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## **EU JOINT TRANSFER PRICING FORUM**

### **COMPILATION OF NGM CONTRIBUTIONS ON COMPARABLES IN THE EU**

**Meeting of 23 June 2016**

**DISCLAIMER:**

This document contains a compilation of contributions received from various Non-Governmental Members of the JTPF on using comparables in the EU since the JTPF meeting in February. The comments do not represent a consensus view of the JTPF's Non-Governmental Members and are submitted as individual contributions to the discussion. This document does not represent a formal Commission or Commission services position or policy.

Contact:

Hartmut Förster, Telephone (32-2) 29.55.511

Morgan Guillou, Telephone (32-2) 29.54.146

E-mail: [taxud-joint-transfer-pricing-forum@ec.europa.eu](mailto:taxud-joint-transfer-pricing-forum@ec.europa.eu)

# Compilation of NGM contributions

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## A. Introduction/Background

### 1. Scope of the work

#### 1.1 Mandatory status

1. Documentation: We think that the EU JTPF should think about qualitative / quantitative thresholds should be established to determine when an economic analysis should be mandatory in documentations.
2. Update: The EU JTPF should make a recommendation. Depending on the materiality / complexity of the transaction: An annual update of the financials / review of the comps + completion of a new search every 3 to 4 years could be an option..

#### 1.2 Taking Comparable Searches to the next level

Here below we share some thoughts on where we think lies the future of Standard Comparable Companies Searches ('SCCS') for advanced taxpayers:

- Possibility to adjust thresholds to account for country representation: In order to reflect the footprint of the group / tested parties (when a SCCS is used for different companies, as it is usually the case with MNEs), it should be possible to modulate thresholds (e.g. turnover) in the search strategy to have a sample more representative of the group geography
- IQR & Risk: It should be emphasized that granting a profit to a group company within the bounds of an industry-based IQR substantially reduces the risk of these group companies compared to the very companies in the sample. Hence an adjustment for this reduction of risk would be useful

#### 1.3 General comments

When discussing comparables we need to classify some groups of potential comparables:

- Comparables for the purposes of intangible transactions
- Comparables relating to financial transactions
- Comparables relating to commodities
- Comparables relating to business activities based on profit level indicators (services, production, distribution, R&D).

Those 4 main groups of potential comparable data should be addressed for the EU market separately since each of the category will have its own characteristics and potential best practices. The outcome of the works of the JTPF should clearly define the category of comparables addressed. We should avoid the situation that the comparability analysis is limited only to the search of profit level indicator for a particular business activity.

#### Situations when lack of comparable data exists

The term "lack of data" should be addressed to the 4 main groups of potential comparable data mentioned above.

“Lack of data” is very subjective and case sensitive. When using commercial databases (in particular in the field of intangibles) the search is performed based on the set of criteria that can potentially be modified/loosed when we identify the “lack of data”. In such a situation a generic search is performed using more general criteria/using broader classes of potential comparables. The issue of professional judgement is to what extent it is possible to modify search criteria to classify the transactions/data as sufficiently comparable to the tested party/transaction/activity.

Example: transactions involving transfer of trademark for natural cosmetic for hair or licencing the trademark can be searched using text search “hair”, “natural” and „cosmetics” or only “cosmetics”. One of the factors to be taken into account in such a case is the profitability on the selected exploitation field. When there is no data for a particular pricing method, we should consider using other pricing method or a valuation technique.

#### 1.4 Other considerations (1)

- Although it is obvious, it might be worthy to stress that the comparability analysis should be seen as a game of balance between accuracy and reliability when seeking for comparability, on one side, and administrative burden, on the other. Some common grounds should be set up between TAs and taxpayers in order to avoid infinite litigation and uncertainty; consented solutions on a reasonable level of comparability could be helpful to this end (e.g. regional criteria: EU as one market instead of local searches)

#### 1.5 Other considerations (2)

Benefit and reliability of in-house search strategies has been underlined as they tend to achieve the following:

- Audit defence - the company can explain each step in the benchmark to the tax authority and also modify the search if additional information is requested during audit.
- Consistency - the search strategy is similar each time and tailored to the company's industry and specifics of our group entities –to the extent this is possible.

## 2. Delineation of transactions/Relation to BEPS Action 8-10

### 2.1 Focus: Combination with the new OECD TPG

The focus of the work should clearly be the combination with the new OECD TPG. The drafting of a common guidance, or best practice as you described it below, could create significant value and potentially set a standard even on a global scale.

### 2.2 Context & impact of the BEPS project

Even though the 2006 project on Comparability (“**Comparability Draft**”) launched by the Organization for Economic Co-operation and Development (“**OECD**”) was a good starting point, what is of a paramount importance at this stage is to rehearse that project and following the example of the work done in the context of the Base Erosion Profit Shifting (“**BEPS**”) project with reference to the application of the arm’s length principle to intangible assets. In particular, the EU Joint Transfer Pricing Forum (“**EUJTPF**”) should take into account the clarifications regarding the pragmatic approach implemented in the new Chapter VI of the OECD Transfer Pricing Guidelines for

Multinational Enterprises and Tax Administrations (“TPG”), where several cases are addressed, and developing on the basis of those clarifications further guidance on comparability.

Developing a common guidance is of a paramount importance and inevitable in order to avoid that the application of the same principle to different transactions creates double taxation.

The importance of the broad-based analysis of the controlled transaction

Actions 8-10<sup>1</sup> of the BEPS stresses the key role of the comparability analysis - with particular emphasis on the importance of the functional analysis - for ensuring the alignment between transfer pricing outcomes with value creation.

This objective should be achieved by analysing functions performed, assets employed and risks assumed not only at the level of tested party but rather for all the entities of a multinational enterprise (“MNE”). This is also in line with our previous commitment: the Country by Country report. Now the focus must be on the overall MNE!

The performance of a broad functional analysis allows MNEs to accurately detect all the conditions made or imposed in the control transaction and to allocate among the value chain the value created in accordance with the arm’s length principle. This must be the starting point for any comparability analysis: performing this step without focusing on qualitative information (such as organisational charts, modus operandi, ability to take decisions) and significant people functions will lead to a comparability analysis lacking of alignment with the real substance of the value chain. Indeed, the analysis of the specific circumstances of the controlled transaction is the input for performing the second key step: the comparison of the controlled transaction with a transaction occurred in the open market between independent enterprises<sup>2</sup>.

In light of this, although the NGM input was requested on comparable search, we want to stress that more emphasis must be put on the importance of the understanding of the specific facts and circumstances of the controlled transaction.

In this respect, what it is found in practice is a high level analysis (mainly based on documents or general overview of the business provided by tax people) of the controlled transaction without putting enough efforts in analysing the aspects/sources that could affect the transfer pricing outcome (e.g., interviews with the significant people functions). In light of this, we suggest to the EUJTPF to focus also in developing a best practice on performing an appropriate analysis of the five comparability factors of the controlled transaction.

### **2.3 On Transaction Delineation and articulation with the OECD BEPS Deliverables**

Transaction delineation specifically: Transaction delineation and the definition of the purpose of the SCCS are interrelated: the transaction delineation should (i) fit the actual fact pattern / conduct of

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<sup>1</sup> Aligning Transfer Pricing Outcomes with Value Creation Actions 8-10 2015 Final Reports (“**Actions 8-10**”). For the purposes of the this document reference is made to the first part of Actions 8-10 dealing with the Guidance for Applying the Arm’s Length Principle - Revisions to Section D of Chapter I of the Transfer Pricing Guidelines.

<sup>2</sup> See paragraph 1.33 of Action 8-10.

the tested party but it should also be defined so as to enable to find appropriate comparables under the SCCS.

#### 2.4. Impact of the revised OECD guidelines (BEPS Actions 8-10)

- Impact of the revised OECD guidelines (BEPS Actions 8-10): the new guidance perfectly fits in the traditional process of conducting a TP analysis as the delineation of the transaction should be conducted prior to the search process: the better the transaction is defined, the more accurate the search process will be. Nevertheless, it should not be forgotten that the integration of the risk analysis into the comparability search is a difficult, subjective and uncertain (as regards to the final outcome) task. Benchmarking functions, or even assets is much easier than looking for risks. The limited availability of data usually determines that it is not possible to come up with an accurate set of comparable companies in terms of risk. Possible approaches to face this issue could be the performance of adjustments (financial ones?) or the graduation of the tested party profitability within the arm's length range. In my opinion this is one of the most thorny topics to address after BEPS in the TP analysis.
- Finally, as regards to adjustments, they should be analyzed on a case-by-case basis; TAs should be ready to admit this practice; however, they should not be performed automatically, but only aiming at increasing comparability.

In conclusion, I would see any kind of common guidance concerning the comparability analysis and/or the benchmarking process as very positive for the purposes of standardizing a critical stage of the transfer pricing analysis. The commitment of EU TAs and taxpayers to adopt certain rules would mean a successful advance and would avoid future litigation.

#### 2.5 Need to push forward comparability analysis and connection (?) to the DoT

I am conscious of, and I do share, the need for pushing forward comparability analysis / benchmarks that, as it is seen today in practice, might be considered as leading to similar and homogeneous outcomes (profit levels) to the detriment of potential particular characteristics of tested parties, and as such creates skepticism among many tax administrations.

But I have to say that I am still a bit perplexed with the potential perspective of establishing a direct link between benchmarks and Delineation of Transactions ("DoT"). It seems to me that DoT, according to the OECD "typical process" for "accurately delineating transactions", is in fact the comparability and functional analysis itself (economic environment, business model, functions, assets, risks, contracts and strategy). DoT is then complex, due to its multiple factors, and I can't see the relevance nor how to "fully" integrate it in benchmarking exercises e.g. in screening strategies when using external comparables.

DoT is indeed of a paramount importance in characterizing parties to a transaction, in identifying the less complex entity to be tested (for one-sided methods) – which is not necessarily a 0 value / 0 asset / 0 risk entity-, and in selecting TP methods & PLIs (step 1).

As a step 2, and when it comes to benchmarking, we are mainly talking about one-sided methods applicable to the less complex entity i.e. the one which does not have material entrepreneurial attributes in terms of valuable/unique functions, assets and risks, and it seems to me that coming



back to material DoT factors at this stage is likely to reveal defaults in step 1 functional characterization / selection of TP method (i.e. one-sided) & tested party.

Also, it might lead to a multiplication / aggregation of material adjustments that would create a virtual / artificial “arm’s length reference”.

In short, it seems important to me to make clear and not ambiguous that DoT factors should be mainly treated in step 1, and that “benchmarking adjustments”, as legitimately suggested by the Secretariat (§ II of the draft discussion paper), should not materially address critical DoT factors especially multiple and aggregated.

That being said, and from experience, I am sharing some thoughts that I hope might be of interest.

## B. Search for comparables, compliance

### 1. Internal Comparables

#### 1.1 Envisageable scope and adjustments

I do agree that, in theory, internal comparables are a great reference but do rarely exist notably due to current OECD criteria. Indeed MNEs generally don't deal with related and third parties at the same time, in the same geographic area and in the same position within the commercial cycle (master distributor, wholesaler, distributor...).

It might be considered to allow the use of internal comparables that exists within the group but are not dealing with the tested parties and are acting on a different geographic area.

Then some adjustments might be relevant and seem technically workable:

- Geographic area: adjustments based on gaps in GDP or in profitability of the global sector/industry in the given country. It might be difficult if, for example, the tested party is located in country A, the related party dealing with the third party located in B and the third party in C (EU and non EU countries).
- Position within the commercial cycle: this mainly consists in differences in the number of intermediaries before reaching the final customer. It should be possible to assess respective contribution of the different commercial actors, may be by sharing the "arm's length" global distribution margin.

#### 1.2 Possible methodology

##### Internal Comparables

Creating a Methodology for the analysis of internal comparables could clarify and provide some level of certainty for the tax payers and tax administration. I present below (Exhibit one), a flow chart for the evaluation of internal comparables and those issues where the work of the JTPF would be helpful.

##### 1) *Detailed Guideline on Delineation of a Transaction.-*

The OECD has rephrased what we used to call the characterization of the parties into a delineation of transaction. Although the second might be more detailed and related not only to the legal entities but also to the transaction itself, I believe the JTPF could work on this characterization of legal entities and delineation of transaction. The taxpayers and tax authorities should have a common understanding of the steps and methodology to characterize a legal entity/delineate a transaction. That means we have to develop within the EU same concepts and understanding for processes and terms. In the case of processes the OECD has detailed in Action 8-10 pretty much the general guideline for an analysis. But in the case of concepts there is still a lot of room for improvement. Terms like full-fledged manufacturing company, low risk distributor, agent etc. should be defined and described. At the end of the controlled transaction analysis the conclusion is basically what "character" has the legal entity? A lot of the disputes with the tax authorities turn into a characterization discussion, a different delineation of the reviewed transaction. At this point it also makes

sense to go into the concept of creation of value and how this concept should play a role in the delineation of the transaction.

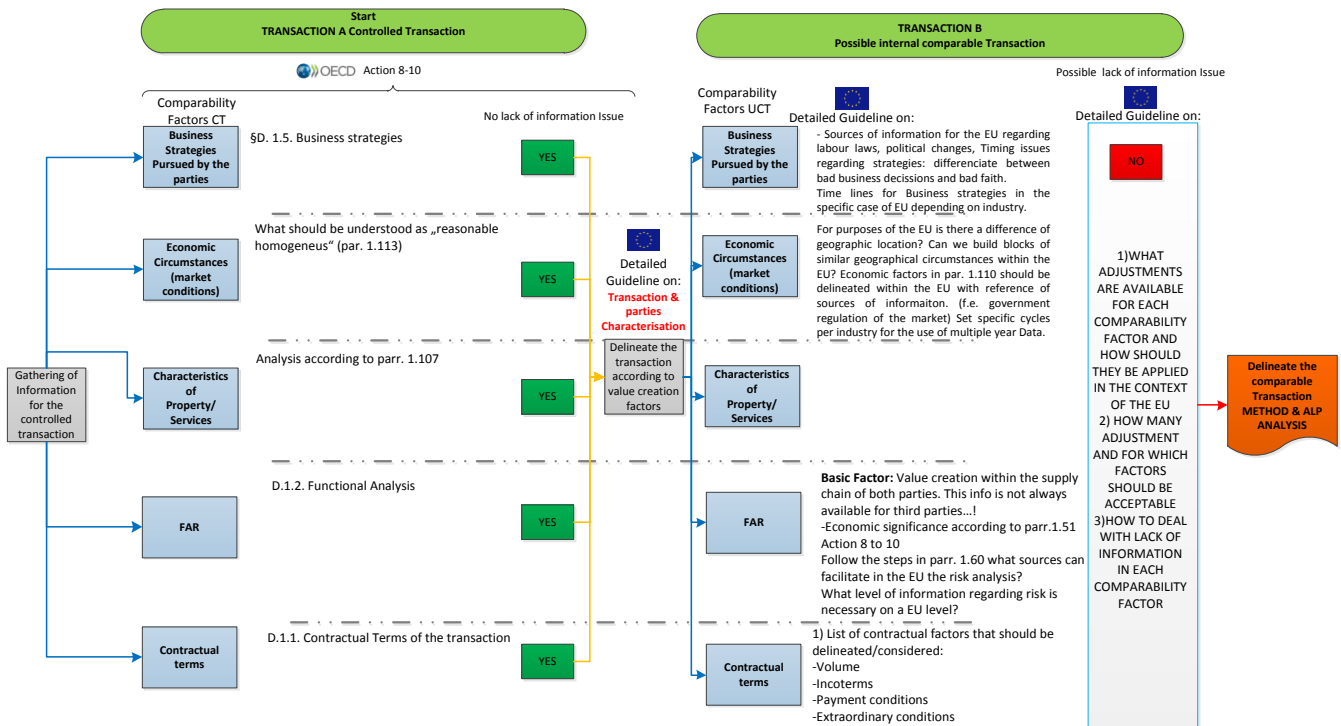
At this point there is no “lack of information” problem because the tax payer has all information regarding a controlled transaction, nevertheless for the search of an internal comparable the tax payer is challenged with lack of information in relation to the third party.

2) *Detailed Guideline on Comparability Factors within the EU for an internal comparable analysis.-*

Each comparability factor is an opportunity for the EU. An opportunity to harmonize terms, provide sources of information and suggest a methodology for the analysis. The EU has already a very robust source of information which could be used for some of the comparability factors. Please see Exhibit one.

3) *Detailed Guideline on Adjustments and lack of information.-*

This is another area where the JTPF has a great opportunity to simplify and help improve the application of the OECD TPG within Europe. What adjustments are appropriate in each comparability factor, how should they be applied, and how could we deal with the lack of information in regard to each comparability factor. How many adjustments are still acceptable for the transaction to be comparable and what weight does each comparability factor has in relation to the method being applied.



### **1.3 Identification and search strategy description**

As regards internal comparables, JTPF works should concentrate on identification of potential internal comparables and use of such data. Comparability factors' test in the case of the internal comparables should be well scrutinised, in particular taking into account functional and risk differences. For internal comparables we should not describe "a search strategy" but "an identification strategy". Mostly the internal comparables will be defined in the contracts and in the financial data so the main issue is to identify accurate internal comparables.

## **2. External comparables / Search Strategy**

### **2.1.General**

#### **2.1.1 Simplification/strategy/where an external study**

- A real simplification in my mind would be if the JTPF could make /publish a library of (common) benchmark studies (e.g. general accepted benchmark study for back office service or some listed head quarter services).
- What we do have in place to address possible concerns is a write up on our global benchmarking strategy. That means, what are the standard search criteria applied specified in 7 regions around the world. With such write up of our global benchmarking strategy we are able to demonstrate that we do not randomly apply search criteria, but follow a fixed step plan.
- If I understand correctly, the Commission was to command a study from an external party to see how the local requirements differ in the EU. I think that is helpful in the process as well.

#### **2.1.2 Selection/search criteria – need for consistency in the EU**

- Selection of comparables should be achieved under consideration of quantitative selection criteria rather than pure qualitative reviews of business descriptions and websites.
- For EU countries, a framework of search criteria should be defined that can consistently be applied among all EU countries.

#### **2.1.3 Assessment and corresponding of FaR at the level of comparables**

- The assessment of the correspondence of functions and risks of the tested party and the comparables identified is a challenging task.
- In practice, the selection of comparables that have an appropriate function and risk profile is often based on qualitative analyses.
- Qualitative analyses focus mainly on reviews of websites and company descriptions provided in the databases.
- This manual process is not only burdensome and time consuming but involves also subjective judgments to a large extent.
- Especially challenging is the fact that company descriptions in databases are often not reliable and website information limited.

- It is therefore recommended to apply quantitative measures in the search process that allow for a more objective decision making on the final set of comparables.
- Although the selection of quantitative measures itself is somewhat subjective, a consistent application of quantitative measures increases reproducibility of benchmarking results by different parties.

#### 2.1.4 Examples of quantitative criteria

Examples of quantitative criteria increasing comparability in regard to F&R profiles

- The table below shows a selection of quantitative criteria that can help to align the search strategy to the function and risk profile of the tested party.
- For example: As the difference of fully-fledged and routine entities stems especially from different levels of IP ownership, a consideration of an intangible-related search criterion is deemed to be beneficial for identifying only comparable companies that actually possess routine functions.
- For a service provider as tested party it is deemed to be supportive to apply in addition a quantitative criterion in regard to the level of “property, plant & equipment”.
- A set of appropriate quantitative measures should be identified and agreed upon for typical function and risk profiles as a basis for common guidance and consistent search strategies.

<b>Contract manufacturer</b>
<ul style="list-style-type: none"> <li>• Exclude companies with R&amp;D/sales or intangibles/balance sheet total &gt; X%</li> </ul>
<b>Limit risk distributor</b>
<ul style="list-style-type: none"> <li>• Exclude companies with R&amp;D/sales &gt; X%</li> <li>• Exclude companies with Property Plant &amp; Equipment/sales (or balance sheet total) &gt; X%</li> <li>• In case of a pure sales agent: Consider to exclude companies with an inventory to sales turnover &gt; X days</li> </ul>
<b>Contract R&amp;D</b>
<ul style="list-style-type: none"> <li>• Exclude companies with Property Plant &amp; Equipment/sales (or balance sheet total) &gt; X%</li> <li>• Exclude companies with an inventory to sales turnover &gt; X days</li> </ul>

#### 2.1.5 Examples of pre-screening criteria

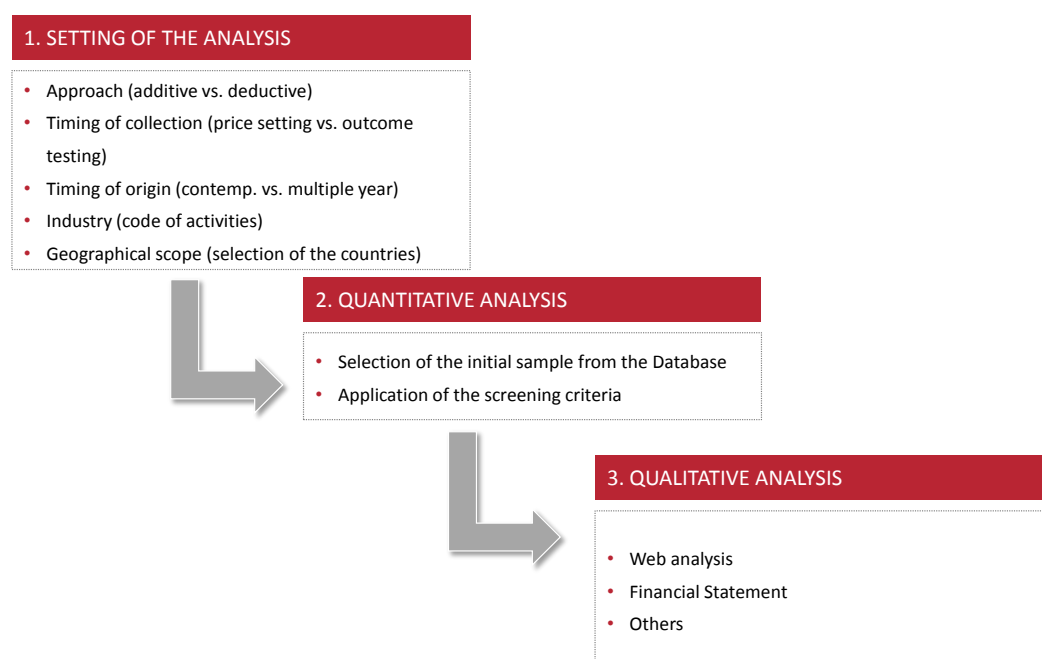
A list of pre-screening criteria which we have developed as a best practice for Amadeus searches in Europe. In a way, this is a working compromise, given that in practice the approaches may differ based on various reasons, e.g. due to country tax authorities preferences and practice.

Step	Fully-fledged analysis
Amadeus Version	Amadeus top 3.0 million version
Legal status	Active Unknown Situation
Region	Generally European Union enlarged (27 / 28) Generally: Include companies with A,U independence indicator
BvD Independence indicator	Subsidiaries: companies that have more than 25% interest in one or more subsidiaries are excluded. Companies with unknown subsidiaries structure should be included  The independence criteria may be narrowed down based on local requirements  Manual review of the shareholder structure of the potential comparables based on the information published in the Internet
Type of accounts	U1 + C2 (holding companies with consolidated data for further review)
Industry	Primary NACE Rev. 2 Codes
Business overview Screening	Generally, business overview screening may be applied
Trade description Inclusion or Exclusion Keywords	Inclusive and Exclusive key words may be used as an optional criterion to narrow or expand initial sample of companies
Relative / absolute	absolute
Year of incorporation	three-year start-up phase assumed
Availability of Financial Data	3 years out of 3 years 5 years out of 5 If the criterion limits the number of potential comparables to a significant extent, it may be allowed on a case by case basis to accept entities for which financial data is available for at least two of 3 years / three out five years
Internet Screening	Generally, Internet screening may be applied to all potential comparables identified based on screening in Amadeus database and screening of financial data
Comparability of Products and Functions	Perform the screening on product comparability next to functional comparability. If no comparable can be identified, focus only on functionality.
One Source	Generally, independence status of the entities included in the final sample of comparables may be verified
Independence Check	Verification of independence is based on BVD independence indicator. Subsequently, the companies' websites are checked. The independence status is double checked based on information about the companies in OneSource, Hoover's or other database.
Loss Making	Generally, exclude permanent loss makers, in particular in cases of analysis of profitability of low risk entities (e.g. contract manufacturers).
Turnover threshold	Apply turnover threshold depending on the facts and circumstances of the tested party In general: acceptable in cases where it can be reasonably expected to increase the comparability of data
Diagnostic Ratios	Decisions to apply and selection of diagnostic ratios need to be based on robust analysis of facts of the case
Capital Adjustments to Zero	Only in very specific circumstances when working capital is close to 0
Capital Adjustments to tested party	Only in very specific circumstances (eg. with regard to agents/tollers/flash title distributors), when comparability of the data of comparables related to working capital is highly imperfect
Printout / print screens (soft copy) of Website of Accepted Companies	Make printouts / screenshots of websites of accepted companies.
Printout / print screen (soft copy) of additional database Information regarding Accepted Companies	Make printouts / save soft copy of additional database information regarding accepted companies if web-based as it can also change over time.
Printout / print screens (soft copy) of Website of Rejected Companies	Make printouts / save soft copy of fragments of websites of entities rejected based on manual review that clearly indicate reason for rejection in cases where a decision on the rejection is made based on the information available on the website. Report website address in Search matrix.
Printout / print screen (soft copy) of additional database Information regarding Rejected Companies	Make printouts / save soft copy of fragments of additional databases' (e.g. Onesource database) websites related to entities rejected based on manual review that clearly indicate reason for rejection in cases where a decision on the rejection is made based on the information available in those databases.
Sufficient Financial information of Accepted Companies	Make printouts / screenshots of financial information of the accepted companies in cases where the analyzed financial information was obtained from other sources than Amadeus database. For audit defence / APA also make printouts of financial information of rejected companies in cases where the analyzed financial information was the reason for rejection of the given entity and was obtained from other sources than Amadeus database.
Reason for Rejection	Information on reason for rejection is recorded in rejection matrix.
Detailed Description of All Steps taken	Keep detailed description of all steps Screenshots in the report.
Print Screen of Search Strategy	Screen shots of Amadeus search strategies could be inserted in the transfer pricing reports. The Amadeus / Excel file indicating search strategies could be saved.
Additional Remarks	Indicate in report the Amadeus version used.

## 2.1.6 Adopting a transparent and step-based search strategy

Setting a transfer pricing policy in line with the arm's length principle by adopting a transparent approach verifiable by Tax Authorities requires the exact identification of all the steps to follow in order to be able to identify the most reliable comparable information available on the open market.

In particular, any benchmarking analysis in order to be consistent with the arm's length principle must be based on the steps represented in the chart below.



By following the above depicted approach, starting from an appropriate analysis of the controlled transaction, an outcome aligned with the substance is likely to be reached.

However, the three phases are not regulated in detail by any official transfer pricing documents. Therefore, it is strongly suggested to the UEJTPF to set a common standard on the performance of the benchmarking analysis and further developing the above depicted phases.

## 2.1.7 Additive approach vs. deductive approach

The TPG recognise two type of approach for the identification of potentially independent comparable<sup>3</sup>: (a) the additive approach which is based on the experience of the person making the comparability analysis, and (b) the deductive approach which starts with the wide set of companies that operate in the same sector of activity, perform similar broad function and do not present economic characteristic obviously different.

The deductive approach is generally preferred being more objective and reproducible. In this respect, the use of regional databases would avoid the risk of having different industry codes in different countries (in particular, for Europe the NACE codes should grant consistency among different

<sup>3</sup> See TPG Chapter III paragraph 3.41 and 3.42.

countries). Use of domestic databases should be confined to situation where only one country is considered in the regional scope of the analysis.

The additive approach is claimed to be too subjective. However, although it could not be applicable as unique tool for selecting the initial sample, it may be used as important source of information for further refining the parameters of the deductive analysis.

### 2.1.8 Need to promote quality over standardized approaches

#### II.C The need of promoting quality over standardised approaches

Difficulties might be encountered during the research of independent comparables due to (a) the absence of specific public data, that obliges the taxpayer/tax authorities to conduct an analysis based on assumptions (in most of the cases based more on experience than on economic principles); (b) the lack of common guidelines for the research of comparable, that leads to analysis based on subjective judgements (and therefore, questionable).

These two issues can jeopardise the application of the arm's length principle and lead to a transfer pricing outcome not aligned with the value creation. Whether the first issue is undeniable in absence of internal comparables, on the second issue there is room for performing additional work.

In this respect, the TPG do not provide a sharp position on how a comparability analysis should be performed but rather put forward general recommendations emphasising an approach based more on the quality of the information available rather than on the quantity.

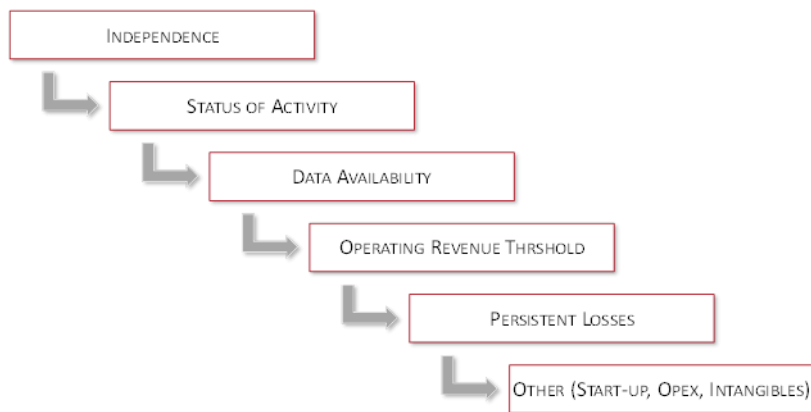
*3.33 Use of commercial databases should not encourage quantity over quality. In practice, performing a comparability analysis using a commercial database alone may give rise to concerns about the reliability of the analysis, given the quality of the information relevant to assessing comparability that is typically obtainable from a database. To address these concerns, database searches may need to be refined with other publicly available information, depending on the facts and circumstances. Such a refinement of the database search with other sources of information is meant to promote quality over standardised approaches and is valid both for database searches made by taxpayers/practitioners and for those made by tax administrations. It should be understood in light of the discussion of the costs and compliance burden created for the taxpayer at paragraphs 3.80-3.83. [emphasis added]*

On the other hand, a common mistake in the standard practice is to refine the database search through which statistical tools (like the interquartile range) rather than performing extra efforts looking from alternative source of information.

In light of this, we suggest to the EUJTPF to develop a common framework on how to perform an economic analysis in particular by providing:

- a list of quantitative screenings to be performed for reducing the initial sample (see chart below) with the related guidelines





Examples of alternative source of information to be used for enhancing the outcome of the search (e.g., financial statements and web-sites);

### 2.1.9 Proposed scope and definition for the search strategy in and outside the EU – General objectives and considerations

Definitions & scope of our comments and of what we think should be the mandate of the EU JTPF in this space

- **Definition:** We'll refer in this document to "Standard Comparable Companies Searches" or SCCS as comparable companies search typically performed in order to apply the TNMM and performed on public databases. SCCS involve first a search strategy (Boolean query based on industry, keywords, etc.) on the database and then a manual review of the elements in the database / on websites. Typically, these searches end up with a number of companies, say between 4 to 50 or more independent companies. SCCS may be involved in the pricing of a large number of intercompany transactions, typically used to determine the remuneration of the simplest functions.
- **Out of Scope :** We do not comment on other comparable searches (including for instance search for royalty rates, or analysis of internal comparables or comparables identified through qualitative search only, or searches resulting in large (30+) sample, etc. ) in this short email.
- **Non Intra-EU:** Furthermore, whilst we understand that the current focus is on comparables searches focusing on a European tested party, the EU JTPF may have something to say about the searches when the tested party is outside of the UE.
- **Nature of the EU JTPF output:** In addition, our view is that transfer pricing is an always evolving field. Evolutions are essential in order to cope with changes in business models / in the practices of taxpayers / tax administrations. In this context, we do believe that recommendations from the EU JTPF should not prescriptive, and concentrate on non-binding best practices

## Introductory comments: objectives for the EU JTPF

- By nature such studies aim to select independent companies. We note that data access has improved (more data and more country) – the number of companies in the databases is significantly larger than before / probability to find better comps has increased
- Objectives of comparable searches: The advantage of the SCCS are that they provide a relatively fair discussion space between taxpayers and tax administrations. As such, we believe that the objectives of the guidance that the EU JTPF should provide on these matters should include:
  - Reducing the burden on both taxpayers and tax administrations as regard Comparable Searches execution and review
  - Reducing the uncertainty in terms of the selection of the comparables
  - Improve the reliability of the analyses

## Comments on the purpose and principle of Comparable Searches

- Sampling vs Surveying: We emphasize on the fact that, in our mind and based on economic theory, Comparable Searches should not aim to capture all the “best” comparable companies but a statistically significant sample of reasonably comparable companies. Comparable Searches are about sampling, not about comprehensive surveying.
- Groups: the arm’s length principle provides for the consideration of independent parties. It does not provide for the exclusive consideration of single-entities groups, i.e., groups comprising several legal entities, potentially across different jurisdictions, should be accepted in SCCS, to the extent that (i) consolidated accounts are used and (ii) the group, as a whole, is comparable to the tested party. We would like to emphasize this point as we think that, in a number of situations multi-entities groups are much more likely to provide economically comparable data points than single-entity groups. We note that a number of European tax administrations disregard in practice multi-entities groups
- Losses: Independent companies on the marketplace incur losses. Profit is the explained variable in Comparable Companies Searches. Consequently companies experiencing losses should not be disregarded on these sole grounds (individual companies making recurring / extremely significant losses may be rightfully disregarded as they are likely to be the sign of inconsistent data). We note that a number of European tax administrations disregard this aspect and impose that loss making companies are excluded from the search.

### 2.1.10 Comments on the search strategy (definition, industry Codes, keywords, manual review)

#### Comments on the search strategy

- a. Definition of the purpose of the search: The first key step is to clearly articulate what type of comparable companies the SCCS shall seek to identify. This step directly stems from (i) the comparability analysis of the tested party (ii) an understanding of the key value drivers of the tested party at arm’s length, so as to make an informed choice on to which industry segments potentially expand the search.

- b. Industry Codes: Based on our experience, relying on industry codes (e.g., NACE or SIC codes) provides a relatively unbiased way to identify comparable companies.
- c. Inclusion keywords: If applied, the choice of inclusion keywords should be carefully documented so as to ensure objectivity and reliability in the process. In particular, there is a high risk that inclusion keywords lead to sample selection bias. Based on our experience, we believe it is preferable to use “exclusion keywords” rather than inclusion keywords as the risk of sample selection bias is lower.
- d. Sample at this stage: based on our own practices, we tend to be comfortable with a number of companies to review after the quantitative screening steps (i.e., the steps that are performed on the database itself, prior to a one by one review of the companies) ranging from 100 to 500 companies. This is only our practice in general and do not recommend that any best practice is issued in this respect.

#### **Comments on the manual review**

- e. Manual review: this step probably is the most subjective / sensitive to perform in the SCCS. We recommend a particularly thorough and documented analysis. In particular the key aspects to consider are, in this order:
  - Independence / absence of presumption of intercompany dealings
  - Functional comparability
  - Market level comparability
  - Overall business comparability (product, business, etc.)

#### **2.1.11 External comparables – challenges, practical problems, possible ways forward**

##### **External Comparables.**

In the case of external comparables the first challenge for the tax payer is that in most of the cases its competitors are not a source of information or a probable comparable because they are also MNE's and failed therefore the independence search criteria. A MNE has a lot of information regarding its competitors but not a lot of information about all none MNE's that performs the same activity they do.

From my perspective the source of the problem by external comparables is that there is no data base created for TP purposes.

While performing a Benchmark for analyzing gross or net margins of a company NACE codes are used. We need to understand the challenges of the use of such data base if we want to understand all other subsequent problems we have for finding right comparables.

NACE is the European standard classification of productive economic activities. NACE presents the universe of economic activities portioned in such a way that NACE code can be associated with statistical unit carrying them out. An activity as defined for the NACE may consist of one simple

process , but may also cover a whole range of sub- processes, each mentioned in different categories of the classification (for example, the manufacturing of a car consists of specific activities such as casting, forging, welding, assembling, painting, etc.) If the production process is organized as an integrated series of elementary activities within the same statistical unit, the whole combination is regarded as one activity.

NACE does not draw distinctions according to the kind of ownership of a production unit or its type of legal organization or mode of operation, because such criteria do not relate to the characteristics of the activity itself. Units engaged in the same kind of economic activity are classified in the same category of NACE, irrespective of whether they are (part of) incorporated enterprises, individual proprietors or government, whether or not the parent enterprise is a foreign entity and whether or not the unit consists of more than one establishment. The manufacturing activities are described independently of whether the work is performed by power-driven machinery or by hand, or whether it is done in a factory or in a household. Modern v traditional is not a criterion for NACE.<sup>4</sup>

NACE consists of a hierarchical structure (as established in the NACE Regulation), the introductory guidelines and the explanatory notes. The structure of NACE is described in the NACE Regulations as follows:

- i. A first level consisting of headings identified by an alphabetical code (sections),
- ii. A second level consisting of headings identified by a two digit numerical code (divisions),
- iii. A third level consisting of heading identified by a three- digit numerical code (groups),
- iv. A fourth level consisting of headings identified by a four-digit numerical code (classes)<sup>5</sup>

The point on describing the NACE classification as source of information is to demonstrate that our starting point which usually is the use of a Bank of information with this NACE classification is actually not aim for TP purposes. We are basing our searches in a source that was not created for transfer pricing purposes and we deal therefore with following challenges:

Information limited to financial information and a short description of the activities.

- In terms of contractual terms: there is not enough information
- In terms of FAR analysis: If the company performs more than one activity, there is no segmentation of PL information. The Industrial codes might include companies that perform more than one activity. The processes are not being considered, information regarding the development of technology is not available. There is no information about assumption of risk or control.
- In terms of Characteristics of products: the only way to analyze this comparability factor is by visiting the web site of the companies, in a lot of the cases the companies are so small that there is no information available in English.

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<sup>4</sup> NACE Rev. 2 Statistical classification of economic activities in the European Community, Eurostat.

<sup>5</sup> Idem.

- In terms of Strategy: Companies usually do not disclose their strategies, for some of them there is not even information available about their goals or how they want to increase sales of market penetration.

To think that we or the tax administration can really perform a comparability analysis as deep as described in Action 8-13 with this quality of information illusory.

Nevertheless, the EU has here also a great opportunity. The creation of a Bank of information for TP purposes available to all MNE with headquarters in Europe and EU tax administrations would facilitate the comparability analysis performed on an EU level. The EU has already robust organizations and sources of information that could be used to develop the right Information Bank. All information gathered within Eurostat would be more helpful as the sources available now.

In this Information Bank the EU could think of including Economic information regarding the EU States, classify them for TP purposes, include information regarding Industry development and cycles gather public available information regarding company's strategies and level of development etc.

We cannot think of a real external comparability analysis as deep as expected by the OECD in terms of risks, economic circumstances, and business strategies with the amount of information available now for TP purposes.

In order to avoid the patching of problems and difficulties for tax payers and tax administrations the EU has to look for practical tools and solutions that end with these difficulties from the root. One tool that would benefit taxpayers and tax administrations in terms of work and costs is a bank of information designed for TP purposes and available at a EU organization and not by license providers that at the end have developed a screening criteria that in most of the cases have to followed by a manual screening and search due to its deficiencies.

### **2.1.12 Adjustments and search strategy**

#### **Adjustments/search strategy are likely to be industry or region specific (availability of data)**

From a general perspective, search strategies do not vary based on industries and/or regions as it is preferable to have a common "standardized" approach for comparables searches. Nevertheless, as anticipated above, in defining a search strategy additional criteria may be considered for countries and/or industries with limited information, such as:

- Using textual searches (through keywords) in addition to the selection of industrial classification codes;
- Using more generic industrial classification codes (e.g., macro codes rather than sub-codes);
- Focusing the comparability analysis on functions performed and risk assumed;
- Using less restrictive criteria with reference to factors that, under certain circumstances, may have a more limited effect on the comparability analysis, such as:

- The size of the companies, as “Net Sales” do not always show a direct correlation with profitability;
- The characteristics of products or services, e.g. some differences in products/services’ characteristics are less likely to have a material effect to margins used as profit level indicators in a comparability analysis
- Using multiple sets of comparable companies, e.g. pan-European sets in addition to a local sets
- Using more than one method to perform a comparables search, e.g. by considering the implementation of analyses based on the “additive approach” in order to corroborate the results of a deductive comparable search

### **2.1.13 Search strategy, selection of comparables, use of multiple year data**

#### **Selection of comparables**

According to paragraph 1.55 of the OECD Transfer Pricing Guidelines, arm’s length prices may vary across different markets even for transactions involving the same property or prices. As a consequence, in order to ensure that the entities selected are comparable, it is necessary that the independent companies and the tested party operate in comparable markets and that any differences do not have significant impact on the price.

In the case under analysis, in order to ensure that the comparables operate in a similar market, we have carried out a search of European entities using the database TP Catalyst.

#### **Use of multiple year data**

The OECD guidelines suggest that the use of multiple year data is appropriate in order to reduce the potential distortion caused by business and product life cycles. The OECD Guidelines do not specify the number of years to use. Rather, the number of years of data to use should reliably capture the effects of any business, economic and cyclical forces on the financial profitability of both the company and the comparable companies. Generally, three years data is considered sufficient to eliminate the potential fluctuations in the results of the company. For the purposes of this report, we have used data from 2013, 2012 and 2011 since these years can be found complete in the data base.

#### **Search strategy**

In this present case, we have realized a pan-European search using the TP Catalyst database, “very large, large and medium companies”, March 2015 version (update 60), which includes information on companies resident in the EU.

##### **Criterion 1: Country**

Since Company X carries out its activities in France, the search was centered on companies resident in the EU-15, as Western Europe is considered as one single and comparable market.

After the application of this criterion, the number of potentially comparable companies ascended to 1.995.636.

#### Criterion 2: Active companies

It is important that the potentially comparable companies are actively trading, given the fact that, for example, companies in the process of being liquidated face conditions that could affect their financial results. For this reason, a criterion was introduced that all companies should be active.

After the application of this criterion, the number of potentially comparable was 1.725.260.

#### Criterion 3: Consolidation

This criterion was introduced in order to avoid the duplication of certain companies given the fact that TP Catalyst includes both the consolidated and unconsolidated results of companies. For this reason, we selected only the unconsolidated financial statements of potentially comparable companies.

After the application of this criterion, the number of potentially comparable was 1.605.213.

#### Criterion 4: Independence Criterion – Shareholders

According to the 1.15 paragraph of the OECD Guidelines, the application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions present within transactions carried out between independent entities.

In this step, the companies were screened on their ownership. The reason for this step was to include only independent companies since companies that are not independent could possibly be engaged in transactions with related parties, using inappropriate transfer prices, which thus influence their profits. Therefore, we only included companies which are attached to companies with no shareholders with ownership of over 25%.

After the application of this criterion, the number of potentially comparable entities was 680.537.

#### Criterion 5: Independence Criterion – Subsidiaries

Following the Transfer Pricing regulations regarding related party definitions, we have also excluded parent companies that are the ultimate owner or own more than 25% of a subsidiary.

The companies of the sample that did not disaggregate the information of the shareholder or had no information of the available shareholder were removed of the sample. Subsequently these companies were analyzed in more detail to ensure their independence. In case that there was no hint in the Internet that the company was not independent, these were considered as potentially comparable. After the application of this criterion, the number of potentially comparable companies amounted to a 555.747.

#### Criterion 6: Activity Code

We selected the following primary Economic Activity codes NACE Rev. 2:

- 4671: Services wholesale of solid, liquid and gaseous fuels and related products

Following the application of this criterion the number of potential comparables amounted to 1.684.

#### Criterion 7: Elimination of small companies – Minimum turnover

According to the European Commission Recommendation (6th of May 2003), the micro size entities are defined as those with maximum operating revenue of € 2 million. Considering the size of the comparables we only included companies with turnover in excess of € 2 million in each year during the period of information available (2011-2013). This criterion was applied to eliminate smaller or start-up companies which may face different business risks and distortions. After the application of this criterion, the number of potentially comparable companies amounted to 833.

#### Criterion 8: Elimination of small companies – Minimum number of employees

Similarly, according to the European Commission Recommendation (6th of May 2003), the micro size entities are also defined as those with a maximum number of 10 employees. Therefore, we only included companies with 10 or more employees in each year during the period of information available (2011-2013). This criterion was also applied to eliminate smaller or start-up companies which may face different business risks and distortions. After the application of this criterion, the number of potentially comparable companies amounted to 227.

#### Criterion 9: Manual review of the data obtained

Finally a manual review was performed on the remaining potentially comparable entities using TP Catalyst and the Internet. Based on this manual review, a further 196 companies were rejected for the following reasons:

- The entity carried on significantly different activities to the activities of the concerned entity.
- The entity formed part of a group and therefore there exists a risk that there were transactions with related parties that could materially affect its results.
- Insufficient information was available to determine whether the entity is comparable to the brokerage activities of the concerned entity.

After the application of all of the abovementioned search steps, the final sample of comparable companies was 31.

The elimination matrix detailing the manual selection outlined above, specifying the reason for accepting or rejection of the companies initially selected as potentially comparable.



The benchmark identified 31 comparable companies in 7 EU MS dedicated to rendering wholesale services of solid, liquid and gaseous fuels and related products. The Return On Sales Range of the entities identified as comparable, related to the period 2011-2013, is shown in the following table:

<b>Interquartile Range (Period 2011-2013)</b>					
	<b>Minimum</b>	<b>Lower quartile</b>	<b>Median</b>	<b>Upper quartile</b>	<b>Maximum</b>
ROS	-2.62%	0.60%	0.99%	2.52%	8.18%

## 2.1.14 Search strategy, selection of comparables, challenges and differences, industry classification

- We always search all countries available in the database (BvD TP Catalyst/Osiris) for the region where we have activities.
- Industry classification (by the data providers) involves subjective judgment and there seems to be inconsistency in the industry classification between countries.
- To capture all potential comparable companies when a pan European search is performed, with the intention of also producing local sets, the search strategy must be very broad in certain countries while narrow in others. Such approach would lead to that the number of companies to (manually) review will be too many.
- The amount/quality of data differs between countries.
- How much time/effort/cost are we as taxpayers to spend?
- What is the intention: to find an indication of arm's length result/range or the right answer (which do not exist)?
- Example of screening tests and/or rejection tables in a benchmark strategy for Retail/Wholesale and manual review of 411 companies.  
Search strategy in BvD TP Catalyst for Retail/Wholesale companies – 926 Co's remain in set from 24 out of 30 European countries (including non-EU countries) after first step:

Selection Summary				
Criterion	Excl./Incl.	No per step	Result	
1. Ownership: Companies with subsidiaries	<b>Exclusion</b>	1,400,779	18,362,341	
2. Independence indicator: A - independent; no shareholder with more than 25%, B - no shareholder with more than 50%; at least 1 shareholder with more than 25%, Include companies with owners being individuals	Inclusion	1,168,266	938,707	
3. Companies with at least 3 consecutive years of accounts and latest year for analysis 2013	Inclusion	2,436,792	938,707	
4. Active companies only	Inclusion	2,372,905	931,594	
5. World region: Austria, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Italy, Latvia, Lithuania, Macedonia, Montenegro, Netherlands, Norway, Poland, Romania, Serbia, Slovakia, Slovenia, Spain, Switzerland, Turkey, Ukraine, United Kingdom	Inclusion	1,608,396	597,445	
6. Items available for all years: Operating Revenue (Turnover), Operating P/L (EBIT)	Inclusion	1,890,073	423,771	
7. Year of incorporation before 2010	Inclusion	2,366,272	413,507	
8. Accounting practices: IFRS, Local GAAP	Inclusion	2,421,577	413,432	
9. NACE Rev. 2 primary codes: 4519 - Sale of other motor vehicles, and accessories, 453 - Sale of motor vehicle parts and accessories, 4614 - Agents involved in the sale of machinery, industrial equipment, ships and aircraft, 4662 - Wholesale of machine tools, 4663 - Wholesale of mining, construction and civil engineering machinery, 4669 - Wholesale of other machinery and equipment	Inclusion	63,519	11,114	
10. Inventory/Operating Revenue: to 30%	Inclusion	1,524,010	7,892	
11. Operating Revenue (thEUR): from 6,000	Inclusion	419,322	926	
<b>The companies resulting from the search match at least one of the activity criteria</b>		<b>Total</b>	<b>926</b>	
<b>Note: access to All companies, worldwide - Very Large, Large and Medium, with unconsolidated accounts sourced from annual reports preferred</b>				

## Companies per country

Country	Count
Austria	6
Belgium	8
Bosnia and Herzegovina	1
Bulgaria	3
Croatia	2
Czech Republic	17
Estonia	9
Finland	17
France	181
Germany	63
Hungary	17
Italy	150
Latvia	4
Lithuania	9
Norway	21
Poland	47
Romania	19
Serbia	4
Slovakia	13
Slovenia	8
Spain	112
Turkey	117
Ukraine	20
United Kingdom	78
Belgium	0
Denmark	0
Macedonia	0
Montenegro	0
Netherlands	0
Switzerland	0
Grand Total	926

## Rejection – automated text search in business description and check of independence – 593 Co's remain in set

Step		Criterion	Excl./Incl.	Cos per step	Result
<input checked="" type="checkbox"/>	1	Population selected Text search: "IT solutions", "recreational", "production", "manufacture", "design", "book", "consumable", "carrivan", "general freight trucking", engineering, household (trade description, business lines, description and history, overview, products & services)	Inclusion	926	926
<input checked="" type="checkbox"/>	2	Ownership: Companies with subsidiaries owned between 0.00% and 100.00% or with an unknown %	Exclusion	135	593

Save the Ids of the comparable companies TOTAL : 593

Row Labels	Count of Country
Austria	4
Belgium	4
Bosnia and Herzegovina	1
Bulgaria	2
Croatia	1
Czech Republic	11
Estonia	5
Finland	11
France	126
Germany	37
Hungary	11
Italy	88
Latvia	1
Lithuania	5
Norway	15
Poland	39
Romania	14
Serbia	3
Slovakia	6
Slovenia	6
Spain	81
Turkey	43
Ukraine	14
United Kingdom	65
(blank)	
<b>Grand Total</b>	<b>593</b>

## Rejection in excel due to insufficient data – 411 Co's remain in set

SEARCH STRATEGY		Load	Save	Clear all steps
1. All companies in the scope of analysis		4,262,297	4,262,297	
2. ByD ID number: AT9270082256, AT9110103110, AT9110445920, AT9150015295, BA4209406030009, ...		593	593	
3. Loans: All companies with a known value, 2013, 2012, 2011, 2010, for all the selected periods		1,807,027	545	
4. Current Assets: All companies with a known value, 2013, 2012, 2011, 2010, for all the selected periods		2,142,580	545	
5. Cash & Cash Equivalent: All companies with a known value, 2013, 2012, 2011, 2010, for all the selected periods		1,874,584	530	
6. Operations Revenue (Turnover): All companies with a known value, 2013, 2012, 2011, for all the selected periods		2,024,073	530	
7. Operations P/L (EBIT): All companies with a known value, 2013, 2012, 2011, for all the selected periods		2,003,520	530	
8. Current Liabilities: All companies with a known value, 2013, 2012, 2011, 2010, for all the selected periods		2,103,747	530	
9. All companies with website address		1,278,784	411	
Boolean search: 1 AND 2 AND 3 AND 4 AND 5 AND 6 AND 7 AND 8 AND 9				TOTAL: 411

Country	Count of Country
Austria	4
Belgium	3
Bosnia and Herzegovina	1
Bulgaria	2
Croatia	1
Czech Republic	11
Estonia	4
Finland	10
France	92
Germany	26
Hungary	7
Italy	22
Latvia	1
Lithuania	4
Norway	14
Poland	30
Romania	8
Serbia	3
Slovakia	5
Slovenia	4
Spain	71
Turkey	33
Ukraine	3
United Kingdom	52
<b>Grand Total</b>	<b>411</b>

## Manual review and rejection

70 out of 411 remain and 341 rejected due to the following reasons:

1. Company homepage unavailable / Lack of information 2. Non-independent/related parties 3. Other functions/services 4. Own products/brands/other assets 5. Insufficient/inconsistent information 6. B2C Retail Trade 7. Insufficient/inconsistent data							Total pre manual review:
							411
1	2	3	4	5	6	7	Total rejected
47	71	150	15	0	58	0	341
							Total Accepted
							70

NB: Rejection matrix attached:

## Final set

Country	Count of Country
Czech Republic	2
Estonia	2
Finland	2
France	15
Germany	8
Hungary	1
Italy	5
Lithuania	1
Norway	2
Poland	5
Romania	1
Slovakia	3
Slovenia	1
Spain	13
United Kingdom	9
(blank)	
<b>Grand Total</b>	<b>70</b>

Conclusion : 30 countries included in search. 7 countries with 3 or more comparable companies: FR, GE, IT, PL, SLK,ESP and UK.

## 2.2 Independence and other criteria

### 2.2.1 Proposed criteria

- Independence criteria should not only be applied to shareholders but also to the amount of shares in subsidiaries.

### 2.2.2 Other relevant criteria

- An agreement between TAs and taxpayers on independence indicators would also be highly advisable in order to avoid uncertainty and litigation. At the moment, different thresholds can be observed across the EU (25%, 50%, etc.).
- Financial criteria: turnover, profit, number of employees. Use of common standards such as the European Commission Recommendation (6th of May 2003), as regards to the definition of the micro size, small and medium entities, based on their financials.

## 2.3 Industry classification

### 2.3.1 Industry codes

- Industry codes (like SIC or NACE codes) do often not allow for a reliable selection of companies in the same industry. It is recommendable to concentrate more on a comprehensive selection and combination of precise keywords rather than a narrow selection of industry codes when defining search strategies.

### 2.3.2 Difficulties arising from classification(s) – Possible improvement

In particular, a common issue encountered in performing benchmarking analysis is the different industry codes' classification. There are cases where a specific industry code does not exist (e.g., eye glasses wholesalers) and other cases where there is more than one potential industry code (e.g., manufacturers of foods). In such cases, we have found in practice useful the information provided by internal source of the taxpayer.

Furthermore, other possible sources for researching reliable industry codes are (a) the industry code of the tested party; and (b) the industry codes of competitors.

In light of this, internal information (or information relevant for the application of the additive approach) would improve the process of selection of the initial sample.

Finally, a further tool used for improving the quality of the initial sample is represented by the use of key words, which could be helpful in identifying potentially comparable which have not be detected by the database through the selection of industry codes.

### 2.3.3 Subjective judgment dimension and challenges (1)

**Industry classification (by the data providers) involves subjective judgment and there seems to be inconsistency in the industry classification between countries**

The inconsistency in the industry classification between countries does not seem supported by the fact that current versions of the industrial classification codes are widely standardized at an international level. As an example, the ATECO codes adopted by the Italian National Institute of Statistics (“ISTAT”) are the Italian version of the NACE codes which, in turn, represent the European implementation of the UN classification (“ISIC”).

However, considering that the methodology adopted to assign industry codes to each company is based on a subjective judgment, standard industrial classification codes are not always accurate in identifying the actual business activity performed by a company. For example, it may happen that:

- A company adopts an industrial classification code that is incorrect as it does not match with the activity actually performed;
- A company performs many different activities which cannot be easily classified by a single code (e.g., companies involved in manufacturing and distribution activities are generally classified as manufacturing entities).

In the light of the above, a benchmarking study cannot be limited to a mere selection of the most appropriate industrial classification codes to the circumstance of the case but it should be necessarily integrated with:

- A textual search (through the use of keywords), in order to add in the benchmarking search companies that may perform comparable functions although classified in different industrial classification codes;
- A qualitative analysis, to assess consistency between the activity as resulting from the industrial classification code and the actual functions performed by each comparable company as resulting from other public sources (e.g. official website, other databases).

#### **Some industry codes are more commonly represented in certain countries than in others**

The relation between industrial code classification and geographical location may be due to a structural aspect linked to the economic characteristics of each country that, as an example, may be more specialized in a specific industry than in others, or have a larger number of companies operating in a specific business sector than others. It may also be due to the fact that certain industry definitions are more commonly used in certain countries than in others.

In general, it is worth noting that the information and data publically available within the EU on potential comparable companies is significantly larger than the ones available in other geographical area such as the Americas and Asia. This generally allows the identification of larger comparables sets within the EU and sets composed by companies with a relatively high level of comparability.

### **The same type of company (according to public information) could have different industry code in different countries**

It is possible that the same type of company has different industry codes in different countries. This is due to the methodology adopted to assign the industry classification code to a company.

As noted above, this methodology involves a subjective judgment by companies which, in general, are free to select their own industry classification code.

The easiest and most efficient way to mitigate such situation may be through the creation of a standardization process, as mentioned in the first bullet above.

#### **2.3.4 Subjective judgment dimension and challenges (2)**

**Does industry classification (by the data providers) involve subjective judgment and is there inconsistency in the industry classification between countries? Are some industry codes more commonly represented in certain countries than in others?**

Official Polish industrial classification called PKD2007 (Polska Klasyfikacja Działalności 2007) derived from European NACE Rev.2. Both classifications are compatible up to fifth level – so called class (A 99.99) – which very often is sufficient to find an initial group of comparables (in this case comparables are companies carrying the similar business activity). So as long as data providers in all EU countries use NACE Rev.2 as the reference classification, the general comparability between each country should be maintained. However there are two more significant problems regarding comparability by using local industry classification based on NACE Rev.2.

First problem is the way companies describe their primary and secondary lines of business. Under the Polish law, each company registered in Poland has to declare its line of business by using the proper PKD2007 codes – so called subclasses (A 99.99.Z). One code has to be declared as “primary”. All other codes are declared as “secondary”, very often in random order. Up to 30 September 2014 there was no limit of codes declared by each company in register. Since 1 December 2014 all newly registered companies are limited to 10 codes (one “primary” code + nine “secondary” ones). Companies registered before this date have 5 years (until 1 December 2019) to meet this new limit. Unfortunately at this moment some registry entries of Polish companies have dozens of codes declared (see example below). Furthermore most of these codes are entirely not related to actual business activities of such company – they are declared “just in case”. As the result, the data providers face considerable difficulties to correctly classify each company to proper code (especially primary codes when the company conducts intersectorial activity) which presents its real line of business.

Example: various codes declared for a company involving wholesale of various goods, production, services, retail sale of various goods, road transportation, publishing, data processing, purchase and sale of real estate, lease and management of real estate, market research, packing/confectioning (table in Polish, but the codes should be generally in line with NACE classification)

PROWADZONE DZIAŁALNOŚCI WG. PKD		
Kod PKD	Nazwa	Przeważające PKD
4690Z	SPRZEDAŻ HURTOWA NIEWYSPECJALIZOWANA	DZIAŁALNOŚĆ PRZEWAŻAJĄCA
1721Z	PRODUKCJA PAPIERU FALISTEGO I TEKTURY FALISTEJ ORAZ OPAKOWAŃ Z PAPIERU I TEKTURY	
1723Z	PRODUKCJA ARTYKUŁÓW PIŚMIENNYCH	
1729Z	PRODUKCJA POZOSTAŁYCH WYROBÓW Z PAPIERU I TEKTURY	
1813Z	DZIAŁALNOŚĆ USŁUGOWA ZWIĄZANA Z PRZYGOTOWYWANIEM DO DRUKU	
4618Z	DZIAŁALNOŚĆ AGENTÓW SPECJALIZUJĄCYCH SIĘ W SPRZEDAŻY POZOSTAŁYCH OKREŚLONYCH TOWARÓW	
4642Z	SPRZEDAŻ HURTOWA ODZIEŻY I OBUWIA	
4644Z	SPRZEDAŻ HURTOWA WYROBÓW PORCELANOWYCH, CERAMICZNYCH I SZKLANYCH ORAZ ŚRODKÓW CZYSZCZĄCYCH	
4648Z	SPRZEDAŻ HURTOWA ZEGARKÓW, ZEGARÓW I BIŻUTERII	
4649Z	SPRZEDAŻ HURTOWA POZOSTAŁYCH ARTYKUŁÓW UŻYTKU DOMOWEGO	
4676Z	SPRZEDAŻ HURTOWA POZOSTAŁYCH PÓŁPRODUKTÓW	
4719Z	POZOSTAŁA SPRZEDAŻ DETALICZNA PROWADZONA W NIEWYSPECJALIZOWANYCH SKLEPACH	
4761Z	SPRZEDAŻ DETALICZNA KSIĄŻEK PROWADZONA W WYSPECJALIZOWANYCH SKLEPACH	
4762Z	SPRZEDAŻ DETALICZNA GAZET I ARTYKUŁÓW PIŚMIENNYCH PROWADZONA W WYSPECJALIZOWANYCH SKLEPACH	
4765Z	SPRZEDAŻ DETALICZNA GIER I ZABAWEK PROWADZONA W WYSPECJALIZOWANYCH SKLEPACH	
4771Z	SPRZEDAŻ DETALICZNA ODZIEŻY PROWADZONA W WYSPECJALIZOWANYCH SKLEPACH	
4778Z	SPRZEDAŻ DETALICZNA POZOSTAŁYCH NOWYCH WYROBÓW PROWADZONA W WYSPECJALIZOWANYCH SKLEPACH	
4791Z	SPRZEDAŻ DETALICZNA PROWADZONA PRZEZ DOMY SPRZEDAŻY WYSYŁKOWEJ LUB INTERNET	
4941Z	TRANSPORT DROGOWY TOWARÓW	
5811Z	WYDAWANIE KSIĄŻEK	
5819Z	POZOSTAŁA DZIAŁALNOŚĆ WYDAWNICZA	
6311Z	PRZETWARZANIE DANYCH; ZARZĄDZANIE STRONAMI INTERNETOWYMI (HOSTING) I PODOBNA DZIAŁALNOŚĆ	
6810Z	KUPNO I SPRZEDAŻ NIERUCHOMOŚCI NA WŁASNY RACHUNEK	
6820Z	WYNAJEM I ZARZĄDZANIE NIERUCHOMOŚCIAMI WŁASNYMI LUB DZIERŻAWIONYMI	
6831Z	POŚREDNICTWO W OBROTCIE NIERUCHOMOŚCIAMI	
6832Z	ZARZĄDZANIE NIERUCHOMOŚCIAMI WYKONYWANE NA ZLECENIE	
7320Z	BADANIE RYNKU I OPINII PUBLICZNEJ	
8292Z	DZIAŁALNOŚĆ ZWIĄZANA Z PAKOWANIEM	

Second problem is the internal structure of the NACE Rev.2 classification and its inconsistency with “TP expectations”. On the one hand some codes are too general and cover too many different types of business activities (especially in relation to different functions), on the other hand some codes are too detailed. One of the best examples to show the problem is a case of code 62 – Computer programming, consultancy and related activities. This group contains of 4 classes:

#### 62.01 – Computer programming activities, which includes:

- designing the structure and content of, and/or writing the computer code necessary to create and implement:
  - systems software (including updates and patches)
  - software applications (including updates and patches)
  - databases
  - web pages
- customising of software, i.e. modifying and configuring an existing application so that it is functional within the clients' information system environment



**62.02 – Computer consultancy activities**, which includes the planning and designing of computer systems which integrate computer hardware, software and communication technologies. Services may include related users training

**62.03 – Computer facilities management activities**, which includes the provision of on-site management and operation of clients' computer systems and/or data processing facilities, as well as related support services

**62.09 – Other information technology and computer service activities**, which includes other information technology and computer related activities not elsewhere classified, such as:

- computer disaster recovery services
- installation (setting-up) of personal computers
- software installation services

A lot of IT companies, offering wide range of IT services, struggle to choose only one primary code to describe their main business activity, because their products and services are complex and closely related to each other. They perform all kind of services (software design, hardware & software sales, management services, support services, etc.) included in the value chain. Proper classification becomes virtually impossible to perform (one company could choose all four codes as primary). Only in Poland there are over 30 000 companies (all legal forms of commercial entities) which have declared one of these four codes as primary, including approx. 10 000 companies registered in official Court Register and legally obliged to make their annual financial statement available to the public (according to statistical data from Quick TP Analytics database delivered by Polish data provider InfoCredit).

Another example of “difficult to analyse” NACE code is **7022 – Business and other management consultancy activities**, which includes: the provision of advice, guidance and operational assistance to businesses and other organizations on management issues, such as corporate strategic and organizational planning, business process reengineering, change management, cost reduction and other financial issues; marketing objectives and policies; human resource policies, practices and planning; compensation and retirement strategies; production scheduling and control planning.

In Poland, this code is used as primary by companies from very wide range of business activities, such as:

- strategic consultancy
- financial consultancy
- marketing & sales consultancy
- human resources consultancy
- production optimization consultancy
- production quality consultancy

- supply chain consultancy
- data security consultancy
- occupational safety and health consultancy
- EU subsidiaries consultancy
- M&A consultancy
- etc.

Unfortunately, most of MNE's intra-group consultancy services are very specific and very "narrow". For most taxpayers "consultancy services" might be completely different from each other in terms of functions, risks, costs and their significance in the value chain. One "consultancy service" might be considered as "low value added service", another "consultancy service" might be classified as "critical". So it is difficult to perform a pan European search strategy to find enough comparables that might fit the desired description. Very often a taxpayer has to expand the range of "comparable business activity" in order to be able to get any statistically reliable results.

In conclusion, any industrial classification gives only a general idea about the nature of business activities performed by entities classified in each code. The search of specified external comparables (in relation to functions performed, risk profile, product type etc.) for selected types of business activities (e.g. based on selected NACE codes) may become extremely time-consuming and difficult to perform by any taxpayer. Tax authorities should be aware of these limitations when conducting tax audit.

#### **Whether some industry codes are more commonly represented in certain countries than in others?**

Similar statistics for code group NACE 62 – Computer programming, consultancy and related activities was made for all 28 EU countries (based on pan European database Amadeus delivered by global data provider Bureau van Dijk Electronic Publishing).

No of companies in:	Industry (NACE Rev. 2 primary code)				Total	% share in total
	Country	6201	6202	6203		
AUSTRIA	605	516	762	2 211	<b>4 094</b>	0,94%
BELGIUM	2 577	7 538	98	2 317	<b>12 530</b>	2,87%
BULGARIA	1 910	1 072	708	3 079	<b>6 769</b>	1,55%
CROATIA	1 681	352	105	411	<b>2 549</b>	0,58%
CYPRUS	30	20	1	17	<b>68</b>	0,02%
CZECH REPUBLIC	1 700	978	276	257	<b>3 211</b>	0,74%
DENMARK	2 585	3 564	38	973	<b>7 160</b>	1,64%
ESTONIA	1 521	866	467	977	<b>3 831</b>	0,88%
FINLAND	5 475	2 064	376	239	<b>8 154</b>	1,87%
FRANCE	11 912	21 022	613	1 627	<b>35 174</b>	8,06%
GERMANY	23 911	9 705	3 508	7 172	<b>44 296</b>	10,15%
GREECE	414	60	1	30	<b>505</b>	0,12%
HUNGARY	5 704	4 352	705	3 106	<b>13 867</b>	3,18%
IRELAND	137	105	0	2 894	<b>3 136</b>	0,72%
ITALY	10 855	3 393	90	3 099	<b>17 437</b>	3,99%
LATVIA	1 698	477	140	811	<b>3 126</b>	0,72%
LITHUANIA	1 104	328	54	422	<b>1 908</b>	0,44%
LUXEMBOURG	7	14	2	400	<b>423</b>	0,10%
MALTA	1	11	0	31	<b>43</b>	0,01%

NETHERLANDS	12 621	7 756	647	2 949	<b>23 973</b>	5,49%
POLAND	15 071	5 227	1 237	3 496	<b>25 031</b>	5,73%
PORTUGAL	1 820	2 280	86	1 151	<b>5 337</b>	1,22%
ROMANIA	6 306	3 030	364	2 076	<b>11 776</b>	2,70%
SLOVAKIA	1 492	849	101	2 131	<b>4 573</b>	1,05%
SLOVENIA	1 115	556	133	470	<b>2 274</b>	0,52%
SPAIN	2 534	2 941	937	5 819	<b>12 231</b>	2,80%
SWEDEN	10 744	8 808	598	183	<b>20 333</b>	4,66%
UNITED KINGDOM	29 334	84 315	2 954	46 062	<b>162 665</b>	37,27%
<b>Total</b>	<b>154 864</b>	<b>172 199</b>	<b>15 001</b>	<b>94 410</b>	<b>436 474</b>	<b>100,00%</b>

As seen in above table, there are significant differences between numbers of companies in each EU country classified in one of four IT codes. Performance of pan-European search based on the same set of criteria for all countries might result in very diversified “sample sizes” which in the end might lead to “geographical inconsistency” of final results.

### 2.3.5 Industry classification – Challenges (3)

#### Industry classification:

- Fully agree with your observations. It is quite a subjective criterion. However, as long as taxpayers and TAs utilize same databases, this issue could be solved.
- In this regard, it might be useful to benchmark the most popular databases used by MNEs and TAs to check whether they are the same or not and thus whether inconsistencies could arise due to this.
- It is also true that for certain activity codes it is really hard to find comparables in some countries. In these cases, pan-European searches should be accepted by the TAs as a good solution to find a significant set of comparable companies as well as relaxing the industry criteria (by allowing the inclusion of more codes), accepting comparable companies performing similar (but not the same) activities.

## C. Treatment of comparable data and adjustments

### 1. Ranges

#### 1.1 Full range Vs Interquartile range

It seems to me that many European tax administrations do not favor the use of the full range as it is seen as potentially too wide and as such, allowing to justify too many different levels of actual profits.

In the other hand, interquartile range could result in a very narrow (and uniform) range, which causes the above mentioned skepticism.

One alternative could be, starting with the full range, using other statistical tools aiming at measuring the concentration of observations i.e. linear correlation ratios (the Gini ratio is one of them I think). This would determine the range where observations are more concentrated, and might significantly differ from the usual interquartile range.

#### 1.2 Use and determination of the IQR

1. Use of the IQR: By default, for SCCS, the consideration of the IQR should be advocated.
2. Determination of the IQR: We recommend that the EU JTPF defines and promote a default process to determine the IQR, once the dataset has been established, as this process is largely similar across the industry (multi year data, average per company, then Excel IQR on the basis on the range obtained, etc.). Based on economic theory, we would be inclined to recommend, by default, some measure of average and multi year period. Of course, practionners should be allowed to take a different position depending on facts and circumstances, (business cycle, etc.)

### 1.3 Location within the AL range

- Location within the arm's length range. Should adjustments (by the TAs) to the median be acceptable once the tested party results fall within the interquartile range? Should results above/below the interquartile arm's length range be admitted provided that they are properly supported (e.g.: limited risk profile compared to the comparable companies)

## 2. Timing issues/Multiple year data

### 2.1. Multiple year data

Multiple year data:

- From a practical perspective, most recent years should be considered in the search strategy. In case that the tested year has to be considered, timing conflicts could arise in regard to data availability and mandatory filing dates for TP documentations.
- Generally, a multiple year perspective is preferred in order to avoid detrimental effects on the benchmarking results caused by outliers.

### 2.2 timing aspects

Comparability is based on the information about: (a) economic circumstances (b) the controlled transaction, and (c) the comparable uncontrolled transactions.

There are two relevant moments in time in this respect:

- timing of origin, i.e. when the transaction under review is undertaken; and
- timing of collection, i.e. when the information is collected to determine the arm's length price of the transaction under review.

The TPG, as amended in 2010, acknowledge the relevance of timing issues by introducing an entire sub-section headed "timing issues in comparability" in the new chapter on comparability analysis to address: (a) the issues under (i) and (ii), and (b) the use of multiple-year data<sup>6</sup>.

#### (a) Timing of origin - absence of contemporaneous data

Comparables' data referring to transactions undertaken during the same period of time as the controlled transaction are considered to provide the most reliable information since by definition they refer to the same economic environment<sup>7</sup>.

Where the comparable uncontrolled price method ("CUP") method is not applicable, the object of comparison for the application of the other methods is represented by gross or net margins. In such a case, there is no doubt that best accomplishing economic environment comparability would require the determination of the margins derived by comparable entities in the same period when the controlled transactions are undertaken. This means, for example, that if transfer prices are set on the basis of the transactional net margin method ("TNMM") where the tested party is a distributor,

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<sup>6</sup> Chapter III, Sub-section B of the TPG.

<sup>7</sup> See Paragraph 3.68 of the TPG.

the net margin of such a distributor for the year 2016 should theoretically be determined on the basis of the net margins derived by comparable distributors in 2016. This approach would also imply that transfer prices are set provisionally during the year and then subject to a year-end adjustment. It is worth mentioning that where internal comparables do not exist, it is often difficult to get contemporaneous data on uncontrolled comparable transactions in time for ultimately determining transfer prices. This generally leads to the use of historical (multiple year) data.

**(b) Timing of origin - use of multiple year data**

Even in absence of contemporaneous data, the comparability analysis should be consistent with the economic circumstances under which the controlled transaction is carried out. Therefore, before selecting the timeframe of historical data it is key to determine what the comparable economic circumstances are. As a consequence, the starting point can only be the analysis of all the economic environment relevant information. This would lead to the determination, among other things of:

- the existence of cycles;
- the duration and amplitude of cycles;
- the point in the cycle where the transaction under review is positioned;
- historical and expected market trends;
- correlation of the relevant economic indexes in the particular market;
- the market position of potential comparables.

The analysis of this information should, among others, form the basis for defining the number of years relevant for the analysis of the uncontrolled comparable transactions.

The analysis of multiple year (only where needed) financial data of comparable uncontrolled transactions thus represents only a second - and subordinate - step.

The TPG seems to confirm this approach when addressing the use of multiple year data<sup>8</sup>:

*3.76 In order to obtain a complete understanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price [...]*

*3.77 Multiple year data will also be useful in providing information about the relevant business and product life cycles of the comparables. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability. The data from earlier years may show whether the independent enterprise engaged in a comparable transaction was affected by comparable economic conditions in a comparable manner, or whether different conditions in an earlier year materially affected its price or profit so that it should not be used as a comparable.*

*3.78 Multiple year data can also improve the process of selecting third party comparables e.g. by identifying results that may indicate a significant variance from the underlying*

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<sup>8</sup> See Paragraph 3.77 of the TPG.

*comparability characteristics of the controlled transaction being reviewed, in some cases leading to the rejection of the comparable, or to detect anomalies in third party information.*

Although the TPG has not provided any guidance on the number of years to be considered, in performing the multiple year financial data analysis it seems reasonable to cover, at least, the entire cycle of the industry in which the controlled transaction is undertaken.

Despite this, in practice, the first step of the analysis is generally not performed and economic circumstances comparability is simply taken into account by benchmarking averages of multiple year comparables data. The basic assumption behind this line of reasoning is that:

- the existence of cycles is assumed; and
- the simple averaging of prior years' data has the effect of making economic circumstances comparable by smoothing the variances of the business cycle. This exercise is often made by applying rules of thumb (three or five years' average), i.e. without a proper economic analysis.

This approach, which is even endorsed and applied by the majority of the tax authorities, was generally supported by making reference to the 2009 TPG on TNMM. There reference is made to the use of multiple year averages in order to mitigate the absence of contemporaneous comparables data.<sup>9</sup>

It is difficult to find support for such an argument, since the OECD is clear in tracing the path for the use of multiple year data in applying comparability and, thus, such a reference in the specific case of TNMM cannot be viewed as jeopardizing the entire comparability guidelines. One should thus read this sentence in the context of the guidelines provided on comparability.

It is worth mentioning that such a reference to the use of multiple year averages has been dealt with in the Comparability Draft where the OECD pointed out<sup>10</sup> that although the use in practice of multiple year data averages is based on the reference made in the 2009 TPG on TNMM, (a) *“the use of multiple year data do not necessary imply the use of multiple year averages as a statistical tool”*; and (b) *“the use of multiple year data and the use of statistical tools should be considered as separate issues”*.

In the 2008 Draft on Transactional Profit Methods<sup>11</sup> the OECD proposed deleting such a reference to the use of multiple year averages, in the context of the TNMM, by merely referring to multiple year data. This approach was endorsed by the TPG where the term “averages” has been definitely deleted<sup>12</sup>.

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<sup>9</sup> See Paragraph 3.30 of the 2009 TPG: Application of any arm's length method requires information on uncontrolled transactions that may not be available at the time of the controlled transactions. This may make it particularly difficult for taxpayers that attempt to apply the transactional net margin method at the time of the controlled transactions (although use of multiple year averages as discussed in paragraphs 1.49 through 1.51 may mitigate this concern).

<sup>10</sup> See Paragraph 19 at page 62 of the Comparability Draft.

<sup>11</sup> See Paragraph 3.30 at page 14 of the 2008 Draft on Transactional Profit Methods.

<sup>12</sup> See Paragraph 2.65 of the TPG: *Application of any arm's length method requires information on uncontrolled transactions that may not be available at the time of the controlled transactions. This may make it particularly difficult for taxpayers that*

However, tax authorities are still following the consolidated approaches of basing benchmarking on the most recent 3-5 years period (on the basis of the data available).

**(c) Timing of collection**

In relation to the point in time when taxpayers may collect all the relevant information to be used in the comparability analysis two main alternatives exist.

Price-setting approach, the relevant information is collected on an ex ante basis, i.e. at the time when the transaction under review is undertaken<sup>13</sup>. Therefore, the analysis should rely on the information available at that time: for example, if the controlled transaction is entered into in January 2016, the most up-to-date financial data on comparables are those referring to 2014, even though economic and market data of 2015 are certainly available. The main point is then to define what use has to be made of those economic and market data. In particular, the information about the most up-to-date economic and market data may also be used to approximate the expectations on market trends that independent parties would have taken into account;

Outcome-testing approach, the relevant information is collected on an ex post basis, i.e. generally at the time when the tax return is prepared/filed. In such a case the actual outcome of the transaction under review is tested on the basis of the most recent data available at year-end.

This does not necessarily mean that contemporaneous data are used, in that frequently those data are not available in time.

The two approaches may lead to different results<sup>14</sup>. The TPG does not take a position on whether the arm's length principle requires the application of a sole approach in terms of timing and leave the choice to the domestic tax regimes. This, *de facto*, amounts to admit - from a theoretical point of view - the consistency with the arm's length principle of all the approaches ranging from the price-setting approach to the outcome-testing approach.

In light of the above, the EUJTPF should carefully address such issue in order to avoid that different approaches adopted by domestic regimes could lead to double taxation.

**(d) Conclusion on timing issues**

The application of the arm's length principle is intrinsically a very difficult exercise. On the one hand, the aim is to replicate (or better, approximate) what independent parties would have agreed upon under the same circumstances but, on the other hand, the scope of the economic analysis is significantly limited by four main constraints:

Objectivity: the determination has to be as objective as possible in light of the contrast between the interest of taxpayers and tax administrations. The real problem then becomes what "objective" means in this context. Transfer pricing determinations have to be based on an analysis that contains the minimum possible number of estimations. Thus, for example, the application of the game theory

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*attempt to apply the transactional net margin method at the time of the controlled transactions (although use of multiple year data as discussed in paragraphs 3.75-3.79 may mitigate this concern).*

<sup>13</sup> See Paragraph 3.69 of the TPG.

<sup>14</sup> See Paragraph 3.71 of the TPG.



has not been ordinarily considered for transfer pricing purposes to approximate independent parties' bargaining powers. Similarly, the conjoint analysis is not commonly used in transfer pricing to attribute value to clauses of contracts (e.g. exclusivity or duration). In other words, the economic or advanced statistical tools that are most commonly used in economic analysis are ignored by transfer pricing standard practice;

Unavailability of data; many relevant data are simply unavailable because these are not public. The main issue in this respect is that, on the one hand, the OECD requires a transaction approach where, on the other hand, the financial information available is (in most cases) only those contained in balance sheets, i.e. not transactional. Apart from the transaction approach issue, there is much information that is not public. A very basic and simple example of this problem is represented by the application of cost plus, which requires the determination of the mark up derived by comparable companies full cost of production. The problem is that it is not possible to determine what the direct industrial costs of comparable companies are from their balance sheet;

Non-availability of contemporaneous data; those data that are available are, however, not up-to-date. For example in 2016, the most up-to-date financial data, unless internal comparables are available, on comparable companies are those referring to 2014;

Time and resources; both taxpayers and tax administrations need to define application methods that are not excessively burdensome.

The combination of all the above issues inevitably has led to a misalignment between theory and practice that have laid the foundation for the application of oversimplified mechanisms that - and this is the major issue – are applied mechanically. Any qualitative reasoning grounded on the rationale behind the arm's length principle is confined to the application of standard and basic statistical tools that in most cases coincide with the interquartile range on a set of results deriving from the use of multiple year averages for historical comparables data. The use of such statistical tools has the perverse effect of strengthening lack of quality of the analysis, i.e. there is no need to pay too much attention to the principles of comparability since the interquartile by itself has the effect of fine tuning the analysis.

Valid arguments militate in favour of applying simple methods as objectively as possible in the interest of both taxpayers and tax administrations. At the same time, it is in the same interest of the parties involved that the rationale and the theory behind the arm's length principle do not turn out to be jeopardized. There is thus the urgent need for a compromise between theory and practice on the application of the arm's length principle.

In this context, the EUJTPF should work on finding a reasonable common framework for setting the benchmarking analysis in a way consistent with the nature and aim of the arm's length principle.

### **2.3 Use of multiple year of data/time period**

#### **Use of multiple year of data/time period:**

Which/how many years should be analyzed?

In general, the year selected for the tested party is compared with the three-year average period of the comparable companies.

Most recent available years at the time the targets/TP is set or including the tested year?

In general, the year to be tested should not be included in the benchmarking analysis, that should cover the three-year period prior to the tested year. E.g., a transfer pricing documentation for FY15 should include a benchmarking analysis covering the years from 2012 through 2014

### **3 years, 5 years, business cycle?**

In general, a three-year period is preferable, but longer (e.g. 5 years) periods may be useful under specific circumstances

## **2.4 Use of multiple year of data/time period (2)**

### **Use of multiple year of data/time period: Which/how many years should be analysed? Which most recent available years should be included (as a tested year) at the time the targets/TP is set? 3 years, 5 years, business cycle?**

It's difficult to clearly define the proper period of time that should be analysed for TP purposes. From the technical point of view, taxpayers should take into account at least two issues regarding availability of external comparables in international and local databases:

- a) the delay in collection of external data by data providers in different countries (last tested year)

Data providers always face the certain delay in data collection from their official data sources, especially regarding annual financial statements. For example, in Poland all companies registered in official Court Register are obliged to file their annual reports up to approx. 6-7 months after the closing date of each financial statement to one of 27 Court Registries. This obligation applies to approx. 300-350 thousands companies. Unfortunately only about 150 000 – less than 50% – satisfied this obligation (30% of them do it after the official deadline). Furthermore, all financial data are filed in the form of paper copies which have to be archived by Court Register's officials (it takes about 2-8 weeks). Then data providers have to copy these documents and digitalise them (entered into an electronic database). Such process is repeated every year.

As a result, the process of collecting the annual financial statements regarding year 2015 (closing date of 31 December 2015) will begin in July/August 2016 (with approx. 7-8 months delay) and will take about 12 month to be completed. Statistically speaking, 2015 financial statements may be included as "tested year" in comparable analysis performed at the end of 2016 at the earliest.

In the UK, the similar functions as Polish Court Register are fulfilled by House of Companies, where documents are delivered and archived electronically, which significantly reduces the data collection time.

- b) the number of potentially comparable entities with 3, 4, 5 or more available financial statements over the analysed period of time

A comparable entity is usually required to have at least 2-5 financial statements available in database to be considered as “statistically reliable comparable”. Using such selection criterion in comparability analysis results in a further reduction in number of potential comparables available in local and pan European databases. Table below presents the statistical data regarding continuity of financial statements in pan European database Amadeus delivered by global data provider Bureau van Dijk Electronic Publishing.

<b>Availability of unconsolidated financial statements in EU (28 countries)</b>			
<b>at least one statement available in 2010-2014 (5 years period)</b>	<b>all 3 statements available in 2012-2014 (3 years period)</b>	<b>all 4 statements available in 2011-2014 period (4 years period)</b>	<b>all 5 statements available in 2010-2014 period (5 years period)</b>
≈ 11 000 000	≈ 6 600 000	≈ 5 850 000	≈ 5 200 000
100%	≈ 60%	≈ 53,2%	≈ 47,3%

## 2.5 Use of multiple year of data/time period (3)

### Use of multiple year of data/time period:

- General rules on a standard period for analysis would be useful and would help to homogenize analysis.
- In my experience, except for very particular situations, a 3-year period is enough to test the profitability of “standard” activities and no significant variations are observed in the final results when a 3-year analysis is compared to a 5-year analysis.
- Exemptions could be admitted when the business cycle justifies to do so (i.e. long-term R&D activities in the pharma industry).
- The most updated financial information available at the moment the TP policy is set of the TP documentation is prepared should be considered; usually, one year previous to the tested-party data analyzed.

For example, to test the profitability of Company “A” in 2015, financial information from comparable companies for the 2012-2014 period should be considered. Usually, this information would be available at the moment of conducting the benchmarking (as far as I know, the incorporation of financial data in the commercial databases I have worked with usually has a time lag of 1 year aprox.).

- In light of the above, the use of the tested-year data is not a practical solution in order to prepare contemporaneous documentation, but using the most recent available at the moment of conducting the analysis. Otherwise, the administrative burden for taxpayer would increase dramatically.

## **2.6 Use of multiple year of data/Overall considerations**

- The use of multiple year data is commonly favoured
- Guidance would be useful on which period to pick, on how to review it: e.g. "whether we chose beginning of the cycle or end of the cycle"
- Guidance would be useful on how to update the data: at the time of the audit, it is common to have new data and the question is how to use such data (timing issues)

In practice:

- We perform annual benchmarks to set the target range or mark-up for each function being performed by the group service providers, e.g. distribution, manufacturing, R&D, logistics, IT services, warehousing etc.
- Is data for all years needed or two out of three years to be able to gather a larger set?
- When setting the targets for 2015, a search is performed in Q1 2015, to capture latest available financial data, which then is up and until FY 2013.
- When 2015 is audited, perhaps in 2018, 2019 or 2020, the tax authority want to “test” the outcome with comparables and then often request us to provide comparables that includes the FY 2015
- Depending on whether you pick 2011-2013 (most recent 3 years available when the target was decided), 2009-2013 (a 5 year cycle) or 2015-2017 (for example when audited in 2019) you get very different results.

## **3. Adjustments**

### **3.1 Adjustments to benchmarking results for purposes of increasing data reliability**

- The objective of adjustments to benchmarking results is to refine the comparability of results and therefore to increase the results’ reliability.
- Adjustments generally affect the profitability of the company under consideration.
- The uncontrolled transactions must be sufficiently comparable to the controlled transactions before considering any adjustments.
- Most commonly applied adjustments to benchmarking results are working capital adjustments and LIFO/FIFO adjustments.

Economic adjustments	Components	Effect on profitability
Working capital related adjustments	<ul style="list-style-type: none"> <li>• Accounts receivable</li> <li>• Accounts payable</li> <li>• Inventory</li> </ul>	<ul style="list-style-type: none"> <li>• The higher the net working capital (=current assets ./ current liabilities) the higher the assumed gross profit</li> </ul>
Accounting method related adjustments	<ul style="list-style-type: none"> <li>• Last In, First Out (LIFO)</li> <li>• First In, First Out (FIFO)</li> </ul>	<ul style="list-style-type: none"> <li>• In periods of inflation: gross profit lower</li> <li>• In periods of inflation: gross profit higher</li> </ul>

### 3.2 Geographic / market adjustments (external comparables)

Generally, within the EU and as long as a relevant part of the panel is located in the tested party's jurisdiction, there is no need for geographic / market adjustments. If such adjustments are needed (no potential comparable in the particular jurisdiction), then see above.

### 3.3 Industry adjustments (external comparables) and other adjustments

#### Industry adjustments (external comparables)

Sometime it is difficult to get a sufficient number of potential comparables in the same industry and with similar function / risk profiles.

Then functions could prevail on the industry criteria, as long as reasonable adjustments are workable.

For example if the tested party provides fund transfer services to consumer it is unlikely to find independent comparables within the finance industry, which is generally B2B and not B2C and is also capital intensive and risky businesses (contrary to a mere b2C transfer of funds i.e. almost no risk and no real capital needed).

In that case it might be envisaged to look at other industries but with similar functional profile e.g. B2C services, no risks, very low capital needs, say travel agencies.

When an industry adjustment would be performed for example based on the gap in global industry profits between financial and tourism sectors.

Also, I have seen at least once, in the context of a bilateral APA (within the EU) 8 years ago, a pan European benchmark of "routine" distribution functions (entity) irrespective of the industry (one criteria was similar level of sales, which was high)

#### Size adjustments

The issue of comparable levels of activity (sales/volumes) is often questioned by tax administrations (including for internal comparables). Especially when the tested party is a large enterprise, as European independent companies are generally significantly smaller.

I think this is a valid point but difficult to implement as many factors might interfere such as the effect of over/under capacity.

It might be relevant to recommend that the level of sales should be part of the screening strategy when possible i.e. when it leaves a sufficient number of observations.

## **Functional adjustments**

Being the less complex entity, and without being an entrepreneur or co-entrepreneur (see my introductory comments), a tested party might perform valuable functions in a slightly more intensive way than most of potential comparables (same question if conversely value added functions are less intensive than comparables).

One way we've seen in practice is a specific positioning within the arm's length range (higher or lower quartiles). The question will then be: which criteria will govern the positioning? Question is open. I have seen the level of wages (total salary charge/headcounts) but it might be problematic as it might vary from a country to another (part of location savings). I have also seen the level of SG&A.

## **Asset adjustments**

Again the less complex entity, without having entrepreneurial attributes, might own significant intangibles slightly higher than comparable (same question if lower), especially in the context of BEPS i.e. broader recognition of economic ownership.

It might be considered to either have a direct dedicated screening criteria (e.g. ratio of intangible assets / total assets) or a particular positioning within the arm's length range (see above).

## **Risks related to combination of adjustments**

I have the feeling that the combination of certain adjustments might lead to over (or under) estimate profits to be attributed.

By way of illustration, assuming that the tested party is being recognized a certain level of IP economic ownership, say a ratio of 15% (IP/total assets). Then this ratio would be part of the screening strategy i.e. selected independent comparables, which are de facto entrepreneurs, would own some IPs with related profit potential (and related risks).

But the tested party, being also a low risk entity, loss making comparables (e.g. more than one year at loss over the covered period) are excluded from the sample.

As a result, comparables will be entrepreneurs with IP related profit potential, but without significant IP related risks. If this is correct, we would have a non-arm's length profit attribution.

## **3.4 Gross Margin Vs TNMM**

Gross margin methods would be very helpful, especially for benchmarking local full-fledged entities but, and even if we have fully harmonized accounting gaaps within the EU, they are very sensitive to many factors which are not publically accessible e.g. product portfolio mix, commercial strategy i.e. High volume / low price Vs Low volume / high quality-price, level of SG&A to be covered by gross margins ...

### 3.5 Comments on adjustments and the determination of the arm's length range

- a. Principles of adjustments: By default, for SCCS, adjustment may not be needed. They should be required only in case both (i) there is a substantial comparability deviation between the comparables and the tested party and (ii) an adjustment may be performed which unarguably adds reliability and accuracy rather than it lowers it. In more complex / high stake situations, with more advanced taxpayers, adjustments should be in the toolkit of practitioners of course.
- b. PLI: A thorough analysis of which PLI is fit to the situation should be made (including "exceptional items" or "financial items", etc.). Care should be taken to use a PLI that reflects both the functional and industry dynamics.

### 3.6 Adjustments – General considerations & proposals

- Only adjustments used are a priori those dealing with working capital (lots of inventories..) but this may not be representative.
- Exploring the potential to make adjustments based on the overall margin of an MNE would be useful: for instance, in some industries, the margin is very low at consolidated level, it would be appropriate to explore whether this can be reflected at the level of the subsidiaries.
- Exploring the impact and possible adjustment needed due to the existence of centralized intangibles may also be useful: one may have a different risk profile than the tested entity. The question would be whether there is any possibility to adjust and consider the risk taken by the entrepreneur (e.g. could a different risk profile justify an adjustment?).

## D. Pan European Comparables

### 1. Use of pan European comparables

#### 1.1 Acceptance and general aspects

- Acceptance of pan European benchmark studies is important.
- For large MNE's this already is standard practice. We generally use a pan European search of 28 EU countries + Norway + Switzerland and in most cases this is accepted throughout Europe. We sometimes prepare specific benchmark studies e.g. for the Iberian countries but that is only in a few instances.
- For smaller companies this may be more burdensome so it is an important issue. If that creates issues for smaller companies, it also may be relevant to also harmonize the interpretation / use of the searches: mean or weighted average, median or any point inside the range, adjustment when outside range etc.

#### 1.2 Geographic/market adjustments (1)

Geographic / market adjustments (external comparables)

Generally, within the EU and as long as a relevant part of the panel is located in the tested party's jurisdiction, there is no need for geographic / market adjustments. If such adjustments are needed (no potential comparable in the particular jurisdiction), then see above. \_

### 1.3 Geographic/market adjustments (2)

- Geography: The geography on the companies sought after is a major point of dispute. We think that as a matter of practicality, one may consider that by default Pan-European comparable search should be acceptable when the tested party is in Europe. In less simple / more material situations:
  - An analysis of what the “relevant market” (the same concept as in competition policy) is for the service / product sold by the tested party would be paramount.
  - In case the relevant market is local (national) the taxpayer / tax administration seeking to establish that local comparables are required, it should be demonstrated that the characteristics of the local market are sufficiently different to account for the need of a local comparable search, as compared with the administrative burden it represents.
  - We would strongly recommend to leave this option open to the practitioner. An example, in some industries in the past, we have considered 2 sub-regions (Western / Eastern Europe).

### 1.4 The amount/quality of data differs significantly between countries

The amount/quality of available data depends on various aspects, among which the most important are:

- Local reporting requirements, which may imply different levels of disclosure of company data depending on the economic background and current financial situation of each country, the size and the legal nature of companies (e.g., in certain countries only listed companies are required to report financial data to local registry offices), the business sectors of operations, the shareholders’ composition, the functions performed, etc.
- Characteristics of the market of reference, e.g. certain industries are more developed in some countries, whereas other countries may have a smaller number of companies than others.

In this regard, an harmonization of the reporting requirements at European level may help in reducing differences related to amount/quality of data between countries.

**To capture a sufficiently large set of “comparable” companies when a pan European search is performed, with the intention of also producing local sub-sets, the search strategy must be very broad in certain countries while narrow in others.**

In the process of creating a search strategy, differences between countries are related to the amount of data available that may vary from country to country (see above). This aspect may imply the need to extend and broaden the search strategy for countries and/or industries registering limited data available (see below).



## 1.5. Discrepancy in the amount/quality of data (general assessment)

### Does the amount/quality of data differ significantly between countries?

Each country in EU has implemented different rules regarding sharing of companies' financial data to the public. For purposes of TP comparability analysis, comparable entities need to have at least detailed financials available in data providers' databases. Table below presents the statistical data regarding availability of financials vs EU country in pan European database Amadeus delivered by global data provider Bureau van Dijk Electronic Publishing.

Country vs Availability of financial data								
Country	Companies with detailed financials		Companies with limited financials		Companies with no recent financials		Total	
AUSTRIA	150 184	1,24%	79 487	1,78%	22 390	2,16%	<b>252 061</b>	1,43%
BELGIUM	440 829	3,64%	25 007	0,56%	7 686	0,74%	<b>473 522</b>	2,69%
BULGARIA	336 728	2,78%	103 252	2,32%	37 306	3,59%	<b>477 286</b>	2,71%
CROATIA	112 852	0,93%	361	0,01%	8 107	0,78%	<b>121 320</b>	0,69%
CYPRUS	754	0,01%	11 342	0,25%	9 539	0,92%	<b>21 635</b>	0,12%
CZECH REPUBLIC	215 494	1,78%	266 138	5,97%	7 250	0,70%	<b>488 882</b>	2,78%
DENMARK	243 820	2,01%	4 732	0,11%	2 156	0,21%	<b>250 708</b>	1,42%
ESTONIA	113 763	0,94%	4 653	0,10%	4 219	0,41%	<b>122 635</b>	0,70%
FINLAND	195 285	1,61%	86 774	1,95%	8 752	0,84%	<b>290 811</b>	1,65%
FRANCE	1 357 420	11,20%	930 019	20,86%	354 403	34,13%	<b>2 641 842</b>	15,00%
GERMANY	1 063 642	8,78%	457 548	10,26%	105 833	10,19%	<b>1 627 023</b>	9,24%
GREECE	24 943	0,21%	10	0,00%	27	0,00%	<b>24 980</b>	0,14%
HUNGARY	495 100	4,09%	7 976	0,18%	38 851	3,74%	<b>541 927</b>	3,08%
IRELAND	143 748	1,19%	17 441	0,39%	20 267	1,95%	<b>181 456</b>	1,03%
ITALY	1 098 156	9,06%	1 632	0,04%	44 538	4,29%	<b>1 144 326</b>	6,50%
LATVIA	122 955	1,01%	5 471	0,12%	25 426	2,45%	<b>153 852</b>	0,87%
LITHUANIA	15 767	0,13%	93 959	2,11%	8 133	0,78%	<b>117 859</b>	0,67%
LUXEMBOURG	16 657	0,14%	3 438	0,08%	4 088	0,39%	<b>24 183</b>	0,14%
MALTA	11 569	0,10%	395	0,01%	6 758	0,65%	<b>18 722</b>	0,11%
NETHERLANDS	761 339	6,28%	379 280	8,51%	3 390	0,33%	<b>1 144 009</b>	6,49%
POLAND	158 324	1,31%	1 133 350	25,42%	88 936	8,56%	<b>1 380 610</b>	7,84%
PORTUGAL	392 960	3,24%	3 449	0,08%	26 066	2,51%	<b>422 475</b>	2,40%
ROMANIA	742 225	6,12%	11 598	0,26%	39 174	3,77%	<b>792 997</b>	4,50%
SLOVAKIA	187 591	1,55%	54 303	1,22%	2 038	0,20%	<b>243 932</b>	1,38%
SLOVENIA	75 618	0,62%	8 476	0,19%	62	0,01%	<b>84 156</b>	0,48%
SPAIN	868 398	7,17%	1 811	0,04%	98 250	9,46%	<b>968 459</b>	5,50%
SWEDEN	427 673	3,53%	179 477	4,03%	8 548	0,82%	<b>615 698</b>	3,50%

UNITED KINGDOM	2 344 837	19,35%	587 184	13,17%	56 286	5,42%	<b>2 988 307</b>	16,96%
<b>Total</b>	<b>12 118 631</b>	<b>100,00%</b>	<b>4 458 563</b>	<b>100,00%</b>	<b>1 038 479</b>	<b>100,00%</b>	<b>17 615 673</b>	<b>100%</b>

Table's description:

**Detailed financials** – companies where the last available accounts are less than 48 months old

**Limited financials** – companies where available financials are often based on rounded figures - or class level (sometimes also collected from other directories or web sites). In most cases only the number of employees and the operating revenue are available.

**No recent financials** – companies where the last available accounts are more than 48 months old.

Furthermore, due to the different accounting standards (GAAP) in different countries, most of pan European benchmarking studies require access to some kind of “standardised” accounting format. Such “standardized” format often allows taxpayers to compare financial data from many different tax jurisdictions and execute calculations of most appropriate profit level indicators (PLIs). Conducting such calculations without access to “standardized” format could be considered as problematic. However this kind of “standardisation” has also some drawbacks. “Standardisation” usually leads to “generalisation” of data and removing certain details which might prove to be useful in applying necessary adjustments. Example of standardised format below.

**Example:** Profit & Loss account (standard global format in Amadeus database)

No.	Code name	Formula	Full name
1	PRE		Operating Revenue / Turnover
2	TURN		Sales
3	COST		Cost of Goods Sold
4	GROS	OPRE-COST	Gross Profit
5	OOPE		Other Operating Expenses
6	OPPL	GROS-OOPE	Operating Profit (Loss)
7	FIRE		Financial Revenue
8	FIEX		Financial Expenses
9	FIPL	FIRE-FIEX	Financial Profit / Loss
10	PLBT	OPPL+FIPL	Profit (Loss) before Taxation
11	TAXA		Taxation
12	PLAT	PLBT-TAXA	Profit (Loss) after Taxation
13	EXRE		Extraordinary and other Revenue
14	EXEX		Extraordinary and other Expenses
15	EXTR	EXRE-EXEX	Extraordinary and other Profit (Loss)
16	PL	PLAT+EXTR	Profit (Loss) for Period
<b>Additional items (optional)</b>			
1	EXPT		Export turnover
2	MATE		Material Costs
3	STAF		Cost of Employees
4	DEPR		Depreciation
5	INTE		Interest Paid
6	RD		R&D expenses

Basic, standardised global format of P&L account in Amadeus database has 16 items + 6 additional items (which are not available in all countries). Whereas according to Polish GAAP, an unconsolidated Profit & Loss account has between 43 and 48 items (depending on a type). As a result, some adjustments or verification methods are not available in pan European databases in contrast to local databases. Use of local databases may lead to different result than similar pan European analysis.

There are limited data available in the EU as regards intangible transactions. In Poland there is no obligation for public filing of such data therefore there are no commercial databases providing reliable information in that area.

### 1.6. Amount & quality of data

- The same conclusion applies to the fact that the amount/quality of data differs significantly between countries, only a global geographic criterion could help to get a reasonable solution; for example, in practice, very few German / Swiss comparables come up when performing a pan-European search. Actually, even when German comparables are found, there is no financial information available for said companies.
- As to the production of local sub-sets, derived from a previous global process, according to my point above and in line with your mention, the number of comparables may vary significantly from one territory to another, resulting in insufficient number of accepted companies in some cases. Thus, I would reiterate the need of giving priority to global searches over local ones (especial need for the TAs to agree on this point). Otherwise, same problems will come up again and again.
- Adjustments/search strategy are likely to be industry or region specific (availability of data).

## E. Further conclusions

### 1. Value Chain

#### 1.1 General considerations – Some proposals towards best practices

- A discussion on the benchmark study in many cases is triggered by a disagreement on the underlying functional analysis and qualification of the local activity. A discussion about the benchmark study then can be the ‘wrong’ discussion.
- Following BEPS there will be new requirements that focus on value creation (area 2 below). Instead of disputing the benchmark study, tax authorities will be better equipped to discuss the underlying functional analysis / qualification.
- A relevant question here may be i) whether the relevant skills to perform a value chain analysis are equally available in all tax administrations in all countries, and ii) the level of subjective assessment involved.
- For that reason a risk may be that countries start applying their own version of a value chain analysis. In Europe but also non-EU countries tax administrations.

- For that reason, I believe it is useful if the JTPF works out guidance including the following elements:
  - The OECD TPGL do not require a Value chain analysis (VCA). The text of the TPGL should be carefully followed. It should be avoided to increase compliance requirements by imposing an (expensive) VCA.
  - A VCA is highly complex, not all tax admins able to perform, and also for companies it is often difficult. A value chain analysis (per legal entity) is not the type of knowledge / understanding that is available because it requires intra company assessment and that is not how companies work /think.
  - The transactional focus of TPGL important, the newly required items in the TPGL (see extractions below) is to broadly understand the background (not a step up to profit split or formulary apportionment). A high level description of what drives value should be sufficient.
  - Possibly describing best practice??
    - A VCA can support a primary method (voluntarily)
    - A VCA can support a corroborative method (voluntarily)
    - A VCA cannot be applied at all, i.e. it should not become a requirement
  - A VCA is not a method, it does not result in a profit split and it does not only support profit split
- With such guidance, I believe the JTPF provides something meaningful to the EU and beyond.

## 1.2 Proposal for a EU-tailored approach

### **Design a EU-tailored approach on how to link the comparability analysis to the value chain and functional analysis and delineate the transaction being tested**

In the discussion paper (JTPF/001/2016/EN), point 7 paragraph 2 does not seem to relate to the issue of comparability analysis and value chain.

We see no EU characteristics that should be specific to the issue of linking the comparability analysis to the value chain. With this regard TPG should be applied and potentially JTPF might provide some interpretational guidance. We would like to underline that delineation of a transaction for the purposes of comparability analysis might be less detailed than delineation of a transaction for the purposes of functional analysis. However, in the situation of internal comparables accurate delineation of a transaction and relevant risks is critical for accepting potential internal comparables. In the situation of external comparables, there is no possibility to compare all detailed characteristics of the transaction due to the lack of information (no financials published, commercially sensitive information involved, not publically available contract clauses or aggregated financials). When we

will aim at making a strict alignment between the delineation of the transaction and comparability analysis, we might end up with no possibility to make a comparability analysis or such analysis will be subject to numerous adjustments that will make the results not reliable.

### 1.3

#### **Consider a company's internal price setting within an economic comprehensive analysis**

From my perspective transfer pricing documentation has pretty much turned into a financial analysis more than a comprehensive economic analysis. In most of the cases the TNMM is used as preferred method. With this method not only MNE's but also tax authorities are slowly starting to be satisfied if the PLI is acceptable (pure financial analysis) without putting much attention to the economic logic behind an IC price.

In this regard, the "economic comprehensive analysis" also depends on other external circumstances like market development, raw material price, industry development, expectations etc. MNE's should consider also this information to be able to explain if the transactions make sense, if they are commercially substantiated and if they are at arm's length.

When a company decides on setting a price with a third party they analyse following factors:

- Target price: the price the customer would be willing to pay
- Analysis of costs and mark up internal experience in the industry with a specific mark-up how competitive would the price be
- Imports and Export Statistics

That means that every MNE that has third party transactions is used to set market prices. Necessarily the MNE has to look for this conditions/information from some kind of source (public/private) in order to be able to price its products or services with third parties.

In this order of ideas, the specific information in hands of non tax people within the MNE should also be used for applying the "arm's length principle". (e.g. the purchasing department, export import compliance, marketing department etc.)

Marketing departments are usually the divisions in a MNE that better understand the strategy and economic conditions that surround the controlled and the non controlled transactions. Companies should look for information within the different areas of the company and use it for the transfer pricing analysis.

Please take following information as an example from sources that a MNE can use to perform a deeper comparability analysis. We are in a very specific industry and our market is very limited. Therefore, it depends on the circumstances of each MNE what sources they should be looking at, and how they should use them. Most of the sources in our case, are a starting point because the industry is very specific and we barely have competitors, we use the data bases and have them analyse internally in order to confirm that the information makes sense.

Example: There are sources where we can look for Molybdenum and Tungsten products and the results of market information may not be relevant for us because we need to look specifically for “Molybdenum parts for industrial furnace”. If we only look for Moly and Tungsten numbers the information is not going to make sense, we have to look deeper into the information and look for what we specifically are looking for.

**Eurostat.-**

In our case we use the following link for EU import export statistics.-

<http://ec.europa.eu/eurostat/data/database>

<http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do>

With this database you are able to look for specific periods and you have the possibility of using Custom codes for the search. These sort of information leads also to economic analysis.

International trade of EU, the euro area and the Member States by SITC product group

Last update: 01-04-2016  
Table Customization [show](#)

TIME: Standard International Trade Classification (SITC Rev. 4, 2006) | GEO: Geopolitical entity (partner) | External trade indicator: Imports in million of ECU/EURO

GEO	2014	2015
European Union (28 countries)	:	:
European Union (27 countries)	:	:
Euro area (19 countries)	:	:
Euro area (18 countries)	:	:
Belgium	342,215	338,750
Bulgaria	26,118	26,408
Czech Republic	116,203	126,805
Denmark	74,783	76,957
Germany (until 1990 former t	908,575	946,454
Estonia	13,775	13,074
Ireland	60,721	66,530
Greece	48,004	43,639
Spain	270,173	281,298
France	509,299	515,938
Croatia	17,154	18,558
Italy	356,939	368,715
Cyprus	5,089	5,016
Latvia	13,285	12,900
Lithuania	25,889	25,397
Luxembourg	20,099	20,878
Hungary	78,978	83,487
Malta	5,132	5,220
Netherlands	443,689	456,370
Austria	137,001	140,132
Poland	168,366	174,990
Portugal	58,976	60,162
Romania	58,555	62,976
Slovenia	25,551	26,789
Slovakia	61,689	66,289
Finland	57,769	54,251
Sweden	122,132	124,467

Special value:  
: not available

There are other statistics in terms of Turnover, Business Demography etc.

Gross Operating information is also available per activity. Even if the activities included in the statistics are very general, the information provides a rough estimate of the activity development through time in other words reasonable understanding of how the rates have changed through specific periods. This kind of information is also useful if you want to compare countries. In case for example that you are performing a Pan European Benchmark with several EU Countries you can see how similar they are.

**Gross operating rate by NACE Rev. 2**  
 %  
 This is an indicator of probability that corresponds to the share of gross operating. [more](#)

Year: 2012

geo	max_12	Administrative an	Professional, aciv	Real estate activi	Information and c	Accommodation i	Transportation an	Wholesale and re	Construction	Water supply; en	Electricity, gas, ht	Manufacturing	Mining and quar
EU (28 countries)	15.4	18.3	42.6	20.3	13.1	12.6	4.2	10.6	19.9 <sup>9</sup>	10.7	7.9 <sup>9</sup>	23.9 <sup>9</sup>	
EU (27 countries)	.	.	.	.	.	.	.	.	.	.	.	.	.
Euro area (18 countries)	.	.	.	.	.	.	.	.	.	.	.	.	.
Euro area (17 countries)	.	.	.	.	.	.	.	.	.	.	.	.	.
Belgium	14.5	20.7	43.9	20.5	14.1	10.7	4.5	9.5	15.3	9.0	6.5	12.3	
Bulgaria	13.9	18.6	30.7	23.4	13.8	14.6	3.9	8.3	19.0	12.6	8.8	40.3	
Czech Republic	11.8	16.2	32.1	21.9	11.4	11.0	4.1	8.9	12.4	9.6	9.5	23.0	
Denmark	13.1	12.5	49.4	15.9	9.9	7.4	4.1	6.8	27.2	5.8	11.3	71.4	
Germany	16.1	20.9	56.4	21.7	16.7	12.6	4.3	9.8	23.2	5.4	6.6	19.5	
Estonia	17.1	16.2	37.5	20.3	10.1	11.0	3.8	8.3	21.6	19.8	9.2	15.4	
Ireland	13.4	14.3	28.5	14.8	7.0	10.0	6.1	.	9.5	32.4	24.3	18.1	
Greece	14.4	25.4	48.5	16.5	6.0	20.9	4.4	26.0	34.7	16.0	8.5	17.9	
Spain	10.7	16.8	40.8	19.2	9.9	16.1	4.7	10.9	19.6	19.8	7.1	21.4	
France	10.6	7.2	32.2	14.9	5.6	9.4	2.9	5.4	8.7	13.1	4.7	13.5	
Croatia	8.4	17.4	45.4	25.8	18.4	14.6	4.5	7.4	20.7	11.9	9.4	25.2	
Italy	11.5	30.8	41.4	23.6	13.5	11.6	5.2	10.8	13.0	11.0	7.6	4.0	
Cyprus	20.2	22.3	36.1	19.4	23.7	9.8	3.9	15.9	30.9	.	9.2	.	
Latvia	11.8	13.9	31.8	20.8	10.5	14.7	4.4	8.6	19.3	16.1	11.6	26.6	
Lithuania	15.0	19.2	34.8	21.7	7.3	12.3	5.5	7.7	19.0	12.4	6.6	28.4	
Luxembourg	34.0	11.5	58.6	18.8 <sup>9</sup>	11.5	5.5	2.8	7.3	19.9	3.9	4.0	23.5	
Hungary	12.7	13.5	28.8	20.6	4.0	8.9	3.3	7.7	13.7	7.9	10.2	26.4	
Malta	15.4	27.7	35.8	29.1	14.4	12.0	5.8	19.0	.	.	.	.	
Netherlands	15.4	14.6	47.1	22.3	17.9	12.5	4.7	8.5	18.9	13.6	7.8	21.6	
Austria	18.4	17.4	45.7	14.7	17.7	15.8	4.7	6.6	10.8	7.4	9.7	17.8	

[http://ec.europa.eu/eurostat/statistics-explained/index.php/Archive:Manufacture of basic metals statistics - NACE Rev. 2](http://ec.europa.eu/eurostat/statistics-explained/index.php/Archive:Manufacture_of_basic_metals_statistics_-_NACE_Rev._2)

UN Comtrade Database for import and export analysis using Tariff Codes.

<http://comtrade.un.org/db/dqBasicQuery.aspx>

Some of the sources also provide regulatory information which is also a factor to consider for TP purposes.

There are several other sources depending on industry, in our case we use:

- 1) <http://www.statista.com/topics/1143/mining/>
- 2) <http://www.imoa.info/index.php>
- 3) <http://www.itia.info/hse-regulatory.html>

In some cases the information is available in reports that are usually private. But as I said before, it might be that the MNE is already using these reports for other purposes within the company and they are already available.

<https://roskill.com/product/tungsten-market-outlook-to-2018-11th-edition-2014/>

We purchase for some products lists of prices for the Asian market from private Data basis providers usually the Marketing departments have this kind of information.