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URL: http://mobile.deloitte-tax-news.de/german-tax-legal-news/the-platform-for-collaboration-on-tax-issues-a-discussion-draft-toolkit-for-addressing-difficulties-in-accessing-comparables-data-for-transfer-pricing-analyses-on-january-2017.html

30.06.2017

German Tax and Legal News

The Platform for Collaboration on Tax issues a discussion draft Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses on January 2017

Responding to a request by the G20 Development Working Group on the impact of BEPS in Low Income Countries the Platform for Collaboration on Tax has developed a draft toolkit designed to assist developing countries in transfer pricing. Many developing countries report uncertainties and difficulties in conducting comparability analyses, in particular, the scarcity of the financial data necessary to carry out a comparability analysis.

I. Highlights

1) A framework for the selection of the most appropriate method

The accurate delineation of the controlled transaction (prioritizing substance over form) and from it, the selection of the most appropriate method (and where relevant, the selection of the appropriate tested party), 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 (comparables) used in the method's application (The five economically relevant characteristics or comparability factors described in Paragraph 1.36 of OECD TP Guidelines (2016) and UN Practical Manual on Transfer Pricing (2013), paragraph 5.1.6. are usually considered to perform the accurate delineation of the controlled transaction).

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. It will be important to judge the relative reliability of the available options, including the extent to which the 'imperfections' impact upon the comparison; and bearing in mind the likely imperfections that would impact upon the application of any other transfer pricing method.

2) Measures for the best use of existing commercial databases

Many developing countries report two core challenges: access and limited data coverage. First, they highlight difficulties, including costs involved, in relation to accessing commercial databases. Second, even where they can be accessed, such databases often contain limited, or no data concerning local economic operators that may potentially serve as comparables.

• The use of data from foreign markets

Where local comparables to the tested party are scarce or unavailable, data from other geographic markets (potential 'foreign comparables') can be considered. Where the transaction occurs in a truly global market, geography may not make a material difference. 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.

Developing countries, often out of necessity, have to rely on foreign comparables. Country specific risk adjustments can, therefore, be of particular importance for developing countries. However, these types of adjustments are hard to quantify.

• The use of data drawn from widened search criteria

Where necessary, loosening initial screening filters may also increase the pool of information available for comparability studies. The challenge here is striking the right balance as a wider selection criterion comes at the cost of loosening comparability. In particular, the use of data from other industries with similar functional profiles (The possibility of looking at domestic data from different industries with similar functional profiles is also proposed in Paragraph 5.4.3.4 of the UN Practical Manual on Transfer Pricing (2013)) can be considered. Such approaches are likely to be more effective when applying a one-sided method that relies on a net profit measure, i.e. TNMM.

• The use of comparability adjustments

Where there are material differences in the condition under examination between the potentially comparable transactions and the controlled transaction, it is important to consider if reasonably accurate comparability adjustments can be made to eliminate the effect of such differences (Paragraph 1.40 of OECD Transfer Pricing Guidelines (2016); Section 5.3.5 of the UN Practical Manual on Transfer Pricing). However, comparability adjustments themselves can introduce additional complexity and potential subjectivity and should be made only if they are expected to increase the reliability of the comparison or whether the unadjusted results (while imperfect) will provide greater reliability (Paragraph 3.50 of OECD Transfer Pricing Guidelines (2016)) and should not be applied automatically without consideration of the applicable facts and circumstances. It must be noted that the use of comparability adjustments and diagnostic ratios should only be made to increase the comparability and the reliability of the data, and not to create comparability.

Statistical methods (such as an interquartile range) may appropriate to improve the reliability of the analysis in cases where the comparables are not of the highest quality or best consistency and material differences cannot be sufficiently accounted for using comparability adjustments.

3) Approaches to applying internationally accepted principles in the absence of comparables

The draft also provides discussions which may be of particular relevance to policy makers, including the potential for developing safe harbours or prescriptive approaches, as well as benefit tests, profit splits and protective measures. It also explores how data in the possession of tax administrations, typically derived from tax filings or customs, may be used to identify arm's length results in a way that preserves confidentiality ("secret comparables") (The UN Practical Manual on Transfer Pricing and the OECD Transfer Pricing Guidelines caution against the use of this kind of information for transfer pricing comparability purposes ("secret comparables"), unless requisite information can be disclosed to the taxpayers within the limits of domestic confidentiality rules).

II. Conclusions

Despite the potential of the measures mentioned throughout the draft, the toolkit recognizes that they do not offer a complete and comprehensive solution to mitigate the effects of poor availability of data.

The commercial databases are not necessarily designed for transfer pricing purposes, they collate information for purposes other than transfer pricing. Additionally, tax administrations of developing economies frequently report that they face challenges in accessing these databases, mainly due to budgetary constraints in purchasing access to commercial databases.

Rather than undertaking a full comparables search themselves, it may be appropriate instead for the tax administrations to critically analyse the comparables search undertaken by the taxpayer. Reportedly, some countries' tax administrations have sought to deal with the lack of access to databases by increasing their requirements of taxpayers, for example, by requiring taxpayers to include screenshots in their transfer pricing documentation files as part of the documentation of the benchmarking study.

Furthermore, the toolkit suggests some measures which should be taken into consideration with regards to the best use of existing data will still lead to a satisfactory approximation of an arm´s length outcome such as the use of data from foreign markets, the use of data drawn from widened search criteria, the use of comparability adjustments and diagnostic ratios, and the use of statistical methods.

Finally, the toolkit suggests that developing countries are likely to gain by placing emphasis on the accurate delineation of the controlled transaction and the selection of the most appropriate method in order to determine the appropriate arm´s length outcomes.