency and data source for TA in their determinations, for example, with "residuals" suggested in this toolkit like the last option when nothing more works in the audit process. Companies' superintendence in every country must be the data source, but nowadays **they are the lack of source.**
3. The toolkit proposed requires to be "approved" by TA more than the others. Only the auditors and their experience along these countries could reinforce the idea of this toolkit really works for all of them. The aim is to make sure that the toolkit gets approved by 25-40% of TAs.
 - I'm grateful for this open invitation as part of CSO, but TA knows better their limitations and experience to solve the problems faced in their work.
 - Due the technical process; the Tax Administration from undeveloped countries (UC) must be invited to give an official or at least a technical feedback (considering the legal national framework, their own realities in every country).

For undeveloped countries, the solution might be more capacity building program inclusion of nationals Enterprise Superintendence, laws harmonization in all UC, and the validation/approval of any proposal from Global platform including official feedbacks of UC TA. The global platform in this toolkit and every

future proposal could develop an important duty like coordinator, analyst, and proponent. So that global platform makes possible the real inclusion of experiences, realities in a transparency and consistency framework.

I hope this comments could be useful for you.

Our group is open to have a conversation with you if you find necessary to be precise in any point. We expect the best for you and your task in progress.

Best regards,

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OECD/IMF/UN/World Bank Group

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7 April 2017

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Dear Sirs,

Response from FTI Consulting to the Platform for Collaboration on Tax draft publication of "A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses"

We welcome this opportunity to comment on the draft publication titled "A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses" ("the Toolkit").

We agree to have our comments posted publicly.

We would like to thank you for the opportunity to comment on the Toolkit and hope our comments are helpful.

Yours sincerely,



Ruth Steedman
Enc.

Introduction

We believe that the Toolkit is most helpful and is welcomed as a practical tool for assisting tax authorities in cases where there is difficulty in assessing comparables data for transfer pricing analyses. It is apparent that a large degree of time and care has been spent on the development of the Toolkit. The Toolkit is clear, well-constructed, and provides useful examples for the application of commonly used transfer pricing concepts.

Availability of data

We recognise the fact that the Toolkit will be of great value to tax authorities where country specific comparables data is available. However, from a practical experience of using commercially available databases, we are aware that often, e.g. in Africa and South America there is insufficient data. In response to this, some tax authorities have made it clear that alternative data is acceptable e.g. the South African Revenue Services and the preference for pan-European comparables. Where there is a significant lack of local comparables, we recommend that tax authorities are encouraged to take a similar practical step.

In some regions, this issue of the lack of comparables also limits the application of other valuable suggestions as to how alternative / additional comparables can be sought. An example of this is where the Toolkit discusses the use of data from countries in close geographic proximity. We note that in Africa for example, the most developed economies in terms of fiscal bases, political stability and resources have a wide geographic dispersion (aside from Tanzania and Kenya). Another example, is where the toolkit discusses the use of sovereign credit ratings or other equivalents to derive a set of potential comparables, but again in Africa, there are very few countries with reported sovereign credit ratings.

We recommend therefore that a pre-amble be introduced to the Toolkit which states that the Toolkit is primarily for use where local comparables are available or where there is a general acceptance of foreign comparables by the relevant tax authority (preferably defined data sets). In the absence of acceptance by a tax authority for the use of foreign comparables, the Toolkit may not be as useful with regards its intended purpose. We suggest that a collective effort (and further research if needed) should be pursued by tax authorities (perhaps through forums such as ATAF) to reach consensus on the issue of the acceptability of foreign comparables. In addition, the collection of local comparables data which is made available for transfer pricing assessment purposes is encouraged.

Safe harbours

Carefully constructed safe harbours are often an effective tool in providing certainty for both tax authorities as well as MNEs in the absence of local comparables and we welcome the guidance provided on safe harbours in the Toolkit. However would like to emphasise that the use of safe harbours should not become a long term alternative to the collection of publicly available local comparables data for transfer pricing analyses. It should be made clear that the collection of local comparables data which is made available for transfer pricing assessment purposes is the most preferred scenario in the long term.

Anti-avoidance

The UK has introduced new legislation as of 1 April 2017 dealing with corporate interest restriction rules. We suggest the removal of references to the UK in this section as, in our view, the UK have departed somewhat from the position stated in this section (“purely arm’s length approach” and references to the “Worldwide Debt Cap provision” in Part III - 8).

Conclusion

We are encouraged by the development of the Toolkit in assisting with the assessment of potential comparables, but conclude that there is still a considerable amount of work that is needed to provide an appropriate level of local comparables and / or reach consensus amongst tax authorities on the use of foreign comparables. We do acknowledge that where there are local comparables or there is clarity provided by tax authorities on alternative data sets, the Toolkit will be a highly effective manual in the assessment of potential comparables.

Comments received from Georgia Revenue Service

21st February 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: Draft toolkit designed to help developing countries address the lack of comparables for transfer pricing analyses

Dear Sir/Madam.

Please find some comments of Georgia Revenue Service, on a **draft toolkit designed to help developing countries address the lack of comparables for transfer pricing analyses**

Regarding to Transfer Pricing adjustments we would highlight 2 issues which might have a very important impact on the results of TP audit in Georgia.

Country risk adjustment:

We agree that differences between geographical market might lead tax auditors to the wrong conclusion if they use foreign comparable from very different market but also we doubt that using country risk adjustment can guarantee more exact results, in all cases, and not on the contrary.

Georgia's opinion on country risk adjustment while evaluation financial controlled transactions is the following:

If Georgian company (borrower of loan) has credit rating B+ or lower than B+ while country's rating also is B+ (It's important that rating does not exceed rating of country itself or "country ceiling" is used) and we find as comparable bonds issued by, for example, US Company with the same credit rating (B+ in that case) issued in the same date, with the same maturity and all other comparability factors are satisfied.

If we use country risk adjustment we should assume that when all other comparability conditions are met we should still adjust the interest rate of loan borrowed by Georgian company by about 5% (approach used by Georgia tax payer) because once government bond issued by US was 5% lower than government bond issued by Georgia.

That adjustment means that any Georgian bond/loans should have 5% higher coupon/interest than American bond when all other conditions are satisfied. If we see even one case that while all comparability factors are met bond issued by Georgian company has lower coupon than bond issued by American company with the same credit rating that automatically means that adjustment was wrong.

opinion is that we should use "country ceiling" and always search for foreign bonds issued by companies which has the same credit rating as the Georgian borrower company which is the same or lower rating than Georgia, taking into consideration "country ceiling". That would mean that country risk does not

limit the company's possibility to repay the loan therefore does not have influence on the interest rate. Country risk adjustment is not appropriate because does not provide the possibility of the exact results. In addition, country risk adjustment is indirectly used while calculating credit rating of the borrower company (noting Georgia as country of risk) and using the principle "country ceiling" which means that a company can't have higher credit worthiness than the country where it operates.

Currency devaluations since 2015:

The report misses one important aspect, which make crucial for developing countries, during last couple of years and relates to currency devaluations.

Another big problem to which Georgia and probably many other developing countries face since the year 2015 is significant strength of USD against currencies of many developing countries in the region. (Georgia, Azerbaijan, Turkey, Russia, Ukraine, Belarus, etc). To illustrate the substance of the problem, we will provide detail example from our practice:

We are finalizing TP audit of Georgian company (tested party) which is contract manufacturer. Controlled transaction is sale of finished goods to parent company. We used TNMM as the most appropriate method, PLI -EBIT/operating expenses, database-Amadeus, geographical area-eastern Europe. we got about 12 comparables (Romanian, Polish companies mostly). We calculated interquartile range and got the following result:

year	price of product	EBIT/operating expenses	fell into the market range
2013	6,7USD	-2,50%	NO
2014	6,6USD	-2,78%	NO
2015	6,55USD	2,50%	YES

Between the years 2014 and 2015 nothing has changed, price was even slightly decreased, all functions, assets, risks, remained the same but because of devaluations of Georgian currency against USD we got high margin which fell into the range because our comparable companies did not experience such high currency risk. Georgian company occurs most of expenses in Georgian Lari, while receives revenue in USD that factor was reason of their positive margin, while the price was not consistent to market principles.

We needed to make the adjustment using average currency trend against USD but could not find any clue which would guarantee more exact results.

Mr. Dachi Kinkladze

Deputy Head

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Comments to the Platform for Collaboration on Tax Draft Toolkit for addressing difficulties in accessing comparables data for transfer pricing analyses

ICC welcomes the opportunity to comment on the draft toolkit for addressing difficulties in accessing comparables data for transfer pricing analyses, developed by the Platform for Collaboration on Tax.

In general terms, ICC commends this initiative, as we believe that the work performed by the Platform for Collaboration on Tax will enable and enhance the position of both tax authorities and taxpayers, particularly developing countries in regard to transfer pricing controversies. Whilst substantial work remains to be done, ICC applauds the efforts made and the direction taken so far.

The wide scope intended to be covered by the document may be rather ambitious but any advance in this direction may result in relevant benefits for taxpayers and tax authorities. It is essential to reduce the administrative burden and compliance costs and to move forward towards a mutual understanding between both parties. To this end, providing Tax Authorities with adequate training and tools is critical to be able to get balanced and technical discussions during tax audits.

ICC believes that it is crucial to provide tax authorities, especially in developing countries, with internationally consistent tools and standards in order for them to make an assessment on the appropriateness of transfer prices based on the arm's length principle. We strongly support the application of the arm's length principle as the basis for any legal/administrative development and it should be viewed as the common ground for developing any discussion. This will ultimately benefit not only the respective tax authority, but also the taxpayer, as it would increase legal certainty.

Part II: Issues arising when conducting a comparability analysis

In general terms, Part II is a very complete manual of the main issues on transfer pricing and can be used as reference material supplementing the OECD Guidelines and local regulations.

Particularly in developing countries, it is difficult to find comparable transactions to determine transfer prices in line with the arm's length principle and therefore widening of the geographic market of the tested party might be reasonable. This is largely because the comparability of a transaction does not stop at the border of a country in which the tested party is resident for tax purposes, but usually can be applied within a wider geographic region. We agree that reliance on foreign comparables may be a simple and feasible approach, especially for margin-based methods.

The Discussion Draft has a strong focus on the underlying data for a comparability analysis; it is very detailed on the mechanical aspects of identifying and reviewing comparables, but does not address the assessment of risk of inappropriate transfer pricing in any detail. This increases the likelihood of disputes arising, and makes it less likely that the process will be efficient for either taxpayer or tax authority. For example, a taxpayer may have provided a detailed and thorough transfer pricing analysis, which the tax authority is unable to substantiate using the tools and information at their disposal. By failing to carry out a proper assessment of the risk of incorrect transfer pricing, it is very possible that the tax authority will put forward a proposed transfer pricing adjustment which is not justified and gives rise to a costly, and ultimately fruitless, dispute.

Further, we would like to point out that the comparability analysis should also include a detailed functional and risk analysis of the parties concerned. This is, in fact, the basis for any benchmark study in order to identify comparable transactions. Therefore, it is also necessary to provide further guidance on the functional and risk profile of certain types of foreign engagement (e.g. distribution subsidiaries) in the Discussion Draft.



A general loosening of screening filters as suggested in the Discussion Draft (see Sec. 4.2, p. 33 of the Discussion Draft) may, on the one hand, increase the pool of information available for comparability studies. On the other hand, there is a potential risk of how to address the loosening of screening filters. Both tax authorities and taxpayers would have the opportunity to take advantage of lower requirements on the comparability, which would inevitably widen the gap between the views of the respective case of both parties. The same concern applies for the proposal of less rigid independence criteria when conducting benchmarking analysis, which could be a simplified option if applied homogeneously. It may also improve the number of potential comparables in a scenario of scarcity.

Another possibility would be to reduce the requirements on the number of comparable transactions needed. The screening filters could remain by using the international standard, but the number of comparable transactions necessary is reduced. Furthermore, it is crucial that every country has legal disclosure obligations, so that the databases are able to gather information and the intensity of companies and transactions recognized in the databases is increased (see Sec. 3.3 p. 22 et seq. of the Discussion Draft).

A good option for the respective determination and justification of transfer prices is the internal arm's length comparison. (see Sec. 3.4 p. 26 of the Discussion Draft)

ICC would like to raise a concern with tax authorities' potential use of confidential information as secret comparables (see Section 4.1.1, p. 32), which we believe should be strongly avoided. It would be preferable to provide verification of the reliability of the analysis, making publicly available a detailed description of the analysis, including the criteria used in selecting data for inclusion and/or aggregated results, as is proposed in the toolkit. In this regard, it is essential to ensure that both tax authorities and tax payers have the same tools and information available in order to defend their respective positions.

Comparability adjustments (Section 5 of Part II of the Toolkit)

With respect to the use of adjustments, this appears to be a good option as it would help solve problems arising from the lack of sufficient quality data. In this case, it should be guaranteed that taxpayers and tax authorities apply them in a similar manner. There is concern about the technical difficulties that may arise when applying them and that specific training may be needed by tax authorities

In this section, comparability adjustments have been discussed and it is recommended that capacity adjustments should also form part of such adjustments. Capacity adjustment is an adjustment carried out to eliminate the functional and economic differences created by varied levels of capacity at which the taxpayer and comparable enterprises are operating.

To improve the quality of comparables, an economic/ comparability adjustment to account for the differences in the level of capacity utilization by the comparables and the tested party can be calculated.

Taking into consideration that the toolkit is designed for the benefit of emerging markets, it is pertinent to note that the industries are still developing and have not reached their optimal stage. Thus, underutilization of capacity is a common phenomenon and a capacity adjustment will result in improved comparability while undertaking an economic analysis for determination of arm's length range.



Use of multiple year data (Section 5 and 6.1 of Part II of the Toolkit)

It has been rightly noted in Section 5.3 of the Toolkit that timing differences in accounting standards can be mitigated by using multiple year data. The use of multiple year data further captures market cycles and reduces the variability / distortions in the financial results arising from the use of single year data. Further, in most cases the current year data is generally not available and hence the emphasis on only the use of current year data may lead to the rejection of potentially good comparables. In addition, as stated in Section 6.1 of Part II of the Toolkit, the use of a range (e.g.: inter-quartile range) instead of an arithmetic mean leads to a better comparison by eliminating the extreme results.

Part III: Approaches to applying internationally accepted principles in the absence of comparables

ICC also supports setting up safe harbours as a simplification measure, with companies having the option to use them or not (as long as an alternative arm's length outcome can be demonstrated).

We believe that the use of anti-avoidance measures would also be a good initiative with the condition that they are used to solve valid high-risk issues and not as a hidden revenue maximising rule established only in tax authorities' favor. In that sense, measures should be taken in order to reduce the risk of double taxation.

Standardization of reporting financial information by companies (Section 2 of Part III of the Toolkit)

The Discussion Draft highlights the importance of an internationally accepted electronic reporting format. In this regard, the eXtensible Business Reporting Language ("XBRL") is an information format standard that enables automated, global sharing of business information as contained in company ledgers, income statements, cash flow, balance sheets as well as textual information included within footnotes and other requirements of business reporting.

Implementing XBRL reporting by emerging markets will not only help to facilitate easy access to financial information, but also improve in establishing comparability. XBRL helps in streamlining and structuring data and reporting in a standardized format which consequently results in improving transparency and efficiency in financial reporting. Reliability and adequacy of financial information of a company plays an important role in deciding comparability of such company with the taxpayer and thus, XBRL can be used as a tool in achieving that.

Advance Pricing Arrangements ("APA") (Section 7 of Part III of the Toolkit)

APAs are gradually emerging as a game changer in the transfer pricing space with a greater number of taxpayers exercising this option to reduce litigation arising out of Transfer Pricing issues. By concluding APAs on a large scale, emerging markets could generate revenue on one hand and attract foreign investments on the other. Specific programs for industry-specific APAs, and for small and medium enterprises, could be considered that allow differentiation on the basis of facts, while keeping comparability criteria largely consistent. However, filing APAs is resource intensive, not only for tax authorities but also for taxpayers. Nevertheless, both parties need to ensure that the process is conducted in a reasonable time frame in order to avoid uncertainty.

Guidance on application of quantitative filters (Appendix 8 of the Toolkit)

Appendix 8 of the Toolkit refers to the typical process of identifying comparable companies and the requirement of application of diagnostic ratios have been dealt with. However, recommendations should be made to provide broad guidelines on the quantitative filters to be applied in order to identify comparable companies in different industries (e.g. various kinds of Services, Manufacturing, Distribution, etc.). For instance, in case of a distributor/ marketing and sales support service provider, the threshold applied (upper cap) on a filter such as Advertisement and Marketing Expenses to Sales may not be the same relevant threshold as for a routine software development/ Information Technology enabled service provider. In other words, there could be quantitative differences in applying the same filters across industries. Recommendations on the broad guiding principles for application of quantitative filters are of prime importance.



The International Chamber of Commerce (ICC) Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy.

Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.



February 21, 2017

To: The Platform for Collaboration on Tax

From: International Tax and Investment Center (ITIC)
Oil and Gas Taxation and Regulatory Dialogue

Re: Request for comments on DISCUSSION DRAFT: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analysis

The Oil and Gas Taxation and Regulatory Dialogue of the International Tax and Investment Center is pleased to submit the following overview comments on the Discussion Draft. We look forward to working on elements of future work as envisioned in the Discussion Draft, and as noted at the end of this comment letter.

Comment 1: We believe that as an overall matter, the detail and descriptions contained in the Toolkit can be an important resource for developing countries. We do believe that while there is a significant amount of additional detailed analysis in this document, to be most practical, it would be helpful to insert even additional detail and work specifically through numerical examples to show precisely how an adjustment is actually calculated and what the numerical results would be. Perhaps some of these specific cases can be worked as part of the additional work in a subsequent phase, since such examples would help make the resource as practical as possible.

Comment 2: With respect to oil and gas extractive activities and particularly for crude oil, we believe that comparable uncontrolled pricing often exists or is available by means of reference to readily available published data. The availability of actual or benchmark prices, and the use of widely recognized quality and location differentials, provide a major opportunity to simplify transfer pricing for this commodity. Therefore, one priority focus of the toolkit could be to provide additional detail and support for developing practical and defensible arm's length values for crude oil. This is potentially "low hanging fruit" which could provide value for

developing countries and investor companies alike. Background explaining the basis for this suggestion is contained in the following excerpt from Chapter 4 of “International Taxation and the Extractive Industries¹,” where Jack Calder writes:

“Oil is generally valued for tax and royalty purposes either on the basis of sales prices subject to a specific transfer pricing rule or on the basis of general norm or reference pricing. The latter is less common but is adopted by some major producers such as Norway, Angola, and Nigeria. For oil, arm’s length sales from the same reservoir can reasonably be regarded as providing a CUP for the purpose of valuing non-arm’s length transactions, since the quality is generally fairly consistent, at least over the short to medium term. Oil valuation rules are generally based on this assumption. They commonly allow for use of monthly or quarterly average prices to increase the pool of CUP.

Since there may be insufficient arm’s length sales from the reservoir to provide a reasonable range of CUP in the period, some countries require use of benchmark prices. These may be used on their own or in conjunction with actual arm’s length sales of the crude to be valued, and combinations of different benchmarks may be used. There are differences in the quality of different crudes—light or intermediate crudes contain a higher proportion of the lighter fractions, such as gasoline, most in demand, and sweet (low-sulfur) crudes can be refined more cheaply than sour crudes—but crude from one reservoir is often physically comparable in quality with crudes from other locations and priced similarly in commercial transactions. FOB prices for a range of widely traded crudes are quoted by price-reporting agencies such as Platts, Argos or ICIS, providing the data required for benchmark or reference pricing. Generally, once a similar-quality benchmark crude has been identified, standard formulae can be applied to adjust its price to reflect measured differences in its physical quality. It may also be necessary to make an adjustment for transport cost differences, in which case, as discussed earlier, standard international freight charges could be used. Benchmark pricing is consistent with commercial practice, since sales between independent parties are often priced on the basis of a benchmark crude with a premium or discount. If arm’s length sales of local crude are consistently priced this way, it may be possible just to use the standard market premium or discount rather than calculate comparability adjustments independently.”

We note that additional work in this area is envisioned and is mentioned in several places in the document. We support that work. We would point out that the practice of utilizing benchmark prices can be viewed simply as a part of developing a CUP under “traditional” transfer pricing methodologies [“Benchmark pricing is consistent with commercial practice...”], and does not rely on further development of a “sixth-method” approach (in fact its utilization precedes the evolution of that “method.”)

¹ Philip Daniel, Michael Keen, Artur Swistak and Victor Thuronyi, eds., *International Taxation and the Extractive Industries*, International Monetary Fund, Abingdon, Oxon; New York, NY: Routledge 2017, 91.

Comment 3: As noted in the paragraphs quoted above, reference is made to price-reporting agencies such as Platts, Argos, and ICIS. We would suggest adding these to the listing of databases referred to in Appendix 3.

Comment 4: In addressing costs charged into extraction companies and projects, it should be noted that the oil and gas industry typically conducts such operations via joint ventures, with one of the partners functioning as the operator. Costs charged by the operator to the venture are, by long standing convention in the oil and gas industry, billed at “cost.” The presence of the other co-venturers and their audit rights ensures that the operator abides by this cost approach, which will undoubtedly be reflected in the operating agreement. Again—in looking for ways to eliminate transfer pricing disputes and analyses, this unique feature of the oil and gas industry should be fully taken advantage of when assessing transfer pricing risks.

Comment 5: The above comments illustrate that in many cases oil and gas activities and operations have unique characteristics which can be taken advantage of and can reduce risks associated with transfer pricing issues. We would recommend that these points be emphasized and explained. Again quoting from Jack Calder’s chapter, “Transfer pricing of different extractive industry products involves common, broad issues, but there are significant differences of detail among oil, gas and minerals².”

Additional General Comments: We appreciate the chance to offer these comments and look forward to continuing opportunities to comment upon revisions to this toolkit and to the additional work identified in Part IV.

Submitted by Daniel A. Witt and Karl B. Schmalz; International Tax and Investment Center; USA; +1 202 530 9799; dwitt@iticnet.org; kbschmalz@gmail.com

² Ibid at p. 90.

The Platform for Collaboration on Tax

Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

Comments on Draft Toolkit for transfer pricing analysis

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) in response to the invitation to public comments by the Platform for Collaboration on Tax regarding the “A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses” released on January 24th, 2017.

The JFTC is a trade-industry association with Japanese trading companies and trading organizations as its core members. One of the main activities of JFTC’s Accounting & Tax Committee is to submit specific policy proposals and requests concerning tax matters. Member companies of the JFTC Accounting & Tax Committee are listed at the end of this document.

General Comments

- We find the draft toolkit (“Toolkit”) to be a concise and practical summation of the existing OECD Transfer Pricing Guidelines, and duly acknowledge its effort to propose alternative approaches (notably geographical/country risk adjustments) that may prove to be viable means to alternate the established methods in the absence of reliable information.
- On the other hand, although the Toolkit demands "careful consideration" to be given as to whether such approaches should be used, as these approaches lack reliable empirical evidences, we (as taxpayers) fear that there could be quite a significant gap between the tax administrations and taxpayers and even between different tax administrations, upon interpreting what is meant by "careful consideration." It would be greatly beneficial to all parties involved, if the Toolkit specified that these novel approaches “should not be applied in principle” until there has been a joint effort by an international body (e.g. OECD, UN) to deliver practical guidelines backed by reliable empirical evidences and broad consensus among the participating countries, so that uniform assessment practices and prevention of double taxations can be ensured.
- We would also like to note that there are cases that transfer pricing assessments are easily made

in emerging countries where the number of comparable companies is limited and the risk and function analysis of taxpayers and related parties and the analysis of the appropriate transfer pricing method are not sufficiently carried out. The toolkit should emphasize that transfer pricing assessment should not be easily made without adequate and appropriate analysis.

- Additionally, while the case studies provide some informative step-by-step depictions of transfer pricing audit, where the taxpayers have failed to arrive at the most appropriate transfer pricing analysis of their circumstances, it would also be highly resourceful to introduce some examples where the tax administration had made inappropriate judgments (e.g. reckless selection of TPM (especially CUP, PS) or comparability) as well.

Specific Comments

- **Part II. 4. Making optimal use of available data (Page 31-Page 34)**
In this section, approach to obtain information from customs in addition to tax returns filed by taxpayers is introduced, however, we are highly concerned about securing taxpayers' confidentiality and the possibility of using secret comparables under the situation where taxpayers have limited access to information owned and used by tax authorities. Therefore, in order to enable transfer pricing enforcement to be effective and transparent, we request that tax authorities should avoid using secret comparables and basically proceed with their assessment in accordance with transfer pricing analysis made by taxpayers.
- **Part II. 6.2 Statistical approaches (page 47)**
In "Box 18.Sugar Producer," the Toolkit introduces a simple illustration where the actual PLI of the tested party was below the interquartile range and subsequently adjusted to the median point of the range, which we agree is a method commonly used by majority of tax administrations around the globe.

We believe the Toolkit could benefit more by taking note of the instances where some tax administrations (namely China (*)) deviates from the above-mentioned norm and applies reckless adjustments to the median point even when the PLI falls within the interquartile range (lower half). It would be useful for the report to emphasize the rationale behind using the interquartile range, which is to improve the reliability of the analysis by eliminating the lowest and the highest 25% of the comparables set, as opposed to blindly assuming that only the median point or above should be considered ALP.

(*) Article 41 of the Special Tax Adjustment Measures (2009)

"When the tax authorities analyze and evaluate the enterprise's profitability by using the quartile method, if the enterprise's profit level is below the median of the range of profitability

established by comparable enterprises, in principle the tested enterprise's profit should be adjusted up to a level not lower than the median of the range established by the comparable enterprises."

- **Part III. 2. Approaches to increase the availability of primary comparables data (Page 52-Page53)**

In this section, approaches to increase the availability of primary comparables data are introduced. However, we are concerned that it could result in requiring taxpayers' compliance more than now. We request the toolkit should mention that it is necessary to consider taxpayers' burden of compliance costs when considering the enforcement of transfer pricing.

- **Part III. 4.1 Safe Harbors for TP (Page 54 – Page 60)**

Safe Harbors may improve predictability and reduce compliance costs for taxpayers as well as tax collection costs for tax authorities if properly designed and exercised.

While an "opt-out" regime may contribute to reducing administrative costs for tax administrations, the burden of proof borne by taxpayers should be carefully taken into account when designing a safe harbor.

For instance, where a safe harbor requires a relatively high profit level, the taxpayer may be inclined to opt out of it. It is observed, however, that in certain countries, the tax administrations impose excessive burden of proof on the taxpayers and sometimes even on the overseas associated enterprises of those taxpayers. It would be beneficial for the Toolkit to note that such kind of practices would not only deviate from the original purpose of achieving simplification, but also may lead to double taxation for certain taxpayers without sufficient administrative capacity to cope with the burden of proof.

In addition, it should be emphasized that the price or profit level of safe harbor rule needs to be set at a reasonable level which will be treated as appropriate for transfer pricing purpose even in the counterparty countries. If it is not the case, it should be noted that taxpayers are exposed to double taxation risk, and tax authorities will also increase the enforcement cost thereafter, so that the main purposes of the safe harbor rule cannot be achieved.

- **Part III. 5. Transactional Profit Split (PS) Method (Page60 – Page 61)**

An approach where Profit Split ratio is not calculated using external data is introduced, but without finalizing the revised OECD Transfer pricing Guidelines which are still under discussion at OECD, the descriptions may lead to tax authorities' misuse of PS method. Therefore, in order to avoid unnecessary misunderstanding, we request to delete the descriptions or add more detailed notice for the application of PS method if it is difficult.

- **Part III. 8. Anti-avoidance and other tax base protection measures (Page 63 – Page 64)**

While it can be useful to introduce anti-avoidance measures other than transfer pricing in the Toolkit, in the absence of detailed guidance on how to apply such measures, tax administrations may misinterpret them as a quick alternative that can be exploited whenever they find difficulties in applying transfer pricing. We suggest for this part to be removed from the Toolkit all together or at least, appropriate remarks/examples regarding the challenges in applying each measure be added.

- **Case 1 (Page 71)**

Case Study 1 provides some useful insights on re-visiting both contractual and circumstantial evidences of a controlled transaction, and arrives at the conclusion that B Co should be re-characterized as a service provider (commissionaire) in order to better reflect the economic substance presented by the case. The Toolkit suggests that the TNMM with (full) costs is the appropriate PLI in this case while the Toolkit suggests in Part II, 2.4.1, when remunerating tested party that is a service provider, one should bear in mind that its PLI should reflect "the strong correlation between the profitability...and its costs." As such, B Co, which in essence is deemed a limited risk intermediary with no recognizable marketing intangibles, should be compensated using Berry Ratio (Footnote 32). It would be beneficial if the Toolkit could include this point to the conclusion (and as a precaution, also mention that selecting Full Cost Plus is a commonly made mistake, where there is no correlation between COGS and the service provider's profitability as can be observed in this case).

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Members of the Accounting & Tax Committee of JFTC

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Sumitomo Corporation

Toyota Tsusho Corporation

Yuasa Trading Co., Ltd.



Date: February 20, 2017
To: Whom It May Concern
From: David R. Jarczyk, ktMINE, CEO
Subject: Comments Regarding: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

There is a need to educate the transfer pricing community on the data available in the public domain prior to furthering discussions regarding adjustments, interpretations, and determining the arm's length nature of tested transactions. The purpose of this memorandum is to provide information on the availability of market data:

- 1) for independent transactions involving intangibles, and
- 2) for other independent transactions analyzed for transfer pricing purposes.

The spirit of comparability analyses is properly discussed in the following paragraph from the discussion draft:

“Comparability analyses are an important element in the implementation of the arm's length principle, requiring a comparison of the conditions in transactions between associated parties (“controlled transactions”) with the conditions in comparable transactions between independent parties (“comparable uncontrolled transactions” or “comparables”). It is important to emphasise that comparability analyses are not always primarily focused on the actual price of the transaction (emphasis is mine). In many instances, transfer pricing rules operate to consider whether a transaction has occurred at all, or has occurred in a way that is substantively different from that which is described in contracts or documentation; in ways that are substantively different from those which would occur at arm's length; or are not commercially rational (emphasis is mine).”¹

¹ OECD, IMF, UN, WBG, January 2017. *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses*.



However, the discussion draft quickly turns to the incorrect assessment that there is a lack of reliable, usable information. Below I provide information on the availability of market data for transfer pricing purposes.

Data Available for Transactions Involving Intangibles

While it may be true that information on the arm's length nature and pricing of intangibles transactions are difficult to find for certain developing countries, many practitioners seem to misunderstand the very structure of license agreements. In fact, most license agreements are made to cover all geographies (i.e., worldwide territory rights) or regional geographies (i.e. regional territory rights, such as Africa, South America, and European Union).

In fact, based on ktMINE's research, over 75% of publicly available license agreements include territories for regions outside the United States.

Why is this the case? When independent parties get together to make a deal, their lawyers' job is to protect corporate interests. An owner of intangibles (i.e., Licensor) wants to ensure the intangible rights are exploited in a specific region which will not infringe upon or compete with its other business interests. A party looking to exploit intangibles (i.e., Licensee) wants to ensure it receives a clear understanding of the territory in which the intangible rights are permitted to be exploited and maximize its geographical reach in the hopes of maximizing profit. As such, we find that many independent market transactions allow for worldwide or broad regional rights. The contract terms surrounding pricing structure, functions, risks, and exploitation of intangibles factor into the negotiation of royalty rates, flat payments, milestone payments, etc.



Data Available for Other Transactions Analyzed for Transfer Pricing Purposes

It must be noted that independent contracts exist for a variety of transactions beyond those involving intangibles. These contracts provide a detailed representation of the functions performed, risks assumed, and assets employed by both parties. Furthermore, they provide specific definitions regarding pricing structure and the payments themselves. Many of these contracts are made to cover all geographies (i.e., worldwide territory rights) or regional geographies (i.e. regional territory rights, such as Africa, South America, and the European Union).

- Manufacturing Services
- Research and Development
- Trademark Licensing
- Technology Licensing
- Buying Agent Services
- Toll Manufacturing
- R&D Cost Sharing
- Marketing Distribution
- Franchise
- Joint Development
- Software
- International Distributor & Marketing Services
- Sub-License
- Asset Purchase
- Cross License
- Intangible Property
- Contract Manufacturing
- Confidentiality
- Commissionaire Services
- Commission Agent
- Administrative Services

Common Myths vs. Facts

MYTH: Global Market Information is Not Available

FACT: Based on ktMINE's research, over 75% of publicly available license agreements include territories for regions outside the United States.

MYTH: Information is only available for U.S. companies

FACT: Based on ktMINE's research, most companies that are party to publicly disclosed contracts are not U. S. companies.



MYTH: Information is only available for public companies

FACT: Based on ktMINE's research, publicly disclosed contracts are available for not only non-U.S. companies, but also for companies from most geographies. In fact, it is possible to find contracts between one private company to another private company.

Suggested Edits to Appendix Regarding ktMINE

Please make the following edits to the appendix of the discussion draft when discussing ktMINE's content coverage:

ktMINE provides transfer pricing users with 3 distinct data sets:

- Royalty Rates – With over 60,000 disclosed rates, support intercompany royalty rates and document findings with evidence found in independent party agreements.
- Agreements – Support intercompany transactions by referencing how independent parties have structured similar transactions and allocated risks and functions.
- Intangibles Portfolios & Intangibles Intercompany Movement – Gain access to a company's intangibles and licensing portfolio to assist in developing a value chain analysis and identifying legal intangibles ownership (which is the starting point for determining economic ownership).

To The Platform for Collaboration on Tax Date February 20, 2017

From Sean Foley, Global Leader, Global Transfer Pricing Services, KPMG in the U.S., and Natasha Vaidanis, Leader, Global Transfer Pricing Services, KPMG in South Africa Ref Comments on a draft toolkit designed to help developing countries address the lack of comparables for transfer pricing analyses

Special thanks to Christian Wiesener, Associate Director, Global Transfer Pricing Services, KPMG in South Africa, for his contributions to this response document.

KPMG International (“KPMG”) is pleased to provide comments on a report released by the Organisation for Economic Co-operation and Development (OECD) consisting of a *draft toolkit designed to help developing countries address the lack of comparables for transfer pricing analyses* (the Toolkit). The Platform for Collaboration on Tax (PCT) comprising the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), the United Nations (UN) and the World Bank Group, developed this draft Toolkit in response to a request by the Development Working Group of the G20. The Platform Partners seek public comment on the draft Toolkit including the supplementary material on minerals pricing by 21 February 2017.

CONTENTS OF THIS RESPONSE DOCUMENT

This response document is structured as follows:

A General

This section of this response document includes general comments and suggestions.

B COMMENTS IN RESPECT OF THE SPECIFIC QUESTIONS RAISED

Responses to the specific questions where KPMG believes it has relevant experience in respect of the Toolkit are set out in this section.

C ADDITIONAL COMMENTS

This section contains specific comments to the various items discussed in Parts I to IV of the report as well as comments in respect of the case studies included and the appendices.

D DISCUSSION DRAFT ADDRESSING THE INFORMATION GAPS IN PRICES OF MINERALS SOLD IN AN INTERMEDIATE FORM

Comments on the Discussion Draft are set out in this section.

E CONCLUDING REMARKS

This section sets out concluding remarks.

A GENERAL

The report is well written and the Toolkit appears to be useful for developing countries, both revenue authorities as well as taxpayers. Particularly useful are the examples and case studies provided as well as the supporting information set out in the appendices.

However, while it is understood that the Toolkit is designed to merely provide different options on a high level for revenue authorities and taxpayers regarding how to address the lack of (suitable) local or regional comparables, it is submitted that in order for the suggested approaches to be effective, specific and detailed recommendations should be made regarding which approach should be followed in what case, e.g., if no local comparables are available, regional comparables should be used. If regional comparables are not available, foreign comparables from other markets should be used. Thereafter, recommendations in respect of adjustments, safe harbours etc could be applied.

The Toolkit was designed, in collaboration by the IMF, the OECD, the World Bank and the UN, to assist developing countries applying local transfer pricing rules following the OECD Transfer Pricing Guidelines or the UN Transfer Pricing Manual, to overcome or at least mitigate problems arising from the lack of suitable local comparables. Therefore, and to avoid any misconception, it should be clarified that when applying the Toolkit, revenue authorities must also continue to follow the OECD Transfer Pricing Guidelines and the UN Transfer Pricing Manual.

B COMMENTS IN RESPECT OF SPECIFIC QUESTIONS

We set out below comments in respect of the specific questions to the Toolkit as raised by the PCT:

- 1. Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit?***

General

KPMG is of the view that the toolkit seems comprehensive and helpful for addressing challenges faced by developing countries relating to the limitation or lack of comparable data for conducting benchmarking database searches. The approaches set out give a broad range of options to revenue authorities to choose from when checking benchmarking searches provided by taxpayers to support cross-border controlled transactions entered into.

However, a major concern is that many revenue authorities in developing countries are still in the process of building transfer pricing capacity, and the majority of approaches set out in the toolkit requires significant theoretical and practical experience on the side of the authorities.

In addition, in order to ensure that taxpayers are able to comply with any specific local requirements and/or approaches to be followed where there is a lack of suitable comparables in respect of a specific developing country, it should be made clear that the local revenue authority should publish clear, consistent guidance regarding the acceptable approach or approaches available to taxpayers.

Thus, while the Toolkit is very useful, it may not achieve the desired effect where revenue authorities do not have the manpower and/or skill to implement it. Further the Toolkit should make clear that, to the extent that local authorities adopt specific approaches to identifying suitable comparables, they must provide certain and clear guidance to taxpayers to facilitate compliance and minimize controversy.

Financial transactions

The toolkit does not specifically address approaches for benchmarking financial transactions such as loans and credit guarantees.

In practice, multinational groups often finance part of their operations in developing countries via intra-group financing arrangements. This could be between a developed country and a developing country, or between group companies in two different developing countries.

In the absence of safe harbour rules, some countries require that the interest rate applied in respect of a loan should be arm's length, other countries require that both the interest rate in respect of a loan, as well as the amount borrowed from a related party must be arm's length.

Currently, developing countries often rely on comparables from similar geographical markets based on information from databases that can only provide limited financial data.

Additionally, developing countries have often foreign exchange control rules in place, which impact the free outflow of capital. This may result in differences between on-shore and off-shore lending rates and guidance regarding the treatment of such differences would be helpful.

KPMG recommends that more detailed guidance in respect of financial transactions should be included in the Toolkit.

2. How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level?

KPMG is very concerned that sharing of taxpayer information between tax authorities for purposes other than a tax audit of the particular taxpayer or its related group will lead to loss of confidentiality.

In addition, as noted in the Toolkit, any use of such secret information by tax authorities will lead to unfair tax audits as taxpayers are challenged with information that they cannot analyze or even understand.

KPMG specifically recommends clarification that “use of administrative information” for development of secret comparable databases by tax authorities would not be appropriate as it would lead to the chaotic application and misapplication of the arm’s length principal. Further comments on secret comparables are included below in Part II of our Additional Comments.

3. *How could the reliability of potential comparables from other geographic markets be tested?*

It may be challenging to test the reliability of comparables from other geographic markets depending on the location of the tested party and the type of transaction under review. However, one approach would be to compare available data from local companies to that from candidate foreign geographic markets. While the number of local companies would be low (leading to the problem at hand) such comparison could pool that data and perform an economic / statistical analyses to determine the most appropriate similar geographies. Given the need to have access to global databases, assistance with this type of testing could be provided by the private sector as part of a joint revenue authority/taxpayer initiative.

It is recommended that revenue authorities should inform taxpayers which databases they regard as acceptable and if specific search filters should be applied.

4. *Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft?*

Instead of focusing on local or regional comparables, a different but useful approach could be to focus on regional comparable from a region where the economic environment is comparable to the country/region where the tested party is based. For example, Eastern European comparables could be used to support a tested party in South Africa.

5. *What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?*

In KPMG’s experience, making reliable adjustments is very specific to the particular circumstances of the analysis. KPMG does not have broad applicable suggestions in this regard.

6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?

It is KPMG's view that the mineral pricing case studies generally reflect market trading terms. More detailed comments relating to the mineral products studies are set out in section D below.

C ADDITIONAL COMMENTS

Below, we set out comments and suggestions relating to Parts I to IV of the Toolkit as well as the case studies and appendices.

Part I: Introduction

Formulary apportionment

Unitary Taxation/Formulary apportionment approach is briefly discussed on page 6. Although it is stated that formulary apportionment approaches are specifically excluded from the discussion in the Toolkit because "they are unlikely to be implemented at global level in the foreseeable future", the statement may be confusing in that this approach is still mentioned and the footnote mentions the re-launch of the CCCTB initiative in Europe. As the Unitary Taxation/Formulary apportionment approach continues to surface as an alternative method to applying the arm's length principle, the reference in the Toolkit may be confusing and send the wrong message. KPMG therefore suggests that the reference to formulary apportionment should be removed as the purpose of the Toolkit is to provide alternative options where suitable local comparable data is not available, i.e. specifically where the arm's length principle is followed.

Part II: Issues arising when conducting a comparability analysis

This part of the Toolkit provides a high level overview of how to perform a comparability analysis, considerations regarding comparability data, the availability data, adjustments and the interpretation of data collected and the determination of the arm's length remuneration. Below, specific comments and suggestions are set out:

Other sources of information: secret comparables

The use of secret comparables is addressed on pages 31 and 32. It is correctly pointed out that both the OECD and the UN state that secret comparables should not be used unless requisite information can be disclosed to the taxpayer. In KPMG's experience, the requisite information is not disclosed to the taxpayer as this would almost always breach local confidentiality rules. As a result, KPMG recommends that the Toolkit make it clear that secret comparables are not a fair or reasonable approach to benchmarking arm's length pricing or arm's length results. See KPMG's comments on the OECD Paper on Transfer Pricing Comparability Data and Developing Countries dated April, 11 2014. KPMG also notes that the use of secret comparables makes resolving double tax cases more difficult under Mutual Agreement Procedures.

Explicitly acknowledging this issue in the Toolkit would help developing countries understand why secret comparables are not endorsed by the OECD and the UN. KPMG further recommends that the Toolkit state that revenue authorities should first consider the benchmarking analysis provided by the taxpayer before considering any non-public data.

China is the only country quoted as an example in the Toolkit of a jurisdiction where the use of secret comparables is explicitly sanctioned by the transfer pricing legislation, and the Toolkit further points out that “most, but not all, countries either specifically prohibit the use of secret comparables or refrain from using them in practice.” Reference is made to SAT’s Circular 2, which includes a specific provision empowering tax authorities to use non-public information to analyse and evaluate the compliance with the arm’s length principle in the context of an investigation.¹

In practice, however, KPMG’s member firm in China has observed a number of audit cases where tax authorities initially pointed to the existence of secret comparables but, after careful consideration of taxpayer’s arguments, then decided to rely solely on the publicly available data provided by the taxpayer. Thus, this supports the view that secret comparables cannot be used reliably or fairly in practice.

Accordingly, KPMG is of the view that the Toolkit should make it clear that secret comparables should not be used by revenue authorities even where there are reliability concerns with publicly available comparable data. Rather, alternative approaches or methods under the OECD Guidelines should be explored.

Comparability adjustments

While the guidance provided in respect of comparability adjustments (pages 34 to 45) is useful, the different options of adjustments and the methodologies available for making these adjustments may lead to uncertainty for taxpayers and revenue authorities alike. This is specifically the case where broad experience and skills are limited within the relevant revenue authority. Also, the making of adjustments often requires judgment, which may lead to subjective results. It is therefore KPMG’s view that the Toolkit should clarify that the making of comparability adjustments requires clear guidance and consistent application. It would also be important for revenue authorities to publish local guidelines to set out what approach must be followed by taxpayers and revenue authorities to avoid uncertainty.

¹ Implementation Measures of Special Tax Adjustments (Guoshuifa n° 2), issued in January, 2009 (“Circular 2”), Article 37.

Part III: Approaches to applying internationally accepted principles in the absence of comparables

Negotiated settlements

On pages 51 and 52 of the Toolkit it states that taxpayers and tax authorities need to be realistic with respect to the use of comparables. KPMG agrees that comparability is not an exact science and that all parties must reasonably utilize the available data.

KPMG strongly agrees with the Toolkit that the available data should inform any dispute settlements. To do otherwise would be an abandonment of the arm's length standard and lead to arbitrary tax results.

Testing the benefits received

On page 53 of the Toolkit, reference is made to a benefits test for services and intangibles. In KPMG's experience this area is one of the most contentious for multinationals operating in developing countries. In particular, it is KPMG's experience that revenue authorities demand extremely high levels of documentation and other types of proof in support of the benefit received by the local taxpayer for services rendered by a related party. KPMG suggests that the effort involved as part of these discussions is disproportionate to the level of risk of non-arm's length pricing. Consistent with the OECD Final Report on BEPS Actions 8-10's discussion of low value added services, KPMG recommends that the low value added services listed in paragraph 7.49 of the OECD Final Report be presumed to provide a benefit to the local taxpayer. The taxpayer and the revenue authority can then agree on the appropriate arm's length charge. This presumption of benefit is important because, in KPMG's experience, too often the revenue authorities refuse to recognize any benefit and determine that the arm's length charge is nil. In KPMG's view, these types of services are common and necessary for multinational groups to operate. The arm's length charge is not nil and guidance on the benefit provided would be very helpful.

In addition, while the concept of a "benefit requirement" is not new in respect of services transactions, this may lead to confusion when considering the arm's length nature of a royalty transaction. In practice it is often difficult to determine the benefits in terms of a related party cross-border services transaction, and it can be even more difficult where the use of intangible property is concerned.

KPMG believes that the concept of a "benefits test" for intangibles transactions to confirm arm's length nature of any transaction is not useful as it complicates and does not help in mitigating the issue of lacking comparables in developing countries. KPMG recommends focusing on whether the local taxpayer is making use of the intangible. This determination is generally simpler to make.

Safe harbours

The Toolkit, on page 54, sets out the benefits of using safe harbor rules and it also sets out certain shortcomings and issues. KPMG supports the view that safe harbor rules may constitute a simple method to address the lack of suitable local comparables, but safe harbours can create a deviation from the arm's length principle unless there is regular review and update of the safe harbor,

The process of deriving the safe harbour rate should be transparent.

Transactional profit split method

It is stated on page 61 of the Toolkit that “*valuable contributions most frequently derive from the utilisation of valuable scarce contributions, including those from intangibles and from the assumption (including the control and management) of the key business risks.*” The term “valuable scarce contributions” appears to be new and not generally known. KPMG believes that it would be useful to clarify the meaning, e.g. by giving an example, to avoid confusion.

Royalty caps and other anti-avoidance measures

Page 63 of the Toolkit discusses royalty caps, i.e. a top limitation of the royalty deductions that may be claimed by the licensee. KPMG strongly believes that this approach directly contradicts the arm's length standard and objects to its use as an anti-avoidance mechanism on the basis that it goes beyond any of the Base Erosion and Profit Shifting initiative related recommendations.

The Toolkit states that some developing countries have exchange control restrictions in place which may lead to a similar result as royalty caps. However, in KPMG's experience there have been cases where exchange control authorities have allowed a higher royalty deduction in a developing country on the basis of a transfer pricing study that supports a royalty rate higher than the standard rate approved by the exchange authorities is appropriate.

The Toolkit is entirely unclear as to its view on the various anti-avoidance and tax base protection measures set out on pages 63 and 64. In KPMG's view they do not offer a solution to the lack of suitable comparables that a developing country may face and will typically distort the arm's length standard in their application. KPMG recommends that the Toolkit unambiguously support the arm's length standard and admonish countries not to adopt short cuts such as royalty caps.

Part IV: Summary, conclusions, and recommendations for further work

KPMG finds this section of the Toolkit useful and agrees with the recommendations for further work to assist revenue authorities and taxpayers in developing countries from a transfer pricing perspective.

Case studies

The case studies are useful. KPMG suggests that more case studies dealing with specific issues experienced in developing countries should be included, e.g. management services provided to a multinational group entity in a developing country, regional distributor/limited risk distributor.

Appendices

The information contained in the appendices supports the information in the main parts of the Toolkit and appears to be very useful. Some specific comments relating to the appendices information is set out below.

Appendix 1 (functional and risk analysis):

The questionnaire provided in this appendix is very detailed and seems to aim to address a wide variety of scenarios. We suggest that it should be clarified that revenue authorities should gain an understanding of the taxpayer's business from the transfer pricing documentation provided first before embarking on a potentially lengthy exercise to gather the information as set out in this functional and risk analysis.

D DISCUSSION DRAFT: ADDRESSING THE INFORMATION GAPS ON PRICES OF MINERALS SOLD IN AN INTERMEDIATE FORM

KPMG's specific comments relating to "addressing the information gaps on prices of minerals sold in an intermediate form" are set out below:

1. The case studies in the Toolkit provide detailed overviews of the typical processes for the extraction and refining of four categories of minerals into intermediate and finished products. In particular, the Toolkit focuses on the types of contracts entered into between industry players at several common stages in the extraction and refining processes for each of the four minerals. The Toolkit is a useful resource for both revenue authorities and taxpayers in terms of developing an understanding of industry dynamics. This type of analysis and discussion demonstrates some of the elements taxpayers should consider in their transfer pricing documentation. However, the application of the examples presented in the Toolkit should be applied with the recognition that MNEs may exhibit some differences to the examples and these differences can impact the overall value chain and transfer pricing. As discussed in the points below, the Toolkit should be used with caution as it does not provide a complete guide to application of the arm's length principle.
2. The Toolkit outlines the extraction and refining phases of the value chain. But, discussion of the exploration, feasibility assessment, mine development, marketing, sales and logistics processes would enhance the guidance contained in the Toolkit. These additional components of the value chain may be important to the transfer pricing analysis of the various transactions that occur throughout the value chain.

3. The Toolkit focuses on application of the CUP method, including identifying sources of public information where internal comparable uncontrolled transactions do not exist and contemplating various adjustments for comparability differences. While it may be possible to reliably apply the CUP method to price the sale of minerals, we recommend the Toolkit recognize there will be circumstances where there will be insufficient data on comparable uncontrolled transactions for the reliable application of a CUP or adjusted CUP method. The Toolkit should make it clear that another transfer pricing method should be considered when comparability differences between the controlled transaction and the uncontrolled transactions cannot be resolved.

4. Where the CUP method cannot be reliably applied, it may be more reliable to test the margins or results of one of the transacting parties, such as a processing or selling/marketing entity against the results for comparables that have a similar functional profile. We recommend the Toolkit include guidance on how to apply these other transfer pricing methods.

E CONCLUDING REMARKS

KPMG welcomes this Toolkit as it is very useful, and commends the PCT for developing it. The Toolkit will provide, once finalized, relief to revenue authorities and taxpayers operating in developing countries alike.

Overall, KPMG notes that it would be good to include in the Toolkit a recommendation for developing countries to put in place specific guidance for revenue authorities and taxpayers regarding which approaches should be followed when facing a lack of suitable local and/or regional comparables, and in which order they should be applied. It is important that this guidance ensures clarity and consistency.

In addition, the Toolkit will only be successful to the extent that sufficient skilled transfer pricing teams are placed at the revenue authorities in the relevant developing countries to enforce transfer pricing. It is understood in this regard that various measures are currently in place to build skills at various levels.

About KPMG

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 152 countries and have 189,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

Tuesday, February 21, 2017

Platform for Collaboration on Tax

Comments to the draft toolkit to address the lack of comparables on developing countries

Gentlemen,

On behalf of the Transfer Pricing Commission of the Mexican Federation of Economists Colleges, herein you will find our comments on regards of the questions raised by the Draft Toolkit Designed to Help Developing Countries Address the Lack of Comparables for Transfer Pricing Analyses. We hope you can find them useful:

1. Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit? Yes, the toolkit considers the main issues dealing with the lack of comparables in emerging countries.

2. How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level? It is entirely up to the national authorities to establish provisions whereby local and regional financial and business information of the taxpayers can be accessed. But it is important to consider that in some countries, there are business information systems that gather information from companies at the domestic level, and that in some cases provide useful information for transfer pricing analysis, including the id of the issuer of such financial information (i.e. el Sistema de Información y Reporte Empresarial, SIREM de Colombia).

3. How could the reliability of potential comparables from other geographic markets be tested? Based on the Platform of Tax Collaboration and the OCDE Transfer Pricing Guidelines, we consider three important points that could support the analysis with reliable comparable data. It's important to mention that paragraphs 3.80 – 3.83 of the Transfer Pricing Guidelines mention the extent of the burden and costs that should be borne by a taxpayer to identify possible comparables and obtain detailed information. There is no requirement for an exhaustive search of all possible relevant sources of information. Pragmatic solutions may be appropriate to find a reasonable response to each transfer pricing case.

With this being mentioned, we consider that one way to assure reliability in the comparable set to be selected could be done with a previous comparison of countries. This would be through an assessment of default rating scores, prepared by independent and international institution such as Moody's or Standard and Poor's, by choosing the countries with similar rates, thus excluding economies with better or worse score. This would help to select comparable companies from countries with similar risks.

1/5

The second consideration that may help would be to analyze how the economies react to external economic events, i.e. if the United States market grows, then search for countries which would have similar outcomes after such event. A search for similar effects in different countries would provide a more comparable data in specific sectors under similar circumstances.

The last point would be to analyze the economic indicators infrastructure investment, communication and inflation with indexes such as: Investment in Energy, Investment in Telecoms and Investment in Transport issued by the World Bank. After gathering the indexes of the country in which the tested party operates, then make a comparison with data from all over the world to find the most comparable countries.

An important point to analyze is how the economic sector or industry has developed within the countries of residence of comparable companies or transactions by analyzing growth rates, employment or investment levels, for example; Additional to assure if there is or not any governmental policy favoring these sectors, since significant differences in such indicators could generate different levels of profits or prices that are not necessarily linked to the functions, assets and risks of these comparables.

4. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft? A potential solution to address the lack of comparable transactions that were not explored in the discussion draft has to do with the selection of the tested party. For example, in the Latin American case, intercompany transactions often involve related parties from countries where much more information is available. (United States, Germany, France, Netherlands, Japan, Spain). As a result, it might be a real option to choose the residents of those jurisdictions as entity under analysis. Of course, this raises important challenges for the correct implementation of the transfer pricing method at least in terms of the quality of the information provided by these countries, as well as the possible position of the counterparty's tax authorities on regards of the access to the information of the tested party. Additionally there is the possibility that the chosen tested party wouldn't be the simpler one within the transaction as emphasized in the OECD Guidelines (A.3.3.). However, and considering the abovementioned circumstances, this might be an acceptable approach considering the possibility of affecting the results of the method due to lack of functional or economic comparability. We suggest exploring the mechanisms under which this approach can be used, as well as the considerations that should be made to alleviate any questions from the tax authorities involved.

5. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested? There are numerous economic circumstances that could affect comparability of entities located in different countries. The toolkit focuses in certain country risk adjustments that eliminate some of these differences, such as inflation rates, interest rates, access to credit market, etc. Other differences, such as labor costs may be better addressed by location savings adjustments, which have also been generally discussed by transfer pricing practitioners and members of the Platform for Collaboration in Tax. Finally, differences in economic circumstances associated to the specific industry or product such as level of competition, availability of substitute goods or services, local regulations, etc., could be eliminated by specific adjustments on a case by case basis.

In fact, in our view, it is important to emphasize that geographic market adjustments should not be generally applied by the mere fact that comparable entities are located in a different country. The appropriateness of the adjustment should be assessed on a case by case basis, after careful analyzes of the market and competitive conditions in both countries; and of the accuracy of the adjustment to improve comparability.

The case by case analysis, becomes even more important for developing countries that tend to rely on comparables located in countries perceived as low risk, because some country risk adjustments only move the arm's length range up. While we appreciate that a rational investor would expect a higher return to invest in a riskier country, one could also argue that in a riskier country there are not only higher probabilities to earn more but also to lose more, and therefore an appropriate country risk adjustment should widen the range.

An adjustment that could be considered is about the differences in quantities. One of the challenges faced by specialists in applying Comparable Uncontrolled Price Method (CUP) is the scarcity of domestic information that can be used for comparability analysis, especially in countries where public information is very limited.

For example, analyzing an inventory purchase controlled transaction, it may be the case to have information about uncontrolled transactions of identical goods, however, differ in amounts purchased in relation to the controlled transaction.

In an open market, differences in the quantity of a good exchanged can generate differences in the agreed prices, that is, a greater quantity of a good, the offerer would be willing to reduce the price of that. This is based on the laws of supply and demand, which state that the greater the quantity of a good or service offered the price tends to decrease and vice versa.

The paragraph 1.33 of the Transfer Price Guidelines mention that to be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences.

One way to make a reasonable adjustment in which quantities differences can be eliminated is through elasticities, elasticity is defined as the percentage variation of a variable χ as a consequence of the variation of a variable Y , in our case, would be defined as the change in the price of a good as a consequence of the variation of the purchased quantities of that. The above can be calculated with the following formula:

$$\varepsilon_p = \frac{Px_1 - Px_2}{Px_2}$$

$$\varepsilon_u = \frac{u_1 - u_2}{u}$$

Definitions:

ε_u = Elasticity per unit.

ε_p = Elasticity per price

u_1 = Unit comparable 1.

u_2 = Unit comparable 2.

Px_1 = Unit price comparable 1.

Px_2 = Unit price comparable 2.

Once obtained the value of the variation in the prices as a consequence of the variations in the demanded units, we proceed to obtain the price that independent parties would have agreed under similar circumstances and similar amounts to those that were agreed in the controlled operation making possible the implementation of the CUP

6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold? In general, a problematic that arise when a transfer pricing analysis is performed for mining companies, is the comparable information derived from the operation structures that some mines follow in development economies. For example when a search of comparable companies is performed, in general such companies operate integrally, this is, the extraction of the minerals, the chemical process to these minerals, obtaining licenses and the sale of minerals, among other activities. Mining companies in development economies have different structures for its operation, for instance, there are different companies of the group involve in the process, one company has licenses, other company has the assets require for the extraction of minerals or the chemical process, other company performed the chemical process, and in some cases, other company, perform the final sales.

Derived from the abovementioned, search of comparable companies that performed same activities for the companies that are involve in the mine process could be a problem.

Notwithstanding that the transfer pricing analyses for mining companies consider comparable companies in the same industry, not always they will reflect the market conditions, derived from the above-mentioned.

Regarding the adjustments that could be performed, there is a specific adjustment for the mineral price when it is extracted and sells for the company that performs the chemical process. In general, this adjustment consider the commodity price (market information), and then it is subtracted all the costs incurred in the chemical process and different concepts regarding the concentration of mineral.

A database that includes this kind of adjustments for the principal minerals (gold, silver, copper, etc.) could be helpful for transfer pricing analyses.

Commission Members:

Mario Barrera Vázquez
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Allan Pasalagua Ayala
Fernando Pliego Vincent
Jesús Aldrin Rojas M.
Jaime Zaga Hadid
Varic Sebastian Baus
Yessica Valor

To: Platform for Collaboration on Tax

From: Michael C. Durst

Date: February 19, 2017

Subject: Comment on Draft Toolkit for Addressing Difficulties in Accessing Comparables Data

I appreciate the opportunity to comment on the draft of the Toolkit. I am a researcher and practitioner in the international transfer pricing field, and I offer this comment in my personal capacity.

The draft Toolkit, I believe, has many potentially useful suggestions of ways by which developing-country tax administrations might achieve more useful results from the application of transfer pricing methods, particularly the transactional net margin method (TNMM), which is used frequently by taxpayers and tax administrations in countries of all levels of economic development. I believe, however, that the Toolkit should give greater, and explicit, attention to a problem that in my experience has greatly impaired the reliability of TNMM as it usually is applied in practice: namely, the difficulties introduced when taxpayers or tax administrations apply statistical methods under TNMM, including but not limited to the “interquartile range,” to very small sample sizes of comparables.¹

In my experience, private and government practitioners often apply statistical analysis to sample sizes in the range of 6 to 9.² These sample sizes are much smaller than can permit useful statistical inference. One consequence of this problem is that the medians of the ranges that are computed cannot be seen as reliable indicators of the level of income that would be expected of a taxpayer acting at arm’s length: there are simply insufficient data points to yield a reliable measure of central tendency like a median.

Far more important in practice, especially in developing countries, is the tendency of very small sample sizes to generate very wide purported arm’s-length ranges. In my experience, it is not unusual to see reports that present arm’s-length ranges using, say, the net operating margin as the profit level indicator, that range from near-zero or even negative margins at the low end, to margins in the double digits at the high end. Arm’s-length ranges of this width offer no useful guidance to either taxpayers or tax administrators. Often, these ranges can turn the tax examination process into one of wide-ranging negotiation between taxpayers and governments, with no objective reference points. Inevitably, especially in countries that feel strongly beholden to pressures of tax competition, the allowable profit level for the taxpayer is agreed at a very low level.

¹ For prior discussion of this topic see Michael C. Durst and Robert E. Culbertson, “Clearing Away the Sand: Retrospective Methods and Prospective Documentation in Transfer Pricing Today,” 57 *Tax Law Review* 37, 108-114 (2003).

² The draft toolkit contains an example, in Box 18 on page 47, in which a sample size of 32 is posited. This appears to be a reasonable number of observations for use in statistical inference. In actual practice, however, in my experience, sample sizes are much lower than that posited in the example.

The Toolkit's utility in enabling developing countries to deal more effectively with base erosion will be enhanced by a thorough analysis of problems related to sample size, especially under TNMM. Steps the developers of the Toolkit might take include:

- (i) Providing an explanation, incorporating authoritative expertise in statistical theory, of the effects of sample size on the reliability of arm's-length ranges under TNMM.
- (ii) Obtaining unbiased samples of transfer pricing documentation in the examination files of different countries, in order to gather empirical indications of sample sizes used, and the width of computed arm's-length ranges, in actual practice. (This information would be extremely valuable in developing the Toolkit, although considerations related to taxpayer confidentiality may limit its availability.)
- (iii) Asking practitioners to provide unbiased samples of documentation that they have provided in practice with, of course, the identification of taxpayers deleted. (Again, information of this kind would be extremely valuable, but various concerns of practitioners may limit its availability.)
- (iv) Performing simulated TNMM analyses under assumed but realistic fact patterns, and using the commercial databases typically used in practice, employing a range of different sample sizes. On the basis of these analyses, the Toolkit could offer tax administrations informed and detailed observations about the relationship between sample size and the apparent usefulness of the resulting arm's-length ranges.

I hope this information proves useful. The practical difficulties raised by the problem of sample size in transfer pricing analysis will be difficult to address, but I believe doing so is essential if tax authorities are to be able to apply TNMM in a reasonably effective manner. I would be pleased to discuss this topic further if that would be helpful.

Comments received from National Tax Services (Republic of Korea)

24th February 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: Comments on a Draft Toolkit Designed to Help Developing Countries Address the Lack of Comparables for Transfer Pricing Analyses

1. Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit?

(Comments) I think this toolkit would be very helpful to developing countries. However, because there is not specified pattern in TP study, I suggest that many cases should be provided for the purpose of additional information.

2. How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level?

(Comments)

First, administrative information must be submitted and used by tax authority through the law. Second, in that situation, another law that can prevent from the abuse of administrative information is necessary. Tax authority should control the system of information use and huge penalty must be imposed to the abuser.

Third, systematically DB that handles administrative information must be isolated from public network and several layer of firewall is necessary.

3. How could the reliability of potential comparables from other geographic markets be tested?

(Comments) In the TP field, Not only developing country but also advanced country have difficulties for finding appropriate comparables set within their own country. In some cases, we can expand region to neighbor country or continent in order to search comparables. In those situation, we could adjust the geometrical and economical difference in order to enhance the reliability.

4. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft?

(Comments) I could not find any other approaches beyond your draft.

5. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?

(Comments) We do not have any experience for adjustment to the geometrical difference until now.

6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?

(Comments) There is no case that is related to the mineral pricing in Korea.

The Platform for Collaboration on Tax

Draft Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

Comments by NERA Economic Consulting¹

February 21, 2017

VIA E-MAIL to GlobalTaxPlatform@worldbank.org

Dear Sir or Madam,

We thank you for the opportunity to provide comments on the Draft Toolkit released by the Platform for Collaboration on Tax (“PCT”) on January 24, 2017, comprising two separate documents (i) A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses (the “Draft Toolkit”) and (ii) Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form (“the Minerals Draft”).

Introduction

As an introductory comment, we would like to stress our strong support for application of the Arm’s Length Principle (“ALP”) in controlled transactions, including the transactions that involve taxpayers in developing countries. We recognize that challenges with implementation of ALP for developing countries are real, and these challenges have sometimes been cited as reasons for developing countries to apply methods alternative to the ALP. One of the most often mentioned challenges with the ALP implementation in developing countries is the absence of reliable data for independent companies in those countries that could be used as comparables for the purposes of the transfer pricing analysis. This challenge has led NERA economists to conduct research on techniques that could potentially help to cope with the absence of comparables data in certain countries/regions. This research was discussed in the following publications:

¹ These comments represent views of the authors and do not necessarily reflect the views of NERA Economic Consulting.

1. S. Gonnet, V. Starkov and M. Maitra, “Comparability adjustments in the absence of suitable local comparables in emerging and developing economies”, *Transfer Pricing International Journal*, July, 2013,
2. V. Starkov, S. Gonnet, A. Pletz, and M. Maitra, “Comparability adjustments in the absence of suitable local comparables in emerging and developing economies – Case studies”, *Transfer Pricing International Journal*, March 2014.
3. V. Starkov, M. Maitra, and A. Li. 2015, “Comparability adjustments in the absence of suitable local comparables in emerging and developing economies – Adjustment for risk”, *Transfer Pricing International Journal*, May 2015.

While this research is far from being exhaustive in addressing the topic of comparability adjustments, we are pleased to note that some of these publications have been referenced in the Draft Toolkit (e.g., in Part II, Sections 5.3 and 5.5, and in Appendix 14).

In our comments below, we confirm that in cases when suitable local comparables are absent, we support using comparables from other countries or regions with adjustments for differences in the economic conditions in which they operate. We believe that this approach is a viable option to cope with the absence of comparables in a certain country / region, particularly in light of the large amount of reliable financial information available in certain regions of the world covering a wide spectrum of industries and functions.

We also agree with the suggestion contained in the Draft Toolkit that the proposed country risk adjustments techniques need further studies and refinements. While these adjustments have been used in practice in real transfer pricing cases, additional research and substantiation needs to be performed to confirm the relevance of such adjustments, the circumstances in which they may apply, and the limitations of such adjustments.

Our comments below principally focus on the feasibility of using comparables from other regions and adjustments that can be made to improve reliability of these comparables. We have also commented on a few other questions posed by the Draft Toolkit authors, but our comments do not cover the entire range of topics for which comments were requested.

In our opinion, any approach that departs from the ALP is far from ideal. For instance, secret comparables should be avoided (outside of the risk assessment tools used by tax authorities); safe harbors, while appealing due to the simplicity of their application, should be used with caution as their unilateral application may lead to pricing distortions; the Location Specific Advantages framework may also prove relevant for transfer pricing analysis in developing countries.

Economists at NERA will be pleased to continue assisting the PCT in developing tools that rely on sound economic analysis in order to make the ALP implementable in developing countries.

Best regards,

Vladimir Starkov

Sébastien Gonnet

Guillaume Madelpuech

Comments by NERA Economic Consulting on Certain Questions Posed by the Platform for Collaboration on Tax²

2. How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level?

As mentioned previously, the ALP is not always simple to implement. It relies heavily on facts and circumstances. As such, it requires an open dialogue between taxpayers and tax administrations. Consequently, we do not think that the ALP can be, in its very principle, applied where a tax administration would rely on non-public administrative information (“secret comparables”). Secret comparables are a way to enforce a policy that pose many disadvantages for taxpayers, such as pricing distortions, taxpayers, and risk of double taxation.

The Draft Toolkit rightly points out that:

“non-public administrative information can be highly relevant in practice. Typically, it is the main source of information for the design of benchmarks for risk assessment guiding audit selection”

We certainly agree that tax administrations have a right to design benchmarks using the information available to them. Yet, the Draft Toolkit should emphasize that such information should only be used for risk assessment purposes and discourage the use of secret comparables in tax audit and litigation proceedings, for the reasons stated above.

² These comments represent views of the authors and do not necessarily reflect the views of NERA Economic Consulting.

3. How could the reliability of potential comparables from other geographic markets be tested?

4. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft?

5. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?

To begin with, reliability of comparables depends first and foremost on *functional comparability* between the controlled tested party and the uncontrolled companies selected as candidate comparables.

Second, when considering using comparables from other regions, it's important to recognize that markets for different products and activities may have very different geographic footprints: while markets for some products and services are globalized, markets for others are local.

The comparability analysis should consider both of the above factors. Provided that functional comparability is established as a first step, the second step would be to determine whether the market for a given product or service can be described as global, regional, or local. Insights from the industrial organization field may be helpful as well (industry analysis, market structures, etc.).

Further, companies located in the same country (or region) as the controlled tested party but that are *not* functionally comparable with the tested party should not be expected to serve as proper comparables. The reason for this is twofold: (1) different functions are expected to have different economic returns and (2) local companies with dissimilar functions may be involved in value chains that are entirely different from the one the controlled party operates in.

Let us consider some examples to illustrate the above points.

In the first case, we assume that the market for a given product or service is globalized and functions in a long-term equilibrium (meaning that first-mover location savings advantages are not present).

In this scenario, it may be the case that independent companies from one country or region are well suited as comparables to a controlled party that operates in a different region, and *no geographical comparability adjustments are required*.³

³ Depending on the facts, working capital adjustments may still be considered.

However, if the global market for a product or service is in an evolving mode, certain countries or regions that are part of the global supply chain may present temporary opportunities for location savings, and the location savings dynamics will have to be taken into account.⁴

In another case, let's assume that the market for a product or service is localized.

Here, it is likely that an application of functionally comparable independent companies from another region to test profitability of a local controlled party will require some adjustments, because companies from economically isolated markets may be expected to earn different rates of return.

A case when such adjustments are needed may be illustrated as follows:

A controlled taxpayer operates in a Country A that is characterized by:

- A high cost of capital (that may be manifested by high yields on government bonds denominated in local currency) and, in addition,
- The index of the stock market in Country A historically has exhibited very volatile returns linked to volatile economic conditions of Country A.

These economic factors indicate a relatively high risk of investing capital in Country A.

If the identification of a sufficient number of functionally comparable uncontrolled taxpayers based in Country A proves difficult, it would be reasonable to turn to other regions in search for comparables.

Let's assume that Country B has a sufficient number of functionally comparable uncontrolled taxpayers that disclose their financial data. Country B has:

- A low cost of capital environment (e.g., yields on government bonds in this country are low) and
- A relatively stable stock market.

Based on this information, it would be logical to conclude that, for the same type of business activity, the cost of capital in Country B will be lower than in Country A. Thus, independent investors in a company located in Country A should be expecting ex-ante to earn a higher return on their capital than investors in a similarly situated company in Country B. This leads to a conclusion

⁴ The series of articles on location specific advantages published by NERA authors can be considered as a reference. See: S. Gonnet et al., "Location Specific Advantages: An Economist's Viewpoint". *Transfer Pricing International Journal*, Special issue: November 2011

that profitability of a company located in Country A expected ex-ante should be higher than profitability of the same company in Country B.

However, due to the higher volatility of the economic conditions in country A, it may be possible that a company located in Country A earns lower actual returns (i.e., ex-post returns) than the similar company in Country B (although it is also possible that the returns of a company in Country A will end up higher than in Country B).

If the arm's length range of returns for Country A is being computed using the comparables from Country B with the adjustment for economic conditions of Country A, based on the differences in the cost of capital and market volatility assumed above, the result will likely be that the arm's length range in Country A:

- Will have a higher median and
- Be wider compared to Country B. It is even possible that the lower bound of the Country A's arm's length range will lie below the lower bound of the unadjusted range derived from the Country B comparables.

Thus, in the case of localized markets, when applying results of the comparables from a specific country or region to a controlled party located in another country characterized by dissimilar cost of capital and/or economic dynamics, it is important to distinguish between:

- Targeting the expected, i.e., ex-ante, returns of the controlled party and
- Testing its actual, i.e., ex-post returns.

Targeting of the expected returns can be accomplished by applying the cost-of-capital ("WACC") adjustment described in two papers by the NERA authors,⁵ while testing of the ex-post outcomes has to take into account the observable differences in volatility of returns on invested capital. One such method is discussed in another NERA paper.⁶

⁵ These two papers are: (1) S. Gonnet, V. Starkov and M. Maitra, "Comparability adjustments in the absence of suitable local comparables in emerging and developing economies", *Transfer Pricing International Journal*, July, 2013, and (2) V. Starkov, S. Gonnet, A. Pletz, and M. Maitra, "Comparability adjustments in the absence of suitable local comparables in emerging and developing economies – Case studies", *Transfer Pricing International Journal*, March 2014.

⁶ V. Starkov, M. Maitra, and A. Li. 2015, "Comparability adjustments in the absence of suitable local comparables in emerging and developing economies – Adjustment for risk", *Transfer Pricing International Journal*, May 2015.

It is clear, however, that any adjustment methods that involve comparables from a different country or region should be used with caution. For instance, the above adjustments for countries with limited liquidity of the markets for government bonds and equities may not be sufficiently reliable.

When using foreign comparables, it is important to consider the degree to which the markets and the economic conditions of the foreign country are comparable to the country in question. In general, it would be preferable to source comparables from the country or region with similar economic conditions. When the economic and market conditions are dissimilar between the country from which independent comparables can be drawn and the country of the tested party, we advocate a case-by-case approach to any comparability adjustments. Such case-by-case approach should consider a broad set of factors that are similar and different between the countries in question, such as macroeconomic indicators, efficiency and liquidity of the markets, bargaining power of the parties, etc.

Many possible qualitative methods to adjust for differences in geographic markets exist or could be developed. As a general rule, we do not think it is possible or desirable to establish an exhaustive list of such methods in the Draft Toolkit, even though the Draft Toolkit may contain references to some methods and best practices, as it does now. We believe that additional research on comparability across economic regions would be beneficial for further development of this topic.

6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?

As a general comment, we note that the Minerals Draft relies heavily on the application of the CUP method and use of spot market prices for commodities. Based on our experience, many arm's length arrangements for mineral extraction do not rely on spot market prices. Examples of such arrangements are long-term contracts, production sharing agreements, streaming agreements, etc. Moreover, volumes of commodities transacted under such arrangements in certain cases may far exceed the volumes bought and sold on the spot market.

Additionally, we believe that other methods, such as the TNMM or the Profit Split Method may be more valid than the CUP method in a number of situations related to the extraction industry. The fact that multinational groups involved in mineral extraction have integrated operations is often overlooked by practitioners who are drawn to the application of CUP method based on the mere fact of availability of pricing information for certain commodities.

We also note that the Mineral Draft does not discuss the concept of Location Specific Advantages which, based on our experience, may be relevant in this industry.



Oxfam contribution to the document "A toolkit for Addressing Difficulties in accessing comparables Data for Transfer Pricing Analyses"

General comments

This toolkit appears as part of the process of implementing BEPS outcomes and the Arm's Length Principle (ALP) in developing countries. It attempts to show developing countries how to find out the price for associated companies transactions following the ALP. We are not sure this document has accomplished this goal; not because this document is not a good attempt but due to the complexity and difficulty of the topic. The objective of this document is so complex because the international taxation standards haven't changed at the rhythm the economic business reality. The international tax system stands far behind. Therefore, this document is an attempt to fit developing countries in a tax system that doesn't fit their reality and global economic development.

In fact, the document recognizes the need for further work on methodologies to be applied in absence of comparables. For intangibles and integrated value chains there are less comparables as days pass because those transactions are becoming exclusive/really specific and unique. **Nowadays, as the globalization and new technologies have changed the way multinationals make their business, the main problem is not accessing comparables but finding them: their existence, their real availability.**

Another fact this document recognizes is the important discretionary element and **subjectivity of transfer pricing determination** following the ALP. This is **also a problem not solved, and at the heart of profit shifting.**

Finally, the goal of this document is delivering practical measures that can be implemented in the short to medium term. The implementation of the ALP implies really sophisticated methods and decision systems that are not easy to implement in the short term.

Further work

The document is more realistic at the end when it presents the part on further work on safe harbours and commodities:

"7.- Develop further guidance on the use of safe harbours in the application of the one-sided methods, including best practices" - Here, it is important to highlight how developing countries will be involved in such work.

"8.- Recognizing the significance of the natural resources and other commodities sectors to many developing countries..." → Six method approach.



Add to these proposals we would suggest the study of formula apportionment methods and their impact. The transactional profit split method is the one recommended by the “Platform for collaboration on tax”, when it concerns integrated value chains business operations.

We would also suggest:

- to include an analysis of the impact of the application of CFC rules by industrialized and other jurisdictions for the revenues in developing countries in order for developing countries to promote and recommend their use and to implement them;
- To map the need for resources to implement the recommendations of this document and the resources actually available. The starting point and approach of this document should have been the adaptation of the proposed solutions to the reality of developing countries. Therefore we propose to start it by the part III: approaches to applying internationally accepted principles in the absence of comparables. To dig deeper in the solutions written in this third part would be really useful for developing countries as they count with more limited resources in their tax administrations than the industrialized ones.

At the end of the document, we would recommend talking about the expensive databases available and how publically create them and privately get/buy them. The access to comparables and its use lead to sophisticated adjustments and difficulties which are resource intensive and complex for developing countries. These difficulties and sophistication are mentioned and recognized in the document several times.

On the other hand, we welcome the boxes with good practices. We think those are really useful for developing countries. Therefore, we would add South – South and regional collaboration on this topic as a recommendation. In that regard we support the suggestion on page 56 referred to safe harbor: “it may be useful for countries and regional and international organizations to assess the potential for building up an international or regional set of data based on data already in the hands of tax administrations, presented in an aggregated format that retains taxpayer confidentiality, and subject to transparency of process” .

Following this line on positive practices, we would suggest to elaborate a summary box at the beginning of the document on when it would be recommended to apply each method for determining the TP of a transaction between associated companies.



Platform for Collaboration on Tax

By email to: GlobalTaxPlatform@worldbank.org

21 February 2017

PwC's Comments on the Draft Toolkit to help developing countries address the lack of comparables for transfer pricing analyses

PricewaterhouseCoopers International Limited, on behalf of the Network Member Firms of PwC (PwC), thanks the Global Tax Platform for the opportunity to provide comments on the draft toolkit to help developing countries address the lack of comparables for transfer pricing analyses.

The BEPS project seeks to prevent profit shifting and to preserve the tax base by focussing on transparency and aligning transfer pricing outcomes with value creation. In the implementation phase, the focus lies on a coherent and inclusive approach, evident in the namesake 'Inclusive Framework' in which developing countries stand on an equal footing with OECD members. Against this backdrop, the discussion draft focuses on the determination of comparable market prices from the perspective of developing economies' tax administrations, who often tackle a lack of local comparable data to derive market prices from as well as a lack of transfer pricing audit capacity.

While the initiative is welcomed and the need for further guidance recognised, we believe the discussion draft could provide additional context on the significant role of one-sided transfer pricing policies particularly in view of the transparency agenda visible in several BEPS work streams but notably Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting) of the BEPS project. This is especially pressing in light of the holistic functional analyses considered in the revision of Chapter I (in particular with regard to Risk) and Chapter V (a three tiered approach including the Master File concept), but also in light of the OECD discussion draft on BEPS Actions 8-10 – Revised Guidance on Profit Splits¹, which references value chain analysis as a tool in helping to accurately delineate the actual transaction. Additional guidance could facilitate the necessary transparency tax authorities desire to put the contributions by local operations into a broader global context.

¹ Discussion Draft Published 4 July 2016 – Public Consultation held on 12 October 2016

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The comments in this submission only address in detail the toolkit, except in relation to question 6 where reference is made to the Discussion Draft Addressing the Information Gaps on Prices of Minerals sold in an Intermediate Form (Minerals DD).

Our main comments are summarized below:

- **General:**
This toolkit is only one of several publications, some still in the pipeline, by partners of the Platform. On 23 December 2016, the World Bank Group published the handbook *Transfer Pricing and Developing Economies: A Handbook for Policy Makers and Practitioners*. The UN is preparing the second edition of the *Practical Manual on Transfer Pricing for Developing Countries* for publication this year. Further, as a result of BEPS, we are still awaiting the updated version of the OECD *Transfer Pricing Guidelines (TPG)*. We recognise the value of these efforts and the need for such toolkits, and see this joint initiative by the Platform as an opportunity to bring the separate publications together to provide coherent, unified guidance to tax administrations and taxpayers.

We also believe there is a benefit in making the toolkit an on-going initiative allowing the opportunity of regular feed-back reviews and updates.

- **Cooperative compliance:**
This toolkit provides guidance from the perspective of developing economies' tax administrations in an audit situation. Though we agree the audit and dispute aspect is very important, the toolkit should also address the compliance perspective of taxpayers, who face similar issues with lack of comparable data. Aware that new systems take time to implement and that capacity building is a long-term goal, we suggest to highlight this toolkit as a platform for a collaborative approach between taxpayer and tax administration, allowing for real-time reviews and taxpayer-tax authorities' co-operation rather than retrospective adjustments in tax audits.
- **Prescriptive rules:**
We generally believe that using prescriptive rules in transfer pricing is not appropriate. In light of the differences between locally established methods, for example, the existing variations of the 'sixth method' under domestic law of certain countries (as recognised on p. 18 of the discussion draft), we question whether this approach provides important consistency in the application of those locally established methods. A unilateral application of such rules and thus a generalization of this model carries a danger of double taxation. This is especially true in cases where prescriptive rules and commodity prices deviate from the arm's length price and lack a mechanism for the taxpayer to demonstrate that a different approach may be considered the market price for a good or service. Further, the toolkit needs clarification on the access to domestic appeal procedures and MAP under the commodity pricing or other prescriptive approaches. This is raised particularly in light of the reference as an anti-avoidance measure, which may limit the access to MAP for the application of national regulations.



When countries choose to apply prescriptive rules for determining arm's length results, it is important that the outcomes under the prescriptive rules:

1. approximate an arm's length result;
2. provide the taxpayer with the possibility to demonstrate that the transfer pricing approach it has considered in the related party transaction is at arm's length; and
3. allow access to appeal procedures and MAP in case the prescriptive rule is used as an anti-avoidance measure.

- **Safe harbours:**

In general, we support the use of bilateral and multilateral safe harbours and APAs. This should promote pro-active sharing of industry information to frame comparability, and over time lead to greater consensus on factors influencing comparability. Safe harbours should however not be used in a manner that overrides the arm's length principle by imposing unilateral or irrefutable directives for an assumed arm's length compensation. In this regard, we refer to our comments on prescriptive rules above.

- **Secret comparables and confidentiality:**

The use of secret comparables to perform a transfer pricing adjustment should not be encouraged in the toolkit. Secret comparables may be used in a transfer pricing risk assessment or case selection as well as the circumstances described in paragraph 3.36 of the OECD TPG. In this regard, tax authorities should be mindful of the commercial sensitivity of taxpayer information in an open economy, as well as the competition law concerning disclosure of information. We further encourage developing economies to sign up to, and adhere to, the international standard on the (automatic) exchange of information and allow for provisions in domestic law that also meet those standards, providing access to a series of useful documentation, including the country-by-country (CbC) reports, if all requirements are met. In such cases developing economies may need to build the necessary capacity, including access to the electronic tools as well as training for tax authority staff.

- **Adjustment calculations:**

Comparability adjustments should be applied in a balanced way and performed only when enhancing the reliability of the analysis rather than a formulaic approach. A thorough comparability, including functional, analysis should be preferred, leading to an understanding of the circumstances and conditions of the transactions. Whether comparability adjustments are needed also depends on the compliance burden and costs related to such adjustments and the relative value of the adjustments in enhancing reliability. It also requires good judgement. Reference could be



made to the guidance developed by the EU Joint Transfer Pricing Forum in its Draft Report on the Use of Comparables in the EU, in particular recommendation 7.²

This document includes two appendices with further comments. In the first appendix PwC has identified various approaches to many of the questions raised in the Draft Toolkit. A second appendix includes detailed comments that follow the structure of the document.

For any clarification of this response, please contact the undersigned or any of the contacts below. We look forward to discussing any questions you have on the points we raise above or on other specific matters raised by respondents to the draft toolkit and would welcome the opportunity to contribute to the discussion as part of a public consultation meeting.

Yours faithfully,

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² EU Joint Transfer Pricing Forum, Revised Draft Report on the Use of Comparables in the EU (doc. JTPF/007/2016/REV/EN).



Appendix 1: Questionnaire responses

In the following, we provide responses to the questions provided in the press release.

- 1. Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit?**

As a starting point, adherence to and compliance with the arm's length principle should be the overriding objective and in no way should provide for major deviations from the arm's length standard.

In this regard, we particularly welcome the use of safe harbours in order to meet and simplify some of the needs and problems of both tax administrations and taxpayers.

Of note is that the issues addressed with this toolkit are valid not only for developing economies, but also developed economies that face a lack of reliable information on local market comparables.

- 2. How can [we make] better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level?**

The term 'administrative information' is unclear and may include secret comparables, i.e. market information that is accessible to the tax administration but not available in the public domain. On the use of secret comparables, please see our general comments in the main body of this submission.

Another issue to be considered is the impact of governmental regulators other than tax administrations, which may provide pricing information for certain products. While these prices are recognized as useful e.g. to estimate differences between local prices and international quotes, they should serve as information only to determine the arm's length price. Alternative sources should be admitted when they are shown to deviate from market prices. This is particularly true in cases where such reference prices serve to establish incentives or disincentives related to economic policies, rather than report the market value of a product or service.

- 3. How could the reliability of potential comparables from other geographic markets be tested?**

In our view there is no "one-size-fits-all" solution; instead, geographic and local considerations and case-by-case evaluations are required. In particular, the comparability of data will depend on whether the transaction takes place in a global market, regional market or a local market, being higher for global rather than regional transactions. In this regard, we welcome further work on the factors of comparability for non-domestic comparables.

Further, we support the notion to reduce overly strict independence criteria where there is a lack of reliable comparables.

Critical are different approaches to safe harbours (bilateral / multilateral / regional), which can serve the benefit of both tax administrations and taxpayers, in reaching an appropriate tax result and avoiding



double taxation. While references to safe harbours are made in the toolkit, the addition of the memorandum of understanding for competent authorities to establish bilateral safe harbours as provided in the revised Annex I to Chapter IV of the OECD TPG is deemed helpful. With regards to the use of unilateral safe harbours and the related danger of potential double taxation we refer to our general comments on prescriptive rules and safe harbours in the main body of this submission.

4. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft?

For commodities transactions, a lack of local reference prices should only lead to the use of international quoted prices if they can accurately reflect the dynamics of the local market and, if necessary, after making adjustments. Quoted prices particularly in organized transparent markets (e.g. Chicago Board of Trade, London Metal Exchange, New York Mercantile Exchange, etc.) may in certain cases not fully reflect transactions of physical products, but rather the supply and demand of financial hedges. The use of standardized contracts and the possibility of settling an obligation through taking an offsetting position without delivery of physical goods allows for the participation of agents whose main purpose is to hedge variations in the general commodity price level, allowing large volumes of transactions not representative of actual goods and service deliveries. While these markets have a fundamental role in the process of price discovery, they might differ from transactions involving the exchange of physical products and often apply pricing formulas, thus providing a statistical framework that for specific tested transactions may serve as information only. This may be true also for fixed-price transactions common in the agricultural market, since fixed prices are negotiated taking into consideration the dynamics of the market in terms of quotes, premiums and discounts, at the moment in which the transaction is carried out.

To deduct applicable market prices and assure comparability versus the quotation price, the following should be taken into consideration:

- Internal comparable uncontrolled transactions between the tested parties and independent third parties where a premium or discount is applied to the quoted price
- Published prices by reporting agencies or brokers for transactions with specific characteristics (products of a certain quality, delivered in a specific place and under regular conditions).
- Comparability adjustments based on specifics of the tested transactions such as data on freight costs, quality premiums or discounts for non-standard products. This may be based on internal data with independent third parties of market data and standards.

5. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?

We have no additional suggested adjustments for geographic market differences.



However, of note is that an increase in profit potential – as is demonstrated in the examples in the toolkit – does not necessarily lead to an increased actual profit, and could even result in a loss, on realisation of the increased risk.

We question the adjustments as described in Appendix 13 as it suggests a correlation between higher country risk and higher profits. Although the OECD TPG consider the assumption of risks to be a crucial part of the functional analysis and the process of delineating a transaction, we disagree with the notion that the assumption of greater risks carries the effective realisation of greater profits. If anything, the assumption of greater risk could result in more volatile results. This is equally important in the context of country risk adjustments where some Revenue Authorities expect a premium because of country risk. Risk equally implies the potential for profit **and loss**. With regards to the country risk adjustment, we suggest expanding the range to account for the volatility rather than increasing the profitability of the tested party operating in a different market than the comparable.

6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?

We welcome the additional guidance and insight this document provides and would note that it includes useful examples, both in the case studies of the draft toolkit and in the Minerals DD, as we consider the latter is a particularly helpful tool for providing transparency to the pricing mechanism of this industry. We also stress that the Minerals DD should not be viewed and applied in isolation, but rather in accordance with the draft toolkit and existing transfer pricing guidance. Similarly, the formulaic approach proposed in the Minerals DD should be used as helpful guidance to determine the arm's length price, taking into account the facts and circumstances of the individual case. This is especially true for examples which deviate from the specifics of provided examples, for which the approach needs to be reviewed. We therefore recommend that the toolkit should discourage attempts to extrapolate the principles and conclusions reached in the examples to other minerals without a detailed analysis of the underlying transaction.



Appendix 2: Detailed Comments

The following provides comments not directly linked to the questions above, addressing primarily editorial concerns and suggestions under the different parts or sections. The comments follow the structure of the toolkit.

Part I: Introduction – Addressing the difficulties in performing comparability analyses

The first couple of paragraphs seem to put a lot of focus on the transfer ‘price’, while price is only a part of the conditions that may influence the profit allocation between related parties in accordance with the arm’s length principle. We would suggest that the term ‘price’ be explained in that sense.

Part II: Issues arising when conducting a comparability analysis

Section 1, p.9: Selection of the most appropriate method

Original text: ‘Once this [accurately delineating the transaction] is understood, it is necessary to select the most appropriate transfer pricing method and identify one or more potential uncontrolled transactions that may be considered comparable’.

We suggest clarifying that the selection of the most appropriate transfer pricing method to the circumstances of the case does not need to be performed straight after the delineation of the transaction. As indicated in the table under section 2 and in contrast to the typical process for determining a comparability analysis under the OECD TPG, the most appropriate method is only selected after accurately delineating the transaction and the initial review of comparables information (see paragraph 2.2 of the OECD TPG: There are four principles on the selection of the most appropriate transfer pricing method covering: strengths and weaknesses of the methods; appropriateness of the method in view of the controlled transaction, based in particular on a functional analysis; availability of reliable information (in particular comparables); and reliability of comparability adjustments).

We suggest to edit the above sentence as follows: ‘Once this is understood **and one or more potential uncontrolled transactions that may be considered comparable have been identified**, it is necessary to select the most appropriate transfer pricing method’.



Section 2.2, p. 11: Clear priority of substance over form when the contractual relations and the conduct are misaligned

Original text: 'It is important to verify any contractual terms by reference to the conduct of the parties. While a transfer pricing analysis will typically start from the related party contracts, there is a clear priority of substance over form to the extent the two are misaligned.'

We believe the guidance as drafted could be misinterpreted in such a way that the tax administration is allowed to disregard or re-characterise the transaction as it sees fit. We also believe that this is not the intention of the guidance and would be contrary to the revised guidance under the BEPS action plan. Further there could be cases where the contract and the conduct of the parties are aligned, but the transaction as such may not have substance. Care should be taken that a tax administration does not replace a valid commercial transaction by its own interpretation of what the transaction should look like.

The sentences could be revised as follows: 'It is important to verify any contractual terms by reference to the conduct of the parties. While a transfer pricing analysis will typically start from the related party contracts, **when the substance and the form are clearly misaligned or inconsistent the transaction will be determined according to the conduct of the parties.**'

Section 2.2 (and Appendix 1): Functional analysis and questionnaire

The referenced questionnaire provides a detailed overview of the functions and risks that may occur in a multinational enterprise. The warning that the questionnaire should be tailored to the facts and circumstances of the specific case is welcomed. The risk still remains, however, that the list will be copied and sent to the taxpayer without adaption to the specific circumstances. We have noticed that the questionnaire does not address issues related to assets, which is one of the three factors under a functional analysis.

Further, under BEPS Action 13 on transfer pricing documentation, guidance on the master file³ and local file concept was developed. The master file should contain a brief functional analysis at group level and the local file should contain 'a detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years'. We understand from footnote 48 that a toolkit on transfer pricing documentation will be developed. In anticipation of the toolkit on documentation we believe that this toolkit on comparability could make reference to the Master File and Local File concept as developed under BEPS Action 13. It would help the developing economies in accessing the appropriate information for risk assessment and case selection and would assist the multinational enterprise in streamlining the transfer pricing documentation.

Finally, the ongoing work of the Platform to provide additional guidance on the use of the profit split method (PSM) references value chain analysis as a tool in helping to delineate the actual transaction.

³ A reference to the master file can only be found in appendix 8 and footnote 16 of the toolkit.



Additional guidance could facilitate the necessary transparency tax authorities desire to put the contributions by local operations into a broader global context.

Section 2.2: Assumption of risk

In line with the comment above, a developing economy (lacking audit and information capacity) would be best served in performing a detailed analysis as described on p. 12 with access to the Master File and the Local File as developed by guidance under BEPS Action 13 or a value chain analysis as proposed by the discussion draft on 'BEPS Actions 8-10 – Revised Guidance on Profit Splits'.

Section 2.2, p.13: Opportunistic behaviour of the taxpayer in choosing the transfer pricing method

Original text: 'many income tax systems are based on self-assessment under which the taxpayer chooses the transfer pricing method. Tax authorities must be alert to the possibility of opportunistic behaviour in this choice.'

We would welcome more balanced wording in this context. First, the taxpayer choosing the transfer pricing method is the norm, both under a self-assessment approach and under an audit approach. Secondly, this choice should be based on the four criteria defined in paragraph 2.2 of the OECD TPG, which limits the element of opportunism as currently suggested in the draft toolkit.

Section 2.4, p. 14: CUP method application

Original text: 'The CUP method is most often applied:

- where an internal comparable is available;
- [...]
- for the licensing of some intangibles, particularly where the license is not unique and valuable, to benchmark a royalty rate.'

In line with previous comments, we suggest to revise the text as follows:

'The CUP method is most often **reliably** applied:

- where an internal comparable is available, **provided it meets the same functional analysis as the controlled transaction;**
- [...]
- for the licensing of some intangibles, particularly where the license is not unique and valuable, to benchmark a royalty rate and **comparable market data is available.**



Section 2.4, p. 15, 16: TNMM application

The guidance could clarify that 'net profit' should be interpreted as operational profit in most cases (EBIT).

The guidance could also better indicate how the Berry ratio can be used for limited risk intermediary enterprises with no intangibles, as follows.

Original text: 'Berry ratio for limited risk intermediary enterprises with no intangibles, i.e. where the tested party buys from and sells to associates (for example, sales facilitation services).'

We would suggest to slightly modify the bullet as follows: 'Berry ratio for limited risk intermediary enterprises with no **unique or valuable** intangibles, i.e. where the tested party buys from and sells to associates (for example, sales facilitation services).'

Section 2.4.2: Commodity pricing and prescriptive approaches

With regards to the definition and description of these approaches, we suggest to use the wording reflected under the BEPS Action 8-10 and which will be included under paragraphs 2.16A to 2.16E of the revised OECD TPG. See also our general comments above on prescriptive rules in the main body of this submission.

Section 3.2 (p.22): Sources of potential comparables data and typical types of data used

Original text: 'However, in practice, application of the arm's length principle is heavily reliant in practice on external comparables'

Suggest to remove the repetition of the term 'in practice' and revise as follows: 'However, in practice, application of the arm's length principle is heavily reliant on external comparables.'

Section 4.1.1: Information in the hands of the tax authority

The guidance provides a balanced view on the use of secret comparables. The use of such secret comparables to perform transfer pricing adjustments should however be discouraged. Such secret comparables can at most be used for transfer pricing risk assessment or case selection for audit, see paragraph 3.36 of the OECD TPG.

Section 4.1.2 (p.32): Customs data

Original text: 'However, mis pricing can also affect customs values.'

We welcome the general use of the term arm's length pricing or non-arm's length pricing. These terms are neutral and thus preferable over other terms which could be misbalanced towards intent to incorrectly set the transfer price.



Suggestion for revision: 'However, **non-arm's length pricing** can also affect customs values.'

Section 5: Determination of and making comparability adjustments where appropriate

See general comments above on comparability adjustments in the main body of this submission.

Section 6.1: Arm's length range

Section 6.1 on arm's length range suggests on p. 47 'capping' a wide range by determining the highest point in the range as not exceeding a certain percentage of the lowest point of the range. The term capping is understood to include both floor and ceiling, which should be included in a definition. In this case, two issues may arise. The first relates to whether such capping is in accordance with the arm's length principle and the arm's length range approach, in particular when all the comparables left in the set are equally reliable, but still lead to a wide range. The second relates to the fact that the other tax administration may not accept the capping of the range, leading to controversy and possibly unresolved double taxation. When a country decides to have a range cap in its domestic law, appropriate appeal procedures and access to MAP should be warranted. In case the analysis results in a wide range, it may be more appropriate to make use of statistical approaches. Further the taxpayer should be able to demonstrate that the wide range is still an arm's length range.

Part III: Approaches to applying internationally accepted principles in the absence of comparables

Section 1: Objective

On p. 52, mention is made that many developing economies that report a lack of capacity negotiate an arm's length result. This statement suggests that tax administrations in the first instance conduct their own analysis and conclude with an arm's length outcome in all cases. This may be misleading, as a separate analysis is not the initial purpose of an audit.

Section 3.1: Testing the benefit received

We agree with and understand the benefit test in the framework of services (under the revised OECD TPG as a result of the BEPS Action 8-10 Report) and possibly in the framework of intangibles (although the OECD TPG do not refer to a benefit test in the framework of intangibles).

The benefit test is part of the discussion about whether a service is or has been rendered. As such, the benefit test has a place in the first part of the comparability analysis, namely the delineation of the actual transaction. It is not clear to us, however, how the benefit test leads to the correct determination of an arm's length result in the absence of comparables. It only indicates that a transaction would have been performed between independent enterprises under similar conditions.



Section 4: Safe Harbours

See our general comments on safe harbours in the main body of this submission and response to question 3 in Appendix 1.

Section 4.3: Other prescriptive rules

See our general comments on prescriptive rules in the main body of this submission. As above, when countries choose to apply prescriptive rules for determining arm's length results, it is important that the outcomes under the prescriptive rules:

1. approximate arm's length result;
2. provide the taxpayer with the possibility to demonstrate that the transfer pricing approach it has considered in the related party transaction is at arm's length; and
3. allow access to appeal procedures and MAP in case the prescriptive rule is used as an anti-avoidance measure.

Section 5: Profit split methods

It is unclear why the PSM is discussed as an approach that can be applied under internationally accepted principles in the absence of comparables. Although the use of the PSM does not require the existence of comparables as such, the lack of comparables is not a factor for selecting the PSM, as also indicated in the toolkit. The guidance of the toolkit correctly states that both parties must make unique and valuable contributions to the transaction or the operations might be highly integrated. The question remains of course whether these are the only situations in which the PSM can be reliably applied (see also next paragraph of this comment). The fact that no comparables exist or are difficult to retrieve is not a sufficient reason to select the PSM as the appropriate transfer pricing method. The inclusion of the discussion on the PSM in a section on absence of comparables (in all cases) might therefore be confusing or lead to the application of the PSM under inappropriate circumstances.

Also, in light of the further work by the OECD on developing additional guidance on the use of the PSM, we believe that the guidance on the use of PSM by the Platform should be aligned. This is suggested in order not to arrive at divergent approaches between developed and developing economies in the application of the PSM.

Section 6: Valuation techniques

We welcome the reference to valuation techniques and its guidance in the OECD TPG (as revised under BEPS Action 8-10).

Section 7: Advance Pricing Arrangements

We welcome the guidance on APAs. We acknowledge that the conclusion of (in particular bilateral or multilateral) APAs can be very resource intensive and time consuming (from the perspective of the



taxpayer and the tax administration). However, we believe that in line with the development of the revised guidance on safe harbours and the Memoranda of Understanding for low risk activities, a fast track APA-policy for similar low risk transactions could be developed.

Section 8: Anti-avoidance and other tax base protection measures

See previous comments on section 4.3.

Part IV: Summary, conclusions and recommendations for further work

Section 3: Recommendations for further work

We welcome the list of topics where further work may be done and share our willingness to contribute to this further work.

In addition to the current list of topics, we propose adding the need to examine the possibility of fast track APAs for low risk activities, similar to the (bilateral) Memoranda of Understanding on safe harbours.

Case studies

All three case studies concern step one of the revised OECD TPG under BEPS Action 8-10: the delineation of the transaction. Further, the case studies illustrate situations where the taxpayer seems to have incorrectly delineated the transaction, potentially implying that every transfer pricing case poses a high risk that the taxpayer has the intention to file an incorrect tax return. We suggest to provide more balanced examples which additionally illustrate the following cases where:

- the taxpayer has delineated the transaction correctly, but both taxpayer and tax administration face difficulties in finding reliable comparables;
- the taxpayer has delineated the transaction correctly, but the taxpayer and the tax administration disagree about the return based upon comparables;
- the taxpayer has performed a comparability analysis to the best of the available comparables; and
- the tax administration has performed another benchmark study.

Appendices

Appendix 12

Appendix 12 presents an empirical analysis comparing firm profitability across certain manufacturing and distribution industries in Europe. The analysis finds that there is variability of profitability results in different countries for a given industry. It is not clear what practical conclusions can be drawn from such an analysis for tax administrations. It is our view that the comparability of a foreign firm should not be determined by aggregate industry-level testing but should instead be based on the facts and circumstances of the transaction under review. Furthermore, the analysis presented in Appendix 12 relies on data for Europe, which is well known to be heavily represented in public databases. Conducting similar analyses



for developing countries may be difficult as large volumes of firm-level data are not generally available in public databases for these countries.

Appendix 13

Both examples seem to perform a country risk adjustment based on long-term government bonds. It would seem appropriate to include further examples using other adjustment parameters.

The adjustments have the effect that the return of the tested party is increased because of the higher risk factor of the country where the tested party is located. From the point of view of an active party dealing with the tested party in the 'higher risk' country, that active party may assume higher risk such as non-repatriation of royalty payments, blocking of goods at frontiers, social movements and unrests or riots, etc. It remains highly doubtful who should receive the 'benefit of the increased risk'.

Appendix 15

The interquartile range calculated via Excel is just one of various methodologies for estimating Quartiles. Being a statistical approach, the toolkit should provide options (e.g. referenced in a footnote) rather than favouring one approach via exclusive display. This would allow for the evaluation of various quartiles as well as methodologies for estimating the defined range.

Appendix 19

This appendix contains illustrative safe harbour legislation for routine manufacturing activities. Similar illustrative legislation could be made available for other low risk activities. We also suggest to replace the term 'routine' with the term 'low risk'.

Appendix 20

Reference is made to the OECD TPG – safe harbour on low value-adding intra-group services under the revised Chapter VII (BEPS Action 8-10). The safe harbour margin / mark-up under the elective simplification approach on low value-adding intra-group services is fixed at 5% (no range).

Platform for Collaboration on Tax Comments to the draft toolkit to address the lack of comparables on developing countries

Gentlemen,

We appreciate the opportunity to provide our opinion on the lack of comparables in developing countries. We hope to contribute positively to the discussion and we remain attentive to the developments or requests of the platform on this topic.

1. Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit? In general terms yes. It would have been useful a more structured analysis on the positions taken by the national tax authorities to document the existence of specific reject patterns to the sets of comparable transactions proposed by the taxpayers.

2. How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level? It entirely depends on the national governments the approval of regulations requesting the disclose of business information about the taxpayer's operations. Nevertheless, we highlight the Colombian case, where there is the obligation to provide business and financial information to the "súper intendencia de sociedades", due to the law 222-1995 on its articles 83, 84 and 85 (inspection, surveillance and control of Colombian entities). All the information is gathered in a database (SIREM) which publicly disclosed this information. A similar approach can be used in the emerging economies.

3. How could the reliability of potential comparables from other geographic markets be tested? In our view, a quantitative approach is needed. For instance, a correlative analysis of market structures, competition, country risk and sensitivity levels to exogenous variables can be used as an approach. It is also necessary to consider that for commercial purposes, many industries classify its markets according to certain criteria. V.gr. in the pharmaceuticals industry it is commonly used the concept of “pharmerging market¹” in reference to markets with similar levels of economic development² and attractive to the companies. Possibly, economies belonging to the same tier within this classification can be used as comparables in a transfer pricing analysis.

4. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft? We noticed that the potential use of a foreign tested company from a developed country wasn’t discussed. This alternative becomes viable considering the lack of information in the emerging markets, eventhough if the foreign associated company wouldn’t be the simpler one in the transaction, as suggested by the OECD TP Guidelines³. A review of the policies adopted by the national governments following this alternative would be ideal to confirm this approach as possibility of analysis.

¹ https://www.imshealth.com/files/web/Global/Services/Services%20TL/IMS_Pharmerging_WP.pdf

² IMS. Op. Cit. Pp. 2. “Pharmerging definition: The study first divided the global economy into developed and emerging sectors, using a per capita GDP threshold of US\$25,000. Countries classified as emerging were then sub-divided using market data forecasts from IMS Market Prognosis, which are based on a rigorous evaluation of the key events impacting the pharmaceutical and healthcare industries worldwide. The latest and refined definition ranked Pharmerging markets on the basis of their minimum anticipated added value to the total pharmaceutical market between 2012 and 2016”...

³ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. A.3.3.

5. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?

According to Appendix 12 of the toolkit, “limited empirical basis for drawing on unadjusted international market data”, it is concluded in the Meenan et al. (2004) studies that “European arm’s length ranges do not statistically differ from country-specific arm’s length ranges in almost all cases.” As an alternative to the abovementioned approach, we suggest for the emerging markets the use of the Hirschman Herfindahl Index, in our example with data of the refining oil industry. Our approach looks for the elimination of the differences originated in geographic markets, because of the potential effect in the prices or margins of a product or service. Under the principles of perfect competition, prices must be identical from one place to another, regardless of the geographic market. The differences arise due to a *concentration* of the industry. Therefore, the following hypothesis is proposed:

“Because of higher levels of competition, the prices or margins in a developed market will be lower than the prices or margins obtained in an emerging market”

Hirschman Herfindahl Index is proposed to know the concentration conditions in an industry, based on the following:

$$HHI = \sum_{i=1}^n \left(\frac{Q_i}{Q} \right)^2 = \sum_{i=1}^N s_i^2$$

Where:

Q1 = Percentage share of the company in the market.

N = Number of companies in the market.

It is also possible to calculate the normalized Hirschman - Herfindhal index (HHIN), to delimit the values:

$$HHIN = \frac{(HHI - \frac{1}{n})}{1 - \frac{1}{n}} \quad 0 \leq H \leq 1$$

Where:

HHI is Hirschman - Herfindahl Index.

HHIN is Hirschman - Herfindahl normalized Index.

To define it, the following values are required:

Table 1. Values Hirschman - Herfindhal Index

"Concentrated" market	≤ 0.18
Moderately concentrated" market	$0.10 \leq 0.18$
Market "diversified"	$0 \leq 0.10$

Source: Own elaboration, 2017.

Comparison process in the oil refining industry

In order to obtain information from the industry and run the elasticities of the model, we use Research Insight Standard & Poor's database, under the following criteria:

Table 1. SIC Codes

Standard Industrial Classification
This major group includes establishments primarily engaged in petroleum refining, manufacturing paving and roofing materials, and compounding lubricating oils and greases from purchased materials. Establishments manufacturing and distributing gas to consumers are classified in public utilities industries, and those primarily engaged in producing coke and by-products are classified in Major Group 33.
Industry Group 291: Petroleum Refining
2911 Petroleum Refining Establishments primarily engaged in producing gasoline, kerosene, distillate fuel oils, residual fuel oils, and lubricants, through fractionation or straight distillation of crude oil, redistillation of unfinished petroleum derivatives, cracking or other processes. Establishments of this industry also produce aliphatic and aromatic chemicals as by-products. Establishments primarily engaged in producing natural gasoline from natural gas are classified in mining industries. Those manufacturing lubricating oils and greases by blending and compounding purchased materials are included in Industry 2992. Establishments primarily re-refining used lubricating oils are classified in Industry 2992. Establishments primarily engaged in manufacturing cyclic and acyclic organic chemicals are classified in Major Group 28.

Source: Research Insight.



Table 2. Hirschman – Herfindhal Index vs. Gross Profit Margin for SIC Code 2911

Country	IHH Normalized	Gross Profit Margin Average
Argentina	0.567672823	39.6805
Australia	0.999730815	46.793
Brazil	0.991207486	13.4465
Canada	0.030503777	7.95
China	0.413861051	16.2837
Egypt	1	14.336
Colombia	1	40.118
Spain	1	37.859
Cape Verde	1	11.212
Czech Republic	1	7.536
France	0.677985389	19.349
UK	0.011255598	20.46
Greece	0.000766045	12.73
Harvey	1	23.485
Hungary	1	26.472
India	0.16248038	15.999
Israel	0.097357761	24.65
Italy	0.681307528	24.069
Jordan	1	11.942
Japan	0.208592116	13.395
Republic of Korea	0.183102256	14.4586
Morocco	1	2.357
Mexico	1	45.442
Malaysia	0.007840665	7.70
Nigeria	0.705450112	14.099
New Zealand	1	81.249
Norway	1	30.656
Pakistan	0.397787565	6.332
Philippines	1	15.408
Peru	1	23.591
Poland	0.308979889	15.4375
Puerto Rico	1	12.943
Romania	0.934932628	31.2855
Russia	0.16129925	53.3088
Saudi Arabia	0.373661934	26.588



Singapore	0.788826819	10.72
Serbia	1	29.159
Slovak Republic	1	17.63
Thailand	0.370132555	12.8407
Turkey	1	11.988
Taiwan	0.882370524	6.757
South Africa	1	53.71
USA	0.051519086	18.26

Source: Own elaboration using the Research Insight database, 2017.

(*) In the case of countries that assume the value of 1 in the calculation of the Hirschman - Herfindahl Index, it is clear that only a public company operates, or that the conditions of competition are dominated by some local regulation, therefore is not possible to apply the analysis under these circumstances.

In the first case, there are countries with a diversified market that have in their system of internal competence an index value below 0.10. Such is the case of the following countries.

$$y = 126.02 + 11.107 (x)$$

$$r^2 = 0.4372$$

Table 4. Hirschman - Herfindahl Index vs. Gross Profit Margin (Diversified market review)

Country	IHH Normalized	Gross Profit Margin Average
Canada	0.030503777	7.95
UK	0.011255598	20.46
Greece	0.000766045	12.73
Israel	0.097357761	24.65
Malaysia	0.007840665	7.70
USA	0.051519086	18.26

Source: Own elaboration using the Research Insight database, 2017.

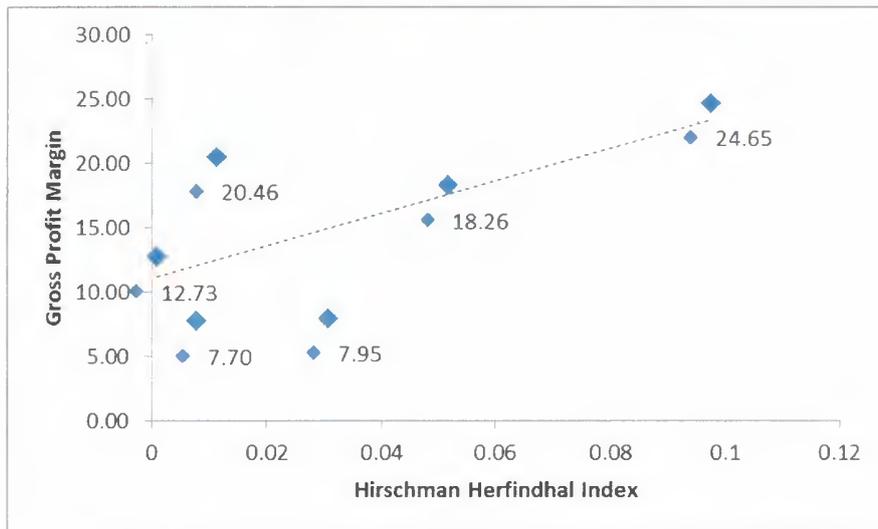
The results obtained in the regression shown that an increase of 100 points in the index produces an increase of 11.107% in the profit margin, which means that there is a correlation of 43.02% between the profit margin and the index. Since there is a positive relation between the index and the profit margin, the hypothesis proposed that the margin increases as the index increases is confirmed.

Table 5. Gross Profit Margins Interval

Minimum	7.70300
First quartile	9.14720
Median	15.49179
Third quartile	19.91190
Maximum	24.64500

Source: Own elaboration using the Research Insight database, 2017.

Graph 1. Scater Graph (Diversified market review)



Source: Own elaboration using the Research Insight database, 2017.



For companies operating in mid-market competitive range, only three observations were found for a "moderately concentrated" market.

$$y = 200.79 - 1023.1 (x)$$

$$r^2 = 0.3252$$

**Table 3. Hirschman – Herfindhal Index vs. Gross Profit Margin
(Moderately concentrated market review)**

Country	IHH Normalized	Gross Profit Margin Average
India	0.16248038	15.9999
Republic of Korea	0.18310225	14.4586
Russia	0.16129925	53.3088

Source: Own elaboration using the Research Insight database, 2017.

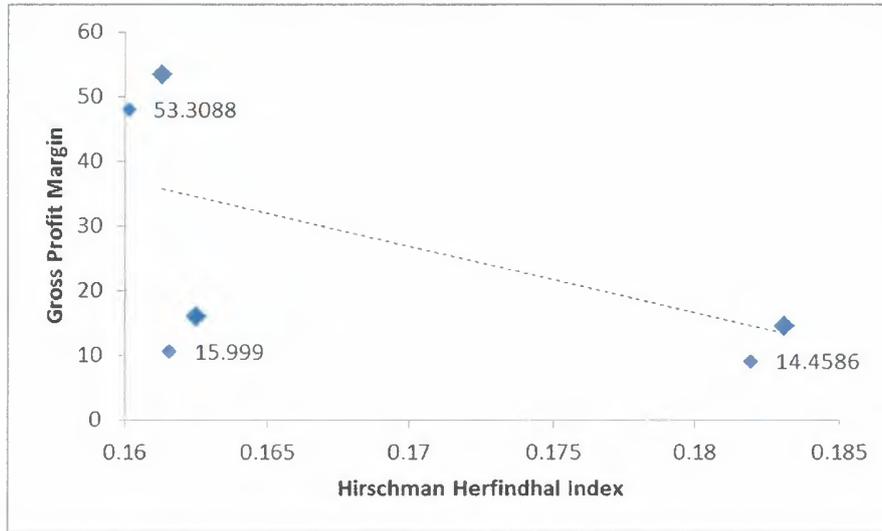
In case of Russia it was not possible to verify the observations, with a total of 8 companies in the industry, it is practically controlled by 3 companies with 96.89% of the market, only Gazprom and respective subsidiaries control 40.69% of the total industry, presenting data completely contrary to the main hypothesis, with negative relation, indicating in first instance, that the companies obtain profits that are not determined by the market conditions.

Table 7. Gross Profit Margin Interval

Minimum	14.45860
Median	15.99900
Maximum	53.30880

Source: Own elaboration using the Research Insight database, 2017.

Graph 2. Scater Graph (Moderately concentrated market review)



Source: Own elaboration using the Research Insight database, 2017.

Finally, companies that are in countries with concentrated markets.

Table 8. Hirschman – Herfindhal Index vs. Gross Profit Margin (Concentrated market review)

Country	IHH Normalized	Gross Profit Margin Average
Argentina	0.567672823	39.6805
Australia	0.999730815	46.793
Brazil	0.991207486	13.4465
China	0.413861051	16.2837
France	0.677985389	19.349
Italy	0.681307528	24.069
Japan	0.208592116	13.395
Nigeria	0.705450112	14.099
Pakistan	0.397787565	6.332
Poland	0.308979889	15.4375
Romania	0.934932628	31.2855
Saudi Arabia	0.373661934	26.588
Singapore	0.788826819	10.72
Tailandia	0.370132555	12.8407
Taiwan	0.882370524	6.757

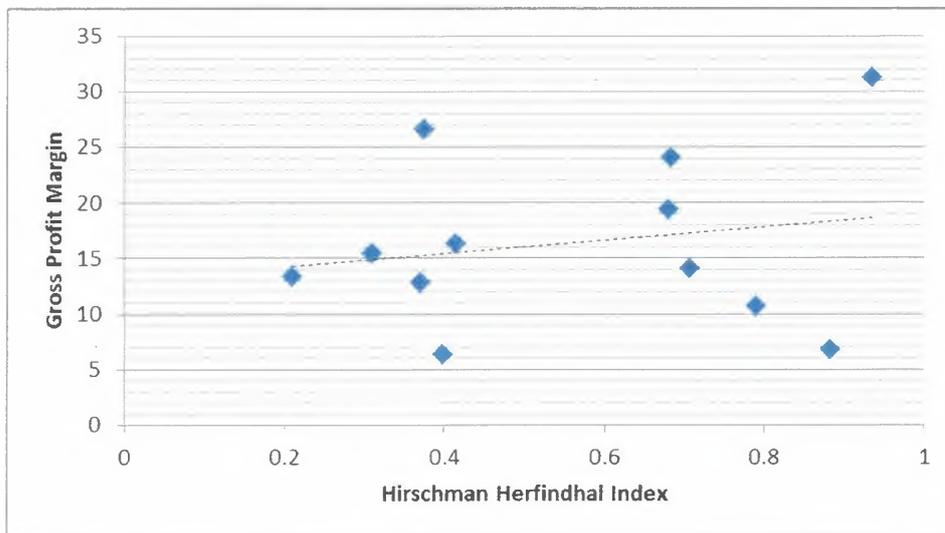
Source: Own elaboration using the Research Insight database, 2017.

Even though the market conditions, the profit margins of the companies belonging to this segment were not determined by the level of competition in the market or by the economic circumstances and therefore (technically the effect is zero), the profit margins are more related with their local regulation than with the economic circumstances.

$$y = 13.117 + 5.8947 (x)$$

$$r^2 = 0.3252$$

Graph 3. Scater Graph (Concentrated market review)



Source: Own elaboration using the Research Insight database, 2017.

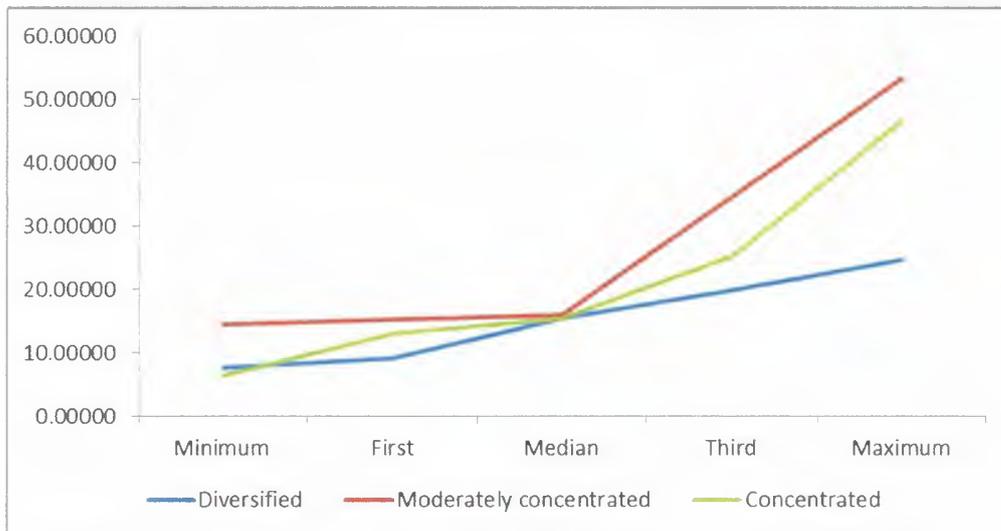
Table 8. Gross Profit Margin Interval (Concentrated market review)

Minimum	6.33200
First quartile	13.11785
Median	15.43750
Third quartile	25.32850
Maximum	46.79300

Source: Own elaboration using the Research Insight database, 2017.

Looking at the ranges we can notice that there is a significant difference in the profit margins between the concentrated and diversified markets, the case of a moderately concentrated market is illustrated by Russia. The distribution of quartiles is more stable in diversified markets, by contrast, in the less competitive markets, there are greater variations in the profit margins, so the same practice is proposed for different industries in order to select comparable countries whose economic characteristics are similar according to the level of competition in the market.

Graph 4. Interval observations for the different market concentration levels



Source: Own elaboration using the Research Insight database, 2017.

6. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?

In our opinion the cases reflect properly the market trading terms. In any case, it is important to confirm the market level associated to the transaction in order to adjust the price or margin due to this potential differences. Additionally it is important to confirm the activities performed by this kind of companies in emerging markets (considering that functionally speaking, they might be different from their peers in developed countries). Finally the effect of governmental policies must be addressed.

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DISCUSSION DRAFT: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

We would like to thank the Platform for Collaboration on Tax for this possibility giving us this opportunity to provide our input on the Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses (hereinafter the "Toolkit").

These comments proceed from Rödl & Partner Transfer Pricing Group, especially from the participating transfer pricing professionals mentioned below.

With best regards,

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I. Introduction

Our comments will be structured as follows: First, we shall present our views addressing the lack of comparables for transfer pricing analyses based on the content of the Toolkit, before providing answers to some of the questions set out to consider in the invitation to commentators.

II. Views addressing the lack of comparables for transfer pricing analyses based on the content of the Toolkit

A. Part II: Issues arising when conducting a comparability analysis

1. The comparables search process (Section 3.4.1)

We welcome the outlining of a typical search process for comparables using commercial databases as it provides certainty in dealing with day-to-day practice in Transfer Pricing. Furthermore, the outlined typical process matches our long-standing practice, which in our experience has been yielding high quality results in terms of comparability.

However, the guidelines of this process should be broadened to help both tax administrations and practitioners by including the following aspects which may help in reducing disputes:

- How to document the complete screening process: which information should be recorded, in which detail, etc.
- How to prove that the source used (e.g. website) actually contained the information used to accept/reject a comparable when performing the benchmark in such a way that it could be considered as sufficient evidence in a tax audit: e.g. type of record, recommended extension for the acceptance/rejection comments, screenshots, saved HTML, saved PDF version, use of specific software, etc.

In this regard, this Toolkit or the future toolkit on Transfer Pricing Documentation would be an opportunity to create a standard in order to reduce disputes arising from the search process and its documentation so as to set the focus on comparability.

One approach that may overcome the lack of comparables in developing countries and/or the access to commercial database by the tax administrations of these countries, would be that both the taxpayers and the tax authorities agree upon a search process before carrying it out. The preparation of the search process could be assumed by the taxpayer, but with the commitment of both parties to accept the outcome of the search once it is finalized, as long as sufficient comparables were to be identified. This solution would be also valid for several taxpayers from the same market and/or region.

Besides giving guidance in respect to the search process it is from our point of view necessary to provide additional guidance concerning the acceptable level of comparability.

Against the background of the five economically comparability factors¹ the comparability analysis through external data seems impossible. See below a few examples:

- **Contractual terms of the transaction:** The comparability of contractual terms cannot be directly observed by database analyses. From our perspective, the sole search for EBIT-margins makes a comparability of contractual terms not necessary.
- **Functional analysis:** Through the manual review of potential comparable companies, only an assumption of the overall functions performed, overall risks born and overall assets used could be derived. In many cases it is difficult to define the level of comparability in respect to the functional profile of the potential comparable entity (e.g. the related routine contract manufacturer does not perform any distribution activities, whereas a third party (contract) manufacturing company in any case is performing at least a minimum of distribution functions).
- **The business strategies pursued by the parties:** The comparability of business strategies cannot be observed by database analyses. From our perspective, the sole search for EBIT-margins makes a comparability of business strategies not necessary in each case.

A recommendation how to proceed within the qualitative screening and what should get special attention would be very welcomed.

2. Information in the hands of the tax authority (Section 4.1.1)

In principle, we welcome the general refusal of the use of secret comparables. In connection with the use of this kind of information it comes, in our view, very rapidly to an imbalance between the tax authority and the taxpayer. For price setting those secret data are not available to the taxpayer. Thus the taxpayer endeavours to apply public information in order to create arm's length conditions. Therefore, the tax authorities cannot blame taxpayers for acting not arm's length on the basis of secret comparables.

Furthermore, the use of secret comparables would expose the taxpayer to his arbitrariness and in this respect a refutation of acting arm's length cannot take place. This is of fundamental importance in cases where only poor data are available.

3. Wider selection of data (Section 4.2)

We have observed that the independence criterion is a requirement with a wide variety of approaches across different jurisdictions. With respect to benchmarking we recommend to treat entities having shareholdership relations to other entities below 50 per cent as independent. Up to this shareholdership there should be no motivation to shift profits for tax purposes. This could increase the amount of potential comparables. Additionally, it should be taken into account which characteristics of the shareholders relations may affect the Profit Level Indicator (PLI) of the potential comparable. In this regard, a company which is totally controlled by an individual may perform transactions with its shareholder at operating level (e.g. wages, payment of services, payment of costs) causing relatively low impact. Furthermore, an entity might be used

¹ Cf. para. 1.36f. of the OECD Transfer Pricing Guidelines 2016.

as comparable if it can be proved that no business relation to affiliated companies were conducted although it is part of a group.

However, commercial databases usually do not disclose information on related party transactions amounts. In this regard, it may be helpful that tax authorities increase the requirements of disclosing such information in such a way that commercial databases can include such information, so that the number of potential comparables could be increased. Thereafter, screening steps with thresholds less than 5% of turnover may be applied.

Furthermore, commercial databases lack information concerning ownership in many cases, classifying companies as independent when they are not. Therefore, it may be helpful that tax administrations increase the requirements for disclosing this information in such a way that the commercial database should integrate such information (e.g. creating in tax return purposes a classification of companies according to their independence: companies with all shareholders who are natural persons, companies without controlling shareholders, etc.).

Elucidation on these issues may enhance the number of potential comparable companies.

4. Determination of and making comparability adjustments where appropriate (Section 5)

In addition to the examples of ratios which are often used for performing comparability adjustments, it would be helpful to provide examples where such ratios would be applied and under which circumstances they would apply.

Moreover, it may be helpful to know how to deal with companies with different degree of comparability within the identified set of comparables resulting from a search process: e.g. should different ranges be created, should comparability adjustment only be applied to less comparable companies, etc.

Furthermore, due to the prevalence of working capital adjustments observed, it would be helpful that tax administrations establish which interest rates should be applied, particularly the rate or rates to be applied to each component to be adjusted.

5. Interpretation and use of data collected, determination of the arm's length remuneration (Section 6)

As mentioned, the application of the most appropriate method may result in a number of financial indicators for which the degree of comparability is uncertain. In addition to the quantitative search process, a detailed comparability review (qualitative search) of the potential comparable entities have to be performed. Since the data collected exhibit only limited comparability, statistical techniques are often required by legislation or tax practice in order to increase the comparability level of the identified comparable companies.

In many cases we have observed that an interquartile range has to be used. As we agreed to para. 6.2 of this Toolkit, an interquartile range is perhaps the most common statistical technique used, but many others exist.

We would appreciate further guidance under which circumstances such statistical means should be used to increase the comparability.

With a thorough manual screening (qualitative search) in many cases only a few comparable entities remain. In this regard the remaining entities already pointing out a high comparability level whereby an arm's length range could be calculated. Narrowing this range through statistical methods in form of an interquartile range or in form of percentiles does not seem from our perspective to be meaningful.

Although, the interquartile range excludes extreme values, the comparability level of identified entities will not be strengthened. It can be observed that companies fitting best to the tested party (in the light of comparable functions, comparable risks, comparable products and markets) could be excluded with this statistical method. In our point of view, the determination of the interquartile range makes only sense where a large number of comparable companies are available because of a wide acceptance of differences in the comparability factors.

From our perspective a better approach to increase the comparability level of identified comparable companies through the use of statistical technique could be in form of a regression analysis. The regression tests the significance of different influences (e.g. is the stock statistically significant in respect to the EBIT? Are the costs of employee statistically significant in respect to the EBIT?). Therefore, the regression can predict if a variable have a strong or weak influence on another figure (e.g. the stock predicts the rise in EBIT when the stock is increased, etc.). Furthermore, regression analyses could be applied in early search steps, e.g. testing the significance of different influences within the quantitative search process. Such statistical approaches would increase the comparability level in relation to the comparability factors whereas the interquartile mean tries to increase the comparability by narrowing the results of a search process.

Showing that differences in some comparability factors statistically do not influence the result could also increase the number of comparables.

B. Part III: Approaches to applying internationally accepted principles in the absence of comparables

1. Safe harbours, fixed margin and other prescriptive approaches (Section 4)

In general, we see safe harbours as a good approach to determine arm's length prices, if comparable criteria are available. Nevertheless, from our point of view, there is a risk that in future only safe harbours will be applied for testing the arm's length principle instead of benchmarking analyses or other comparability analyses. Thus, it should be stated that comparables should have priority. In this context we again want to emphasize the need for further guidance about noteworthy comparability levels. Otherwise we see the risk that comparables are generally rejected and safe harbor rules are the only source for arm's-length testing.

III. Answers to the questions set out to consider in the invitation to commentators

Question 1

We believe that this toolkit generally helps to address the challenges identified by developing countries.

Question 2

We believe that taxpayer confidentiality may be achieved by means of safe harbour arm's length ranges which reflect figures extracted information like cost-mark-ups, etc. out of all tax procedures (big data, e.g. observed achieved mark-ups on costs of certain services).

Question 3

The reliability of potential comparables from other geographical markets may be tested through an identification of different market comparability factors. In this connection, potential comparability factors for geographical areas could be for example the gross domestic product, purchase power, competition, state restrictions, etc. Furthermore, comparability factors concerning the branches could also be helpful. Therefore, the competitive situation, consumer vs. B2B, market size, etc. could be relevant factors in order to test the reliability of potential comparables from other markets. Additional guidance in this respect would increase the acceptance of studies covering different regions or branches.

Question 5

It is perhaps worth emphasizing to define qualitative comparability factors concerning the geographical market (as mentioned in our response from question 3). In this connection it should be prepared a guidance on how to deal with differences within the determined qualitative comparability factors, including a principle of materiality. On the other side there are quantitative comparability factors, which can be adjusted with additional guidance (e.g. comparability adjustments covering country risks in connection with interests, currency, etc.).

February 20th, 2017

Germany

Ansbach ▪ Bamberg ▪ Bayreuth ▪ Berlin ▪ Chemnitz ▪ Colonia ▪ Dresden ▪ Eschborn ▪ Fürth ▪ Hamburgo ▪ Hannover ▪ Hof Jena ▪ Kulmbach ▪ Leipzig ▪ Ludwigshafen ▪ Mettlach ▪ Munich ▪ Münster ▪ Nuremberg ▪ Plauen ▪ Ratisbona ▪ Selb ▪ Stuttgart

International:

Austria ▪ Azerbaijan ▪ Belarus ▪ Brazil ▪ Bulgaria ▪ People's Republic of China ▪ Croatia ▪ Cuba ▪ Czech Republic ▪ Cyprus ▪ Denmark ▪ Estonia ▪ Ethiopia ▪ Finland ▪ France ▪ Georgia ▪ Hong Kong S.A.R. ▪ Hungary ▪ India ▪ Indonesia ▪ Iran ▪ Italy ▪ Kazakhstan ▪ Kenya ▪ Latvia ▪ Lithuania ▪ Malaysia ▪ Mexico ▪ Moldova ▪ Myanmar ▪ Philippines ▪ Poland ▪ Romania ▪ Russian Federation ▪ Serbia ▪ Singapore ▪ Slovakia ▪ Slovenia ▪ South Africa ▪ Spain ▪ Sweden ▪ Switzerland ▪ Thailand ▪ Turkey ▪ Ukraine ▪ United Arab Emirates ▪ United Kingdom ▪ United States of America ▪ Vietnam

- 6 -



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Global Tax Platform

Atención: Members of the Global Tax Platform

7 de abril de 2017

Vía email: GlobalTaxPlatform@worldbank.org

ASUNTO. Comentarios a la Guía práctica para afrontar las dificultades asociadas con la falta de comparables en los análisis de precios de transferencia.

Estimados Señores:

Apreciamos el trabajo realizado por la OCDE y el Banco Mundial para elaborar el borrador para debate en el marco de la Plataforma de Colaboración en materia Tributaria, referente a la Guía práctica para afrontar las dificultades asociadas con la falta de comparables en los análisis de precios de transferencia.

En representación de RSM México, sometemos respetuosamente para su consideración, comentarios y observaciones generales respecto de la Guía práctica para afrontar las dificultades asociadas con la falta de comparables en los análisis de precios de transferencia (en adelante "la Guía práctica").

Dividimos este documento en dos secciones, la primera que contiene Observaciones Generales y comentarios referentes a situaciones que se han presentado en la práctica y la segunda en la que se atiende a los cuestionamientos que señala el documento que se debía poner atención para el análisis del mismo:

THE POWER OF BEING UNDERSTOOD
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Observaciones Generales

Consideramos apropiado el balance que se da en la Guía práctica a las (Directrices de la OCDE aplicables en materia de precios de transferencia (en adelante Guías de PT)) y al Manual Práctico de las Naciones Unidas sobre Precios de Transferencia para Países en Desarrollo (en adelante "Manual ONU").

Si bien es cierto que no todos los métodos aplican para todos los tipos de transacciones, consideramos que se está dando mucho peso a la aplicación del Método de Partición de Utilidades, de forma que pudiera ser considerado como "el mejor método para las autoridades fiscales".

Se hace referencia a que en ocasiones la aplicación de ajustes distorsiona más el resultado que el hecho de no utilizarlos, lo cual lleva a incertidumbre en cuanto a si es apropiado o no su aplicación.

Es cierto como se menciona que en muchos países se da la práctica de aplicar los ajustes de cuentas por cobrar, cuentas por pagar, inventarios y propiedad de planta y equipo de forma mecánica y ahora surge el cuestionamiento de si los mismos deberían o no aplicarse o cuáles y en qué casos.

También lo es el uso de información de varios años o de uno solo.

Por otra parte, cuando se aplican los ajustes y se utiliza la tasa prima para el cálculo de los mismos, qué tasa utilizar para aplicarlos cuando las comparables están ubicadas en diferentes países.

Qué mercados son similares entre sí para poder recurrir a ellos para la búsqueda de comparables?

Un elemento importante en la búsqueda de información comparable también es la temporalidad, ya que la información comparable debe ser contemporánea y por ejemplo en el caso de contratos comparables para analizar operaciones en las que se concede la explotación de intangibles vuelve más complicada la tarea que ya de sí lo es.

Encontramos en la práctica complicado el hecho de que las empresas comparables es posible que tengan ingresos por diferentes tipos de actividades y no necesariamente reportan información financiera segmentada por cada sector y por varios años y cuando lo hacen lo que segmentan es la información del estado de resultados y no del balance.

Dado que los países en donde se presenta mayormente la complejidad para localizar información comparable, son los países emergentes en los cuales la legislación en la materia es reciente, el trabajo de esta guía favorece además del tema principal a unificar criterios para el manejo de información por parte de las administraciones fiscales, lo cual sería útil para unificar criterios por ejemplo en cuanto a la aplicación de lo que se conoce como el sexto método, que no en todos los países se aplica de la misma forma y sería adecuado reglamentarlo.

Preguntas a considerar

¿El borrador de la guía práctica ayuda efectivamente a resolver los desafíos identificados por los países en desarrollo para encontrar los datos necesarios para llevar a cabo un análisis de precios de transferencia como parte de una auditoría fiscal?

Sí , pues presenta los diferentes procesos de selección de comparables de manera detallada, especificando en cada uno de los procesos la forma más eficaz para la determinación y selección de los comparables potenciales, de

forma que a la hora de realizar los ajustes estos sean los más adecuados según el caso.

¿Cómo se puede facilitar eficazmente la utilización de la información administrativa, de manera que se mantenga la confidencialidad del contribuyente, a nivel nacional y regional?

Se hace mención en la guía práctica acerca del uso de comparables secretos por parte de algunas administraciones fiscales, lo cual deja en inequidad de circunstancias a los contribuyentes pues ellos no tienen acceso a la misma a menos que ya estén en proceso de una auditoría, pero podría crearse una base de datos regional y nacional en la que se agrupara cada empresa de acuerdo a la actividad poniendo una descripción de manera general, y en la que solo aparezcan los estados financieros sin necesidad de dar a conocer información particular como nombre, domicilio o RFC; para ello tendría que existir un acuerdo de confidencialidad mediante el cual el contribuyente y la autoridad estén de acuerdo en la protección y la información a proporcionarse dando certeza al contribuyente de que su información se encuentra efectivamente protegida, o bien como el censo que anteriormente publicaba Estados Unidos en el que indicaban los márgenes por sector de acuerdo con el código SIC.

¿Cómo podría examinarse la fiabilidad de los comparables provenientes de otros mercados geográficos?

Mediante un análisis del sector del país o la región de la posible comparable seleccionada y cotejarlo con los estados financieros de las empresas del mismo giro, para identificar si los resultados reflejan la situación del sector.

¿Existen mejores prácticas u otros enfoques fiables para solventar la ausencia de comparables no abordados en la guía práctica?

Con el uso de información pública, no necesariamente de base de datos, como reportes, artículos o informes financieros, periodísticos en los que se haga mención sobre los precios de los productos, y que hagan referencia a la fuente de información. También existe la información que generan los sectores industriales, cámaras y asociaciones la cual es actual y fidedigna.

¿Qué otros ajustes, y bajo qué circunstancias, podrían realizarse para tener en cuenta las diferencias geográficas? ¿Cómo se podría probar la fiabilidad de dichos ajustes empíricamente?

Ajuste por diferencia entre la inflación del país de las comparables con la inflación del país de la empresa analizada. La fiabilidad vendría de los parámetros de inflación de cada país, que son datos públicos y confiables; llevados a cabo por los las instituciones bancarias y administraciones gubernamentales.

¿Los estudios de caso de precios minerales reflejan con exactitud las condiciones del mercado? ¿Hay otros ajustes que se harían rutinariamente cuando se venden estos productos minerales?

Sí están reflejadas de manera clara las condiciones comerciales del mercado, puesto que de minerales existen parámetros de referencias internacionales de donde se obtienen precios para dar cumplimiento en cuanto a materia de precios de transferencia logrando una mayor transparencia, también mencionan que las reglas sobre la determinación de los precios de transferencia deben establecerse claramente y aplicarse de manera eficaz, sobre la base de un buen conocimiento del sector y aprovechando las redes internacionales de intercambio de información ya consolidadas.



Agradecemos la oportunidad de aportar nuestra opinión y esperamos poder participar en las próximas Consultas. Si tiene alguna pregunta sobre nuestros comentarios, por favor comuníquese con la M.I. María del Sol Oregel Mendoza al +52 33 34465877 o marisol.oregel@rsmmx.mx

Atentamente,

En representación del grupo de Precios de Transferencia de RSM México:

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Reference
Addressing Difficulties in
Accessing Comparables Data
for Transfer Pricing Analysis

Date
21 February 2017

International Monetary Fund
Organisation for Economic Cooperation and
Development
United Nations
World Bank Group

Large Businesses
1st Floor, Blocks A and B,
Megawatt Park, Maxwell Drive,
Sunninghill, Sandton
(No postal deliveries to this address)

Private Bag X170, Rivonia, 2128

Attention: GlobalTaxPlatform@worldbank.org

SARS online: www.sars.gov.za

Dear Sir/Madam

**Addressing Difficulties in Accessing Comparables Data for Transfer
Pricing Analysis
A Toolkit for Developing Countries (“the Toolkit”)**

We wish to thank the International Monetary Fund (IMF), Organisation for Economic Cooperation and Development (OECD, United Nations (UN) and World Bank Group (WBG) for the work done to produce the Toolkit. We believe that the toolkit provides a good foundation to assist developing countries in performing a comparable analysis.

Comments:

Box 9. Country Practices

South Africa requests that the explanation of its practice in Box 9 on page 30 is amended as it currently does not accurately represent the South African Revenue Services (“SARS”) practice. We suggest the following wording:

“South Africa always starts with what the taxpayer has done. If SARS does not agree with steps or the results of the benchmarking study performed by the taxpayer, SARS will make adjustments to the taxpayer’s benchmarking study. If there is total disagreement with the benchmarking study, then SARS will run its own benchmarking study.”

Appendix 6: A selection of other types of classification codes

Appendix 6 highlights that SARS uses the Standard Industrial Classification codes, with a website link to the SARS Employment Tax Incentive Program. We wish to point out for transfer pricing purposes, SARS uses both the Standard Industrial Classification ("SIC") codes and the Statistical Classification of Economic Activities in the European Community code, commonly referred to as the NACE. We would therefore request a correction to Appendix 6.

Should you have any queries, please do not hesitate to contact me.

Yours faithfully

South African Revenue Services

Investigative Audit:

Specialist

**ISSUED ON BEHALF OF THE COMMISSIONER FOR THE SOUTH AFRICAN
REVENUE SERVICE**



ANNEXURE A

INTRODUCTION

1. The report is well written and provides a number of useful options for developing countries to address the lack of comparables, both from a revenue authority as well as taxpayer perspective.
2. Particularly useful are the examples and case studies provided, as well as the supporting information set out in the appendices.
3. The Toolkit was prepared by the Platform for Collaboration on Tax including the International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), United Nations (UN) and World Bank Group (WBG) to assist developing countries applying local transfer pricing rules following the OECD Transfer Pricing Guidelines or the UN Transfer Pricing Manual, to overcome or at least mitigate problems arising from the lack of suitable local comparables.
4. Submission: To avoid any misconception, it should be clarified that the OECD Transfer Pricing Guidelines, and the UN Transfer Pricing Manual must still be adhered to.

SPECIFIC COMMENTS TO QUESTIONS

- A. ***Does this toolkit effectively help address the challenges identified by developing countries in finding the data needed to carry out a transfer pricing analysis as part of a tax audit?***
5. Generally, the toolkit seems comprehensive and helpful in addressing challenges faced by developing countries relating to the limitation or lack of comparable data for conducting benchmarking database searches.
6. Many revenue authorities in developing countries are still in the process of building transfer pricing capacity, and the majority of approaches set out in the toolkit requires significant theoretical and practical transfer pricing experience.
7. In addition, in order to ensure that taxpayers are able to comply with specific requirements and/or approaches to be followed where there is a lack of suitable comparables in respect of a specific developing country, taxpayers need to be provided with consistent clear guidance regarding the approach or approaches they need to follow.
8. Submission: While the tool is very useful, it may not achieve the desired effect while revenue authorities do not have the man power and/or skill to implement it,



and until certain and clear guidance regarding what is required from a taxpayer in terms of comparables data has been made available.

9. The Toolkit does not specifically address approaches for benchmarking financial transaction such as loans and credit guarantees.
10. In practice, multinational groups often finance part of their operations in developing countries via intra-group financing arrangements. This could be between a developed country and a developing country, or between group companies in two different developing countries.
11. In the absence of safe harbour rules, some countries require that the interest rate applied in respect of a loan should be benchmarked, while other countries require that both the interest rate in respect of a loan, as well as the amount borrowed from a related party must be arm's length.
12. Currently, developing countries often rely on comparables from similar geographical markets based on information from databases that can only provide limited financial data.
13. Developing countries often have foreign exchange control rules in place, which impact the free outflow of capital. This may result in differences between on-shore and off-shore lending rates and guidance regarding the treatment of such differences would be helpful.
14. Submission: More detailed guidance in respect of financial transactions should be included in the Toolkit.

B. *How can better use of administrative information, in a way that maintains taxpayer confidentiality, be effectively facilitated at a country and regional level?*

15. One way to maintain confidentiality of taxpayer information could be to only rely on comparable companies which publish financial information in any case.
16. However, as generally, only public companies and their subsidiaries are required to publish financial information, this approach may not be suitable as independent companies are often removed during a database search.
17. Submission: Taxpayer information could be used to set and continuously test safe harbour rules. However, secret comparables should only be used in a transparent way, and authorities should be cautioned regarding the use thereof.

C. *How could the reliability of potential comparables from other geographic markets be tested?*



18. It may be challenging to test the reliability of comparables from other geographic markets depending on the location of the tested party and the type of transaction under review.
 19. One possible solution could be a comparison of the performance of a local company (financial information would be available to the local revenue authority) with financial performance of a set of representative samples from the other geographic market.
 20. For example, the results achieved by a company operating in a Sub-Saharan African country, could be compared to comparable East European companies with a functionally similar profile on the basis that political and economic circumstances in the East European and Sub-Saharan region are similar. In the example, information from a global database could be reviewed and filters applied to ensure comparability, for example based on industry classification, independence and revenue.
 21. If a review of the potentially representative samples in the database, say at least 5 or 6 positive validations, reveals that the financial performance of the local company (tested party) is within the range of the East European comparables, then this would suggest that the comparables from the other geographical regions are reliable. Of course one would need to consider any adjustments, for example for foreign exchange differences.
22. Submission: It is recommended that revenue authorities should inform taxpayers which databases they regard acceptable and if specific search filters should be applied.

D. Are there best practices or other reliable approaches for dealing with a lack of comparables not addressed in the discussion draft?

23. Submission: Instead of focusing on local or regional comparables, a different but useful approach could be to focus on regional comparables from a (different) region where the economic environment is comparable to the country/region where the tested party is based. For example, Eastern European comparables could be used to support a tested party in South Africa.

E. What other adjustments for geographic market differences could be made, and in what circumstances? How could the reliability of such adjustments be empirically tested?

24. Making adjustments often requires experience and judgment and this may result in subjective outcomes.



25. Submission: Generally, adjustments should be avoided to not overcomplicate matters, particularly if a developing country has not published sufficient reliable guidance.

F. Do the mineral pricing case studies accurately reflect market trading terms? Are there other adjustments that would be routinely made when these mineral products are sold?

26. The mineral pricing case studies generally reflect market trading terms and they are useful to revenue authorities and taxpayers. However, it should also be considered that multinational entities may reflect different contracts or processes.

27. Submission: It should be clarified that the Toolkit is not a complete guide.

ADDITIONAL COMMENTS

G. Part I: Introduction

28. The Toolkit, on page 6 states that "*in many instances, transfer pricing rules operate to consider whether a transaction has occurred at all, or has occurred in a way that is substantively different from that which is described in contracts or documentation*".

29. This seems to stress that it should be considered whether a transaction needs to be re-characterised.

30. Submission: It is submitted that it should be made clear in the Toolkit that re-characterisation is a methodology that should only be applied in extreme circumstances.

H. Formulary apportionment

31. The Unitary Taxation/Formulary apportionment approach is briefly discussed on page 6.

32. It is stated in the Toolkit that formulary apportionment approaches are specifically excluded from the discussion in the Toolkit because "*they are unlikely to be implemented at global level in the foreseeable future*".

33. However, the document then refers to the re-launch of the common consolidated corporate tax base (CCCTB) initiative in Europe, which incorporates "*an apportionment formula for the purposes of allocating taxing of rights between member states*".



34. As the Unitary Taxation/Formulary apportionment approach still keeps coming up as an alternative method to applying the arm's length principle, the reference in the Toolkit may be confusing and send an incorrect message.

35. Submission: The reference to formulary apportionment should be removed as the purpose of the Toolkit is to provide alternative options where suitable local comparable data is not available, i.e. specifically where the arm's length principle is followed.

I. Part II: Issues arising when conducting a comparability analysis

I.1. Expanding existing commercial databases:

36. While expanding commercial databases to include more companies in developing countries is important, this would be a long term process.

37. In addition, many independent private companies in developing countries, which may be suitable comparables for transfer pricing benchmarking purposes, operate at a different scale when compared to the members of multinational entities that are subject to transfer pricing rules.

38. Therefore, even if financial information in respect of these companies is included in commercial databases, not many may pass qualitative or quantitative filters during the database search process and therefore not be helpful.

39. Submission: Comparables from different geographical regions are useful and the importance thereof and guidance on how developing countries should use this information, is important and should be emphasised.

I.2. Relevance of the geographic market:

40. The Toolkit addresses on pages 27 and 28 considerations in respect of the use of foreign comparables where sufficient suitable local comparables are not available.

41. The Toolkit suggests that "in some cases, the geographic market may be less relevant than other characteristics, meaning that the most reliable comparables available are those from a foreign market".

42. It is pointed out that while some developing jurisdictions, e.g. in Africa, apply a process in practice whereby the focus is on comparable functions, assets and risks as opposed to a focus on geographic proximity of comparables, other developing countries such as China appear to prefer a focus on regional geographic market.

43. Submission: Guidance for a coordinated approach regarding the selection of comparables would be helpful.



I.3 Access to commercial databases:

44. The suggestions set out in the Toolkit on page 24 are useful and could assist revenue authorities with obtaining access to the relevant commercial databases. Existing efforts to bring down costs and to broaden the number of options should be supported.

45. Submission: It should be stated in the document that revenue authorities should first review and consider benchmarking studies provided by taxpayers before performing their own benchmarking study, unless the taxpayer's documentation reflects significant shortcomings. This would simplify the process of a transfer pricing review.

I.4 Other sources of information:

46. The use of secret comparables are addressed on pages 31 and 32. Different countries apply different approaches regarding the use of secret comparables.

47. The UN Practical Manual on Transfer Pricing and the OECD Transfer Pricing Guidelines caution against the use of secret comparables, i.e. the use of information collected by tax administrations through tax filings or at customs for transfer pricing comparability purposes, "unless requisite information can be disclosed to the taxpayers within the limits of domestic confidentiality rules".

48. However, in practice, it is very difficult for revenue authorities to draw a clear line, and that the use of secret comparables by revenue authorities as a risk assessment tool often evolves into their use in supporting specific adjustments.

49. Submission: It is also submitted that the use of secret comparables makes resolving double tax cases more difficult under Mutual Agreement Procedure, and it is submitted that clarifying this in the Toolkit would be useful.

50. The Toolkit should make it clear that secret comparables should not be used by revenue authorities, even if suitable comparable data is not available, unless they are used to establish/confirm a safe harbour rule.

I.5 Working capital adjustments:

51. Submission: The guidance relating to working capital adjustments is in line with the guidance set out in the OECD Transfer Pricing Guidelines and is helpful.

I.6 Adjustments other than working capital adjustments:

52. While the guidance provided in respect of comparability adjustments other than working capital adjustments (pages 34 to 45) is useful, the different options of



adjustments and the methodologies available for making these adjustments may lead to uncertainty for taxpayers and revenue authorities alike.

53. This is specifically the case where broad experience and skills are limited within the relevant revenue authority. Also, the making of adjustments often requires judgment, which may lead to subjective results.

54. Submission: Adjustments should be avoided, or at least clear guidance should be provided by revenue authorities.

J. Part III: Approaches to applying internationally accepted principles in the absence of comparables

J.1 Negotiated settlements:

55. On page 52 of the Toolkit it is mentioned that one of the approaches to mitigate the issue of a lack of suitable comparables, particularly where a transfer pricing dispute has arisen, is through negotiated settlements between tax authorities and taxpayers.

56. While this is an approach often observed in developing countries, this may create several other issues.

57. Submission: To ensure consistency and to avoid double taxation, negotiations should be carried on in terms of a Mutual Agreement Procedure or a bilateral Advance Pricing Agreement, or any similar procedure, between a taxpayer and its domestic tax authority.

58. It could be useful to include best practice guidance in the Toolkit regarding conducting negotiated settlements.

J.2 Testing the benefits received:

59. On page 53 of the Toolkit, reference is made to a benefits test for intangibles. While the concept of a "benefit requirement" is not new in respect of services transactions, this may lead to confusion when considering the arm's length nature of a royalty transaction.

60. In practice it is often difficult to determine the benefits in terms of a related party cross-border services transaction, and it could be even more difficult where the use of intangible property is concerned.

61. Submission: The concept of a "benefits test" for intangibles transactions to confirm arm's length nature of any transaction is not useful as it complicates things, while not alleviating the lack of comparables in developing countries.



J.3 Safe harbours:

62. The Toolkit, on page 54, sets out the benefits of using safe harbour rules and it also sets out certain shortcomings and issues.
63. Safe harbour rules may constitute a simple method to address the lack of suitable local comparables, but there are certain limitations such as that unilateral application of a safe harbour may result in double taxation, and also that safe harbours often mean a deviation from the arm's length principle.
64. Regular review and update of the safe harbour rule would be important.

65. Submission: It should be clarified that the seeming recommendation for the use of safe harbours must be distinguished from using rules of thumb as set out in paragraph 2.9A of the OECD Transfer Pricing Guidelines.
66. Thus, it should be clarified that any safe harbour rules should be based on comparables, i.e. while simplifying the process, there would still be a reliance on comparables, to be determined by the relevant revenue authority.
67. The process of deriving the safe harbour rate should be transparent.

J.4 Transactional profit split method:

68. It is stated on page 61 of the Toolkit that "*valuable contributions most frequently derive from the utilisation of valuable scarce contributions, including those from intangibles and from the assumption (including the control and management) of the key business risks.*"
69. The term "*valuable scarce contributions*" appears to be new and not generally known.

70. Submission: It would be useful to clarify the meaning, e.g. by giving an example, to avoid confusion.
71. In addition, applying the profit split method still requires the use of comparables. It would appear that this method is not suitable where comparables are in fact not available.

J.5 Royalty caps and other anti-avoidance measures:

72. On page 63 of the Toolkit there is the introduction of a royalty cap, i.e. a top limitation of the royalty deductions that may be claimed by the licensee. This approach may lead to double taxation unless the relevant other Treaty Country applies the same rules. \



73. Furthermore, using a royalty cap approach could mean the end of the Transactional Net Margin Method (TNMM) based residual royalty approaches.
74. It is pointed out that some developing countries have exchange control restrictions in place which may lead to a similar result as royalty caps. However, there have been cases where exchange control authorities would consider a higher royalty deduction in a developing country on the basis of a transfer pricing study that suggests a higher royalty rate than the one set by that country.

75. Submission: It is submitted that a royalty cap together with the other anti-avoidance and tax base protection measures set out on pages 63 and 64, would not offer a solution to the lack of suitable comparables that a developing country may face, but rather an anti-avoidance mechanism.

K. Part IV: Summary, conclusions, and recommendations for further work

76. This section provides a useful brief summary of the Toolkit. The recommendations for further work seem appropriate.

CASE STUDIES

77. The case studies provided are useful and are welcomed.

78. Submission: It is suggested that more case studies dealing with specific issues experienced in developing countries should be included, e.g. management services provided to a multinational group entity in a developing country or regional distributor/limited risk distributor.

APPENDICES

79. The information contained in the appendices supports the information in the main parts of the Toolkit and appears to be very useful. Some specific comments relating to the appendices information is set out below.

L. Appendix 1 (functional and risk analysis):

80. The questionnaire provided in this appendix is very detailed and seems to aim to address a wide variety of scenarios.

81. Submission: We suggest that it should be clarified that revenue authorities should gain an understanding of the taxpayer's business from the transfer pricing documentation provided first, before embarking on a potentially lengthy exercise to gather the information as set out in this functional and risk analysis.



M. Appendix 20 (Safe harbours)

82. The OECD safe harbour for services in the table is reflected as 2% to 5%.
83. However, based on the 2005 OECD BEPS Actions 8 to 10 Report, the level is 5% (para 7.61).

84. Submission: We recommend that the percentage be corrected.

DISCUSSION DRAFT

N. Addressing the information gaps on prices of minerals sold in an intermediate form

85. Submission: it should be clarified that the Toolkit is not a complete guide and multinational entities may reflect different contracts or processes other than those set out in the mineral studies.

86. Submission: In addition, it would be useful if the case studies would, in addition to addressing extraction and refining phases, also include a discussion of other phases in the value chain such as exploration, marketing, logistics and restitution.

87. The case studies included in the document refer to the application of the comparable uncontrolled prices (CUP) method for benchmarking purposes.

88. While this is often the most suitable methodology, there may be circumstances where suitable CUP method may not be available.

89. Submission: It would be useful if this could be clarified in the document and guidance/examples should be provided.

21 February 2017

Via E-Mail
GlobalTaxPlatform@worldbank.org

The World Bank
To: The Platform for Collaboration on Tax
1818 H Street, NW Washington, DC 20433 USA

DISCUSSION DRAFT: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses (the “Toolkit”)

Dear Madam/Sir

The business federation SwissHoldings represents the interests of more than 60 Swiss-based multinational enterprises from the manufacturing and service sectors (excluding the financial sector).

SwissHoldings is pleased to provide comments on the draft Toolkit which the Platform for Collaboration on Tax (the “Platform”) released on January 24, 2017.

Our comments to the draft Toolkit are as follows:

General

1. We support all initiatives that help to avoid tax controversy, as well as to minimize compliance burdens for taxpayers.
2. However, we are concerned that the Toolkit (i) introduces several unclear concepts and positions that do not relate to its objectives, and (ii) advocates a number of inappropriate positions and Transfer Pricing (“TP”) adjustments that are both costly and complex to implement, while not necessarily fitting the purpose of the Toolkit. In these regards:
 - a) Tax authorities should build on the TP analysis of the taxpayer, rather than (i) trying to implement a number of complex and burdensome comparability adjustments (as contemplated by the Toolkit) and that neither tax authorities (including the developed ones) nor taxpayers wish to undertake these as a “new standard”, and /or (ii) performing a separate full analysis without consideration for the taxpayer’s business model or organization.
 - b) Delete any references to the application of (i) profit split methods, (ii) (general) anti-avoidance regulations or (ii) to the promotion of *non-arm’s length* limitations to the deduction of royalty payments.

3. We strongly support the comments made on page 52 around using a country's regulatory framework to increase the availability of local comparable data. This is fully within the capabilities of countries around the world to require the filing of all companies' financial returns to a central database. The UK's Company House requirements are an example of a potential model.
4. Further clarifications and /or emphasis on the following topics are required:
 - a) Acknowledge from the Toolkit introduction (i) that TP is not an exact science and also (ii) that taxpayers are facing the same practical difficulties as tax authorities do. Therefore, clear and simple compliance rules are required to avoid tax controversy and minimize the compliance burden.
 - b) Stronger emphasis to the tax authorities that the taxpayer's TP policy, TP analysis applied and documentation package submitted must always be the starting point of any review.
 - c) Further promote reasonable Safe Harbour rules in compliance with the arm's length principle.
 - d) Further promote the development of Advance Pricing Agreement ("APA") programs and in particular leverage on the opportunities resulting from the new international transparency standards.
 - e) In order to avoid controversy and double taxation, it should be clarified that the use of secret data or hindsight (the latter concept being not even covered by the Toolkit) should be prohibited for TP adjustments purposes.
 - f) The Toolkit's contents do not fully reflect the latest version of the BEPS outcome (e.g. definition of intangibles, valuation techniques, etc.). An update is required.
 - g) The Toolkit refers to both OECD and UN Guidelines, however is unclear which reference should prevail in situations where their respective approaches might be inconsistent. Clarification is required.
 - h) Finally, as *follow-up work*, we strongly recommend to address the practical challenges around TP adjustments subsequent to the original transactions (i.e. to ensure that the actual profit of the taxpayer for the transaction under review is at the "right" profit level at year-end). In this context, clarification, simplification and also alignment from an indirect tax and customs perspective is required.

Risk assessment and TP analysis by the tax authorities

5. We believe the Toolkit does not sufficiently draw the tax authorities' attention to the critical importance of first acknowledging the taxpayer's TP policy, transfer pricing analysis performed and other available information (e.g. taxpayer's existing APAs in other countries for functions /transactions similar to those deployed locally), before undertaking a totally different TP analysis and /or a counter benchmarking exercise. The South African approach described in Box 8 (page 30) should be recognized as the best practice.
6. As mentioned above, taxpayers also face the same limitations on comparables data availability as tax authorities do. In line with their respective TP policies, many taxpayers already have developed a position about the right TP method and best possible benchmark

to be used (with or without comparability adjustments), using the best information available at the time the benchmark is performed. Such taxpayer analyses should always be the starting point for tax authorities' review, and they should generally be accepted as long as they remain reasonable (being reminded that hindsight data should be disregarded for TP adjustment purposes).

7. With regards to comparability analyses, it is fundamental that tax authorities should in principle be prepared to *relax the comparability standards* where required (in particular, this implies accepting foreign comparables with similar market conditions, with or without additional country adjustments). In other words, tax authorities should be much more willing to accept a practical solution using data that is available rather than seeking "perfect comparables" that do not generally exist in the context of an often complex business reality.
8. If the benchmarking approach used by the taxpayer is reasonable and consistently applied (without any indications of "cherry-picking") tax authorities should accept it. Moreover, if comparability adjustments (e.g. working capital or country risk adjustments) are not performed by the taxpayer (based on judgment that they would not improve the quality of the results), this should generally be accepted by the tax authorities. Requiring any comparability adjustments as a standard would only increase (i) tax controversy, (ii) the complexity of the TP model and (iii) the administrative burden for both the taxpayer and tax authorities.
9. As noted on page 34, too strict independence criteria required by certain countries can unnecessarily complicate the search for comparables.
10. Appendix 15 describes the calculation of the interquartile range. It should be acknowledged that there are different acceptable methods of calculating the interquartile range though they might show slightly different results. The MS Excel calculation method is only one of them.

Relevance of the Toolkit's contents to its purpose

11. Since the main purpose of the Toolkit is to help tax authorities finding *solutions* to the *lack of local comparables*, this necessarily implies that the scope of the Toolkit should primarily focus on the practical implementation of *one-sided authorized TP methods*. Therefore:
 - a) Any reference to formulary apportionment (page 6) has to be removed from the Toolkit;
 - b) Any reference to the profit split method should be removed from the Toolkit. We remind the Platform that since 2010 the profit split method is no longer treated as a last resort method, and that the mere absence of internal or external comparables cannot justify its application. Referring to the profit split (see page 51 for example) as an answer to the absence of comparables for one-sided TP methods fully contradicts the "most appropriate method" rule.
 - c) It would be helpful to clarify that in general profit split is not appropriate for companies performing limited /routine functions and bearing limited risk in the context of the group's value chain. Moreover, we would like to highlight that proper application of a profit split method is a much more complex exercise as compared to the question whether and /or how to perform comparability adjustments.
 - d) Any proposals to limit the deductibility of royalty payments by applying artificial caps have to be removed. This is not in line with the arm's length principle.
-

- e) It is not relevant for the Toolkit to address any (general) anti-avoidance rules. Those are aimed at tackling artificial set-ups whose purpose is to avoid tax. Conversely, the Toolkit is intended to address difficulties in benchmarking, which is a stage of the TP analysis occurring long after having analyzed and confirmed the substance of the transaction to be benchmarked. In this regard, the Toolkit does not fit its purpose.
- f) For the same reasons, Section 3.1 "testing the benefits received" in Part III should be removed, or alternatively it should be merged into Part II (Section 2 – "delineation of the transaction"). Again, it is not at the time of the benchmarking exercise that one should address the effective benefit or substance of the transaction.

Safe Harbour rules

- 12. We strongly believe that - reasonable - Safe Harbour rules in compliance with the arm's length principle are an extremely efficient method to tackle the issue of comparability. The risks associated with Safe Harbours are overly emphasized (page 56). We also believe that the "most significant benefit" of the Safe Harbour does not accrue to the taxpayer but rather to the tax authorities who can have comfort on an arm's length level of return applied without having to devote scarce resources to routine cases.
- 13. If reasonably applied, Safe Harbours would create a significant *win-win* situation for both taxpayers and tax authorities (this principle also applies to developed countries). Safe Harbours can help minimizing tax controversy and compliance burden, and at the same time they ensure a reasonable reward and profit allocation for the covered transactions.
- 14. By reasonable, we mean having an "arm's length" profit level (not too high or too low, ideally the median of a reasonable benchmarking study for a transaction type /function within an industry sector) with clear and simple compliance rules (e.g. "opt-in" or "opt-out" models, etc.). We recommend to set the Safe Harbour profit level for a longer time frame (at least over 3 to 5 years, in line with usual durations for APA), rather than adjusting it every year.
- 15. In line with the OECD TP Guidelines, a 5% mark-up on costs is a reasonable Safe Harbour rate for "routine" service transactions.
- 16. Given that the Brazilian transfer pricing rules are generally not considered as compliant with the arm's length principle and in practice lead to double taxation issues remained unsolved (e.g. tax treaty enforcement issues), we recommend to either specify these issues in the Toolkit or completely delete the Brazilian example as not recommendable practice.

Advance Pricing Agreements

- 17. The development of APA programs should be promoted by the Toolkit rather than debated or even discouraged.
- 18. Moreover, considering new tax transparency standards (e.g. disclosure and exchange of rulings/APAs, etc.) available APA data from other jurisdictions is an additional reasonable data source to test the TP methodology and profit level of the taxpayer in the respective country.
- 19. This information could also help tax authorities to efficiently build a database on which they could rely to either perform their risk assessment, design Safe Harbour rules, or even engage into (APA) negotiations with taxpayers.

We kindly ask you to take our comments and proposals into due consideration.

Yours sincerely

SwissHoldings

Federation of Industrial and Service Groups in Switzerland



Christian Stiefel
CEO



Dr. Gabriel Rumo
Member Executive Committee

- cc - SwissHoldings Board
- Nicole Primmer, Senior Policy Manager, BIAC
- William Morris, Chair of the BIAC Tax Committee
- Krister Andersson, Chair BUSINESSEUROPE Tax Policy Group

20th February 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: **Comment Letter**

Comment to Draft Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

Dear Sirs:

The toolkit is a most relevant and helpful document for transfer pricing practitioners on both sides of the table. Thank you for giving us the opportunity to comment on the draft version.

We are a provider of comparable data to value intangible assets - in particular trademarks and brands – which often play a major role in the business structure and transfer pricing of multinationals. MARKABLES was launched in 2004, and enjoyed great acceptance and success since its inception from all over the world. As of now we have close to 3,000 registered users. A substantial part of our business comes from transfer pricing professionals (as far as we can see from their identities), although we do not focus our marketing activities on this group.

Our comments relate to Appendix 3 of the draft (list on “Examples of commercial databases used for transfer pricing”).

- Appendix 3 lists a data provider InvoTex and its database “Royalty Connection”. As far as we can tell, this provider ceased to exist back in 2013. We suggest to delete it.
- We appreciate if you list MARKABLES as data provider in this Appendix 3. We provide royalty rate and profit split data on trademarks and brands on a worldwide basis.

Thank you for your consideration.

Kind regards from Switzerland,

Christof Binder, PhD, MBA
Managing Partner
Trademark Comparables AG
Bahnhofstrasse 48
CH-6430 Schwyz
Switzerland
www.markables.net

Comments received from Transfer Pricing Services

6th April 2017

Submitted by e-mail: taxcollaborationplatform@worldbank.org

Sub: **Comments on a Draft Toolkit Designed to Help Developing Countries Address the Lack of Comparables for Transfer Pricing Analyses**

Dear members of the committee,

I appreciate your initiative of providing a robust instrument for the challenges faced by developing economies in the transfer pricing area.

As part of the effort to shed light on some practical issues encountered please see the list below.

1. Regarding “less rigid independence requirements” we would appreciate your opinion on the screening of the management of comparable companies by reference the control dimension of definition of related parties.
2. Regarding “comparability adjustments” we would appreciate knowing your view on the reliability of a fiscal aids difference adjustment and the difficulty of performing such an adjustment.
3. Regarding “determining the arm’s length range” we would appreciate an explicit number of comparables for which an interquartile range can be computed.
4. Regarding “determining the arm’s length range” we would appreciate a formula for multiple year data. In our knowledge there are two methods: (i) weighted average that implies computing the average for each company for the period and based on these values computing the interquartile range with the formula described also in the toolkit (the number of observations is equal to the number of companies) and (ii) pool method that implies computing the interquartile range based on each profit level indicator determined for each company in each of the years in the tested period (the number of observations is equal to the number of companies multiplied by the number of years). The first method provides much smoother results, although the disadvantage relies in the fact that it might be influenced by the exchange rate as it is computed as the sum of results for the period divided by the sum of the appropriate base indicator.
5. Regarding “the choice of the tested party” we would appreciate an opinion on selecting the appropriate tested party (i.e. the lender or the borrower) in a intra-group loan transaction taking into account the moral hazard and information asymmetry issues.
6. Regarding “comparables search process” we would appreciate an example of a screen process for financial intra-group transactions.

7. Regarding “the arm’s length range” we would appreciate an opinion regarding the appropriateness of tax adjustments performed by tax authorities both in the case of a price/profitability lower than the inter-quartile range as well as higher the inter-quartile range.

Best regards,
Ana

Ana Ifrim



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February 21, 2017

VIA EMAIL

Global Tax Platform

GlobalTaxPlatform@worldbank.org

Re: USCIB Comment Letter on the Discussion Draft: A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analysis

For the attention of the members of the Global Tax Platform,

USCIB¹ appreciates the opportunity to comment on the draft toolkit (hereinafter “toolkit” or “discussion draft”). In our view, an open comment process is an important part of developing helpful guidance that will meet the needs of both tax administrators and taxpayers.

Our comment includes a letter and an attachment. The letter sets out our overarching comments. The attachment provides detailed comments on particular paragraphs.

As a preliminary matter, USCIB recognizes that the drafters face a difficult balancing act. The toolkit is intended to provide guidance to developing countries that may be in very different stages of economic development. The toolkit therefore needs to focus on general guidance, as opposed to detailed prescriptions. In our view, the toolkit strikes an appropriate balance between these two concerns. It may also be possible to continue to adjust this balance by adding examples to the case studies as countries and taxpayers gain experience with the toolkit and developing countries increase their tax administration capacity.

The toolkit also takes a pragmatic approach to resolving transfer pricing questions, which USCIB believes is very important. This pragmatic approach includes, for example, the need to take into account the availability of comparables in choosing the most appropriate transfer pricing method. The attachment points out and supports other instances of this pragmatic approach.

USCIB also believes it is important to clarify the relationship between the OECD Transfer Pricing Guidelines (hereinafter “OECD TPGs” or “guidelines”), the UN Practical Manual on Transfer Pricing for Developing Countries (hereinafter “UN TP Manual” or “manual”) and the toolkit. If there is a conflict between the guidelines or the manual and the toolkit, then the guidelines or manual should control and the toolkit should explicitly state that result. As a product of the Platform of Collaboration on Tax, the toolkit does not have the same status as either the guidelines or the manual. The OECD TPGs are the

¹ USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

product of negotiations among governments acting in their official capacity. While the guidelines represent “soft law”, the parties negotiating the guidelines have officially endorsed the guidelines. This is not true for the toolkit. The UN’s Committee of Experts on International Cooperation in Tax Matters is not an official governmental body and the members of the Committee do not participate in their official governmental capacity, so the manual is likely even “softer law” than the OECD TPGs. The drafters of the manual, however, have sought consistency with the OECD TPGs, so to the extent possible the guidelines and the manual should be interpreted consistently. In any event, the toolkit should not supersede these documents and the toolkit should make that clear.

USCIB is concerned that the toolkit overemphasizes the application of substance over form principles and may lead to recharacterization in inappropriate cases. While accurate delineation of the transaction is a part of every transfer pricing analysis, contracts and agreements are important factors in that analysis. Adjustments may be made that do not result in changing the character of the entire transaction. Recharacterization of the entire transaction is inherently subjective and will likely result in double taxation and disputes. Increasing double taxation and disputes will result in a drag on foreign direct investment. USCIB is particularly concerned that all three case studies presented in the toolkit show transactions where recharacterization occurs. In our experience this is not representative. A better approach to the examples might be to show some transactions that are respected without adjustment, some that are respected with adjustment and some in which the transaction is recharacterized.

USCIB is also concerned about the role of and description of profit splits in the toolkit. The toolkit on multiple occasions states that the profit split method is a method that may be applied in the absence of comparables. This is misleading, inconsistent with OECD guidance, and may lead to tax authorities defaulting to the profit split method when its use is not appropriate.

The OECD’s recent discussion draft on profit splits discussed the use of the profit split method when comparables are difficult to find.

A lack of comparables alone is insufficient to warrant the use of a transactional profit split of actual profits under the arm’s length principle. In cases where the accurate delineation of the actual transaction indicates that one of the parties to the transaction assumes only limited risks, but reliable comparables data is scarce, it is likely that a more reliable arm’s length outcome can be reached through the adjustment (under Step 8 of a typical process for performing a comparability analysis in paragraph 3.4) and interpretation (under Step 9 of a typical process for performing a comparability analysis in paragraph 3.4) of inexact comparables data rather than through the inappropriate application of the transactional profit split method. Using a transactional profit split of actual profits in such a case would result in a fundamentally different economic outcome to the one supported by the accurate delineation of the actual transaction.²

The quoted language essentially makes the point that it is more important to use the correct method. Inexact comparables may be adjusted, but using an improper method assigns profits to the incorrect party.

In addition, even in the case in which the transactional profit split method is the best method and should be applied, it is likely that comparables will be necessary to its proper application. Under the

² OECD Public Discussion Draft BEPS Actions 8 -10 Revised Guidance on Profit Splits, paragraph 18.

transactional profit split method, the first step is to assign routine returns to the relevant party based on the application of one of the one-sided methods. Only the residual profit is then split between the parties to the transaction. Thus, comparables are usually needed to properly apply the profit split method. In addition, comparables should be considered in determining the appropriate methodology used to split the profits between the parties to the transaction.

The transactional profit split method may be the most appropriate method when both parties to the transaction make unique and valuable contributions. The interpretation of unique and valuable contributions in the toolkit³ introduces the new notion of “valuable scarce contributions”. It is unclear what the introduction of scarcity adds to the existing unique and valuable contributions. Some contributions may be scarce (e.g. rare earth minerals) but not unique and are capable of being valued without reference to the profit split method.

Finally, highly-integrated operations do not mean that a transactional profit split is the best method.⁴ First, the profit split method is transactional, so parts of the value chain that are not participants in the relevant transaction are not relevant to determining the division of income between the parties to that transaction. Second, high-integration does not mean that the contributions are unique and valuable. For many businesses, high integration is a requirement to remain competitive. Within an integrated business some entities will perform routine functions for which comparables will be available. Thus, high-integration is not necessarily an indicator that the transactional profit split method is the most appropriate method.

Sincerely,



William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

³ Toolkit, page 61.

⁴ OECD/G20 Base Erosion and Profit Shifting Project, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10: 2015 Final Reports, page 60 (hereinafter “Actions 8-10 Final Reports”) provides that “additional guidance will be provided on when significant integration of business operations may lead to the conclusion that a transactional profit split is the most appropriate method.” This implies that not all cases of significant integration should result in the use of the transactional profit split method. Including significant integration as a factor without that further guidance could be misleading and could result in tax authorities routinely applying the profit split method, in many cases inappropriately. This is especially problematic given that the one factor that is mentioned in the Actions 8-10 Final Reports as a possible basis for distinction between cases in which profit split may be appropriate vs. those in which it is not (sequential vs. parallel integration) has been found to be unhelpful outside of the area of global trading of financial assets.

Attachment

1. Page 5, second paragraph, the discussion of transfer pricing as a “necessary feature” of commercial activities should mention that determining a transfer price is a legal requirement for enterprises engaged in cross-border activities with related parties. It should also note that in many countries a history of local country non-compliance has led to countries relying on foreign multi-national enterprises for a disproportionate share of their revenue.
2. Page 6, first paragraph, over emphasizes the need to recharacterize transactions. Although recharacterization is sometimes appropriate, consistent with the OECD guidelines⁵, disregarding or recharacterizing the transaction should be limited to exceptional circumstances. Even if the transfer price should be adjusted, the starting point should be the transaction and comparables, even comparables requiring adjustments should not be rejected prematurely.
3. Pages 6 and 7, carryover paragraph, the toolkit points out that perfect comparables may only rarely be available, nevertheless, “commonly the data that is available will still allow a reasonably reliable analysis to be performed and a satisfactory approximation of an arm’s length outcome to be determined.” USCIB agrees with this and believes that this point should be emphasized and moved to the initial discussion (first paragraph of page 6).
4. Page 9, section 2.2.1, the second bullet refers to the “wider generation of value by the multinational enterprise”. Is this intended to require a value chain analysis in all cases? USCIB believes a value chain analysis is not required in all cases and that the toolkit should make that clear.
5. Page 13, Box 2 provides an example of the application of the arm’s length principle to a sugar producer. The example might be more helpful if there were additional facts concerning how market prices are to be determined. Is a spot rate used? A weighted or unweighted average?
6. Page 14, section 2.4.1 recommends taking practical considerations into account in determining the most appropriate method. USCIB commends this recommendation.
7. Page 17, section 2.4.1(e) concerning the transactional profit split method provides that a transactional profit split method may be the most appropriate method where the business operations are highly integrated. USCIB believes this does not represent the most current thinking on the profit split method and therefore this bullet should be deleted. If the relevance of integration is still being debated at the policy level, then the toolkit should not foreclose that discussion.

⁵ Actions 8-10 Final Reports, page 14.

8. Page 18, section 2.4.1 concerns the application of the most appropriate method. The paragraph contains a sentence that reads as follows: “Moreover, once a method has been determined to be the most appropriate given the nature of the transaction, it should not be easily dismissed due to ‘imperfect’ comparables.” This is an extremely important point and should be emphasized more strongly.
9. Page 15, Cost Plus Method provides that “the determination of the appropriate cost base will often be of greater importance than the amount of the mark-up, particularly where the activities concerned are considered to be relatively low value-added.” Even at low margins, the differences in markups can produce significant differences in taxable income if the PLI base is large. While both the cost base and the mark-up are important to the determination of the appropriate transfer price, the cost base can be more difficult and time-consuming to determine than the mark-up, particularly in the case of pass-through costs.
10. Page 16, second paragraph provides: for a “reseller ...there is normally a strong correlation... between the level of sales and ...profitability.” This raises two points. First, the size of the business is an important factor in selecting comparables, with comparables from businesses of comparable size being more reliable. Second, compensating the distributor for the functions it performs using operating expenses as the PLI may be more reliable, but the return on sales is often used because the comparables may classify some costs as COGS rather than as operating expenses relative to the tested party (and vice versa) and the differences cannot be reliably identified.
11. Page 17 (middle of the page): The transactional profit split method is presented as a method that can be applied in the absence of comparables. As we point out in our cover letter, the toolkit should note, however, that under the OECD Guidelines the profit split method does use comparables to compensate the parties for routine contributions following one of the traditional transaction methods or a transactional net margin method. Comparables should also be considered in determining the appropriate methodology used to split the residual profits between the parties to the transaction.
12. Page 20, Box 3: Scenario 1 mentions “a Cost Plus analogue, but applied at the net margin level.” A mark-up on full costs is a commonly used transfer pricing method, so USCIB supports an example illustrating the use of this method. However, the reference to the parenthetical quoted above might be confusing to the reader because page 16 specifically instructs the reader not to confuse a (full) cost plus with the Cost Plus Method.
13. Page 20, Box 3: The choice of the method and PLI in scenarios 1 and 2 seems to be artificial. It might help to put some context around these choices, for example, by

bringing the last two bullets in the Box into the description of the scenarios or by moving the caveat in the footnote to the beginning of Box 3. Otherwise this example might be easily misread as providing that in a particular case either option would be acceptable. The operating margins should be more realistic. Using unrealistic margins in examples (even with caveats that the illustrations and case studies used in the toolkit are for illustrative purposes only) may create unrealistic expectations of high returns when those expectations would be misguided.

14. Page 21, section 2.4.3 seems to be dismissing one-sided methods too forcefully. If an enterprise assumes economically significant risks, including those associated with a unique and valuable intangible, a one-sided method may still be appropriate, but the other party may be the tested party. The profit-split method should only be used if both parties make unique and valuable contributions to the transaction, including especially the use of unique and valuable intangibles. All businesses take risks; so, the presence of risk does not mean that comparables are unavailable and returns may be routine. Taking on even significant risks is no guarantee of non-routine returns - most businesses fail.
15. Page 21, section 2.4.4 again seems to be driving too forcefully in favor of the profit split, even though it acknowledges no hierarchy of methods.
16. Page 21, section 2.4.4, provides that “a CUP or a one-sided method...” this suggests that a CUP is not a one-sided method, which of course it is. A better formulation would be “a CUP or other one-sided method.” USCIB believes the reference to “highly integrated” should be deleted.

As pointed out above,⁶ Actions 8-10 Final Reports indicates that “additional guidance will be provided on when significant integration of business operations may lead to the conclusion that a transactional profit split is the most appropriate method.” Actions 8-10 Final Reports mentioned a possible distinction between sequential and parallel integration as a basis for distinguishing between cases in which a transactional profit split may be appropriate (parallel integration) and not appropriate (sequential integration). The recent discussion draft on profit splits solicited comments on the helpfulness of this distinction. As USCIB understands that the current view is that this possible basis of distinction has not proved helpful. Therefore, there is no current guidance on when integration should be taken into account. In USCIB’s view, in the absence of any guidance on when integration should be taken into account, this reference to “highly integrated” should be deleted. High levels of integration are not an indicator of either lack of comparables or non-routine returns and should therefore, in the absence of detailed guidance, not be used to justify the use of profit splits.

⁶ Footnote, 4.

USCIB suggests that the second paragraph in section 2.4.4 be deleted. This does not add anything to the guidance provided by the toolkit and could be misconstrued as suggesting that the desire to reach a particular profit allocation outcome could drive the selection of the most appropriate method.

17. Page 22, section 3.2 states that “any source of information should be acceptable, as long as leads to reliable financial and business information for the transfer pricing analysis.” USCIB strongly supports this statement (with the caveat of our previously stated objection to secret comparables). This section also states that there is no hierarchy between internal and external comparables, but then quotes the OECD Guidelines that “internal comparables may have a more direct and closer relationship to the transaction under review”. This implies that internal comparables, when available, may be better than external comparables. Similarly, internal consistency across similar affiliates is also a strong indicator that the transfer pricing method has been appropriately chosen and applied and the toolkit could address this.
18. In several places, the draft mentions the “supplementary study into mineral product pricing” (e.g., bottom of p.24), but we cannot find it in the toolkit.
19. Page 26, Box 4: It might be helpful to note in this example that the return on assets might be preferable in this case and that the return on total cost might be questionable if the costs of ingredients for chocolate and granola bars are different. Either of these methods would be preferable to an inappropriate application of the profit split method.
20. Page 27, Box 5 states that Company A posted an operating loss in the relevant period. The relevance of this information is unclear. It does not appear to be useful in the comparability analysis because there is no discussion on the treatment of losses in the selection of 33 potential comparables. It may be that the existence of the loss was relevant in determining whether Company A was selected for audit. It seems that the example is illustrating a case when control of risk and therefore return to risk is with Company B. The implication being that any losses should be borne by Company B and Company A should in all cases have a routine positive return on its low risk business. If this is the case, then perhaps that should be stated. It might also be useful to show a second year, when the overall business is profitable and that using the same transfer pricing method to determine the return to Company A would be appropriate in that case.
21. Page 27, the paragraph below Box 5 suggests that foreign comparables can be considered when local comparables are scarce or unavailable. USCIB strongly supports this recommendation.

22. Page 28, Box 6 mentions “economic conditions” that are similar to those in Country X. The term “economic conditions” needs to be elaborated further: e.g, what makes Taiwan different from Japan?
23. Page 29, Box 7 contains a broad helpful definition of market, where the market is considered a key comparability factor.
24. Page 30, Box 8 starts with the discussion of how tax authorities approach the taxpayer’s benchmarks. But then at the end it states that Colombia always does its own functional analysis. This seems to be conflating functional analysis and benchmarking where they can be separate: a tax authority can perform its own functional analysis and then use the taxpayer’s benchmarks if the results of the functional analysis are consistent.
25. Page 31, (2.4.1.1), contains paragraphs concerning the use of information in the hands of the tax authority and seems to endorse the use of secret comparables. USCIB strongly opposes the use of secret comparables. The last sentence of the first paragraph should be the first sentence. That is, the caution in the OECD guidelines against the use of secret comparables should be emphasized and a reference to the caution in the guidelines should be included in the toolkit.⁷ The UN TP Manual, while not containing as strong a statement against the use of secret comparables, does recommend against the imposition of penalties on taxpayers for failing to submit data to which they did not have access.⁸ This caution should also be included in the toolkit.
26. Page 34, Box 10 states that “the audit team had a number of options...” but does not provide guidance as to which factors might be relevant to evaluate and select the best option.
27. Page 34, the paragraph below Box 10 recognizes that an independent minority shareholder may mitigate risks of non-arm’s length practices among related entities. USCIB supports this pragmatic approach to independence requirements.
28. Page 38, section 2.5.2.1 talks about working capital adjustments to adjust for differences in functions, including holding inventories. The paragraph needs to have a stronger statement regarding the need to compare functions because holding (or not) of inventory might indicate that one entity is a distributor whereas the other one is a sales agent, in which case their revenues will be very different and no amount of inventory adjustment will fix this.

⁷ OECD Transfer Pricing Guidelines, paragraph 3.36, and

⁸ UN TP Manual section 7.4.3.4.

29. Page 38, section 2.5.3 discusses solutions to the differences in accounting treatment, including multiple year data. This is an important point, with various ways of calculating the results. It would be helpful if this discussion could be expanded.
30. Page 39, section 2.5.4.1 discusses the reliability of adjustments. The drafters of the toolkit should recommend against “black box” adjustments where the adjustment is unlikely to withstand challenge.
31. Page 42, Figure 1. The example would be improved by the addition of cautionary statements that freight rates can vary by product.
32. Page 43, section 2.5.5.1 notes that because of the lack of local comparables foreign data is extensively used, but makes no recommendation concerning whether that is appropriate and recommends further study. Although further study would be welcome, in the interim the toolkit should emphasize that: the reliability of information is always relative; taxpayers and tax administration must use the information that is available; a determination of which information is the best available or most appropriate must be made as transfer prices must be determined.
33. Page 45, first paragraph, last sentence: “In situations where **the companies operate in a region** where not only the economic circumstances, but also the underlying credit risk and interest rates are significantly different from the tested party **and the comparables**, adjustments for those differences should be considered as well.” (emphasis added). What is the relationship between the companies in a region and the comparables?
34. Page 45, second paragraph (the WCA) correctly states that following the second step, the comparable’s revenue and operating profit will increase (relative to the result in step 1). The overall result (i.e., after steps 1 and 2), however, depends on the ratio of accounts receivable for the comparable and the tested party and on which interest rate (A or B) is higher.
35. Page 45, Box 17 needs to define the “geographic market adjustments.” For example, for Mexico, the benchmark based on U.S. comparables can be unreliable if labor/capital intensity of the Mexican operations are different from the U.S. operations, and a return on capital benchmark is used.
36. Page 46, section 2.6 includes a statement that it is common to determine a range of results and accept results that fall within that range. USCIB strongly supports the use of arm’s length ranges and the acceptance of results falling within those ranges.
37. Bottom of page 46, the toolkit should define the meaning of the “relatively narrow” range.

38. Top of page 47, paragraph 2.6.1, provides: “where the range of results from a set of comparables is wide... countries may wish to consider introducing a provision ... that the highest point in a range may not exceed a percentage (say 25 percent) of the lowest point in the range. Where this cap is exceeded, a statistical approach may be stipulated.” The proposed solution to problem of a wide range of comparables may produce results at odds with the arm’s length standard. If the range is wide, perhaps as an initial matter, the tax authorities should take a second look at the functional analysis and determine whether the range can be narrowed by removing inexact comparables. Different approaches to introducing a ceiling or floor on a range can produce very different results. One could go up 25% from the lower point, or down 25% from the upper point which would produce very difference results. Using the range in Box 18, $1.2\% \times (1+25\%) = 1.5\%$ while $14.7\% \times (1-25\%) = 11\%$. Is this what is intended: two ranges, 1.2% - 1.5% and 11% - 14.7%? If tax authorities are going to adopt a ceiling or floor should they be required to apply those rules consistently regardless of whether the tax authorities would prefer a ceiling or floor in a particular case?
39. Page 47, section 2.6.3 suggests using a lower point in the arm’s length range for an entity with limited functions). This approach may not achieve arm’s length results. While in general limited functions may correspond with lower compensation that is not always the case. There may be other reasons for the lower returns including that the lower end of the range may include companies that are simply less efficient than their competitors.
40. Page 48, section 2.6.3.1 the toolkit discusses the use of financial ratios. The paragraph suggests that financial ratios “can be used to help distinguish between results from transactions with differing degrees of comparability and potentially to eliminate those with a lower degree of comparability from the potential comparable set.” Because the application of financial ratios would help narrow the range and eliminate inexact comparables, this step should be taken before applying a ceiling or floor and applying a statistical approach. Therefore, it might be appropriate to move this paragraph or at least cross-reference the need to apply financial ratios first. The paragraph should also elaborate on (i) how to apply the diagnostic ratios, (ii) what the difference is between diagnostic ratios and screening that was explained in Box 7 (point #9), and (iii) what is meant by “refine the arm’s length range” (i.e., does this mean certain comparables should be removed or does this mean they should be adjusted?).
41. Page 49, Box 20 provides an example of a build-up approach. The start of the example suggests that only Australia applies a build-up approach. It would be helpful to know if other countries use this approach. USCIB supports pragmatic solutions to transfer pricing issues. The build-up approach may provide such a pragmatic solution in appropriate cases.

42. Page 51, section 3.1 the final two paragraphs, as written, cast doubt on the reliability of comparability analyses – in particular the language that reads “it is only rarely that data is available to provide a well-defined measure of the arm’s length price or result” -- and seem to sanction departures from the comparables. This should be toned down. While it is true, that transfer pricing is an art, not a science, comparables are essential to implementing the arm’s length standard and the toolkit should not take too negative a tone on the usefulness of comparables. The choice of method and evaluation of comparables is a relative choice and not choosing is not an option. Taxpayers and tax authorities often need to use the best available comparables as a better option than using a different method.
43. Page 53, section 3.3 the contains the following sentence: “Testing the arm’s length nature of a transaction can be particularly *useful* where sufficiently reliable comparables cannot be found.” (Emphasis added.) The meaning of this sentence is unclear. It may be attempting to say that the conditions of the transaction must be similar to the conditions negotiated between independent parties. This is not consistent with the OECD Transfer Pricing Guidelines, which provide that “the mere fact that the transaction may not be seen between independent parties does not mean that it should not be recognized.”⁹
44. Page 53, section 3.3.1 discusses the application of the a “benefits” test to intangibles. While section 6.6 of the OECD TPGs¹⁰ provides a definition of intangibles that looks to whether the “use or transfer (of the intangible) would be compensated had it occurred in a transaction between independent parties in comparable circumstances”, (parenthetical added) the modification of the definition was primarily focused on requiring the taxpayer to pay for something of value, rather than disallowing a payment. As USCIB understands this revision, the primary objective was ensuring taxpayers paid for goodwill. The new “benefits” test may create a real conflict between countries that require payments for goodwill and other countries that insist there is no benefit from the use of the goodwill, or at least no demonstrable benefit. Further, a payment may be required to avoid infringing on intellectual property of a third party. If the payor has an infringing product or service it developed on its own, it does not “need” the third party’s IP, but it must pay for that IP to avoid infringing on the other party’s IP. In our view, the benefits test should be deleted pending further work on the meaning of such a test in the context of intangibles.
45. Page 54, section 3.4 introduces the concepts of safe harbors. USCIB strongly supports the use of appropriate safe harbors. We note that the specific limitations that define the scope of the safe harbors are extremely important and care should

⁹ Actions 8 – 10 Final Report, page 14 and paragraph 1.122.

¹⁰ USCIB understands that the updated UN TP Manual will contain a similar definition of “intangibles”, although the updated manual is not finalized.

be taken in crafting those definitions. Safe harbors help taxpayers (and tax authorities) achieve certainty. However, if the scope of the safe harbors is not carefully defined, then tax authorities may be dissatisfied with the outcomes, potentially undercutting certainty for taxpayers.

46. Middle of page 56, section 3.4.1 describes some of the pitfalls of safe harbors. Many of these pitfalls could be avoided if the safe harbors are set bilaterally or among a regional group. This could be highlighted and a reference to the later discussion on the merits of regional international cooperation could be added here.

47. Page 59, section 3.4.2:

The first bullet should also be part of section 3.4.1 (TP safe harbor).
The benchmarking process mentioned in the second bullet will need to be very detailed. Otherwise a regional search can produce very large sets, which might not provide the sort of narrow range that a safe harbor would like to achieve.
It is not clear what is intended by the fourth bullet. Is this intended to provide for self-adjustment?

48. Page 59, section 3.4.3 provides a brief description of prescriptive rules. Some additional examples (other than the Brazilian case presented on the next page) would be helpful here. Also, prescriptive rules generally are not consistent with the arm's length method because they are prescriptive and do not take into account the facts of the particular case. The toolkit should note that prescriptive rules may, therefore, be inconsistent with treaty obligations, if the country has agreed to apply the arm's length standard in its income tax treaties.

49. Page 61, section 3.5, the second full paragraph overlooks the residual analyses of the profit split in which case the comparables may be required and that comparables are relevant to the choice of method used to split the profit. As we have pointed out above, at this point high-integration is not an appropriate standard for determining whether the transactional profit split ought to be applied and the lack of comparables is not an appropriate basis for choosing the profit split method.

50. Page 62, section 3.6, with regard to large capital assets, the draft needs to emphasize that the value should be arm's length.

51. Page 62, section 3.6 concerning valuation techniques provides: "***In addition to the valuation report***, an analysis based on such techniques should therefore also consider the basis of the ***underlying assumptions...***" (emphasis added). The valuation report itself should consider the underlying assumptions.

52. Page 63, section 3.7 discusses anti-avoidance measures. The first paragraph of that section states that "the topic of anti-avoidance measures is extremely broad, and

thus beyond the scope of this toolkit". If that is the case, then section 3.7 ought to be deleted. More specifically, this section suggests capping royalty deductions by the ratio of royalties payable to EBITDA. This suggestion is not really appropriate for a toolkit aimed at assessing difficulties in comparables data for transfer pricing analysis and should be deleted. Although this concept is somewhat similar to the limitation of the interest deduction developed as part of the BEPS project, any cap with respect to royalties would need to take into account different considerations. Intangibles are not the same as monetary capital. While in some senses money is fungible, intangibles are not. Different intangibles may support different parts of a business and some businesses may be much more intangible intensive than others. Further, the interest limitations were developed after a consultative process and the 2015 Final Report, which was not comprehensive, ran over 100 pages. If a cap approach is to be developed for royalties, a thorough analysis of the issues and approaches should be developed. In the interim this paragraph should be deleted. Finally, with respect to section 3.7, the discussion of CFC rules is too cursory and should be deleted.

53. Page 65, section 4.1, the fourth paragraph discusses some possible approaches in light of the lack of data. In our view, three of the options – benefits tests, profit splits, and protective measures – do not really respond to the lack of data. If an intangible were found to produce a benefit, then the data issue is not addressed. As we have noted at several points in this comment letter, profit splits routinely require the use of comparables. Protective measures are not sufficiently identified to provide solutions.
54. The last paragraph on page 65 should mention ranges.
55. Page 66, section 4.2.2, refers to information contained in tax returns that is normally not useable because it is confidential and therefore cannot be disclosed to another taxpayer. USCIB strongly supports maintaining taxpayer confidentiality and opposes the use of secret comparables. The OECD Transfer Pricing Guidelines explicitly state that tax authorities should disclose such data within the limits of domestic confidentiality rules. A cross-reference to this OECD guidance should be included.
56. Page 67, section 4.2.3.3 overlooks (again) the fact that most profit splits will be residual profit splits. It is important to note that comparables will be required to determine returns to routine functions and that profit splits are only appropriate for the non-routine returns.
57. Page 69, section 4.3.9 recommends "considering the feasibility and the advantages and disadvantages of measures designed to protect the tax bases of developing countries in cases where there is both a systemic high risk of tax loss and an inability to apply transfer pricing measures due to lack of information or gaps in capacity." A possible royalties cap is mentioned in this context. Countries are of course free to

take steps that protect their tax bases especially in the context of systemic high risk. Countries should, however, also take care to implement any such measures in ways that do not discourage investment and development and therefore ought to engage in a consultative process prior to adopting new rules. As discussed in more detail above, the royalties cap would raise significant policy and design issues; because those issues have not been considered, the reference to a royalties cap should be deleted.

58. Unnumbered page 72, Case study 1, the last bullet provides that A Co: “effectively manages inventory, delivery shortfalls, and excesses.” More detail is required to determine how this is the case, if B Co buys the entire production from A Co under the off-take agreement.

Unnumbered page 74, Case study 1, carryover paragraph recharacterizes the transaction and treats the risks that were contractually allocated to A as allocated to B. This decision should be explained in more detail. The last paragraph of the case study should also contain additional explanation, in particular as to why the TNMM method was selected. Further, the example states the analysis focuses on the amount of the costs, since this will have a greater influence on the price. As pointed out above, the mark-up may be equally important, although the costs may be harder to determine. The tax auditor selects B Co as the tested party. “The transactional net margin method (TNMM) **with (full) costs as the profit level indicator** was selected as the most appropriate transfer pricing method for the case. In this regard, much of the analysis focuses on determining **the appropriate cost base** in B Co since this will have a greater influence on the total transfer price than the markup.” (Emphasis added.) It is not clear why B Co’s appropriate cost base is in question since the PLI is based on full costs.

The drafters of the toolkit should consider including a discussion of pass-through costs here. Unless the tax authorities start with a proper functional analysis, pass-through costs can distort the determination of the arm’s length price. For example, if a foreign principal directs the amount, make-up and direction of the local distributor’s marketing, the foreign principal would control and bear the marketing risk. The marketing costs are pass-through costs and are taken into account in setting the transaction price from principal to distributor. Unless the fact that marketing risk is borne by the foreign principal (which is supported by the functional analysis) is properly taken into account when screening for comparables, the set of comparables produced may not be reflective of the function and risk profile of the local distributor. That is, looking only at the marketing costs, might lead to the conclusion that the distributor is bearing the marketing risk, when that is not the case for pass-through costs. The analysis cannot, therefore, start with costs, but must start with the functional analysis, so only relevant comparables will be selected.

59. Case study 1 needs to clarify whether or not B Co bears the risk of price fluctuation. B Co buys from A Co at one price, and resells to customers at another. Case study 1

seems to imply that the price risk is nonexistent because B Co sells to customers “immediately” but it would help if this were stated explicitly.

60. Unnumbered page 75, Case study 2, first paragraph under Part B, the last line uses the word “recharged” to XYZ (S) is this correct?
61. Unnumbered page 76, Case study 2, the paragraphs on delineating the actual transaction indicate that the transaction is recharacterized. The example should explain the basis for this recharacterization.
62. Case study 3, first page, Part B, last paragraph, third line: “A Co pays the cost of refining each bar...” Should it be that B Co pays the cost since B Co has the refinery?
63. Case study 3, end of Part B, transfer pricing method: “Refined gold is a highly commoditized product with a highly liquid international market... [G]old sales are judged to be a routine function and should, therefore, be routinely remunerated using the transactional net margin method (TNMM) with sales as the profit level indicator...” Earlier in the case study, however, B Co is said to bear the risk of price fluctuation. The case study dismisses this risk by saying that B Co on-sells “as quickly as possible.” How quickly is quickly? Gold refining is not as simple or fast as the case study seems to suggest. For example, EDI Refining states as follows: “Once the gold is drawn from the earth, it’s still not ready for the market. It must be refined and smelted and crafted. This is obviously not something that can be done easily and quickly. It takes time and care. If, at any point during this process, a mistake is made, then you can expect the price of gold to drop accordingly. This is further complicated by the fact that gold is an extremely soft metal that often requires special care; a hasty or unexamined refining process can cause issues.”
<http://www.edirefining.com/blog/how-mining-and-refining-can-change-the-price-of-gold/> With this in mind, a profit split between mining and refining might be appropriate.
64. Case study 3, Part C appears to be incomplete.
65. Appendix 1 contains a lengthy questionnaire covering functional analysis. It would be useful to suggest that as an initial matter, the tax authorities look at the material they already have in their possession, particularly the master file and local file, to enable them to gain an understanding of the taxpayer’s business and the transactions occurring in their jurisdiction before deciding whether and how that information needs to be supplemented. It would also be helpful if the draft elaborated on how to use the information collected through the questionnaires.

Perhaps the risk questionnaire can be modified so that it focuses on identifying the economically significant risks first and then go through the more generic checklist.

With respect to intangibles, the questionnaire does not ask questions that go to the issue of control, perhaps such questions could be added.

66. Appendix 7 sets forth possible independence criteria. The appendix refers to “3 ‘collective’ types” that are excluded without defining what these excluded collective types are.
67. Appendix 7, second page, Indicator D: If “D” companies are not selected in the search set, this indicator in particular will eliminate privately held companies. So, unless there is intent to eliminate privately held companies, in order to include them in the set of potential comparables, one would need check the second square from the bottom of the **BvD Independence Indicator** tab whose function is to *“Add companies for which all shareholders belong to categories “one or more individuals or families” or “Employees/Managers/Directors” as well as companies for which all shareholders with a stake greater than 25% belong to categories “one or more individuals or families” or “Employees/Managers/Directors.”*
68. Appendix 8, first page, third bullet from the bottom provides: “To have a good understanding of the outcome of the benchmark, a rough data dump within the database can be made. This number should be in line with the final outcome of the benchmark. If there are big deviations, leading to doubts as to the reliability of the benchmark, this should be discussed with the taxpayer.”

USCIB has several concerns with the data dump:

- How “rough” should the data dump be? (i.e., at which point in the screening is the set sufficiently “rough”?)
- The benchmark from the final set of selected comparables might not be “in line” with the benchmark from the rough data dump if the rough set includes poor comparables. The paragraph suggests that the selected set would be questionable if the benchmarks don’t match, but it can be just the opposite, and the final set can be reliable if the rough set contains a lot of noise.
- Should the rough set should include or exclude loss companies?
- Relying on a rough data dump seems inconsistent with paragraph 1.40 of the OECD Transfer Pricing Guidelines, which provides: “Therefore, in no event can unadjusted industry average returns themselves establish arm’s length prices.”
- The last bullet in Appendix 8 may be inconsistent with the OECD Transfer Pricing Guidelines. The discussion provides: “Comparability adjustments and diagnostic ratios: These adjustments should only be made to increase the comparability and the reliability of the data, not to create comparability. Caution is advised when using adjustments or diagnostic ratios.” Paragraph 1.40 of the OECD Transfer Pricing Guidelines provides: “comparability adjustments must be made, where possible, to improve the reliability of the comparison.”

69. Appendix 8, first page, last bullet concerning loss-making comparables provides that “normally, loss-making comparables are refused...” which is true. The draft should make a stronger case in support of the loss-making comparables whose use can be quite appropriate if the industry as a whole has experienced a downturn lasting several years. The decision as to whether to keep or reject the loss comparables should be made after the state of the industry has been reviewed.
70. Appendix 8, second page concerning the number of comparables provides: “If there is a small number of comparables, this may have a strong influence on the comparability and the use of a statistical interquartile range.” The meaning of this sentence is unclear.
71. Appendix 9 should point out that the calculation of the working capital adjustment depends on the PLI base. In the current Appendix 9 all ratios are calculated relative to sales, which is correct for a sales-based PLI such as the return on sales. For a PLI based on total cost (“TC”) or on operating expenses (i.e., Berry ratio), the corresponding base should be used to calculate AR, AP, and Inv adjustments: e.g., AAR/TC or AAR/OpEx. This is the approach taken by APMA in the APA template file.
72. Appendix 9, first page, last paragraph needs to be revised because, as written, it is confusing.

The paragraph states that “In the case where the tested party is holding higher inventory levels, the comparables’ adjusted inventory will be positive, operating expenses will be reduced, and the comparables’ operating income will be increased to reflect the comparables’ cost savings from holding fewer inventories.”

Comments:

- The COGS reflect inventory adjustment, not OpEx.
- The use of the future tense “will be” is confusing: *will be* after adjustment?

73. Appendix 9, second page, last line: the sign in the formula should be “+”.
74. Appendix 10, second page, second bullet under “Some observations,” in the fourth line the phrase “short-term” should be added so the sentence would read as follows: “In most cases a **short-term** commercial loan rate will be appropriate.”
75. Appendix 13 contains examples on country risk adjustments. Example 1 involves a tested party in country A and a comparable in country B. Country risk in Country A is higher than in Country B. The example suggests that the return on assets of tested party should be increased by 4%, which is the difference in long-term government bond yield between Country A and Country B.

It is not clear why this is an appropriate methodology to adjust for country specific risk. There are different types of country specific risks and different methodologies that may be used in the event that an adjustment is warranted. If other standards may be applicable, the examples should indicate that other calculations may achieve a more accurate result. Example 2 raises the same concerns.

76. Appendix 14 needs to have more precise definitions:

- ΔAR_T is calculated for each comparable. The current Equation 1 refers to plural "Comparables".
- In Equation 3, Adjusted Sales/365 should be calculated for each comparable. From the current Equation 3 it is unclear whose adjusted sales should be used because the variable is not defined.
- These are calculations intend to show how working a capital adjustment can be used as a proxy for country risk adjustment. Presumably, the rationale for this approach is that there is an argument that differences in working capital employed are a reflection of the differences in economically relevant factors such as country risk. Do these adjustments effectively result in the replacement of the amount of working capital of the tested party with an amount equal to the working capital the comparable. Would this be any different than making capital adjustments? If this is the case, the rationale does not support equating working capital to adjusting for country risk.

77. Appendix 15, Step 2, second line should be rewritten as follows: "...need to replace A2:A10 with the actual ~~values from~~ cell references in your data set."

The same change should be made in Step 3: "Replace A2:A10 with the actual ~~values from~~ cell references in your data set."