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Global Tax Alert

OECD, UN, IMF and World Bank issue toolkit for addressing difficulties in accessing comparable data for transfer pricing analysis

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Executive summary

On 22 June 2017, the "Platform for Collaboration on Tax" (the Platform) – a joint effort of the Organisation for Economic Co-operation and Development (OECD), United Nations (UN), International Monetary Fund (IMF) and World Bank Group (WBG) – released a toolkit (the Toolkit) designed to help developing countries address the lack of "comparables" for transfer pricing analyses and better understand mineral product pricing practices. However, the Toolkit goes beyond a narrow examination of how to deal with a lack of local comparables data; instead, the toolkit's aim is to help ensure greater practical implementation of transfer pricing regimes that apply the arm's length principle, in accordance with the realities faced by many developing countries, including limited information availability and administrative capacity. The Toolkit builds on the work performed and comments received on the discussion draft issued on 24 January 2017 (the Discussion Draft).[1] The delivery of the Toolkit coincides with the third meeting of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS), held in the Netherlands on 21–22 June 2017, and demonstrates the commitment of the Platform to work together to tackle a wide range of pressing tax issues.

Building a better working world

Detailed discussion

Background

The Platform, launched in April 2016, is designed to enhance cooperation between the OECD, UN, IMF and WBG on tax matters. One of the aims of the platform is to produce concrete joint outputs and deliverables under an agreed work plan and share information on activities more systematically. This includes developing appropriate tools for developing countries in the taxation of multinational enterprises. It has thus far released a toolkit on tax incentives, on support for building tax capacity in developing countries, and more recently, on transfer pricing comparables.

There will be more toolkits forthcoming, including toolkits on the indirect transfer of assets, transfer pricing documentation, tax treaty negotiation capacity, base eroding payments, supply chain management, and BEPS risk assessment.

Its most recent toolkit is titled *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* and includes a supplementary report on Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate Form (Supplementary Report).

The Toolkit was developed to assist tax administrations of developing countries with the difficulties in implementing transfer pricing regimes that relate to accessing information on comparables (i.e., data on transactions between independent parties used in the application of the arm's length principle). It goes beyond a narrow examination of how to deal with a lack of local comparables data. With this report, the Platform aims to help ensure greater practical implementation of transfer pricing regimes that apply the arm's length principle, in accordance with the realities faced by many developing countries, for example those related to the limited availability of information and limited administrative capacity of tax administrations.

Toolkit for addressing difficulties in accessing comparables data

The Toolkit follows the structure set out in the Discussion Draft, and includes four sections: (i) part I provides an introduction on addressing the difficulties in performing comparability analyses; (ii) part II describes issues arising when conducting a comparability analysis; (iii) part III includes approaches to apply internationally accepted principles in the absence of comparables, and (iv) part IV provides a summary, conclusions and recommendations for further work, and includes several case studies.

The Toolkit explains that difficulties in accessing information on comparables is a common concern of developing countries when implementing transfer pricing regimes. The Toolkit notes that this is an issue across industries in such countries, but highlights in particular the lack of data with respect to the pricing of certain commodities. Similar to the Discussion Draft, the Toolkit focuses on practical measures that developing countries can implement in the short to medium term – noting that while there may be potential alternatives to the "arm's length principle" that do not rely on comparables (e.g., formulary apportionment), they are unlikely to be implemented in the foreseeable future. Further, the Toolkit acknowledges that "perfect" or ideal comparables may only rarely be available. However, often times 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.

Part II of the Toolkit starts by putting the search of comparables into perspective and explaining the general steps in a comparability analysis, while emphasizing the importance of accurately delineating the transaction under review. Special reference is made to this delineation of the transaction because this will drive the selection of the most appropriate transfer pricing method and criteria for the search of comparables. Furthermore, the report goes into the available sources of potential comparables data and how to make the best use of the data that is available, and determining and making comparability adjustments. A range of examples and case studies are provided to illustrate these principles, together with practical tools to assist with delineating the transaction and undertaking a search for potential comparables.

Acknowledging that the actions described in Part II are unlikely to provide a complete solution for many developing countries due to insufficient data, Part III provides common approaches to be used an absence of comparables. These approaches include: (i) approaches to increase the amount of primary source data on comparables, in particular, publicly available information derived from the financial accounts of independent Enterprises; (ii) approaches that focus on the arm's length nature of a transaction (e.g., tests to determine whether there is a benefit for the service recipient or licensee); (iii) policy options such as safe harbors, fixed margin and other prescriptive approaches; (iv) using the transactional profit split method; (v) the use of valuation techniques; (vi) the application of advance pricing arrangements and other cooperative compliance approaches; and (vii) the use of anti-avoidance rules where appropriate.

With respect to the policy options, the Toolkit provides considerations on the use of carefully constructed safe harbors aligned with the arm's length principle. Such safe harbors may relate to transfer prices to be applied in specific scenarios as well as processes that taxpayers must undertake to determine an arm's length price or margin. Tax administrations could also consider the use of prescriptive rules based on the data available to them (e.g., to establish arm's length safe harbor regimes such as fixed margins). Examples of legislation and regulations related to such policy options are also included in the Toolkit.

Part IV summarizes the information in the Toolkit and concludes that there are three key areas that developing countries might consider particularly effective, namely: (i) use of safe harbors; (ii) use of data relevant to comparability analyses contained in information submitted tax administrations; and (iii) use of a framework for the selection and application of the most appropriate method, reiterating the importance of the actual delineation of the transaction. This section also sets out recommendations for the next phase of the work initiated in the Toolkit, while recognizing that political support will be needed to more systematically address a number of these issues.

The Toolkit contains multiple appendices that contain practical guidance and examples that might be relevant when performing a comparability analysis, including examples on working capital adjustments and on country risk adjustments. One appendix provides an overview of country practices on safe harbor rules for low value-adding transactions.

The Supplementary Report

The Supplementary Report on mineral product transactions was prepared as a response to a request of the Development Working Group of the G20. The Supplementary Report states that building an understanding of the mining sector is essential to understanding tax risks and to apply transfer pricing analysis. To build this understanding the Supplementary Report outlines a systematic methodology that could be adopted by developing country tax departments to improve their understanding of their mining sectors. The Supplementary Report starts with an introduction of the relevance of this guidance. Since the pricing of transactions between related parties in the extractive industries is an issue of particular relevance to many developing countries, it also addresses the information gaps on prices of minerals sold in an intermediate form (such as concentrates). The Supplementary Report then proposes a methodology (i.e., a systematic process) to build an understanding of the mining sector, based on a number of steps. A better understanding of the common practices in the industry is expected to lead to lower base erosion risks and reduced areas of dispute. The Platform prepared several case studies demonstrating this process for copper, thermal coal, iron ore and gold.

Furthermore, the Supplementary Report explains that the cross-border sale and purchase of mineral products between related parties creates BEPS risks. An example of this can be a multinational that sells mineral products to a related entity abroad at prices below equivalent sales to unrelated parties, thereby moving sales revenue and profits offshore. Also, losses in tax revenue from intercompany transactions related to these products can be the result of under-quoted prices, mis-specified reference prices, excessive deductions and penalty adjustments, handling fees, or simply not declaring income from valuable by-products.

It also discusses various wider issues connected to mineral product pricing. These issues relate to the relationship between prices under corporate income tax and royalties, and long-term supply agreements. In particular the latter can complicate the use of contemporary spot prices as potentially comparable transactions. The Supplementary Report emphasizes that these offtake agreements must be read in the context of any other agreements between the parties, the motivation for the agreement and the actual conduct of the parties.

Finally, the Supplementary Report concludes with comments on possible future direction of this work, and where additional related work would help meet the needs of developing countries. Based on the feedback from developing countries, it states that additional case studies and expanded study areas may be beneficial to enhance the practical industry knowledge. Further work may also target various wider issues, for example related to implementing effective transfer pricing rules, trading hubs, price risk management (hedging), encouraging greater market price transparency for some minerals, and continued capacity building and training.

Implications

The Toolkit describes approaches that both tax administrations and taxpayers can use when dealing with the lack of comparables. Multinational businesses active in developing countries may want to consider the guidance provided in the Toolkit when developing and applying their transfer pricing policies for such countries. Companies active in the mining industry are recommended to monitor the implementation of the guidance provided in the Supplementary Report.

Endnote

1. See EY Global Tax Alert, *OECD, UN, IMF and World Bank jointly issue draft transfer pricing toolkit for developing countries*, dated 13 February 2017.

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