



17th SGATAR WORKING LEVEL MEETING

**Transfer pricing:
Comparability analysis**

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**General Department of Taxation
June, 2015**



Contents

1. Overview of legal framework in transfer pricing
2. Comparability analysis
3. Main challenges
4. Conclusion

1. Overview of legal framework of transfer pricing

Domestic legislation

1.1.1 General taxation law, 2008

Article 48

- 48.1. Tax assessment by using "indirect method"
- 48.1.1. Use of Arm's length price (ALP)

1.1.2. Corporate income tax law, 2006

- Article 6. Related party
- Article 11. Determining taxable income from goods, work and services provided among related parties

1. Overview of legal framework of International taxation (cont)

1.1.3. The main Transfer pricing guidelines is Finance Minister's decree, 2007.

- Application and methodology for transfer pricing work.
- Tax authority may use OECD TP Guidelines in calculating the ALP.
- ▣ Approved three methods for the determining ALP:
 - 1) Comparable Uncontrolled Price (CUP) method
 - 2) Resale Price (RP) method
 - 3) Cost Plus (CP) method

1. Overview of legal framework of International taxation (cont)

1.1.4. List of the sources for “Price information” and types of transactions between related parties, subject to TP. Commissioner’s decree, 2007

- List of the price information sources transactions subject to transfer pricing.

1.1.5. List of market price information sources of main export products (Government decrees)

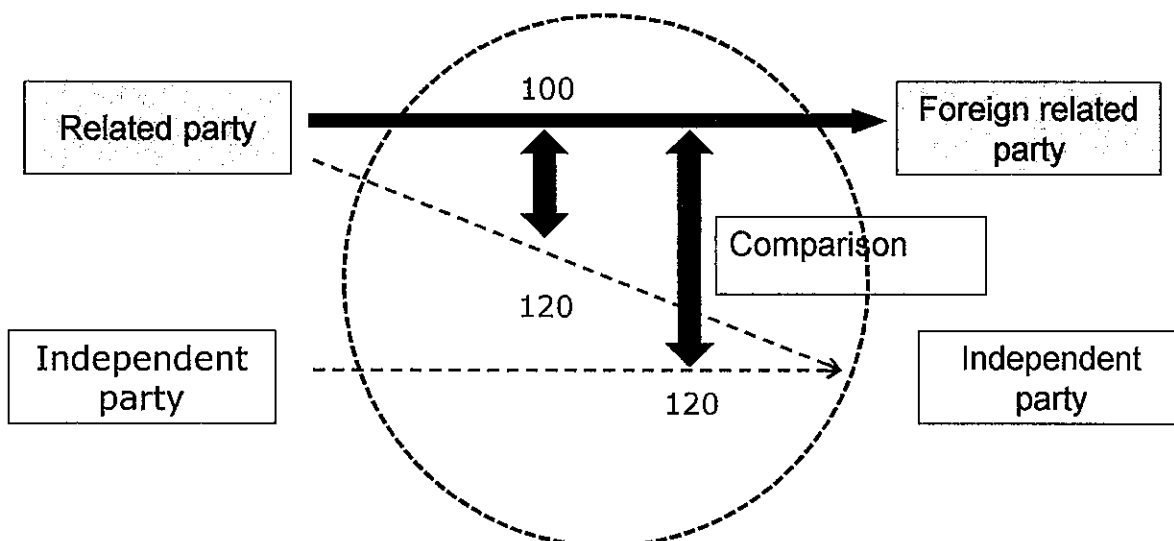
1.2. Mongolia--Double tax treaties with 26 countries,

- MAP regulation. Finance Minister’s decree, 2013

2. Comparability analysis

According to GDT TP guideline (Dec.2014) – updated new approaches

2.1. Definition of comparability analyses



2. Comparability analysis (count)

2.2. Comparability analyses process

2.2.1. Identify risk of the controlled transaction under examination and understanding the taxpayer business

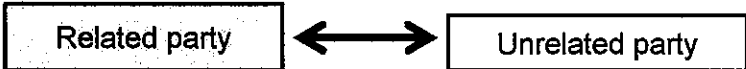
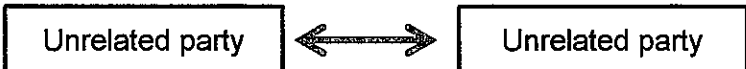
2.2.2. To determine comparability factors

- Characteristics of transaction;
- Functional analysis;
- Contract terms;
- Economic circumstances;
- Other relevant issues.

2. Comparability analysis (count)

2.2.3. To find out comparability unrelated party

2.2.4. Identifying potential comparable transactions - internal and external

- Internal comparable 
- External comparable 

2.2.5. Comparability adjustments

2. Comparability analysis (count)

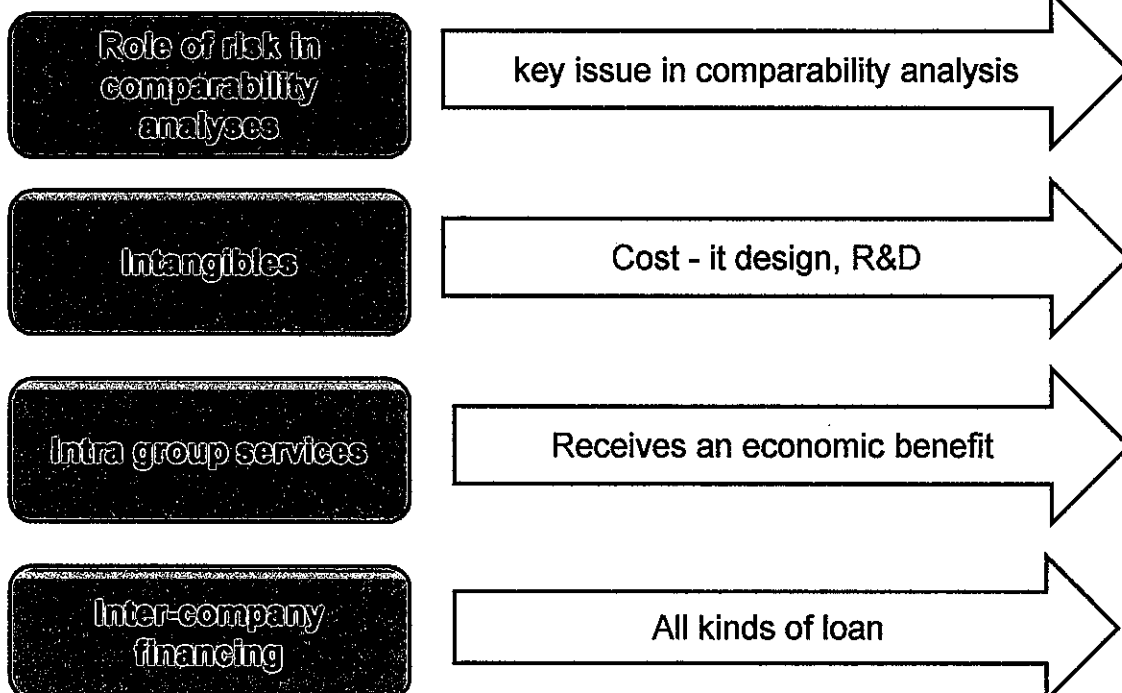
2.2.6. Selection of most appropriate transfer pricing method

- Comparable Uncontrolled Price (CUP) method
- Resale Price (RP) method
- Cost Plus (CP) method
- Transactional net margin method (TNMM)
- Profit split (PS) method

2.2.7. Determination of the arm's-length price or profit (or range or prices or profits)

2. Comparability analysis (count)

2.3. Special issues for comparability analyses



3. Facing Challenges

Main challenges

- ❖ Achieving the balance between the enforcement of legitimate taxing rights while ensuring investment-friendly environment.
- ❖ Building formidable tax administration expertise and gaining of technical experience in transfer pricing.
- ❖ Lack of comparable data and adequate information

4. Conclusion

- ❖ Establishing stricter regulations and improving organizational capacity
- ❖ Aiming to adopt the OECD guidelines for transfer pricing
- ❖ Expecting transfer pricing policies to new stages of development for the coming few years



Question and Answer

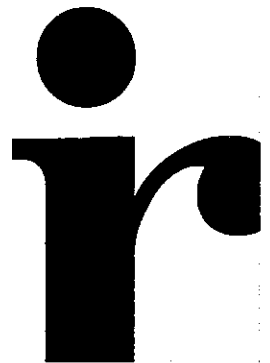
Thank you for attention



Pragmatic Solutions to a Lack of Data New Zealand

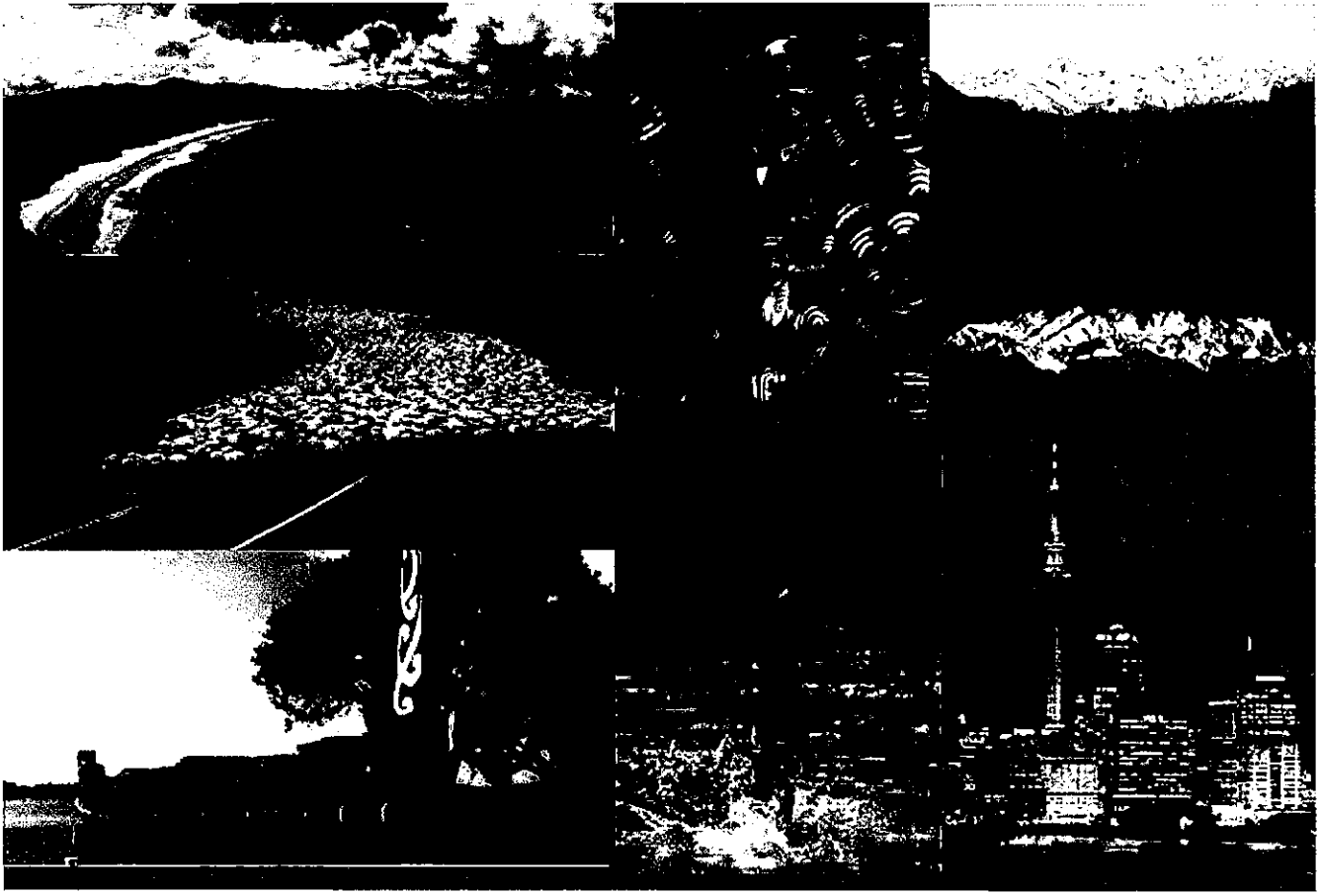
SGATAR 17th Working Level Meeting
Ulaanbaatar, Mongolia,
22 – 24 June 2015

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Specialist Advice
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Contents

- New Zealand Context
- Administrative strategies to assist analysis
- Understanding the tested transaction
- Sources of TNMM Data
- Improving Comparability
- Interpretation / Judgement

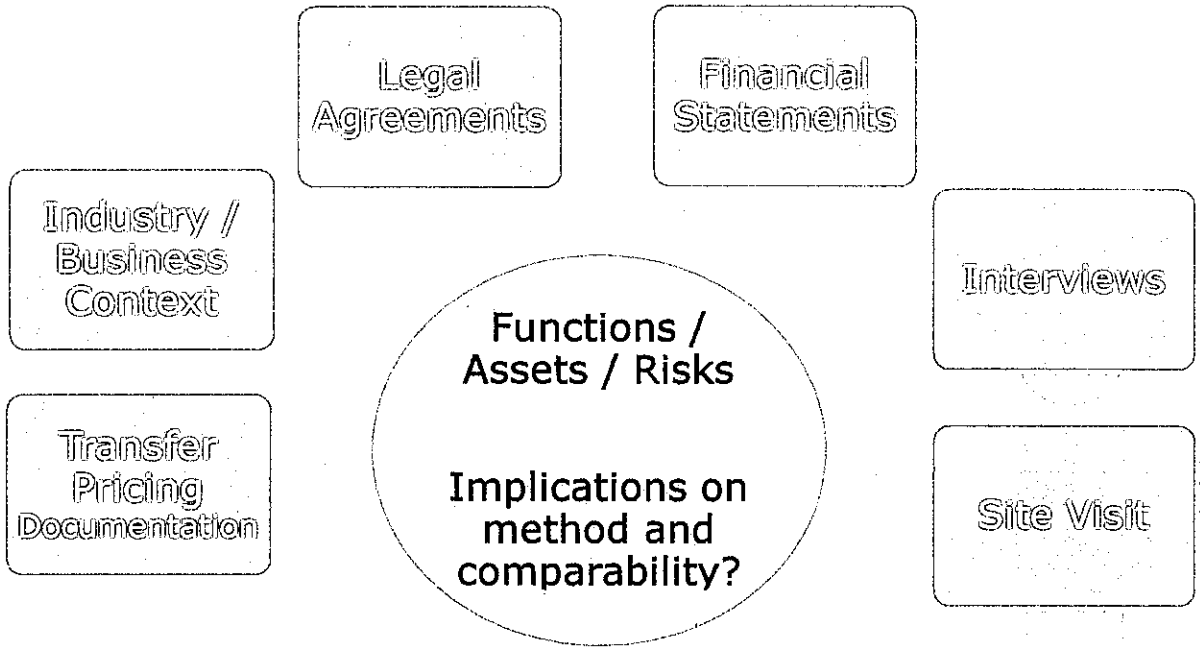


Strategy Design to Assist Analysis


- Risk assessment tools
 - Comparability analysis only undertaken if a risk identified (Profit "rules of thumb", transactions types / materiality)
- ✓ ➤ Early detection strategies
 - As close to "real time" as possible usually results in better data (Plenty of contextual data / wider variety of sources for verification)
- Encourage APAs
 - "All cards on table" approach, get data earlier.
 - Spirit of discussions more co-operative and solution focused

stable
 begin → sales important
 sheep product → royalty

Understanding the Tested Transaction



Sources of TNMM Data

- 
- Local, similar but not directly comparable?
 - Overseas, check same / similar market?
 - Internal, reasonableness check?
- Local comparable data if available (not likely)
 - Australian data, if satisfied same/similar market (usually available)

✓
 NZ
 ⇒ UK, US

Refining Data

➤ Search parameters:

- Independence indicator
- Industry categories
- Geographic locations
- Key financial data
(global standard format)
- Full business description

➤ Filtering:

- Data (Quantitative / Qualitative)
- Ratio analysis (Working capital indicators)
- Too big / too small
- Distortions due to shareholder transactions
- Extreme results / Fluctuations
(Indication of functional differences?)
- Five year data (A complete cycle?)
- Qualitative review of functional analysis
- Business context

➤ Judgement required – not an exact science

Qualitative Considerations

- Avoid: Adjusting quantifiable non-important items while ignoring unquantifiable but significant items.
- Awareness of Market differences
 - E.g. NZ small - monopoly, duopoly situations can occur.
 - Country risk premium
- Working capital differences
- Contextual comparability
- Data integrity – e.g. proprietary vs acquired fixed assets
 - Theoretically best approach might not be so in practice
- There is no "perfect" comparable
 - Which factors are essential? Which can be compromised?

Conclusion

- Pragmatic solutions require standards to be relaxed
 - Based on supporting theory (same / similar market)
 - Based on evidence accumulated overtime

- Judgement essential
 - Qualitative just as important as quantitative
 - Need a common sense, solutions focused approach

- Still more art than science – no such thing as an exact comparable!



17th SGATAR Working Level Meeting

22-24th June 2015
Ulaanbaatar, Mongolia

Celestine Bay and Chan May Ling
Inland Revenue Authority of Singapore



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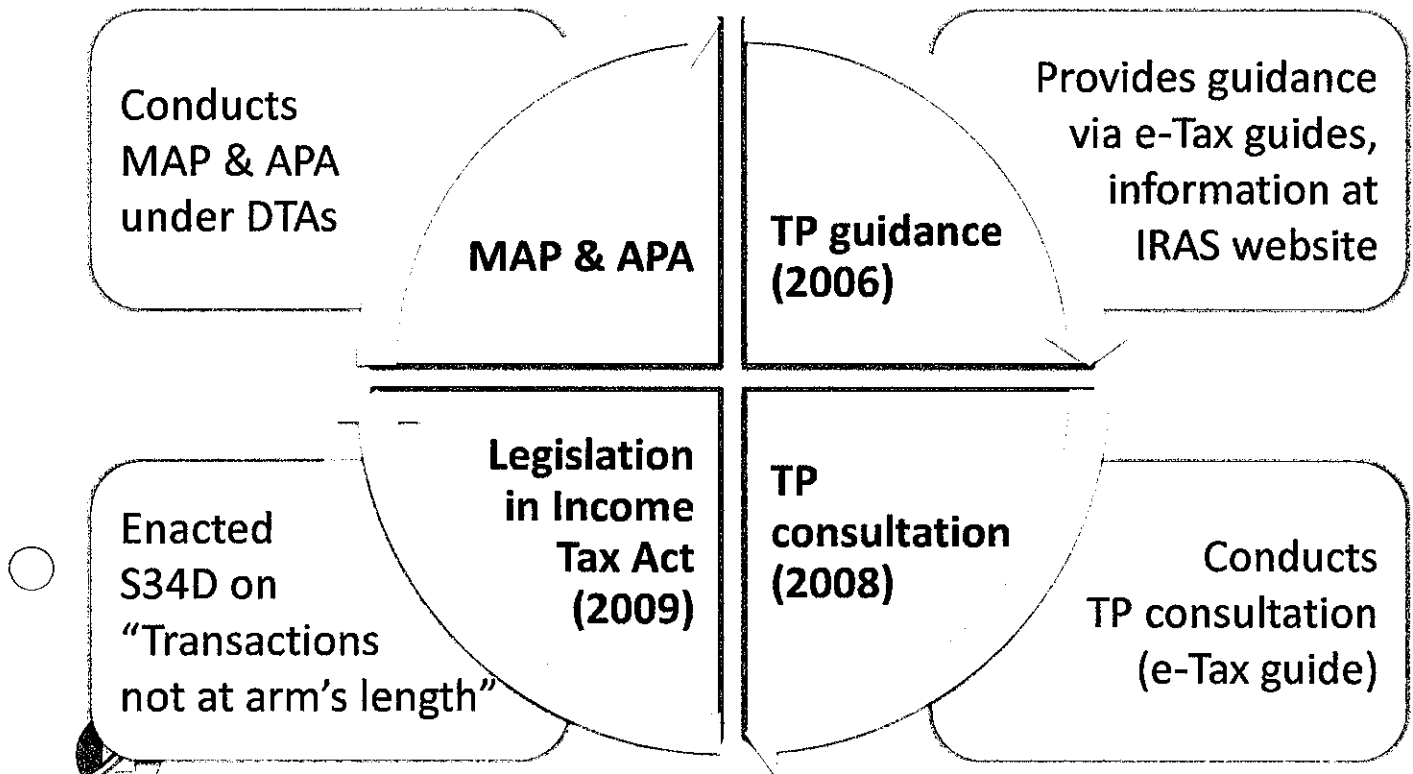
Agenda

- Overview of Transfer Pricing Framework
- Updates of 2015 TP Guidelines
- Practical issues in conducting comparability analysis
- Possible solutions



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Singapore TP Regime



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Singapore TP Regime

- IRAS published an updated e-Tax guide on Transfer Pricing Guidelines (second edition) on 6 Jan 2015
- It consolidated four previous e-Tax guides to provide more comprehensive guidance:

Previous e-Tax guides	Date
Transfer pricing guidelines	23 Feb 2006
Transfer pricing consultation	30 Jul 2008
Supplementary administrative guidance on advance pricing arrangements	20 Oct 2008
Transfer pricing guidelines for related party loans and related party services	23 Feb 2009



2015 TP Guidelines

Updates:

- Evaluating transactions on a separate or aggregate basis
 - Generally apply arm's length principle on a transaction-by-transaction basis for most precise approximation of arm's length conditions
 - Aggregate basis for highly inter-related transactions if independent parties also do likewise
- ■ Using multiple year data
 - Examine multiple year data instead of single year data to enhance reliability of comparability analysis



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2015 TP Guidelines

Updates:

- ■ Considering losses
 - Generally businesses' objective is to generate profits
 - Transacting with related party at a loss may indicate compensation not at arm's length
 - Claim that the loss is genuine for various reasons must be supported with evidence that independent party would likewise incur loss



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2015 TP Guidelines

Updates

■ Selecting external comparables

- Commercial databases
 - No preference so long as it provides reliable information for comparability analysis
- Comparables with publicly available information
 - More reliable as information readily available and verifiable
- Non-local comparables
 - Use local comparables because of higher degree of comparability
 - Use regional comparables if limited reliable local comparables
- Loss-generating comparables
 - May not be reflective of normal business conditions
 - To exclude comparable if it has weighted average loss for tested period or losses for more than half of the tested period



2015 TP Guidelines

Updates:

■ Berry ratio

- Ratio of gross profit to operating expenses
- Should only be used in limited cases as sensitive to classification of costs
- May be used when these circumstances are present:
 - Acts as intermediary purchasing goods from related parties and on-selling them to other related parties;
 - Does not perform any value-add functions other than distribution;
 - Value of functions is not affected by value of products distributed;
 - Direct link between operating expenses & gross profits; and
 - Does not employ any intangibles



2015 TP Guidelines on TP Documentation

- Taxpayers should prepare & keep TP documentation on a contemporaneous basis
- Contemporaneous TP documentation refers to:
 - a) Documentation & information relied upon to determine the transfer price prior to or at the time of undertaking the transactions; and
 - b) For ease of compliance, documentation prepared at any time no later than the time of completing & filing the tax return for the financial year in which the transaction takes place



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2015 TP Guidelines on TP Documentation

- IRAS has provided some administrative rules where taxpayers are not expected to prepare TP documentation. Taxpayers are not expected to prepare TP documentation for such transactions:

Type	Description
a) Local transactions	Transactions between taxpayer and its Singapore related party subject to same Singapore tax rates for both parties
b) Related domestic loan	Loan provided between taxpayer and its Singapore related party and the lender is not in the business of borrowing or lending
c) Routine support service	Service with 5% cost mark-up under IRAS' administrative practice for routine support service
d) APA agreement	Transactions covered by APA agreement. Only keep relevant documents for annual compliance report.



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2015 TP Guidelines on TP Documentation

■ Administrative rules (continue):

Type	Description
e) Transactions not exceeding thresholds	Related party transactions, excluding (a) to (d), which value or amount disclosed in current year's financial accounts does not exceed thresholds

Category of related party transaction	Threshold (S\$) per FY
Purchase of goods from all related parties	15 mil
Sale of goods to all related parties	15 mil
Loans owed to all related parties	15 mil
Loans owed by all related parties	15 mil
All other categories of related party transactions *	1 mil per category

* Examples - service income, service payment, royalty income, royalty expense, rental income, rental expense. For purpose of applying the threshold, aggregate amount for each category.



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Practical Issues in Conducting Comparability Analysis

- Complex business structures and arrangements
- Limitation of commercial databases
- Difficulty in finding reliable comparables
- Inadequate TP documentation



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Possible Solutions

- Importance of keeping contemporaneous TP documentation
- The use of Advance Pricing Arrangement
- The use of bilateral safe harbour arrangements
- Subscription of commercial databases



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Thank you!

Online Resources:

IRAS website

www.iras.gov.sg

Transfer Pricing e-Tax Guides

http://www.iras.gov.sg/irasHome/search_etaxguide.aspx



www.iras.gov.sg

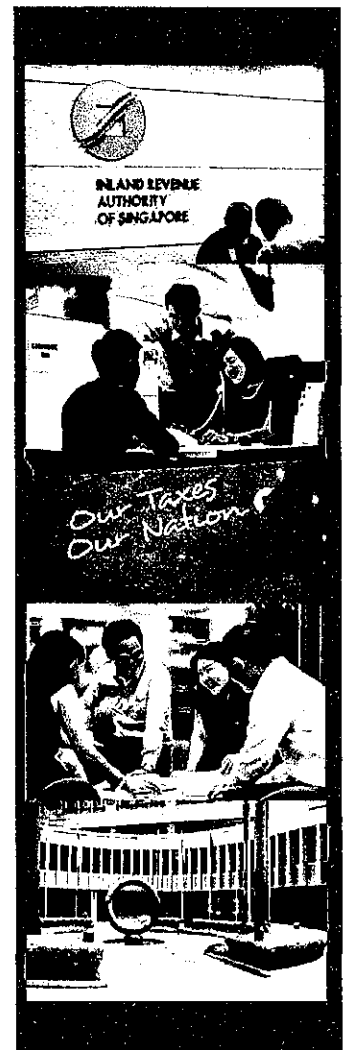


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COMPARABILITY ANALYSIS

Thailand's Experience

-
-

Objectives

-
-
- To select the most appropriate transfer pricing method
- To find the reliable/appropriate comparables and identify the arm's length price.
- By comparing the conditions in a controlled transaction with the conditions in transactions between independent enterprises.
- To apply those results to tested transactions.


Comparability Analysis Process

- ❖ Understanding the taxpayer business
 - Gathering of basic information about the taxpayer
 - Transaction analysis
 - Evaluation of separate and combined transactions
 - Selection of the tested party

Comparability Analysis Process

- ❖ Factors determining ALP
 - Characteristics of goods or services
 - Functional analysis
 - Contractual terms
 - Economic conditions
 - Business strategies

Comparables Selection Criteria

- ❖ Database – Industry, product/ service
 - ❖ Sales size
 - ❖ Years Covered
 - ❖ Independence
 - ❖ Losses
- 
- ```
graph LR; A[Independence] --> B[Shareholder]; A --> C[Transaction];
```

# Comparability Adjustment

- ❖ In case of lacking reliable comparables.
- ❖ Accounting adjustment
- ❖ Special factors or events e.g. flooding
- ❖ No working capital adjustment

# Transfer Pricing Method

- ❖ CUP
- ❖ Resale Price Method
- ❖ Cost Plus Method
- ❖ Profit Method
  - TNMM
  - Profit Split Method

## Issues regarding comparability analysis

- ❖ Product/ Service difference
- ❖ Function difference
- ❖ Evaluation of separate or combined transaction
- ❖ Losses
- ❖ Selection of tested party
- ❖ Foreign comparables X  
*having domestic database.*

# **TP AUDIT IN VIETNAM**

## **TP AUDIT**

- TP audits have largely been administered under general tax audit procedures.
- We don't have specific team carry out TP audit. We are lack of TP expertise to undertake TP audit.



## **TP AUDIT**

- From 2012 up to now, we perform a few TP audit. GDT Viet Nam and Tax provinces has audited 29 cases, the results are as follows:
  - + Adjusting revenue from related transaction: 6655.9 billion VND;
  - + To cover the losses incurred prior audit stage: 312.7 billion VND;
  - + To cover the losses incurred during the period of audit: 1023.8 billion VND;
  - + Increased taxable income : 5325.4 billion VND;
  - + Increased income tax : 476.1 billion VND.

## **TP AUDIT PROCESS**

Risk assessment and case selection normally based on the following criteria:

- Loss declaration year by year.
- Significant transactions with related party.
- Poor results
- Profit indicator is lower than average profit indicator of industries
- Perform transactions with related party in tax heaven...

# TP AUDIT PROCESS

**Step 1:** Broad based analysis of the taxpayer's circumstances:

**Step 2:** Case planning:

**Step 3:** During on – site visitation:

**Step 4:** After audit visit:

# TP AUDIT PROCESS

- **Broad based analysis of the taxpayer's circumstances:**

Understanding company profile in general. Gather Information from internal database and search information from external source (eg : internet, other source). Study & analyze economic circumstance regarding company's industry

## TP AUDIT PROCESS

### • **Case planning**

- + Return form analysis: confirm information in tax form similar as per financial statements and tax computation handed.
- + Financial analysis: financial statement, related party transaction, ratio analysis, vertical and horizontal analysis

## TP AUDIT PROCESS

### • **Case planning**

- + Function analysis: Functions performed and risk assumed

Identifying significant issues based on the financial statement analysis.

Making auditing decision in which presents issues to be audited.

Decision signed by Director and sent to the taxpayer at least 15 days before the date of visit.

Decision contents: Objective of visit, date of audit visit, period under the TP audit, contents of audit, members of audit team.

## TP AUDIT PROCESS

### **During on – site visitation:**

- Interview – personnel in the main division (from the organization chart)
- Visit selected location (e.g Manufacture plants, distribute center ...)
- Understand the taxpayer's operation and the global operation
- Verify the documents.
- Ask taxpayer provided TP document.

## TP AUDIT PROCESS

### **After audit visit:**

After audit visit, we perform further analysis:

- Tabulate and analyze the information/data gathered
- Identify the non arm's length dealing
- Functional analysis
- Study trend/pricing policy
- Focus on segment with high related party.

# TP AUDIT PROCESS

## ***Determine the arm's length price:***

- Understanding the controlled transactions under examination based on a functional analysis
- Functional Analysis and risk assumed
- Comparability Analysis:
- Select the appropriate Method
- Identification of potential comparables
- Make adjustments on tested party where results from performing TP Method show tested party result are not at arm's length.
- Interpretation and use of data collected, determination of the arm's length remuneration.

# THANK YOU!

**17<sup>th</sup> Sgatar Working Level Meeting**  
**Transfer Pricing Comparability Analysis**  
**22-24 June 2015**  
**Ulan Bator**

**Alexandre Thorr**  
**DGFIP – DVNI**  
**France**



  
  
**AGENDA**

- 
- **Context & Challenges**
  - **TP Organisational & Legal Framework**
  - **FTA approach to comparability**
  - **Illustrations from recent TP case law**
  - **Conclusion & Perspectives**

## CONTEXT & CHALLENGES

- Due to globalisation a large part of international trade takes place within multinational enterprises in a context of increasing tax competition.
- Transfer pricing is a key issue for governments wishing to preserve their tax base.
- Proper application of « arm's length principle » should ensure jurisdictions receive their fair share of revenue.
- Transfer pricing audits are getting more and more complex : shortage of potential comparables, new business models and use of valuable intangibles.
- Use of aggressive tax schemes and tax havens eroding tax base of numerous jurisdictions.

## TP ORGANISATIONAL & LEGAL FRAMEWORK

French Tax Authorities are tackling these challenges relying on :

- Risk-analysis based tax audits planning
- Adapted legal framework
  - >> « Arm's length principle » in tax code ( § 57TC)
  - >> Various anti-abuse provision ( § 209 B, 238A TC)
  - >> Abuse of Law ( § L64 TC)
- Dedicated tax audit procedures
  - >> Obligation to submit detailed TP documentation (L13 AA TC)
  - >> On-site tax judicial investigation (L16B TC)
  - >> International administrative assistance (DTC network)
- Skilled personnel
  - >> Transfer pricing and financial experts (national & local) and databases (Diane, Orbis, Bloomberg)

## OVERVIEW OF FTA APPROACH TO COMPARABILITY

- As an active OECD member and key contributor to BEPS project, France follows an approach regarding comparability which is globally in line with OECD transfer pricing recommendations.
- Tax auditors and transfer pricing experts examine in details benchmarking studies included in TP documentation. Focus is on coherence between functional analysis, TP methods and comparables selected. Attention is also given to relevance of strategy and accuracy of qualitative screening. Comparability is assessed taken into account transfer pricing method selected. Adjustment may be performed if it may enhance comparability but are not systematic.
- There is no specific requirement regarding databases. Tax auditors and transfer pricing experts can rely on databases such as Diane, Orbis or Bloomberg (financial and valuation issues).
- Tax auditors and transfer pricing experts usually accept and rely on French comparables where available due to consistency with French GAAP used. However in many cases they may accept and use pan-regional studies.

## ILLUSTRATIONS FROM RECENT TP CASE-LAW

A presentation of recent French transfer pricing case law best illustrates the constraints encountered by the FTA when performing comparability analysis.

- CAA Versailles 12/02/2012 – Microsoft France

- In that case FTA considered that Microsoft France profitability was insufficient compared to profitability showed by comparables in pan-european benchmarks. The Court here ruled in favor of the taxpayer and concluded that the remuneration granted by Microsoft Ireland to Microsoft France was at arm's length relying on two main arguments.

• First, some comparables selected can not are part of groups and can not be considered as independent as defoned by the tax code.

• Second, some somparables selected can not be compared to Microsoft France due to important difference of functions performed (notably economic functions & risks attached to software development).



## ILLUSTRATIONS FROM RECENT TP CASE-LAW

- CAA Versailles 12/06/2014 – Tyco Electronics France
- In that case FTA considered that Tyco Electronics France profitability was insufficient compared to profitability showed by a set of 4 French comparables. The Court here ruled in favor of the taxpayer and concluded that the remuneration granted by Tyco in Switzerland was at arm's length examining to reject them.
- The court rejected the first comparable due to the fact that it was holding significant intangibles. The second comparable was rejected due to the fact that it was part of a group and therefore not independent.
- The third one was disqualified because he was active in Finland a totally different market.
- Last but not least, profitability generated by the fourth one was close to Tyco Electronics France's profitability.

## ILLUSTRATIONS FROM RECENT TP CASE-LAW

- CAA Versailles 08/07/2014 – Carrefour
- In that case FTA considered that Carrefour large retail group headquartered in France did not charge sufficient royalties to its subsidiaries for the use of the Carrefour brand.
- To determine the reassessment, FTA relied on a panel of 6 royalty agreements.
- The Court ruled in favor of the taxpayer considering that benchmark prepared was not relevant. Out of 6 comparables 4 were considered not independent. ✓
- The Court concluded that FTA did not demonstrate that royalties charges were not in line with « arm's length » principle.
- 
-

## CONCLUSION & PERSPECTIVE

- **Comparability remains a key issue for the FTA**
- **Main challenges include :**
  - **>> absence of independent comparables in an increasing number of sectors**
  - **>> comparability of functions performed by comparables**
  - **>> fragmentation of international value chain**
  - **>> economic relevance of different geographical markets**
  - **>> potential problems arising when performing comparability adjustments**
  - **>> issues pertaining to economic valuation (corporates & intangibles)**
- **Tax courts tend to assess comparability in a very restrictive way**
- **FTA tackle these challenges by relying on detailed functional analysis supported by database, technical training and active participation to international discussions including OECD.**