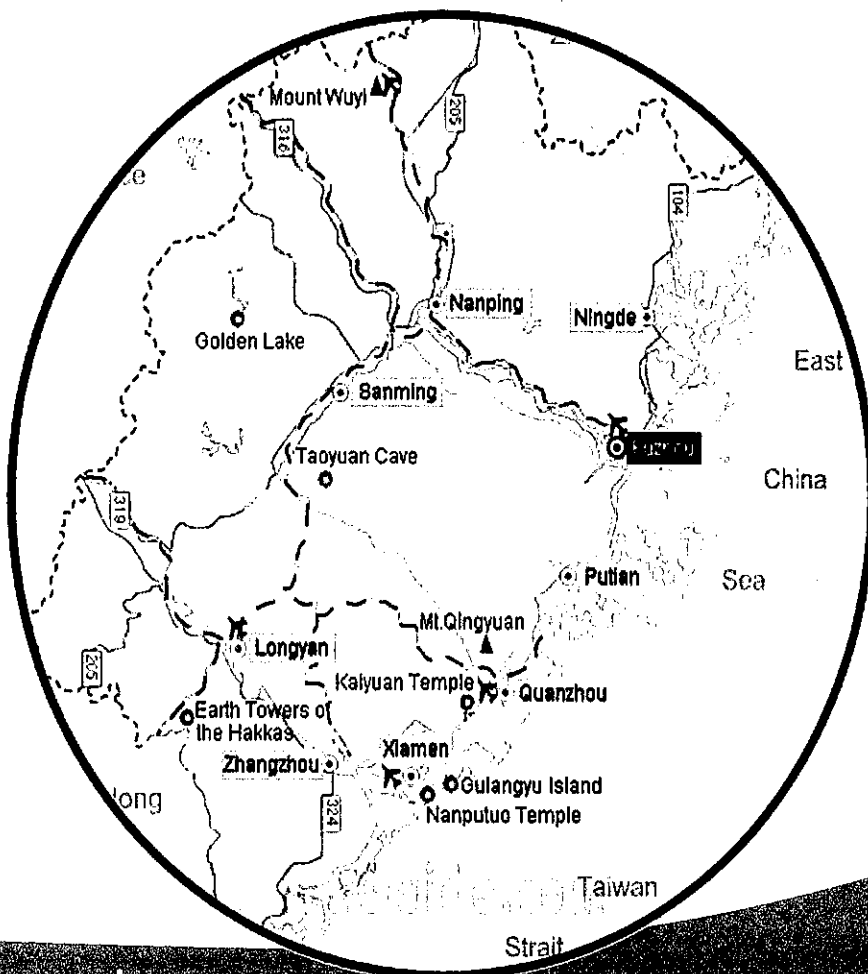


# Transfer Pricing: Comparability Analysis

The Implementation of Comparability Analysis in  
Transfer Pricing Practices of China

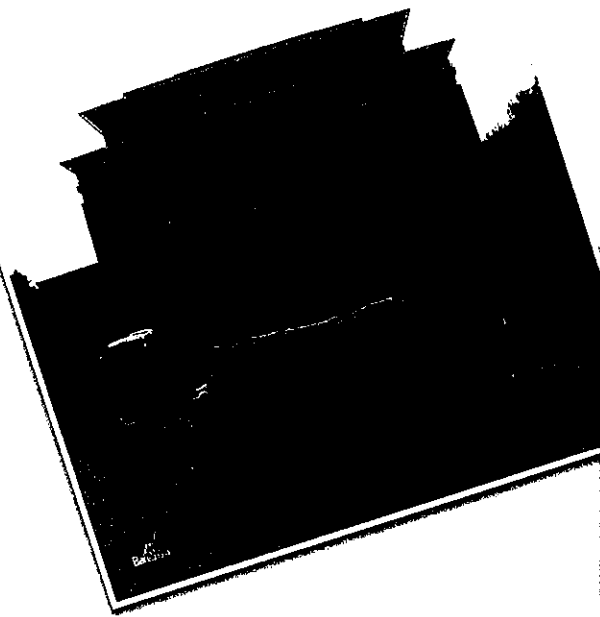
Yifang Guo

People's Republic of China



Self- Introduction

*Who am I and  
Where do I CO  
from?*



## Recent Development of Transfer Pricing

- ◎ Transfer Pricing (Hereinafter referred as TP) report 2014 issued by SAT of China
  - Contribution of the national Tax Anti-Avoidance reached 52.3 billion RMB in 2014, including
    - ✓ 39.6 billion RMB from management (i.e. an overdue tax bill paid by taxpayers from self-adjustment)
    - ✓ 7.9 billion RMB from investigation and,
    - ✓ 4.8 billion RMB from tax service (i.e. signing an APA)
  - 272 TP cases were put on record and 257 TP cases were winded up

## Recent Development of Transfer Pricing

- ◎ Transfer Pricing (Hereinafter referred as TP) report 2014 by SAT of China
  - More and more evaded tax has been paid annually with the enhanced TP auditing and assessment of Chinese tax authorities.
  - The average evaded tax for each case has reached 30.7 million RMB, including
    - ✓ 83 cases with the average evaded tax exceeding 10 million RMB and
    - ✓ 20 cases with the average evaded tax exceeding 100 million RMB.

## Typical Comparability Analysis Process

- ◎ Timing Issues in Comparability and Interpretation and Use of Data Collected
  - Timing of Origin: Examination years of controlled transactions and uncontrolled transactions
  - Timing of Collection: TP documentation of taxpayer
    - ✓ To rationalize intra-group transactions pricing consistent with arm's length principles
    - ✓ Information on comparable transactions
    - ✓ Information on economic and market changes

## Typical Comparability Analysis Process

### ◎ Timing Issues in Comparability and Interpretation and Use of Data Collected

- In China Comparability Analysis will be covered in TP contemporaneous documentation for qualified taxpayers to prepare and preserve before 31 May the next year following the year related transactions happened and
- ➤ To hand in within 20 days as required.
  - ✓ Note: Cost Contribution Arrangements(CCA) TP contemporaneous documentation will be prepared to authorities before 20 June the next year following the year CCA is implemented.

## Typical Comparability Analysis Process

- ◎ Taxpayers' circumstances
  - Broad-based analysis to fully understand the controlled transactions on the first place
    - ✓ Overall industry profile
    - ✓ Competition situation
    - ✓ Economic and regulatory factors

# Typical Comparability Analysis Process

- ◎ Identify the controlled transaction(s) under examination
  - Functional analysis
  - The most appropriate transfer pricing method
  - The financial indicators
  - Significant Comparability Factors

## Identify the Controlled Transaction(s) under Examination

- ◎ Comparability Factors (OECD guidelines as well as Practices in China)
  - Characteristics of Property and Services
    - Tangible Assets
      - ✓ Physical Properties
      - ✓ Quality & Quantity
    - Intangible Assets
      - ✓ Types
      - ✓ Transaction Forms
      - ✓ Time Limit & Scope
      - ✓ Expected Earnings
    - Services
      - ✓ Properties
      - ✓ Scope

# Identify the Controlled Transaction(s) under Examination

## Comparability Factors

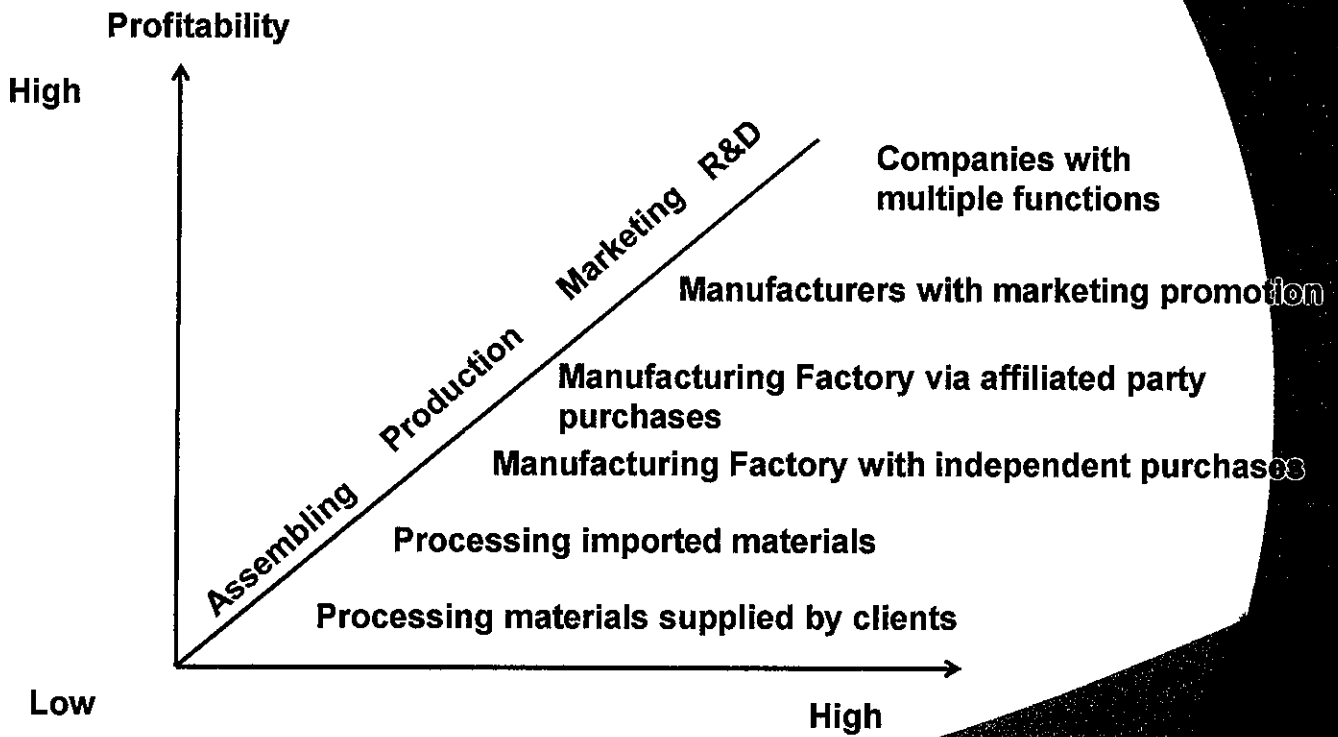
- **Functional Analysis**
  - Functions and Risks of parties of Transactions
- **Terms of Contract**
  - risks, benefits and responsibility divided
  - Terms written or oral, explicit or implied
  - Terms modified
  - Further investigation needed
    - True terms differ from written terms

# Identify the Controlled Transaction(s) under Examination

## Comparability Factors

- **Economic Conditions**
  - Industry Overview, Geographic Area, Market Size
  - Market Shares, Market Competition,
  - Consumer Purchasing Power, Alternative Goods and Services
  - Essential Production Prices, Logistics Costs,
  - Government Regulation
- **Business Strategy**
  - Creation and Exploitation Strategies
  - Diversified Operation Strategies
  - Risk Aversion Strategies
  - Market Share Strategies

## ◎ Functions & Risks and Expected Return



Functions & Risks

## Functional Analysis

Functions Performed

- R&D, Design, Quality Control, Purchase
- Inventory Management, Logistics, Distribution
- Sales and Marketing, Payment Collection, After-sales Service

Risks Assumed

- R&D, Design, Purchases and Inventory, Manufacturing
- Quality Guarantee, Distribution, Marketing Promotion
- Price and demand fluctuation, Management and Finance

Assets Used

- Important Tangible Asset Investment
- Marketing Intangibles
- Productive Intangibles

# Functional Analysis-Continued

## ◎ Marketing Intangible Assets vs. Productive Intangible Assets

- Productive Intangibles
  - Patents, Know-how, technical know-how, etc;
- Marketing Intangibles
  - Trademarks, corporate reputation, sales/marketing team, ability for service provision, etc;

# Functional Analysis-Continued

## ◎ Marketing Intangible Assets vs. Productive Intangible Assets

- Differences between TP aspect and Accounting books
  - Take valuable distribution channels and customer lists from marketing activities for example.
  - These intangibles on TP perspective which do not possess book values on balance sheet may otherwise bring high economic values.
  - Other intangibles such as Proprietary technology on TP perspective with very high economic values may possess only registration fees on accounting books if the technology was developed by the taxpayer itself.



# Functional Analysis-Continued

## ⊙ Marketing Intangibles TP investigation

- Common in developing countries
- More and more MNE set up joint ventures in China
- Marketing activities to establish marketing networks and to maintain customer relationships in China
- MNE tend to TP through the way of extracting high royalty and keep very little profit in China.
- Reasonable to use profit-split method to tax more profits in China via TP adjustments.
  - If foreign companies engage in localized marketing activities in China to increase the value of intangibles and resident companies also engage in such value-creation marketing activities;
  - If the profitability kept in China is unreasonable low;

# Functional Analysis-Continued

## ⊙ Marketing Intangibles TP investigation

- Chinese tax authorities raise the issues of Cost Saving and Premium Price on anti-tax avoidance aspect based on the above ideas consistent with OECD guidelines.
- That is, to emphasize the contribution of special factors in Chinese markets in MNE value-creation and to move upward in global industry value chain.
- Thus functional analysis on marketing intangibles should reflect their real value and protect the tax base of developing countries.

# Functional Analysis-Continued

- In china, tax authorities require qualified taxpayers to fill in the forms of Enterprise Functions & Risks Analysis and Enterprise Comparability Factors Analysis among a package of contemporaneous TP documentation. (Appendix 1 and Appendix 2) The tax authority needs to fill in the Enterprise Comparability Factors Analysis Identification Form (Appendix 3) based on the examination of Appendix 1 and Appendix 2 to get an overall picture of functions & risks as well as comparability factors of the taxpayer.

## Identify the Controlled Transaction(s) under Examination

- **Functional Analysis**
  - Functions and Risks of parties of Transactions
- **Terms of Contract**
  - risks, benefits and responsibility divided
  - Terms written or oral, explicit or implied
  - Terms modified
  - Further investigation needed
    - True terms differ from written terms

# Identify the Controlled Transaction(s) under Examination

## Comparability Factors

- **Economic Conditions**
  - Industry Overview, Geographic Area, Market Size
  - Market Shares, Market Competition,
  - Consumer Purchasing Power, Alternative Goods and Services
  - Essential Production Prices, Logistics Costs,
  - Government Regulation
- **Business Strategy**
  - Creation and Exploitation Strategies
  - Diversified Operation Strategies
  - Risk Aversion Strategies
  - Market Share Strategies

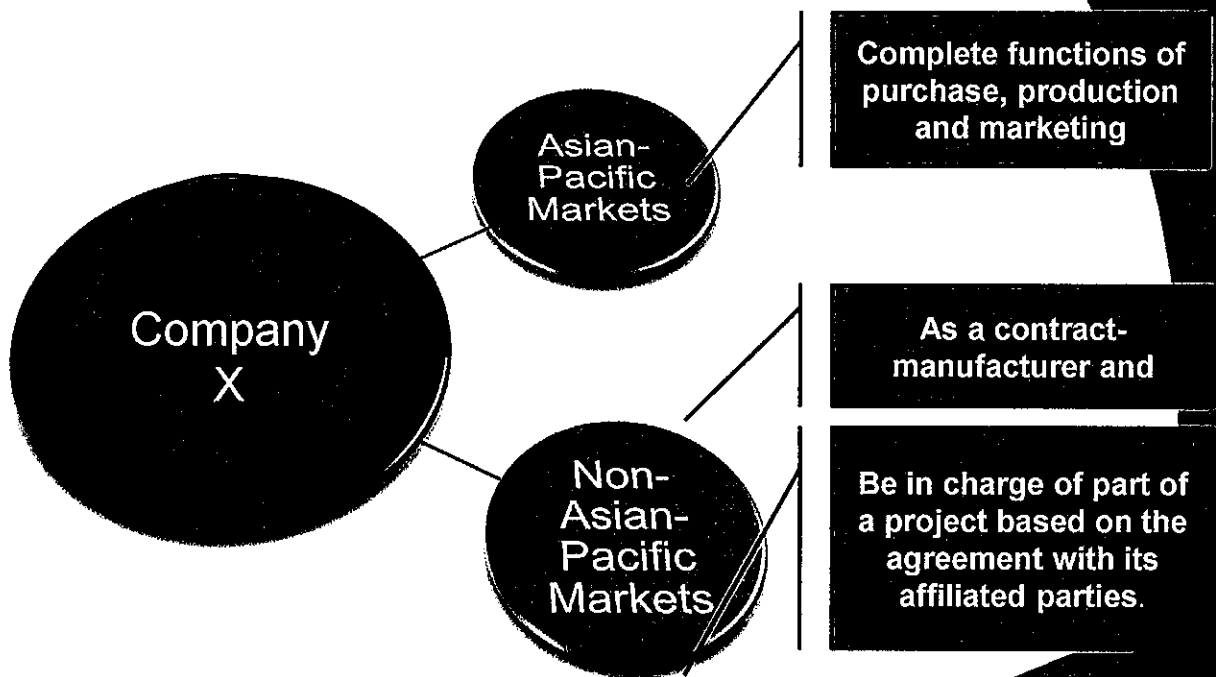
## Case Study

- Case Study on Comparability Analysis of Company XYZ

## Typical Comparability Analysis Process

- ◎ Existing internal comparables, if any
  - Internal comparables must satisfy the five comparability factors as external comparables otherwise they are subject to the comparability adjustments.
  - Case-by-case Approach

- ◆ There is a scenario where transactions of Company X can be broadly divided into Asian-pacific markets and non-Asian-pacific markets.
- ◆ In Asian-Pacific markets the company
  - exploits the markets, accepts orders, takes care of all purchases, manufactures cargo and transports goods to customers.
- ◆ In Non-Asian-Pacific markets where majority of related transactions involved, Company X places an order to its affiliated party which is in charge of purchasing and marketing exploitation.



- ◆ In a word, only in Asian-Pacific markets the company takes care of complete functions and risks. When the same products or services are existed in both markets and reasonably accurate adjustment are made to eliminate the effects of any differences, CUP is available and the prices in Asian-Pacific markets can be viewed as reliable internal comparables.

## Typical Comparability Analysis Process

- **Determination of available external sources and other potential comparables**
  - **Database: BVD Osiris database**
    - ✓ establishes the cross-border tax research and benchmarking comparison of external resources
    - ✓ as a comprehensive worldwide database of more than 71,000 listed companies, banks and insurance companies.
    - ✓ It is practical and somehow cost-effective in MNE TP examination if needed.
  - **Sample of BVD comparables searching**

## Comparability Analysis: Commercial Database

- **Selection of comparables**
  - ✓ SIC Codes and specific Key words including in business description
  - ✓ Geographic Regions: Listed companies in Far-east and Central Asia
  - ✓ Excluding companies which do not conform to the independence requirements
  - ✓ Excluding companies with one or more than one-year insufficient financial data in selected years;
  - ✓ Excluding companies with one or more than one-year consecutive operating losses in selected years;

## Comparability Analysis: Commercial Database

### ➤ **Selection of comparables**

- ✓ Excluding companies with incomparable functions or products;
- ✓ Other qualitative or quantitative criteria if needed;

## Comparability Analysis: Commercial Database

### ➤ **Search Outcome**

- ✓ **Table 1: Search Strategies**
- ✓ **Table 2: Full overview and Primary Product and Services**
- ✓ **Table 3: Financial Data Selected Format**

<b>Product name</b>		<b>Osiris</b>	
<b>Update number</b>			
<b>Software version</b>		<b>144.01</b>	
<b>Data update</b>		<b>10 Mar 2013 (n° 2057)</b>	
<b>Username</b>		<b>ZZGS-PC-zzgs</b>	
<b>Export date</b>			
		<b>Step result</b>	<b>Search result</b>
<b>1.</b>	<b>Listed/Unlisted companies: Publicly listed companies</b>		
<b>2.</b>	<b>Company name: Company A to Company H</b>		
<b>3.</b>	<b>Listed/Unlisted companies: Publicly listed companies</b>		
<b>4.</b>	<b>Company name: Company A to Company H</b>		
<b>Boolean search : 1 And 2 And 3 And 4</b>			
		<b>TOTAL</b>	
	<b>Financial Data</b>		
	<b>Raw Data Format</b>		
	<b>Industria</b>		
	<b>Industrial Companies (anglo)</b>		

	<b>Company name</b>	<b>Country</b>	<b>SIC Code</b>	<b>Full overview</b>	<b>Primary business line</b>	<b>Main products and services</b>	<b>Size Estimate</b>	<b>Total Assets the USD Last avail. yr</b>
<b>1.</b>	<b>Company A</b>							
<b>2.</b>	<b>Company B</b>							
	<b>Company C</b>							
<b>4.</b>	<b>Company D</b>							
<b>5.</b>	<b>Company E</b>							
<b>6.</b>	<b>Company F</b>							
<b>7.</b>	<b>Company G</b>							
<b>8.</b>	<b>Company H</b>							



Year:	Company A-H							
Unit: Thousand USD	A	B	C	D	E	F	G	H
Company name								
Other Revenues								
Net Sales+Other Revenues								
Other Operating Items								
EBITDA								
Total Deprec., Amort. & Depletion								
Financial Revenue								
Financial P/L								
Earnings after tax								

## Typical Comparability Analysis Process

- Determination of available external sources and other potential comparables
  - Other External Source of Information
    - Foreign source or non-domestic comparables,
    - Information undisclosed to taxpayers and
    - Non-transactional third party data
  - Hunting for potential comparables is a case-by-case approach
    - may vary from such as business strategies and models, geographic markets and so on.

## Typical Comparability Analysis Process

- ◎ The most appropriate transfer pricing method and Comparability Adjustments
  - Traditional transaction methods
    - CUP method,
    - Resale price method and
    - Cost plus method,
  - Transactional profit methods
    - Transactional net margin method
    - Transactional profit split method
    - Other appropriate TP methods if any

## Typical Comparability Analysis Process

- ◎ Appropriate Comparability adjustments are needed to increase the reliability of results.

## Other Issues in Comparability

- OECD Guideline

- Losses

- ✓ Do not necessarily indicate transfer pricing abuse

## Other Issues in Comparability

- The Measures for Implementation on Transfer Pricing Adjustment (for Trial), the N.O.2 Documentation issued by SAT in 2009, regulates the rationality of losses of taxpayers in Article 39 as follow:
- If a company specializes in production and processing based on orders from related parties and it assumes no functions on such as business decision-making, R&D, marketing and sales, etc., it should not bear any risks or losses subject to decision-making errors, underemployment, commodities in short supply....that is, it should maintain a certain level of profitability.

## References

- [1] Organization for Economic Cooperation and Development. OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. OECD Publishing.2010, P108-130
- [2] Organization for Economic Cooperation and Development. Public Consultation: Draft Handbook on Transfer Pricing Risk Assessment. the Steering Committee of the OECD Global Forum on Transfer Pricing. 2013, P22-27

○

## The End

○

## Thank you!



**財政部**  
Ministry of Finance

## Recent Developments in TP

### Chinese Taipei

Hsu Fong LIU

June 2015



**財政部**  
Ministry of Finance

## Legislative Background

### Acts

- Article 43-1 of the Income Tax Act (Main Act)
- Article 42 of the Enterprise Mergers and Acquisitions Act
- Article 50 of the Financial Holding Company Act

### Regulations

- The Regulations Governing Assessment of Profit-Seeking Enterprise Income Tax on Non-Arm's Length Transfer Pricing  
–promulgated in 2004, revised in 2014



## **Coordinated Measures**

- ☐ 'The TP Audit Selection Criteria' - 2005**
- ☐ 'The Guidelines for Applications for Advance Pricing Arrangements' -2007**
- ☐ 'The Safe Harbor Rule' and 'The Disclosure Threshold' revised - 2008**



## **Audit projects (1)**

- ☐ Selection criteria issued in 2005**
- ☐ National tax bureaus organized audit teams to conduct TP audits**
- ☐ Training programs are held for the personnel of the TP audit teams**



## Audit projects (2)

27 TP audits were completed in 2012/2013

Total income adjustments:

NT\$3.4 billion

Total tax adjustments:

NT\$613 million



## Current Amendments to TP Regulations

Stipulating the allocation of profits from business restructuring follow arm's length principle

Changes in Applications for APA

Lowering Thresholds of APA

Establishing Pre-filing Meeting Mechanism



## Case Study on Comparability Analysis (1)

### CUP (M Co.)

M Co. is a well-known company engaged in the research and production of tires. It also owns some intangibles, such as technical know-how and trademark. The tax authority found that M Co. licensed its trademark to a subsidiary in T country (T Co.) which just shared the marketing expenditure.



## Case Study on Comparability Analysis (2)

### CUP (M Co.)

**2 contracts submitted by M Co. and underwent comparability analysis**

Comparable Factors	Analysis
Characteristics of the trademark	All are trademark-licensing of tires.
Functions & Risks	All owners of trademarks are engaged with development of trademarks and license the logo to others.
Contract Terms	No difference in applicable areas, terms of payments and effective period.
Economic Circumstance	1. Tires-manufacturing industry 2. Top 10 companies in the industry
Business Strategies	None of them is exclusive-licensing.





## Case Study on Comparability Analysis (3)

### ☐ CUP (M Co.)

- ☐ Another analysis takes into consideration the difference in market share and the ratio of R&D expenditure over turnover between the controlled transaction and comparables.
- ☐ The arm's length range was set up, 0.5%~1.5%, and the trademark-licensing rate was not within the range which led to an adjustment in the revenue of M Co.



## Case Study on Comparability Analysis (4)

### ☐ Consideration of TNMM and PSM

- ☐ Focus on the analysis of functions and risks assumed by the parties
- ☐ Applying within the interquartile range



## Future

- ▣ Placing more emphasis on pragmatic comparability analysis
- ▣ Looking forward to more feasible alternatives



Thank You!

A large, expressive handwritten signature in black ink, followed by a thick, horizontal brushstroke that spans across the bottom of the signature.

# 17<sup>th</sup> SGATAR Working Level Meeting

## Updates on transfer pricing and Comparability Analysis



中華人民共和國香港特別行政區政府  
The Government of the Hong Kong Special Administrative Region  
of the People's Republic of China



稅務局  
Inland Revenue Department

1

## Agenda

- ◆ Legal framework for transfer pricing
- ◆ Transfer pricing audit
- ◆ Comparability analysis
- ◆ Searching for comparables: using commercial database
- ◆ Case sharing
- ◆ Challenges in handling transfer pricing cases



稅務局  
Inland Revenue Department

2

# Legal framework for transfer pricing

- ◆ CTDAAs and statutory provisions of the Inland Revenue Ordinance (“the IRO”)
- ◆ Case law
- ◆ Arm’s length principle of OECD

# Legal framework for transfer pricing

- ◆ No specific transfer pricing legislation
- ◆ Individual provisions in IRO empower the IRD to scrutinize reasonableness of transfer prices
- ◆ Anti-avoidance provisions applicable to transfer pricing issues

# Legal framework for transfer pricing

## ◆ Anti-avoidance provisions :

### □ Section 20

- profits earned by a related non-resident from non-arm's length transactions with local associate deemed taxable through the resident person as his agent

# Legal framework for transfer pricing

### □ Section 61

- Disregard artificial or fictitious transactions

### □ Section 61A

- Disregard or reconstruct transactions entered into for the sole or dominant purpose of obtaining a tax benefit

# Transfer Pricing Audit

- ◆ Selection of cases from the IRD's database
- ◆ Referrals from desk audit and informer
- ◆ Field visits and interviews
- ◆ Fact finding and analysis
- ◆ Examination of books and records

# Transfer Pricing Audit

- ◆ High risk cases
  - Significant amount of various types of related party transactions
  - Long-term consecutive losses reported
  - Profit levels comparatively low
  - Mismatch between profits level and functional and risk profile
  - Business with related parties in tax heavens
  - Violate the arm's length principle

# Comparability Analysis

- ◆ Comparability is central to the application of the arm's length principle of transfer pricing analysis
- ◆ It aims to identify uncontrolled transactions that can be compared to the controlled (“related parties”) transactions

# Comparability Analysis

- ◆ 5 Factors determining comparability:
  - Characteristics of property / service
  - Functional analysis
  - Contractual terms
  - Economic circumstances
  - Business strategies

# Comparability Analysis

- ◆ “Comparable” does not mean “identical”. It is a case-by-case approach.
- ◆ Finding comparables could be a time-consuming process.
- ◆ Understand:
  - the business and operations of the HK company and its overseas counterparts
  - the covered controlled transaction

# Using Commercial Database

- ◆ Advantages
  - Practical and sometimes cost-effective
  - Reliable as from publicly available sources
  - Quick to search for
  - Easy to identify comparables
  - “Open data” can be used by both taxpayer and tax authority

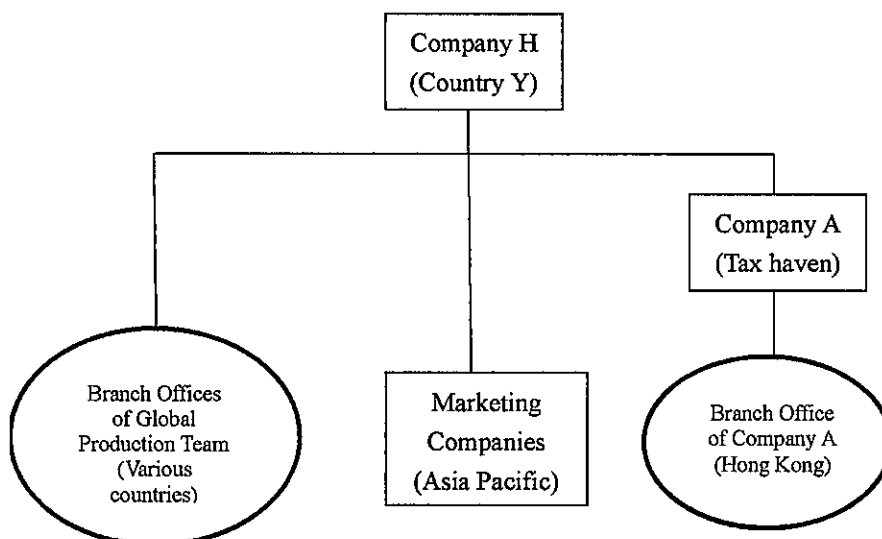


# Using Commercial Database

## ◆ Limitations

- ❑ Not available in all countries
- ❑ Costly
- ❑ Available information differ between countries, in terms of consistency and quantity
- ❑ Accounting differences in standards and policies
- ❑ Comparing companies not transactions

## Case sharing



## Case background

- ◆ Company <sup>A</sup> is incorporated in a tax haven country & a member of X-Group
- ◆ X-Group engaged in marketing, wholesaling and retailing of apparel worldwide
- ◆ Headquarters of X-Group in Country Y
- ◆ Ultimate holding, Company H, incorporated in Country Y

## Reason for Audit

- ◆ Company A's income all came from commissions paid by related group companies
- ◆ Company A reported substantial losses for a number of years

## Information obtained

- ◆ Information obtained through interview with key personnel of Company A
  - Company A engaged by Company H in designing and developing of apparel products for Asia Pacific region
  - Company A had 400 staff in HK under several divisions performing different functions
  - Service fee – 6% commission on invoiced amount of purchase orders placed

## Transfer Pricing Issue

- ◆ Service fee income not arm's length price
- ◆ Commission received insufficient to cover Company A's operating costs
- ◆ Costs re-allocated from parent and other companies might be excessive

## Settlement

- ◆ Unreasonable and abnormal for Company A, with limited risk, to sustain loss
- ◆ Share group costs not in proportion to benefits obtained
- ◆ Full Cost Mark-up (FCNU) percentage for each specialized function – sourcing, information technology & marketing

## Practical challenges

- ◆ Demand for more qualified professional officers
- ◆ Identification of transfer pricing cases
- ◆ Limitation of available comparables

## Practical challenges

- ◆ Demand for more qualified professional officers
  - Local and overseas training courses and international workshops
  - Experience sharing

## Practical challenges

- ◆ Identification of transfer pricing cases
  - Primary source : returns and accounts
  - Secondary source : project case extracted from the IRD's database, news and informer case

# Practical Challenges

## ◆ Limitation of available comparables

- Practical approach on searching criteria
- Efficient use of commercial databases

# Thank You

# Lack of Comparables

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Sgatar WLM Meeting, Mongolia  
June, 2015

1

## Topics

1. Problems : Difficulty to find Reliable Comparables

2. Facts and Basic Model Business in Indonesia

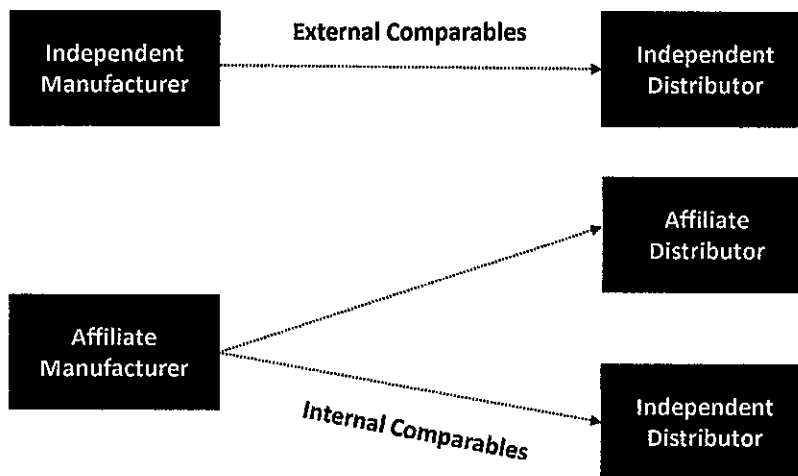
3. Availability of Reliable internal and Eksternal comparables

2

# Problems

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- Comparables are needed in applying Arms Length principle
- Two Type of Comparables



3

# Problems

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Are there any Reliable Comparables ?

- Reliable Internal Comparables are available in Theory but rarely exist in practise
- Realible Eksternal Comparables are very limited in Developing Countries

4



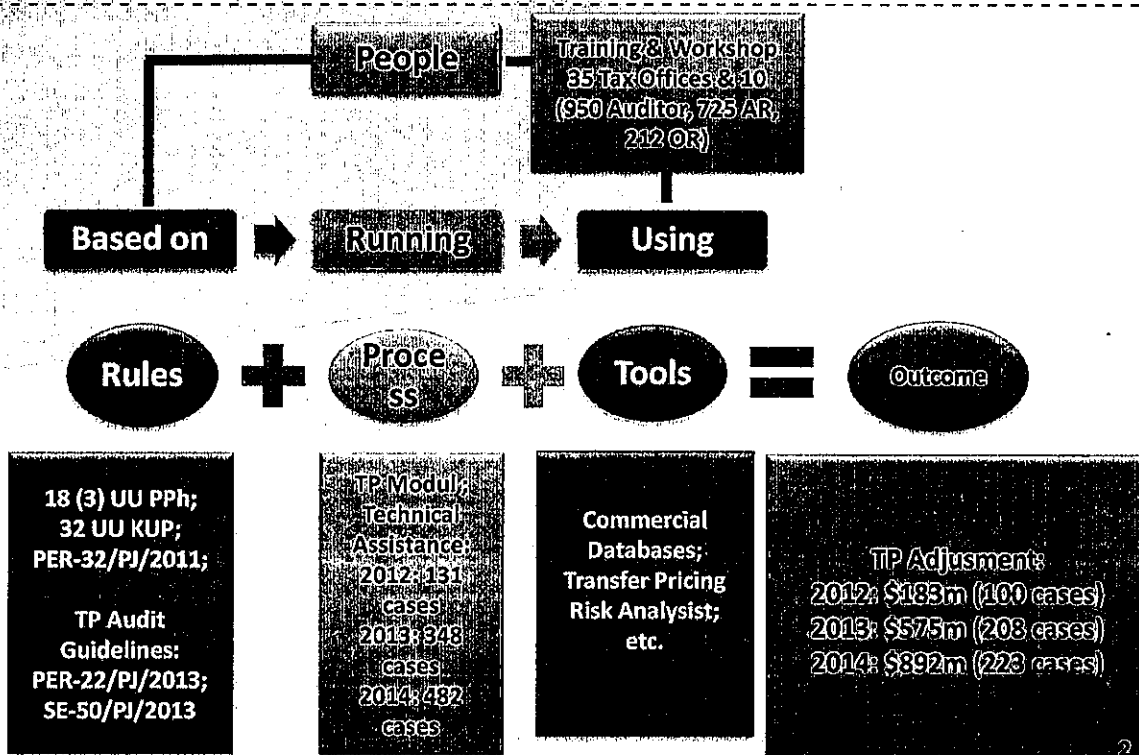


# TRANSFER PRICING RECENT DEVELOPMENT IN INDONESIA

BY : ARMAN IMRAN

1

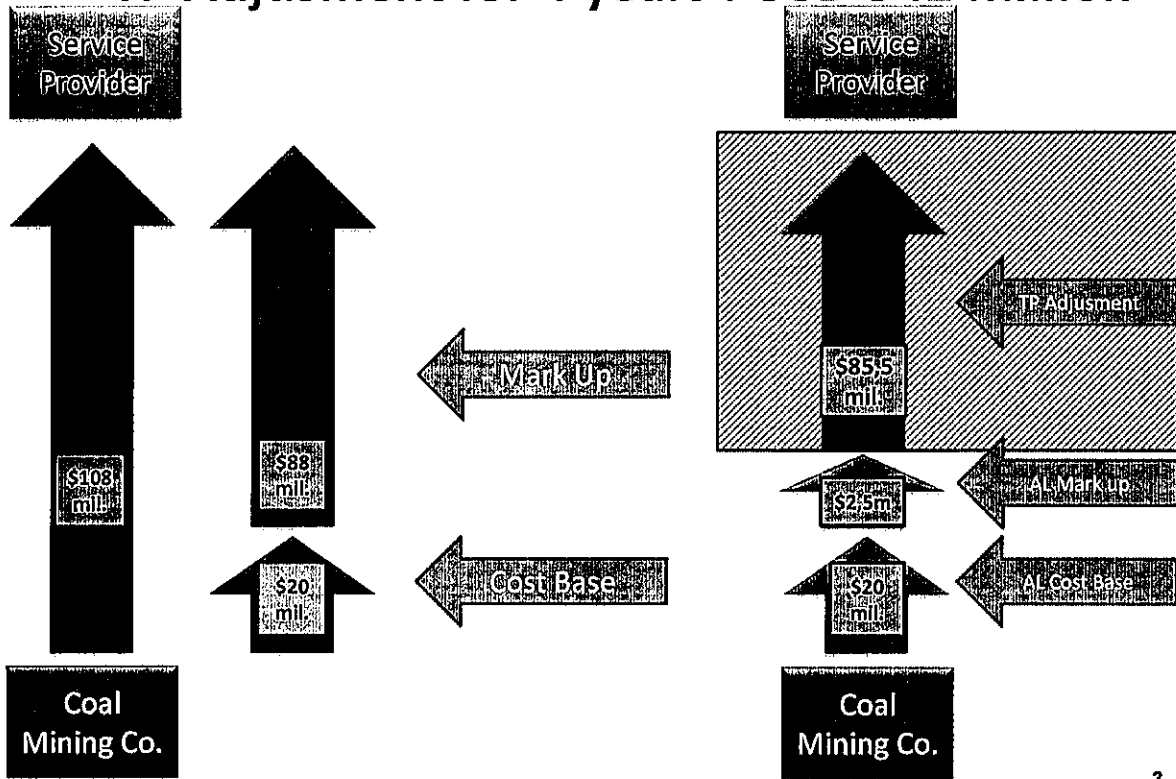
## TP Recent Development



2

# TP Case in Indonesia:

TP Adjustment for 4 years : USD 542 million

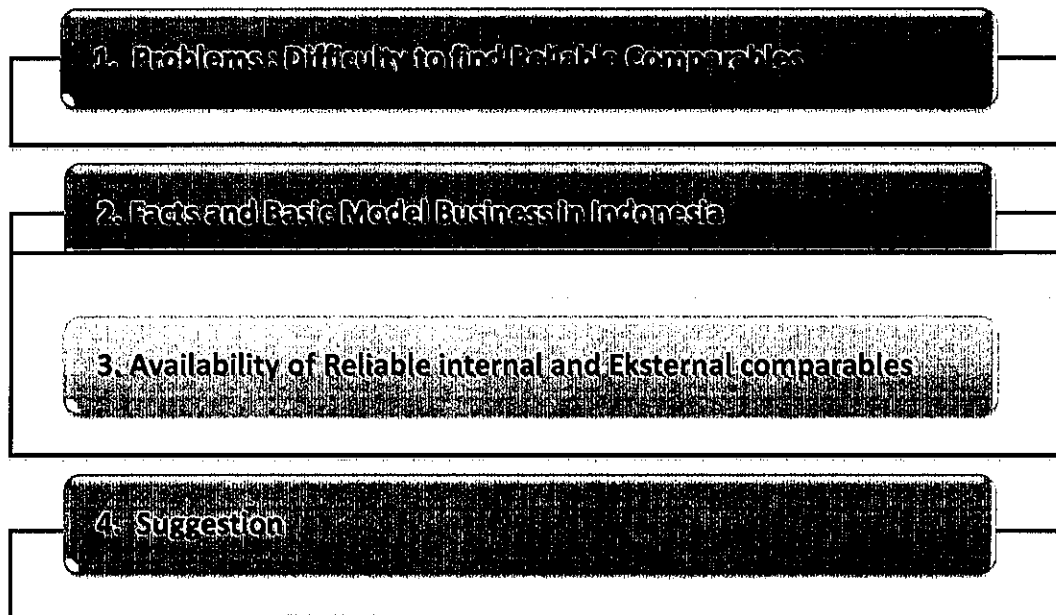


## Lack of Comparables

Sgatar WLM Meeting, Mongolia

June, 2015

# Topics

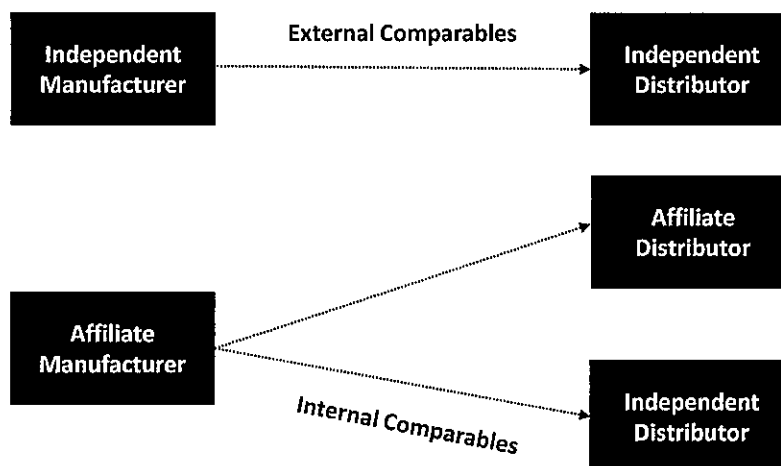


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## Problems

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- The application of Arms Length Principle requires a set of Reliable Comparable
- There are two types of comparables :



# Problems

---

Are there any Reliable Comparables ?

- Reliable Internal Comparables are available in Theory but rarely exist in practise
- Realible Eksternal Comparables are very limited in Developing Countries

## **Facts of & Basic Business Model in Indonesia**

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Sgatar WLM Meeting, Mongolia

June, 2015

## Domestic Market

---

- A large domestic market to offer (240 million people)
- A growing and affluent middle class supports GDP growth with approximately 56.7% of GDP accounting for private consumption in 2010;
- while Consumer Confidence in Indonesia is at an all-time high, consistently reaching over 110 points until May 2011.

## Domestic Market

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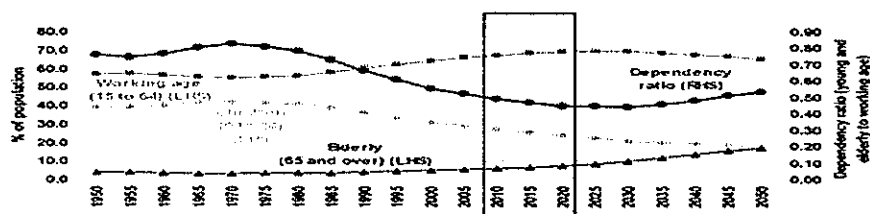
- The service sector in Indonesia has also grown over 16% points from 1998 to 2009 and continued to grow at a pace of 6% in 2010 from the previous year.
- These statistics fare well for many industries, including retail and consumer products, food processing, as well as the automotive industry.

# Demographic

- Indonesia is the 4th most populous nation in the world. Apart from its remarkable fiscal and political transformations during the last decade, Indonesia is also undergoing a major structural shift in terms of demographics.
- Of the 240 million people, over 50% of the population is under 29 years old, and 60% of the population is under the age of 39, with around 52% of the population living in urban areas. This provides for dynamic labor market participation, growing at 2.3 million per year. A rapidly urbanizing population also provides for strategic pools of labor force in centers of investment.

# Demographic

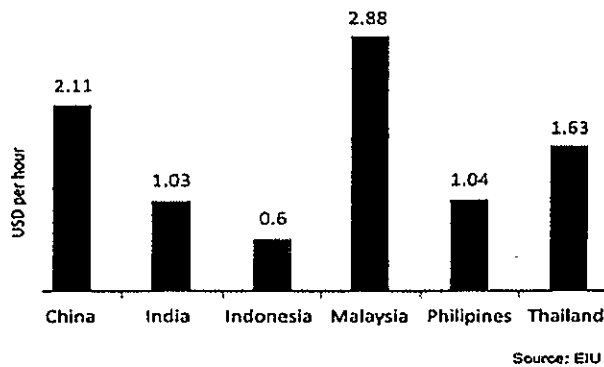
- Table of Demographic



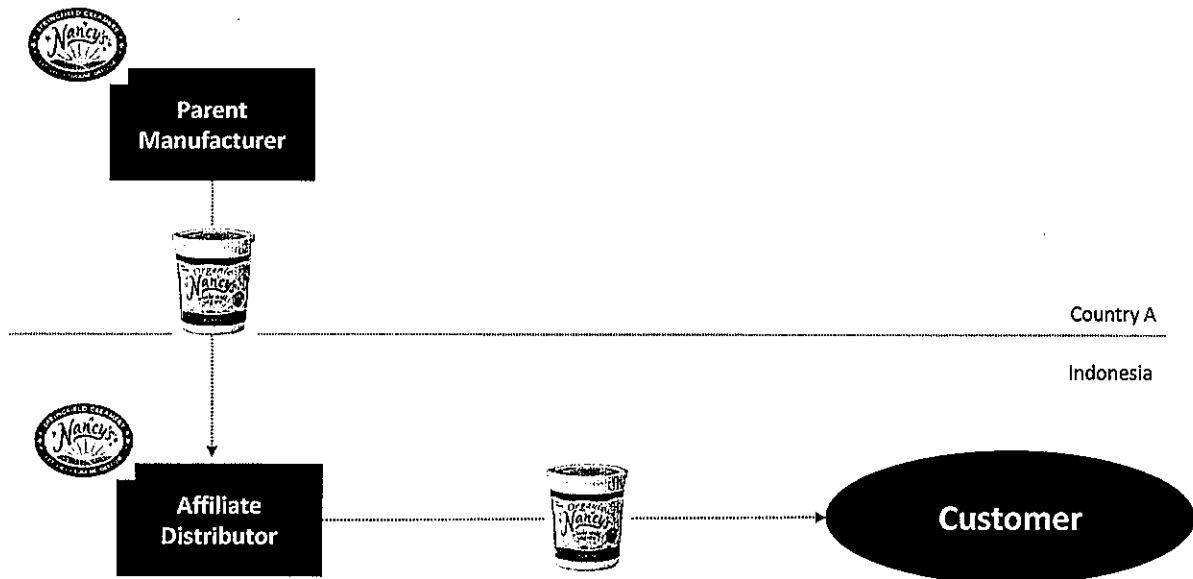
- Coupled with this demographic bonus is Indonesia's commitment to improve productivity and the education level of its youth, with 20% of total government expenditure on education. This expenditure is higher than any other sector. Currently, the majority of university graduates are trained in technical fields such as finance and economics (28%) or engineering and sciences (27.5%).

# Demographic

- Labor costs in Indonesia are the lowest among the 10 ASEAN countries, and even compared to urban centers of investment magnets, China and India

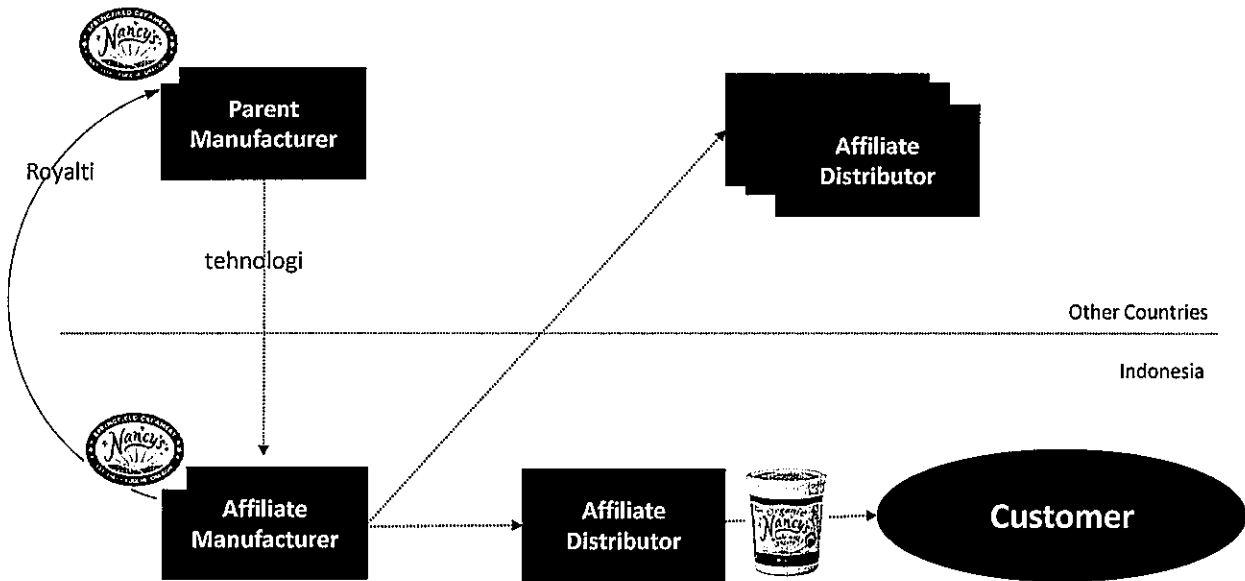


## Business Models A- (Market Driven)



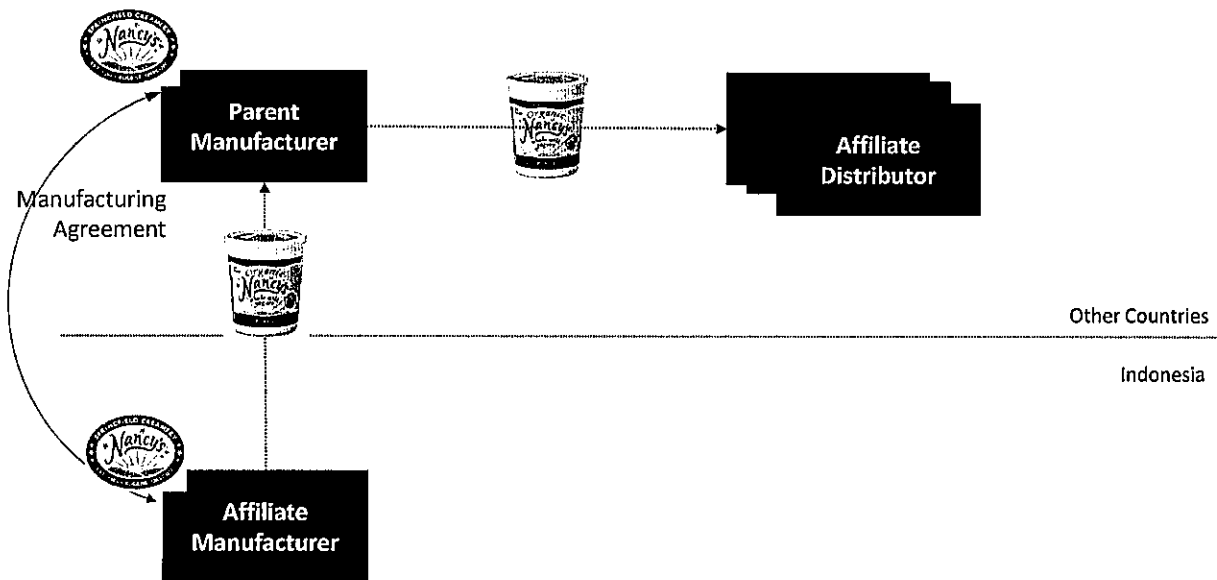
Because of its huge population, many MNC set up a distributor in Indonesia for marketing and selling their product in Indonesian market.

# Business Models B –(Market & Cost Saving Driven)



Manufacturer in Indonesia as Basis of Manufacturing (Cost Saving Driven) , manufacturing the product not only to meet Indonesian need but also Others Countries

# Business Models C- (Cost Saving Driven)



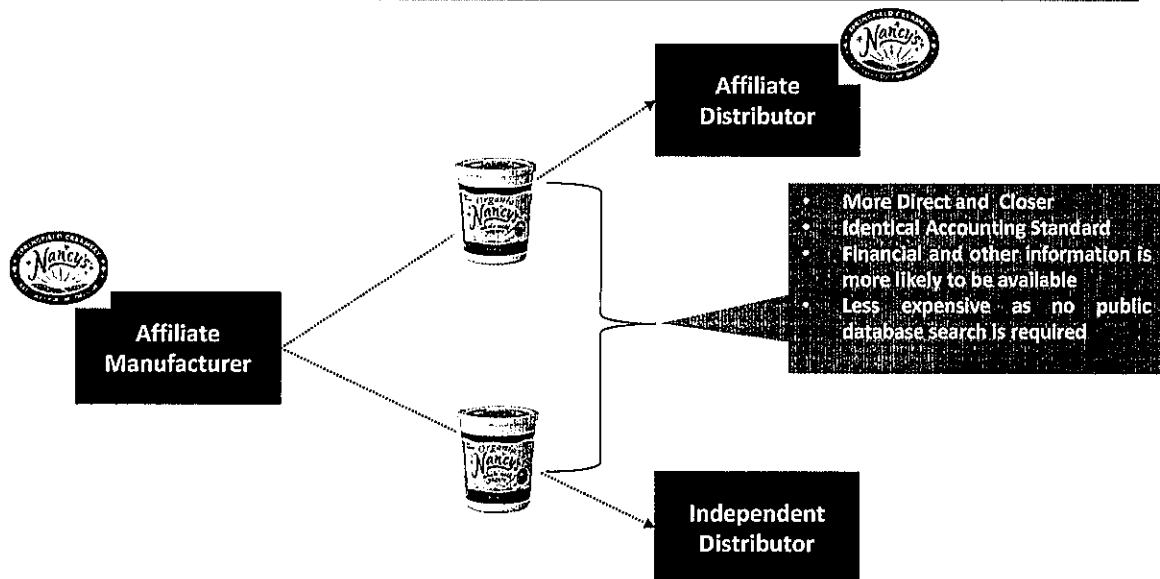
Manufacturer in Indonesia is a Contract Manufacturer (Cost Saving Driven) which manufactured the product only for the parent manufacturer.



# Availability of Reliable Internal and Eksternal Comparables

Sgatar WLM Meeting, Mongolia  
June, 2015

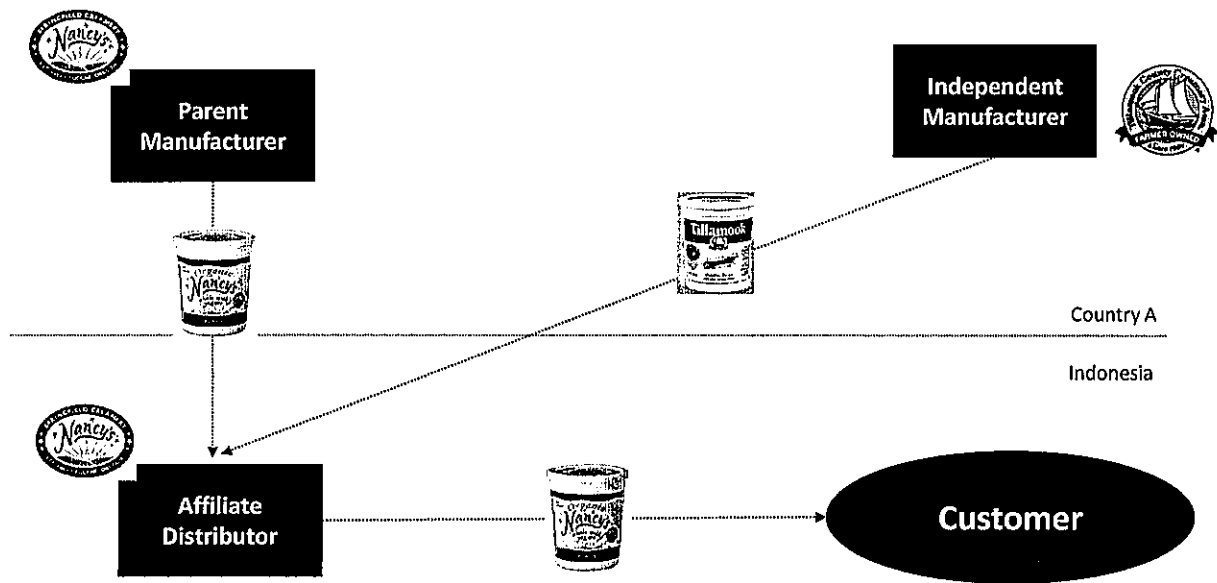
## Internal Comparables



### Para 3.24 OECD TPG

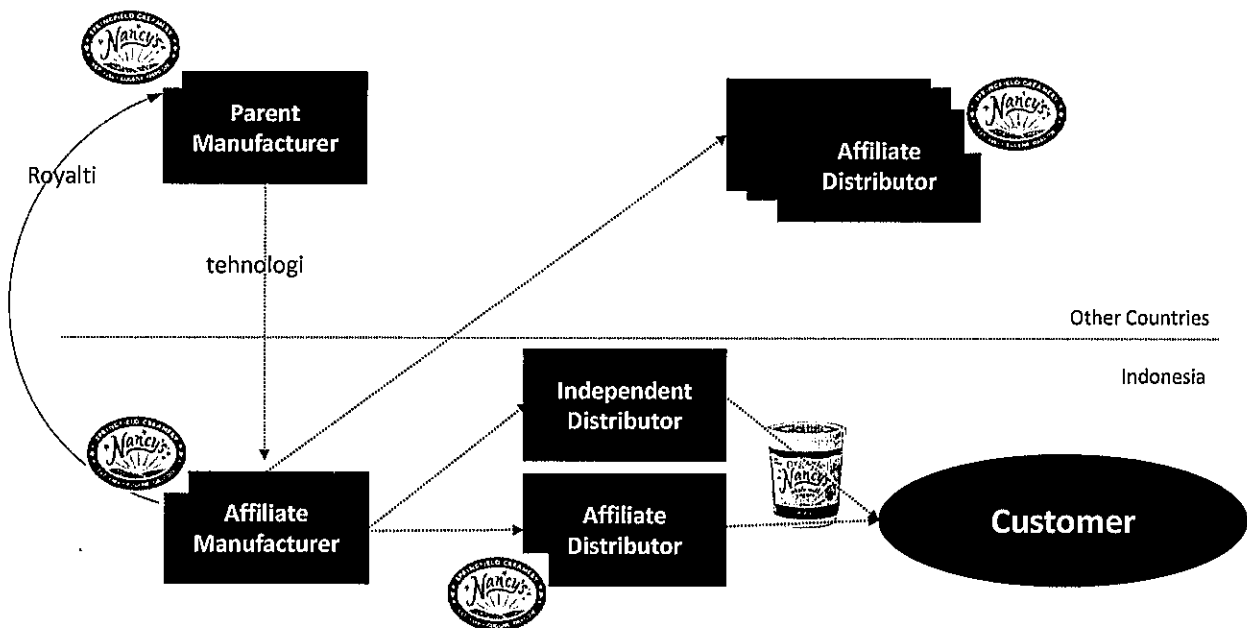
A comparable uncontrolled transaction is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ("internal comparable") or between two independent enterprises, neither of which is a party to the controlled transaction ("external comparable").

# Business Models A



From the economic perspective, it is unlikely that Affiliate distributor would market & sale a similar / substitute product since it would reduce the market share of the NANCY's Product in Indonesia. It would be unfavourable for NANCY's Group.

# Business Models B *(In Applying Cost Plus/Net Cost Plus Method)*

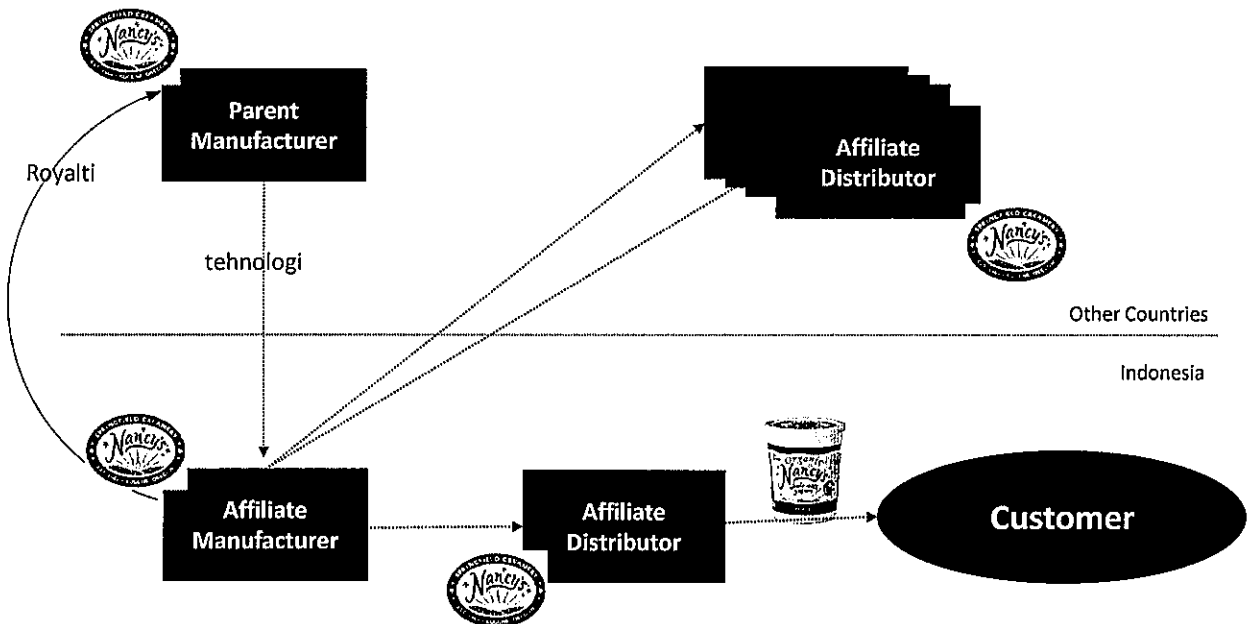


From the economic perspective, it is unlikely that MNC has both affiliate and Independent Distributor in the same Country. The Independent distributor would embezelle the profit of the Affiliate Distributor and would reduce the overall profit of the Group.

# Business Models-B

(In Applying Cost Plus/net Cost Plus Method)

Method)

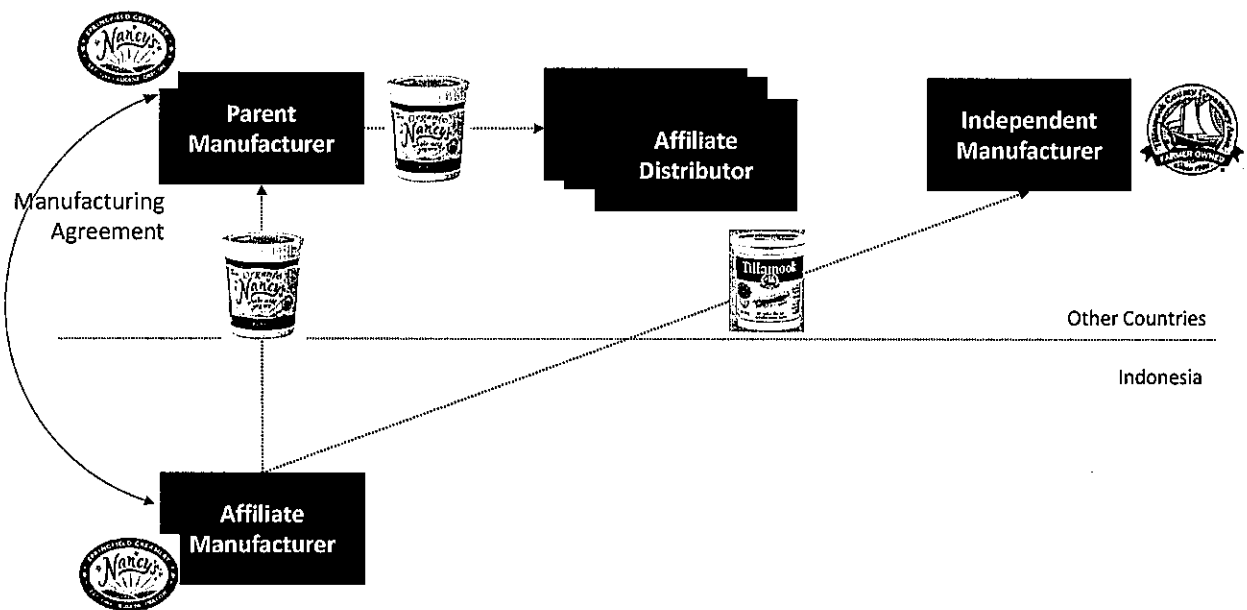


The independent transaction in this business model would only exist for temporary periods when MNC would test the market in the country. In practice, this independent transaction rarely exists since mostly MNC operating in Indonesia has already a good reputable product and has many affiliate distributors around the world.

# Business Models C-

(in applying Cost Plus/Net Cost Plus Method)

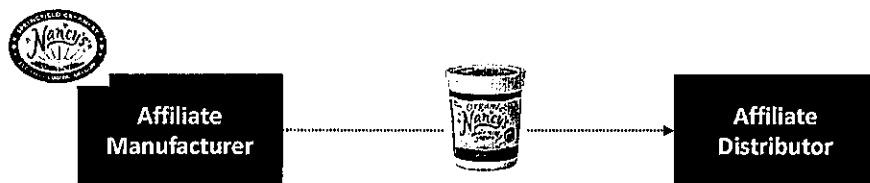
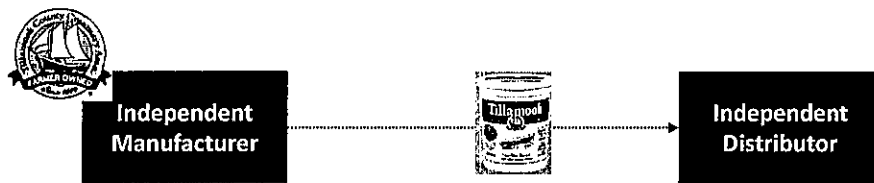
Method)



This independent transaction rarely exists since the main function of the affiliate manufacturer is supporting the parent manufacturer only. In our experience, the manufacturer in Indonesia would not be possible to have two principles in case that it is not part of the MNC (independent party).

# Eksternal Comparables

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## Para 3.24 OECD TPG

A comparable uncontrolled transaction is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ("internal comparable") or between two independent enterprises, neither of which is a party to the controlled transaction ("external comparable").

## External Comparables in Developing Countries

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- Number of listed companies are very limited
- There is no publicly available data of private companies could be found in Indonesia
- Number of companies involved in particular industry are also very limited : otomotif?  
Electronic?

# External Comparables

	Listed Companies	Source
<b>South East Asia</b>		
<b>Malaysia</b>	818	<a href="http://www.bursamalaysia.com">www.bursamalaysia.com</a>
<b>Phillipines</b>	289	<a href="http://www.pse.com">www.pse.com</a>
<b>Thailand</b>	619	<a href="http://www.set.or.th">www.set.or.th</a>
<b>Indonesia</b>	482	<a href="http://www.idx.co.id">www.idx.co.id</a>
<b>Vietnam</b>	100	<a href="http://www.hnx.vn">www.hnx.vn</a>
<b>Singapore</b>	776	<a href="http://www.sgx.com">www.sgx.com</a>
<b>Other Countries</b>		
<b>Pan European</b>	2.478	<a href="http://www.europeanequities.nyx.com">www.europeanequities.nyx.com</a>
<b>Japan</b>	2.301	<a href="http://www.tse.or.jp">www.tse.or.jp</a>
<b>China</b>	957	<a href="http://www.sse.com">www.sse.com</a>
<b>India</b>	5.085	<a href="http://www.bseindia.com">www.bseindia.com</a>
<b>Australia</b>	2.122	<a href="http://www.asx.com.au">www.asx.com.au</a>
<b>USA</b>	2.308	<a href="http://www.nyse.com">www.nyse.com</a>

# External Comparables

Symbol	Company	Market	Industry	Sector
2S	2S METAL PUBLIC COMPANY LIMITED	mai	MAI Industry	Medium-Sized Enterprise
A	AREEYA PROPERTY PUBLIC COMPANY LIMITED	SET	Property & Construction	Property Development
AAV	ASIA AVIATION PUBLIC COMPANY LIMITED	SET	Services	Transportation & Logistics
ABICO	ABICO HOLDINGS PUBLIC COMPANY LIMITED	SET	-	Companies Under Rehabilitation
ACAP	ACAP ADVISORY PUBLIC COMPANY LIMITED	mai	MAI Industry	Medium-Sized Enterprise
ADAM	ADAMAS INCORPORATION PUBLIC COMPANY LIMITED	mai	MAI Industry	Medium-Sized Enterprise
ADVANC	ADVANCED INFO SERVICE PUBLIC COMPANY LIMITED	SET	Technology	Information & Communication Technology
AEC	AEC SECURITIES PUBLIC COMPANY LIMITED	SET	Financials	Finance and Securities
AEONTS	AEON THANA SINSAP (THAILAND) PUBLIC COMPANY LIMITED	SET	Financials	Finance and Securities
AF	AIRA FACTORING PUBLIC COMPANY LIMITED	mai	MAI Industry	Medium-Sized Enterprise
AFC	ASIA FIBER PUBLIC COMPANY LIMITED	SET	Consumer Products	Fashion
AGE	ASIA GREEN ENERGY PUBLIC COMPANY LIMITED	mai	MAI Industry	Medium-Sized Enterprise
AH	AAPICO HITECH PUBLIC COMPANY LIMITED	SET	Industrials	Automotive
AHC	AIKCHOL HOSPITAL PUBLIC COMPANY LIMITED	SET	Services	Health Care Services
AI	ASIAN INSULATORS PUBLIC COMPANY LIMITED	SET	Resources	Energy & Utilities

# Tax Payer Practises

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Sgatar WLM Meeting, Mongolia  
June, 2015

## 4 Different Approaches

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- Strictly used domestic comparables
- Foreign Comparables without any adjustment
- Foreign Comparables with specific adjustment
- Foreign Comparables within specific/similar geographic

## Conclusion and Suggestion

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- There is no further guidance from OECD or UN on making the Geographic Difference Adjustment, in case of using foreign comparables
- Use CAPM model (Risk Free + Risk Premium) as another approach
- Possibility to use another approach such as safe harbour for limited risk manufacturer (ex. Maquiladora program)

## Capital Asset Pricing Model (CAPM)

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- A model that describes the relationship between risk and expected return and that is used in the pricing of risky securities.

- Formula :

$$\bar{r}_a = r_f + \beta_a (\bar{r}_m - r_f)$$

Where:

$r_f$  = Risk free rate

$\beta_a$  = Beta of the security

$\bar{r}_m$  = Expected market return

# Capital Asset Pricing Model (CAPM)

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- The general idea behind CAPM is that investors need to be compensated in two ways: time value of money and risk.
- The time value of money is represented by the risk-free (rf) rate in the formula and compensates the investors for placing money in any investment over a period of time.
- The other half of the formula represents risk and calculates the amount of compensation the investor needs for taking on additional risk. This is calculated by taking a risk measure (beta) that compares the returns of the asset to the market over a period of time and to the market premium ( $R_m - r_f$ ).

# Capital Asset Pricing Model (CAPM)

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Countries	Government Bond 10Y	Reference	Previous	Highest	Lowest	Unit
<u>China</u>	3.57	15-Jun	3.42	4.85	2.51percent	
<u>Hong Kong</u>	1.8	15-Jun	1.68	10.49	0.55percent	
<u>India</u>	7.71	15-Jun	7.88	14.76	4.96percent	
<u>Indonesia</u>	8.47	15-Jun	8.11	20.76	4.99percent	
<u>Israel</u>	2.09	15-Jun	1.71	12.4	1.11percent	
<u>Japan</u>	0.4	15-Jun	0.43	7.59	0.2percent	
<u>Malaysia</u>	4.02	15-Jun	3.88	5.35	2.87percent	
<u>Pakistan</u>	10	15-Jun	8.84	16.65	4.17percent	
<u>Philippines</u>	4.35	15-Jun	4.39	16.4	3.04percent	
<u>Qatar</u>	2.62	15-May	2.58	3.75	2.38percent	
<u>Singapore</u>	2.48	15-Jun	2.4	5.69	1.3percent	
<u>South Korea</u>	2.43	15-Jun	2.45	7.91	2.06percent	
<u>Taiwan</u>	1.5	15-Jun	1.59	6.32	1.12percent	
<u>Thailand</u>	2.97	15-Jun	2.86	6.72	2.44percent	
<u>Vietnam</u>	6.84	15-Jun	6.5	12.53	5.99percent	



# Other Country Experience- Maquiladora

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- Canada : Return for CM > Return TM

**Table 3: Comparison of financial results of pure turkey manufacturers versus manufacturers that perform both turkey and consignment manufacturing services**

Net Cost Plus	2006	2007	2008
Turnkey manufacturers	5.64%	5.37%	3.96%
Mixed manufacturers	3.95%	4.94%	3.22%

- Mexico : Agreement Mexico and USA (maquiladora)
  - a. Safe Harbour : which is greater 6,9% of ROA or 6,5% Net Cost Plus or
  - b. Modified APA