



EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
TAX POLICY
Coordination of Tax Matters

Brussels, 24 February 2004
Taxud/C1/LDH/WB

DOC: JTPF/006/BACK/2004/EN

EU JOINT TRANSFER PRICING FORUM

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*PAN-EUROPEAN VERSUS COUNTRY-SPECIFIC SEARCHES
AND PAN-EUROPEAN VERSUS COUNTRY-SPECIFIC
DATABASES: NOT A CLEAR-CUT ISSUE*

Meeting of Thursday 18 March 2004

Background document

Pan-European versus country-specific searches and pan-European versus country-specific databases: not a clear-cut issue^{1/2}

In order to support/prove the arm's length nature of the remuneration of the intercompany transactions, both the taxpayer and the tax administration (disregarding who bears the ultimate burden of proof) have (at least in theory) various options to take ranging from information readily available within the company/group (e.g. internal CUPs) up to external comparables searches based on databases.

Practice reveals that often, either as a primary (in absence of internal comparables) or as a secondary (test) method of proof, taxpayers and tax authorities have to rely on comparables searches, whereby the search for comparable companies is performed on the basis of (often commercial) databases, containing financial information of companies^{3/4}.

The access to these databases is in most cases not for free and appropriate processing of the information contained in these databases requires often serious time and resource efforts of the party concerned before an acceptable output is obtained.

Various kinds of databases exist⁵. Certain databases contain only information on companies incorporated in one country (databases referred to hereafter as 'country-specific databases'),

¹ This document comments, given the limited time available, in brief on a very important issue. It is clear that the issue deserves more time and discussion. Furthermore it should also be noted that the paper focuses on searches for comparable companies and transactions, which are used to identify PLIs and to apply RPM, GCP and TNMM. As such it does not consider comparable searches used to identifying external CUPs.

² The positions in this document are not necessarily those of KPMG GTPS (Global Transfer Pricing Services) nor that of KPMG. The document is only meant to serve as a basis for further discussion and investigation.

³ We will not discuss/comment in detail the strengths and the weaknesses of a comparables search. Taking into account the fact that in practice one often relies on the outcome of a comparables search, at least its weaknesses should be monitored. The following weak points can be listed: a) the limitation to the comparability of the selected companies due to limited available information; b) the decreasing number of unrelated companies with a comparable functional profile given the current degree of globalisation of the world economy; c) the differences in local GAAP and reporting requirements limit the possibility of analyzing gross-profit level data and as such make the application of the RPM and/or GCP as defined by the OECD sometimes difficult; d) the outcome of a comparables search is a(n) (inter-quartile) range of arm's length profit level indicators, but leaves the question of the positioning within this range open for discussion, etc. Notwithstanding a comparables search remains often the only possible 'best effort exercise' available to both the tax authorities and the taxpayers.

⁴ We also refer to the Working Party No. 6 of the OECD Committee on Fiscal Affairs, who will review comparability analysis as one of their priority areas. See GRECIAN, D. and SILBERZTEIN, C., "*OECD launches and invitation to comment on comparability issues*", *International Transfer Pricing Journal*, Vol. 10, nr. 5, September/October 2003, 178-179.

⁵ A descriptive overview of the most frequently used commercial databases can be found in the following article: COOLS, M., "*International commercial databases for transfer pricing studies*", *International Transfer Pricing Journal*, Vol. 6, nr. 5, September/October 1999, 167-183.

whereas others are containing information at a pan-European level (these databases are referred to hereafter as ‘pan-European databases’).

Country-specific versus pan-European searches

Country-specific searches can be performed on the basis of the above-mentioned country-specific databases or on the basis of a country focused search in a pan-European database. Requiring de jure or de facto a country-specific search to be performed, may result in additional compliance costs.

The enclosed survey reveals that in almost none of the EU countries a local comparables search is mandatory. However in practice a local comparables search may be advisable as many tax administrations do wish to see one-country search results. Reasoning behind this preference is that, in line with the OECD Guidelines, the comparability analysis should take into account a.o. market differences and as such focus on local markets whenever possible⁶.

Practice reveals a certain hierarchy, which is followed in many EU countries, when assessing the required geographic scope or the regional radius range of a comparables search. First one prefers the presence of country-specific comparables in the final set of comparable companies, followed by regional (e.g. Benelux, Iberian, Nordic, etc.) and finally by European comparables.

Arguments put forward to defend the above-mentioned order (1° Country; 2° Region; and 3° Europe) are the following:

- Regional differences in Profit Level Indicators (e.g. Southern European comparables’ PLIs versus Nordic comparables’ PLIs, differences in market structures, degree of competition, etc.);
- Industry specific differences in Profit Level Indicators (e.g. sectors which are subject to country-specific regulations such as the ‘distribution of pharmaceutical products’); and
- The fact that accounting principles and practices differ from one country to another within the EU affect the comparability of financial data of companies located in different countries. This is particularly relevant for the application of traditional methods (RPM and GCP). The use of country-specific comparables mitigate/eliminate this issue of differences in local GAAP and reporting requirements as all the companies in the comparables set will use the same accounting standards.

On an at random basis, some industry specific search results are revealed below, indicating that sometimes some serious differences may exist between the outcome of a country-specific (based on either a country-specific database or on a country focused search in a pan-European database) or a region specific search versus the outcome of a pan-European search.

⁶ OECD Guidelines, 1995, Chapter I, Para 1.30.

I. Aerospace spare parts industry: Euro distributor search

A. Final Set Results- Operating Margin **European Search (Amadeus)**

	1997	1998	1999	WAVG	95-97 WAVG
Maximum	9,9%	8,4%	8,1%	8,7%	7,9%
75th Percentile	9,3%	8,2%	8,0%	8,3%	5,2%
Median	6,2%	4,9%	3,8%	5,5%	2,4%
25th Percentile	3,2%	2,1%	2,1%	2,8%	1,5%
Minimum	-8,1%	-16,0%	-3,0%	-9,5%	-1,9%

B. Final Set Results- Operating Margin **UK Search (Fame)**

	1997	1998	1999	WAVG	95-97 WAVG
Maximum	13,4%	15,7%	14,8%	14,7%	12,7%
75th Percentile	7,6%	8,4%	4,4%	7,9%	6,8%
Median	4,7%	4,5%	3,5%	4,3%	4,2%
25th Percentile	1,6%	1,2%	1,2%	1,4%	2,4%
Minimum	-0,2%	-2,6%	-0,3%	0,3%	-0,6%

II. Industrial machines industry: Distributor search

A. Final Set Results- Operating Margin Benelux Search (Amadeus)

1997-2001 WAVG

75th Percentile	2,7%
Median	2,3%
25th Percentile	2,1%

B. Final Set Results- Operating Margin North/West Europe Search (Amadeus)

1997-2001 WAVG

75th Percentile	4,7%
Median	2,9%
25th Percentile	2,2%

C. Final Set Results- Operating Margin Pan-European Search (Amadeus)

1997-2001 WAVG

75th Percentile	7,1%
Median	4,7%
25th Percentile	2,9%

III. Pharmaceutical industry: Distributor search

Final Set Results- Operating Margin Pan-European Search / Local search (Amadeus)

1998-2000 WAVG

	U.K.	France	Germany	Italy	Spain	Sweden	Europe
Maximum	16,99%	5,55%	3,65%	8,75%	5,25%	7,07%	21,97%
75 th Percentile	4,81%	3,83%	1,89%	2,63%	1,68%	6,50%	3,23%
Median	2,57%	1,12%	1,30%	1,61%	1,12%	3,34%	1,82%
25 th Percentile	1,72%	-0,36%	1,12%	1,24%	0,47%	-0,75%	1,11%
Minimum	0,16%	-1,27%	-1,22%	-3,79%	-1,51%	-4,21%	-5,63%

Notwithstanding the fact that valid arguments exist for the described geographical order of a comparables search, the question can be raised whether pan-European searches should not be acceptable for all parties concerned in order to keep the compliance costs at an acceptable level.

In principle, it is indeed better to establish comparable information from the same market. However this results in additional costs and additional sophistication, which may not be warranted for what are methods, which are used to estimate arm's length ranges (being an approximation and not an exact number).

Indeed in many cases, a local comparables search is not really necessary since the RPM, GCP and TNMM approach is approximate in any event and since, certainly in case of a TNMM approach, there is usually consistency of ranges between a country-specific search and a European search (not always as some of the above examples show)⁷.

The aim of a comparables search should indeed be to compare like with like, and many business sectors operate in the same way across Europe on a homogeneous market. Under these circumstances, pan-European (or at least pan-EU) searches should be allowed as information/documentation to support the arm's length nature of the remuneration of the intercompany transactions. However, if no results for the particular country appears in a pan-European search (or if those results are anomalous) a country-specific search may be advisable as well.

Country-specific versus pan-European databases

In those circumstances where a country-specific search may be advisable, the question can be raised whether such a country-specific comparables search should be performed on the basis of a country-specific database or on the basis of a pan-European database like Amadeus.

The following arguments are sometimes put forward by tax authorities and transfer pricing practitioners in order to have a search being performed on the basis of a country-specific database, rather than on the basis of a pan-European database. These arguments are simply listed below and are in the meantime commented upon from a practical point of view:

- Market segment specific differences in Profit Level Indicators. Local databases often include a larger number of smaller companies, often operating on a different market segment and often disposing of different PLIs than large companies. It is clear that this argument is only valid if the smaller companies are relevant comparables taking into account the market segment the tested party is operating in. Practice often reveals that these smaller local comparables are excluded from the final set of comparables because of such reasons (too small – wrong market segment). As such the question whether or not a country-specific or a pan-European database should be used, depends on the nature of the search to be performed;

- As local database searches tend to be made in the country itself, a higher level of accuracy and precision (in terms of comparability) is expected. Indeed the business descriptions contained in databases are often very generic and rather high level. When a search is performed locally often additional information is obtained in country-specific sources (containing information in the native language), resulting in a higher degree of comparability. It should be noted however that the same result could be achieved if a pan-European database is used for the country-specific search in combination with other local sources of information. As such this argument pleads rather for having searches performed locally rather than that we need to use country-specific databases. Indeed the key point is the knowledge of the local market, the language and the accessibility and possibility to consult alternative information sources, etc.;
- The fact that accounting principles and practices differ from one country to another in within the EU affect the comparability of financial data of companies located in different countries. The use of local comparables from country specific databases mitigate/eliminate this issue of differences in local GAAP and reporting requirements as all the companies in the comparables set will use the same accounting standards. However companies located in the same country should in principle also be recorded according to the same accounting principles in a pan-European database; and
- It is generally advisable when conducting a database search to consult the actual accounts of the companies appearing in the final set. When a pan-European search is conducted, there may be difficulty in obtaining accounts for all the companies, with the result that there may be a tendency to consult only the accounts that are readily available. As a result there may be differences in the level of scrutiny of the data.

The above suggests that it is very important to have searches performed by people disposing of specific knowledge relating to the market, the local language and having the capabilities of consulting additional/alternative sources of information. Often this will result in a comparables search having to be performed locally, but it does not necessarily mean that one needs to use country-specific databases. Indeed, with the required skills, a local (country/region-specific) search can be performed using a pan-European database.

⁷ Some degree of volatility is intrinsic into the use of comparables searches, even when one does not use the method of last resort, being TNMM.

Conclusion: not a clear-cut issue, so reasonableness should reign

It is clear that the issues raised in this paper are complex and deserve more time and discussion.

Summarizing what has been stated above, we may conclude that:

- It is clear that both tax authorities and tax payers should be sensitive to the fact that geographical and business segment differences may exist and may urge them to perform a country-specific or region-specific comparables search. However given the fact that comparables searches are approximate in any event and some of them (in particular the TNMM approach) are often considered as a method of last resort, pan-European search results should be used and allowed as much as possible given the fact that many business sectors operate in a similar way across Europe;
- Acknowledging that not all tax authorities and taxpayers have (unlimited/free) access to the various databases and in order to limit the compliance costs for the taxpayers, the outcome of a comparables search (insofar considered appropriate as an element of proof) performed on the basis of a pan-European database (disregarding whether a country/region focused search or a de facto pan-European search is considered to be suitable) should be accepted as information/documentation to support the arm's length nature of the remuneration of the intercompany transactions. Hereby it is however very important that the comparables search is performed by persons with the right skills (knowledge of the market, the local languages, the alternative sources of information, etc.).

Dirk Van Stappen, 12 January 2004