

**Transfer Pricing Comparability Data
and
Developing Countries**

**SCOPING PAPER FOR A PRACTICAL TOOLKIT TO ASSIST DEVELOPING
COUNTRIES TO ADDRESS DIFFICULTIES IN ACCESSING COMPARABLES DATA AND
USE APPROACHES TO APPLY INTERNATIONALLY ACCEPTED PRINCIPLES IN THE
ABSENCE OF COMPARABLES**

This scoping paper takes forward Recommendation 16 as agreed in the G20's Response to the 2014 Reports on Base Erosion and Profit Shifting and Automatic Exchange of Tax Information for Developing Economies. Recommendation 16 states that the Development Working Group (DWG) "welcomes further work by the OECD and WBG to assess how practical toolkits can be produced to a) assist developing countries address difficulties in accessing comparables data and b) use approaches to apply internationally accepted principles in the absence of comparables (for example safe harbour provisions)."

In accordance with this mandate, this scoping paper elaborates on the terms of reference subsequently submitted to the DWG by the OECD and WBG which calls for the development of a toolkit consisting of two parts:¹

- Part I will detail the issues developing countries face in accessing comparables data and will present and discuss a range of possible solutions
- Part II will present a range of possible approaches to applying internationally accepted principles in the absence of comparables and will propose areas where further work may be required

Drafting of the toolkit will be led by the OECD Secretariat and the WBG, in consultation with the United Nations, IMF and regional tax administration bodies (ATAF, CIAT, CREDAF). Consultations with developing country tax administrations and private sector stakeholders will also be undertaken.

¹ The toolkit will be complemented by a report on supplementary work on determining appropriate prices for mineral commodities that is being drafted by the OECD and takes forward Recommendation 17 of the G20's response. Cross-references from and to this work will be made where relevant.

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PART I - ADDRESSING DIFFICULTIES IN ACCESSING COMPARABLES DATA IN DEVELOPING COUNTRIES

A. The Role of Comparables Data

This section will summarise the role of comparables data in applying transfer pricing legislation, based on existing internationally accepted principles.

To date, the “arm’s length principle” has been widely adopted by all countries (developed and developing) that have introduced specific legislation concerning transfer pricing for direct tax purposes. The arm’s length principle can be expressed in different ways and although definitions in countries’ domestic tax laws differ, the most commonly referred to and internationally accepted expression is found in Article 9(1) “Associated Enterprises” of both the OECD Model Tax Convention (2014) and the UN Model Tax Convention (2011):

Where ... conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Application of the arm’s length principle is generally based on a comparison of the conditions in the controlled transaction with the conditions in comparable transactions between independent enterprises.² There is an international consistency concerning the “standard” of comparability adopted for such purposes as the majority of countries (developed and developing) have adopted a standard similar to that found in OECD Transfer Pricing Guidelines (2010, para. 1.33):

To be comparable means that none of the differences (if any) between the transactions 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.

There is also an international consistency as to the factors taken into account when assessing comparability, with most countries referring in their legislation or administrative guidance to the factors specified in both the OECD Transfer Pricing Guidelines (2010, para. 1.36) and the UN Practical Manual on Transfer Pricing (2013, para. 5.1.6). These are: the characteristics of the property or services; the functions performed by the parties (taking into account assets used and risk assumed); contractual terms, economic circumstances and business strategies.

² See: Para 1.33 OECD TPG and Para 1.4.4 UN Practical manual.

Application of the arm's length principle on the basis described above requires that comparable transactions between independent parties: (a) exist, (b) can be identified by the taxpayer and the tax administration and (c) that sufficient information is available to them to assess comparability and apply the appropriate transfer pricing method.

B. Sources of Comparables Data

This section will analyse available sources of comparables data and consider the challenges faced by developing country tax administrations and taxpayers in obtaining the necessary data to apply transfer pricing legislation based on internationally accepted principles. In particular this will include:

- An overview of the kinds of data typically used in a comparability analysis and a description of sources of data currently available
- An analysis of selected data sources typically relied upon, with a particular focus on the availability and existence of data in developing countries.

The difficulties faced in obtaining comparables data necessary to apply the arm's length principle has been recognised as an area of significant concern by developing country policy makers, tax administrations and taxpayers.. Where data is scarce in the country where the tested party is located, this poses difficulties in applying the arm's length principle not only for the local tax administration and taxpayer, but also for the foreign tax administration and the taxpayer on the other side of the controlled transaction. Both OECD and non-OECD countries frequently express concerns about the availability and quality of financial data on transactions between independent parties that can be used for comparison, as well as the availability and quality of information necessary to interpret such data when available.³ These difficulties are recognised as being particularly acute in developing countries, where access to data sources is typically limited and less (or no) local data often exists or is publicly available.⁴

Overview of the Kinds of Data Typically Used for a Comparability Analysis

This subsection will describe the kinds of data generally required when undertaking a transfer pricing analysis and the means of availability of such data. The types of data discussed will include (a) data on specific transaction types, e.g. licence and loan agreements, (b) financial information (e.g. from financial statements), (c) publicly quoted prices (e.g. commodity markets) and (d) business descriptions.

The typical means for accessing such data will also be described, with a distinction made between internal data sources (information held within a MNE group) and external data sources (information concerning wholly independent parties).

³ <http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-comparability-data-developing-countries.pdf>

⁴ According to the United Nations Practical Manual: “[i]t is often extremely difficult in practice, especially in some developing countries, to obtain adequate information to apply the arm's length principle”. The Manual then elaborates some of the reasons including: fewer operators in a sector, especially in transitional economies, the lack or incompleteness of relevant data, the focus of many databases on developed country data and the difficulties in analysing the data (Para. 1.10.6).

As regards to sources of external comparable data, the feasibility and usefulness will be analysed of developing an online, up-to-date (and possibly non-exhaustive) overview of the databases available (commercial and non-commercial); combined with (a) a description of each database (e.g. what types of data they contain) and (b) how the data is accessed (e.g. via the internet, by DVD/CD, any fee for access).

Analysis of Available Data in Selected Data Sources

This subsection will present an analysis of selected external data sources used in practice by tax administrations and taxpayers, with a particular focus on the availability of data in developing countries. Possible reasons for differences in data availability will be explored (e.g. market size and structure, regulatory financial reporting requirements, compliance levels and data collection practices of database providers) along with possibilities for improving availability of data in developing countries.⁵

C. Improving Access to and Use of Sources of Data on Comparables

This section will present the challenges reported by developing country tax administrations and taxpayers in accessing and using existing sources of comparables data and will catalogue possible measures for assisting developing countries to overcome these challenges.

To support this analysis, surveys of developing countries and the private sector are being conducted, and input is being sought directly from tax administrations through global and regional events, during the delivery of technical assistance and through informal channels.

Internal Data Sources

After describing the challenges reported by developing country tax administrations in obtaining data from taxpayers relevant to a transfer pricing analysis, this sub-section will describe information possibly available within a Multinational Enterprise Group that may be a source of comparables data and will explore the role of transfer pricing documentation requirements, audit/investigation powers, and exchange of information instruments in improving developing country tax administration's ability to access this information. Examples of tools and approaches adopted by selected countries for overcoming these challenges will be presented along with specific reference to ongoing work concerning transfer pricing documentation, transparency and information sharing.

Challenges reportedly faced by developing countries in seeking to use internal comparable data (where available) will be examined, and tools and approaches adopted by selected countries for overcoming these challenges presented.

⁵ The possible benefits (and limitations) for transfer pricing compliance of the introduction of (public) domestic financial reporting requirements will be considered. However, as transfer pricing is only one of many considerations in this context, and is likely to be a secondary consideration, this will take the form of an information box or annex with reference made to other publications on this subject.

External Data Sources

After describing the challenges reported by developing country tax administrations in obtaining access to existing sources of comparable data, possibilities for overcoming these challenges and improving access will be presented (funding, alternative approaches etc.). In addition, how other sources of publicly available information can be drawn upon when undertaking a transfer pricing analysis will be discussed, and, reference to the work being undertaken by the OECD with respect to Recommendation 17 (Minerals Pricing) will be made.

Drawing on the conclusions of the analysis of existing data sources in Section B, this subsection will analyse the challenges faced by developing country tax administrations and taxpayers where sufficient data concerning comparables from the local market is not available. As regards databases, the use of “foreign comparables” will be examined. The economic circumstances of the geographic market in which the taxpayer operates is one of five comparability factors that need to be taken into account in assessing comparability under internationally agreed principles. When comparables from the local market are available, it can be assumed that such economic circumstances are similar and that therefore this comparability factor is met. For foreign comparables such an automatic assumption cannot be made. However, foreign comparables should also not automatically be rejected, but instead a careful evaluation needs to be made taking into account data available on all the significant comparability factors, and including an analysis on what adjustments can reliably be made. In this context the following questions will be addressed:

- *What are foreign comparables (as opposed to the use of data from other markets without due regard to differences in economic circumstances)?*
- *What are the current practices and reported country experiences as regards selection criteria and comparability adjustments made?*
- *What guidance (if any) exists on selection criteria and comparability adjustments?*

This subsection will then discuss the opportunities and limitations associated with the use of “foreign comparables” in developing countries in circumstances where there is little or no local comparables data. In particular, the feasibility and modality of developing widely accepted, practical and implementable guidance for developing countries on selecting, interpreting, and adjusting foreign comparables in a reliable manner will be examined.

D. Conclusion

This section will present conclusions reached in Part I concerning the challenges faced in obtaining access to sources of comparables data, the existence (or lack thereof) of comparables data in developing countries and the possible solutions and tools for addressing these challenges.

PART II - APPROACHES TO APPLYING INTERNATIONALLY ACCEPTED PRINCIPLES IN THE ABSENCE OF COMPARABLES

Part II will examine country experiences and approaches in applying transfer pricing legislation with limited, or no, reliance on comparables data and will present next steps for the development of practical guidance for developing countries for implementing approaches that are consistent with internationally accepted principles (i.e. paragraph 1 of Article 9(1) of the OECD and UN Model Tax Conventions).

A. Analysis of Existing Approaches

This section will present an analysis of various approaches adopted by countries to applying transfer pricing legislation with limited or no reliance on comparable data. Whilst it is intended to be as comprehensive as possible, it is not envisaged that this will be an exhaustive catalogue of all of the different approaches currently or previously adopted by countries. The relevant reference point for the analysis of the various approaches will be internationally accepted principle(s) reflected in Paragraph 1 of Article 9 (1) of the OECD and UN Model Tax Conventions.

This section will, based on data collected through the surveys and various research efforts, outline and provide examples of different approaches to applying transfer pricing legislation that require limited, or no, reliance on the availability of comparables. The following format will be adopted for each of the approaches to be discussed (see below):

- *description*
- *specific country examples, including, to the extent available:*
 - *details of why the approach was adopted in that country, including details of policy considerations*
 - *mode of implementation (e.g. primary law, secondary law, administrative guidance, case law, generally accepted practice)*
 - *tax administration experience*
 - *whether it has raised any treaty issues or led to disputes*
 - *views of business (where available)*
- *perceived advantages and disadvantages / benefits and challenges, with particular attention to assessing how the approaches can lead to simplification and improve efficiency and to the consistency of the approach with the current wording of Article 9 (1) of the OECD and UN Model Tax Conventions*

It is proposed that the following existing approaches will be considered. Please note, however, that this list is for discussion purposes only (additional approaches may be added based and other amendments can be made on the various planned consultations): -

- *Safe harbours*
- *Fixed Margins*
- *Deemed pricing for specific transaction types (e.g. commodities, interest rates etc.)*
- *Use of Profit Splits*
- *Internal rates of return*
- *Use of data from other markets⁶*
- *Use of industry averages/statistics*
- *Use of customs valuations*
- *Reliance on tax authority data*

B. Conclusion

This section will draw preliminary conclusions and outline possible next steps for assisting developing countries to implement specific approaches to applying transfer pricing legislation that have limited or no reliance on comparables data, and that are consistent with internationally accepted principles. This may take the form of the development of new guidance, model legislation and or the development of training materials. This will also include a discussion on the need for coordinated action in this area whilst ensuring timely presentation of guidance for developing countries that is practical and balances simplicity and efficiency. Finally, to identify priorities for future work this section could explore the feasibility of a process to follow developments in the challenges faced by developing countries in conducting transfer pricing analyses.

⁶ To be distinguished from ‘foreign comparables’ as presented and discussed in Part II.

APPENDICES

- Appendix 1 – Glossary of Terms
- Other Appendices to be developed as required.