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EU JOINT TRANSFER PRICING FORUM

DISCUSSION PAPER ON SCOPING THE WORK ON COMPARABLES IN THE EU

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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

I. Introduction

1. JTPF Programme of Work

Chapter I of the OECD Transfer Pricing Guidelines (“TPG”)¹ has recently restated the importance of the “comparability analysis” as being “at the heart of the application of the arm’s length principle”². This “comparability analysis” involves: (i) identifying “*the commercial or financial relations between the associated enterprises and the conditions and relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated*” (hereafter “C.A. Step 1”) and (ii) “*to compare the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises*” (hereafter “C.A. Step 2”).

The present scoping paper is covering this comparability analysis as a whole, with a particular focus on the second term, *i.e.* “search for comparables” or “search for comparable data”.

In this respect, the JTPF Programme of Work for 2015-2019 aims at evaluating whether there are strengths and weaknesses of the current situation in the internal market, in terms of availability, access to and reliability of both, internal and external comparables³. Moreover, solutions should be designed and recommended in order to refine and improve the state of the art in the internal market, ranging from tangible and targeted solutions for the use of (pan-european) comparables, to recommendations for concrete tests or adjustments, introduction of rebuttable presumptions or improvement of European databases.

2. Areas for Consideration

One aspect of the EU Commission’s Action Plan for Fair and Efficient Corporate Taxation in the EU⁴ is the improvement of the transfer pricing framework in the EU. In this respect, there are two priorities for enhancing the comparability analysis: (i) revisiting the current situation within EU-28 in terms of availability, reliability and quality of comparable data to conclude on how to ensure consistency and maximise objectivity in using and interpreting the available data, and (ii) strengthening the state of the art in using such data (techniques, tools, methodologies and adjustments).

¹ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (July 2010 and subsequent revision of 2015)

² Paragraph 1.33 of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

³ Paragraph 2.2 JTPF Program of Work 2015 -2019 (doc. JTPF/005/FINAL/2015/EN)

⁴ *Communication from the Commission to the European Parliament and the Council - A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action* ; 17 June 2015, COM(2015) 302 final and more particularly Section 5.1 Improving Member States’ coordination on tax audits and Section 2.2. Improving the Transfer Pricing framework in the EU

The 3 key areas should be considered consequently:

1. Assess and evaluate situations characterizing lack and/or non-reliability of comparables in the EU, identifying the underlying causes and factors and envisage recommendations, solutions and tools to address these issues
2. Design a EU-tailored approach for using, performing and interpreting comparable data searches, which should take into account the value-chain and functional analysis linked to the transaction at hand (delineated transaction)
3. Consider the specific situation and attributes of the EU Single Market to develop and envisage EU-tailored solutions and possible adjustments by taking into consideration some specific advantages and assets offered by the EU single market.

For Discussion:

Are there further aspects to be considered?

3. Working Assumption/Proposed structure

The outcome of the JTPF work will have to be compatible with the OECD *TPG*⁵. It should in particular take into account the consequences of the updates to Chapter I and Chapter III of the OECD *TPG* and other works performed under Actions 8, 9 and 10 of the OECD BEPS Action Plan regarding delineation of the transaction and the impact this may have on a search for comparables.

The JTPF carried out some previous work⁶ in this respect, which should not be replicated or duplicated.

On aspects of the 3 areas for consideration mentioned above for which the relevant information can be appropriately obtained from Governmental and Non-Governmental Members of the JTPF, questionnaires will be launched. The most efficient way to progress may be to form a subgroup. For other relevant items, the Commission intends to do a prior collection of information and data (*e.g.* consultation of experts, surveys and studies).

⁵ Article 2 (c) of the Commission decision 26 January setting up the EU JTPF C(2015) 247 final

⁶ EU JTPF *Draft Secretariat working document for the EU Joint Transfer Pricing Forum on database searches for comparables*- Doc: JTPF/005/2004/EN Meeting of 18 March 2004 Background document - EU JTPF *Pan-European versus country-specific searches and Pan-European versus country-specific databases: not a clear-cut issue*, Contribution by Prof. Dirk Van Stappen- Doc: JTPF/006/BACK/2004/EN Meeting of 18 March 2004 Background document - EU JTPF *Is Europe One Market? A Transfer Pricing Economic Analysis for Pan-European Comparable Sets*, Deloitte White Paper, Contribution by Dr. Heinz-Klaus Kroppen- Doc: JTPF/007/BACK/2004/EN Meeting of 18 March 2004 Background document

The work of the JTPF will focus on evaluating the findings from the different sources mentioned above, explore potential consequences and draw appropriate conclusions in form of reports, guidelines, recommendations or proposals for other legislative and non-legislative measures.

For Discussion:

Do you agree with the proposed structuring of the work?

II. Scope of the Work on Comparables in the EU

1. Delineating transactions within the wider generation of value by the MNE group: a new deal for comparability analysis within the EU?

1.1 Current state of play and expectations

As said above, the comparability analysis comprises two parts, which are closely inter-related.

The importance of the first part, i.e. identify and delineate the transaction (*C.A. Step 1*), and how it can interact with the comparable search (*C.A. Step 2*) - have been underlined by several Members during the JTPF Meeting of 25 June 2015, when discussing the 2015-2019 JTPF Programme of Work. The following points have been addressed in particular:

- When analysing comparability and identifying transactions at stake, ultimately performing a reliable comparability analysis requires performing a proper characterization of functions and considering them within the wider generation of value by the MNE group (the "value chain analysis");

However, the practices can diverge in the various Member States when applying the above-mentioned principle. Proper guidance and recommendations on what a value chain analysis for transfer pricing purposes is (or should be), are missing and would be useful in this respect ;

- It has been stressed that such a value chain analysis can be very informative and increase transparency;
- Lastly, performing a value chain analysis involves making subjective judgement, at least at some stages of the analysis (*e.g.* assessing qualitatively the relative weight of each chain component, quantifying the possible impact on value of an MNE's strategy and/or environment, assessing the perceived customer value, ...). Formalising common guidance or input on these aspects, based particularly on best practices, would be useful.

The first above-mentioned step (C.A. Step 1) has been also strengthened by the recent revisions of Chapters I and VI of the OECD *TPG* as a result of Actions 8, 9 and 10 of the BEPS Action Plan. Accordingly, the link between C.A. Step 1 and performing an appropriate comparable search under C.A. Step 2 has been restated in the revised 2015 OECD *TPG*.

Functions performed are one of the comparability factors to be considered for each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices.

The concept of value creation and the value chain analysis is therefore now being referred to more systematically from a theoretical standpoint (*Cf.* the above-mentioned revised OECD *TPG*) and not only as regards the implications it may have for specific profit-based methods. However, without guidance, the interpretation of what is meant to be "value creation" and "value chain" may vary significantly within the EU, thus increasing uncertainty for taxpayers, creating risks of challenges and conflicts and reducing benefit and effectiveness for tax authorities.

Working on an EU tailored solution in this respect would complete the OECD work on an essential aspect and should tackle the need for more certainty and effectiveness.

1.2 Proposed Action at JTPF level

It is suggested that the JTPF evaluates and explores whether recommendations and further guidance can be developed on the following:

- a) Define a value chain analysis for transfer pricing purposes and what should be expected from such a value chain analysis, particularly when used in the context of the functional analysis⁷;
- b) Assess what should be expected from a value chain analysis, how it should look like, which steps should be envisaged in such a value chain analysis and how it's content may be substantiated
- c) Finally and based on the results established above, determine whether any additional point or revision of the Code of Conduct on the EU Transfer Pricing Documentation (TPD) are needed with respect to the general description of the controlled transactions involving associated enterprises in the EU and the comparability analysis (description and now delineation of the transaction, description of functions and risks, review of the comparability analysis framework as regards characteristics of the property and services, functional analysis and contractual terms).

For Discussion:

⁷ See Section D.1.1.2 of the revised 2015 *TPG* - § 1.51 & *seq.*

Do you agree with the proposed actions?

Do you have further suggestions?

2. Guidelines and tools for an improved selection and use of comparable data in the EU

2.1 Current state of play and expectations

Although the use of internal comparables⁸ and of database searches for purposes of documenting and pricing intra-group transactions is widely accepted within the EU, there are still diverging approaches regarding requirements for data base searches, as well as on the terms and conditions under which internal comparables can be selected and considered as reliable for transfer pricing purposes.

Both the JTPF and the OECD have already performed works in this area, being aimed at ensuring consistency as well as maximizing objectivity and effectiveness of comparable searches⁹.

However, during the JTPF meeting of 25 June 2015, some Members have mentioned that difficulties are still encountered both by tax administrations and companies, *e.g.* in identifying and fulfilling requirements of all the EU-28 Member States in their comparable searches, in ensuring appropriate processing of comparable searches, or in performing adjustments.

Ensuring appropriate and reliable comparable searches has become more challenging and also crucial considering the outcome of the BEPS Action plan in the transfer pricing area: in the revised TPG. The lack of comparable is for instance a key element when characterizing some risky situations (*e.g.* Unique Intangibles/Hard to Value Intangibles) or considering whether the transactional profit split method is the most appropriate method in a given case.

The OECD has launched an initiative to address the point specifically with developing countries and, more precisely, “*to find ways to address the concerns expressed by developing countries on the quality and availability of the information on comparable transactions that is needed to administer transfer pricing effectively*”¹⁰. Tackling the issues at a EU level appears to be equally appropriate. The situation in terms of quality, availability and use of data is far

⁸ In the present document, internal comparables and external comparables should be construed as defined under the OECD TPG Glossary (see “comparable uncontrolled transaction”).

⁹ See JTPF Documents mentioned under Footnote 5 above and, regarding the OECD works: “Comparability: Public invitation to comment on a series of draft issues notes” CTPA/CFA (2006) 31

¹⁰ See *Paper on transfer pricing comparability data and developing countries* (11/3/2013); Report to G20 Development Working Group on the impact of BEPS in Low Income Countries and July 2015 Business Survey on Transfer Pricing Comparability Data.

more different in Europe than in in developing countries and would need to be envisaged differently, due in particular to advantages and attributes offered by the Single Market. The JTPF work should contribute to explore eventual differences and, accordingly, particularities to consider in EU-28.

Enhancing and refining the state of art in comparability for Transfer Pricing is part of the improved transfer pricing framework announced in the June 2015 Action Plan for a Fair and Efficient Corporate Tax System in the EU¹¹. There is a need to explore further the situation and diagnose weaknesses and strengths at the level of the internal market in terms of availability and quality of comparable data. Several aspects should be particularly considered and updated.

2.2 Input requested from prior collection of information

A review of available databases and of practices in EU-28 needs to be done including both, internal and external comparable searches. This review will be performed as part of a study which will be commissioned by the Commission.

Detailed information and analysis should be obtained in this context on:

- Availability of comparable data in the EU covering both dearth of comparable and lack of comparable data
- Quality of these comparable data
- Tests and adjustments to be made

The following outcomes are expected:

- a) A description of the current situation, its shortcomings and of the problems to address;
- b) An overview of the different possible options in order to ensure (i) availability and reliability of as many data as possible, (ii) assessment of advantages of a pan-European approach and (iii) in this context, ensuring of comprehensiveness of records in the data base and possibility of quality treatments and in depth test processing(s);
- c) An analysis and testing of some specific tools and techniques used in search process as well as common adjustment approaches to support the development on recommendations in this respect;
- d) A presentation and analysis of major technical issues which can occur in the search process and strategies applied in EU-28;

¹¹ COM (2015) 302 final

- e) The identification of good practices (possibly illustrated by case studies abstracted from the above-mentioned study, which could be used as a basis for developing tangible examples by the JTPF) and exploration of some alternative sources of information for comparables.

2.3 Proposed Action at JTPF level

It is suggested that the JTPF evaluates and explores whether recommendations and further guidance can be developed on the following, in order ultimately to propose a revision of the Code of Conduct on the EU Transfer Pricing Documentation (TPD):

- a) What would be an acceptable minimum standard for a comprehensive and economically sound approach in defining "good comparables" in EU-28;
- b) How to improve databases, collection and collation of information by database providers for EU-28, expand the pool of data and improve access to the existing data;
- c) Developing a comparable search process and strategy, which would cover the entire process (*incl.* screening and selection of comparables, homogeneity and comparability tests which can be performed in the EU Single Market; acceptable techniques to be used, reliable adjustments to apply; common minimum standard(s) to improve the use and interpretation of the outcome of comparables –*e.g.* range, updates of comparables, *etc.*-).

<p>For Discussion:</p> <p>Do you agree with the proposed actions?</p> <p>Do you have further suggestions?</p>
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3. Practical considerations with respect to the use of pan-European comparables in the EU

3.1 Current state of play and recommendations

In an effort to harmonise transfer pricing documentation requirements in the European Union, the JTPF has already considered the acceptability of pan-European searches when introducing the EU Transfer Pricing Documentation. However, it seems that Tax authorities still have a preference for country-specific comparable companies searches on the field because they are considered as more reliable.

In the above-mentioned Paper on *transfer pricing comparability data and developing countries* (2013), the OECD has highlighted the possible benefits of broadening comparable searches in a geographic area in situations where information is insufficient or non reliable or even domestic comparables not even available. The paper envisages situations where testing foreign comparables could be ultimately more appropriate.

The EU can be considered as being in an advantageous position in this respect, due to the broad access to companies' financials (statutory accounts) and the harmonized economic and commercial conditions in the Single Market.

Furthermore performing a country specific comparable companies search can be very costly and burdensome for enterprises and the data in some EU Member States and/or Sectors may finally be very limited.

The question whether in a common EU market, more systematic use of pan-European comparable searches and foreign comparable searches should be answered and reconsidered in light of possible recent progress in the databases, availability and quality of information and also by assessing the advantages and risks currently at the level of the Single Market. Depending on the outcome, establishing commonly agreed, practical and implementable guidance on the use of pan-European and cross-country comparables appears also to be necessary.

3.2 Input requested from prior collection of information

Prior collection of information should provide significant updates and inputs in order to assess the current situation and possible ways forward, in particular:

- a) An update of the 2004 Studies presented by JTPF Members¹²;
- b) A comparative assessment and analysis on the availability, reliability and quality of data in the context of country-specific versus pan-European searches in the EU;
- c) A test of the benefits and feasibility of a pan-European comparable search when applying selection tests, adjustments, *etc.* and;
- d) A testing of methods and approaches for defining a “relevant” and “homogeneous market” for the purpose of broadening the territory of reference in comparable searches performed in the EU.

The Commission intends to commission a study in order to perform the above-mentioned tasks a) to d) and report about them.

3.3 Proposed Action at JTPF level

It is suggested that the JTPF evaluates and explores specific and targeted issues which could lead to practical and implementable guidance for the processing, use and interpretation of pan-European or cross-country comparable searches in the EU. In particular, the following points could be addressed:

- a) What would characterize a relevant territory/region, which could be the basis for an acceptable test when scoping comparable references in the EU (either pan-European or cross-country references)?

¹² See above footnote no.6.

- b) Refining the above-mentioned proposals on search process and strategy in the context of pan-European and cross-country comparables (screening techniques and tests, adjustment tests, interpretation of the outcome of the search).

For Discussion:

Do you agree with the proposed actions?

Do you have further suggestions?