
PCT releases Toolkit for Addressing Difficulties in Accessing Comparables Data

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In brief

The Platform for Collaboration on Tax (PCT) on June 22 released a toolkit to help developing countries address the lack of comparables for transfer pricing analyses and better understand mineral product pricing practices.

The toolkit was developed as part of the G20 Development Working Group mandate given to International Organizations under the BEPS project to help protect developing countries from base-eroding payments. In particular, the toolkit includes suggestions as to how developing countries can overcome a lack of data on comparables in a transfer pricing benchmarking study.

The initiative serves as a helpful tool in developing a coherent methodology to benchmarking studies around the globe, as well as providing support to build capacity in developing countries. However, some questions remain on its overall objective and ultimate impact.

In detail

On June 22, 2017, the Platform for Collaboration on Tax (PCT) – a joint initiative of the International Monetary Fund (IMF), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), and World Bank Group – published its Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses.

The toolkit follows a mandate by the Development Working

Group of the G20 – included in the Final Reports on Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) of the BEPS project published on October 5, 2015 – to provide additional guidance to developing countries on the lack of comparables data needed to determine transfer prices. The guidance also serves to help countries set rules and practices that are more predictable for businesses.

The toolkit is part of a series of reports by the PCT to help

developing countries design or administer strong tax systems. Previous reports have covered tax incentives and external support for building tax capacity in developing countries, with reports on transfer pricing risk assessment and documentation expected in the future.

The toolkit takes into account public comments on a discussion draft released on January 24, 2017. It will be made available in French and Spanish.

This Tax Insight updates the previous release on the January 2017 discussion draft. It covers the objectives of the toolkit, its content, and key observations.

Objectives

The toolkit aims at assisting developing countries in overcoming a lack of data on reliable comparables, i.e., market prices or open market transactions for goods and services transferred between members of multinational corporations. It is part of a broader series of publications designed to help developing countries address capacity limitations to design or administer tax systems, and build tax systems that can apply independently and monitor the principles of the BEPS project. The intent is to protect the tax bases of these countries from perceived inappropriate tax planning by multinational corporations.

Content overview

The toolkit is aimed at tax administrations of developing countries and provides guidelines to evaluate the transfer prices set by multinationals, taking into account a lack of information available in these countries on market-based transactions that are comparable to those undertaken by multinational corporations.

The toolkit provides the following content:

- Context of comparables searches;
- Comparability analysis;
- Absence of comparables and how to address this absence; and
- Extractive industries, in particular the information gaps on prices of minerals sold in an intermediate form (such as concentrates).

The toolkit also contains policy options that developing economies could use in designing an effective tax system on transfer pricing, such as carefully constructed arm's-length safe harbours, the selection of the most appropriate method, and anti-abuse provisions.

Additional details are provided in the section below.

Context of comparables searches

The first section of the toolkit provides guidance into the context of comparables searches. This includes an overview and relevance of the arm's-length principle central to the internationally accepted approach for transfer pricing as outlined, e.g., in Chapter I of the (revised) OECD Transfer Pricing Guidelines (TPG). The section further highlights the importance of accurately delineating the transaction.

Comparability analysis

This section covers the sources of comparables data, including an overview of useful databases and step-by-step selection and screening templates. In addition, the toolkit includes details on the background and calculation of certain comparability adjustments. The appendices include further practical examples, e.g., on working capital adjustments, adjustment for country risk, and financial ratios.

PwC comments: Several issues raised in the comments provided by PwC during the public consultation are addressed in the final version of the toolkit, helping to clarify and better align the text to the principles endorsed by the OECD TPG. While the use of secret comparables is still mentioned, its guidance is comparatively softened as compared to the January 2017 discussion draft.

This is in line with the comments provided by PwC, whereby the use of secret comparables should be limited only to specific circumstances and for specific applications. In line with paragraph 3.36 TPG, disclosure is imperative so that there would be an adequate opportunity for the taxpayer to defend its own.

Other concerns remain, such as the use of the so called "sixth method." This method — which refers to prescriptive rules and is not included in the TPG — is described in detail and with limited reservation. In light of existing variations of the "sixth method" under domestic law of certain countries, a lack of consistency in the application carries the risk of double taxation. This is especially true in cases where prescriptive rules and commodity prices deviate from the arm's-length price and lack a mechanism for the taxpayer to demonstrate that a different approach may be considered the market price for a good or service.

Comparability adjustments detailed in the toolkit should not be considered as a formulaic approach to account for a lack of comparability, but rather only when enhancing the reliability of the analysis. A thorough functional analysis should be preferred, leading to an understanding of the circumstances and conditions of the transactions. Whether comparability adjustments are needed also depends on the compliance burden and costs related to such adjustments and the relative value of the adjustments in enhancing reliability.

Absence of comparables

The third section of the toolkit provides insights into the issue of lack of comparables and guidance into potential policy options such as the development of safe harbours. In the context of a comparability analysis

aligned with revised Chapter I TPG, safe harbours are promoted as a useful tool to promote transparency and compliance while at the same time reducing resources and costs.

PwC comment: The toolkit helpfully emphasizes a consistent application of safe harbour rules. However, the toolkit makes only few references to the Mutual Agreement Procedure (MAP). In the areas of prescriptive rules, the use of the sixth method and anti-abuse provisions may give rise to double taxation concerns as discussed above.

Minerals industry (Case Studies and Supplementary Report)

The toolkit includes case studies on the extractive industries. In addition, it includes a new supplementary report on addressing the information gaps on prices of minerals sold in intermediate form, which previously were presented in a separate document. The studies serve to provide guidance on industries that are of particular relevance to many developing countries.

The supplementary report includes case studies covering transactions involving copper, iron ore, thermal coal, and gold. It further provides a systematic process to delineate transactions related to the minerals industry, identify key traded products, and establish common industry pricing practices.

The six-step process to determine arm's-length prices is as follows:

1. Understanding the extraction process of the mineral and its transformation;
2. Identifying the products and the processing facilities;
3. Analysing the uses of the minerals, their price-setting, and international trade environment;

4. Identifying the intra-group sales and their economic context;
5. Determining what information is available; and
6. Applying a methodology allowing to close information gaps.

PwC comment: A structured and pragmatic approach in the delineation of the transaction is helpful. Although the case studies and supplementary report focus on minerals, the provided guidance can be of more general relevance where there is an information gap between an associated enterprise extracting raw materials and another enterprise that then sells refined products to another (related or unrelated) party.

The takeaway

The Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses released by the PCT summarizes approaches on safe harbours, available data, and frameworks of the selection of the most appropriate method. It provides useful recommendations for further work on increasing data availability via international databases, support in improving access to existing databases, and making the best use of existing data, e.g., through best practice measures.

The BEPS project, which included the mandate to draft this toolkit, aims at countering inappropriate profit shifting by focusing on transparency and aligning transfer pricing outcomes with value creation. Against this backdrop, the toolkit focuses on the determination of comparable market prices from the perspective of developing economies' tax administration faced with a lack of local comparable data from which to derive market prices.

The toolkit provides guidance from the perspective of developing

economies' tax administrations in an audit situation. At the same time, the perspective of taxpayers, who face similar issues with the lack of comparables data, is not directly addressed.

In the context of implementation and capacity building in developing economies, the toolkit does not include alternative approaches to dispute resolution and prevention. These approaches – which include collaborative compliance and real-time reviews – allow for real-time (re)action and co-operation between taxpayers and tax authorities rather than retrospective adjustments in tax audits.

The toolkit serves as a reminder that transfer pricing requirements are becoming more prevalent in developing countries, particularly with regards to extractive industries. The scrutiny towards taxpayers is growing as tax administrations are building capacity in transfer pricing. For taxpayers in developing economies, this emphasizes the renewed need for clear and consistent methodology as well as sophisticated transfer pricing analyses and documentation.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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