Kluwer International Tax Blog

Don’t be so certain

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There are many things in life that we take for certainties, which are not, e.g. that it was the Scots that invented whiskey, the French champagne, or the Italians pizza. All not necessarily true. Similar certainties exist in tax and in transfer pricing. I recently had the honour of giving a training in France to 70 experienced transfer pricing specialists. I took the opportunity to conduct a number of polls with them and I am happy to share the results. I will start with the questions only to allow you to pick the answers yourself as well.

1. How much do you expect transfer pricing documentation for 2017 to differ from transfer pricing documentation for 2014?
    1. less than 15%;
    2. between 15% and 30%; or
    3. more than 30%.

2. BEPS Action 13, Annex I (Master File), under “Description of MNE’s business(es)”, fourth bullet talks about “A list and brief description of important service arrangements between members of the MNE group”. Does “important service arrangements” include the transfer of goods? In other words, are “important service arrangements”
    1. only services like management services and IT-services;
    2. the above, and also toll manufacturing and commissionaires, but not contract manufacturers (who owns and transfer their inventory) and limited risk distributors (who owns and transfer their inventory); or
    3. the above as well as contract manufacturers and limited risk distributors.

3. On which accounts should the local files of BEPS Action 13, Annex II be based?
    1. on the local tax return figures of the tested party;
    2. on the local GAAP of the tested party in one sided TP methods;
    3. on group GAAP for two sided TP methods and the local GAAP of the tested party for one sided TP methods; or
    4. any of the above, the taxpayer can choose.

For any answer other than d, please state the legal source.

4. Benchmarking: when using TP Catalyst and going through the profit and loss account from Gross sales to Excise duties to Net sales and to Cost of goods sold, where does Discounts fit in? This is important, e.g. when applying a TNMM based on Net sales.
    1. Discounts are between Gross sales and Net sales.
    2. Discounts are part of Costs of goods sold.

5. Benchmarking: when using TP Catalyst, "Operating revenue" is:
    1. gross sales;
    2. net sales;
    3. gross sales minus excise duties.

6. I have four comparables: 1, 2, 8 and 19 (total = 30). The upper quartile is:
    7. the average (7.5) + half of the maximum (19) = 13.25
    8. the third highest number (8)

Reason for these questions were to demonstrate that it is important to define what we are talking about, or in the case of a database like TP Catalyst, to know what we are looking at. Imagine comparing your tested party to an external comparable from TP Catalyst. Your party is compensated under TNMM, such that its EBIT margin is 3% of its Net sales. As the business is B2B, your tested party has gross sales of 100, discounts of 20 and net sales of 80. It seems important to know whether your comparable, which also has net sales of 100, has:

1. any discounts at all; and
2. whether those discounts are also deducted from its gross sales, or are included in its COGS.

If your comparable has an EBIT of 5 (and thus an EBIT margin of 5%), but its discounts of 20 were included in its COGS, then its adjusted EBIT margin would actually be (100 – 20 = 80 net sales; 5/80 =) 6.25% instead of 5%.

So without further ado, here are the results of my survey. Food for thought. We may think that we talk about the same things, and are agreeing with each other when we are not; or vice versa. The average number of voters per question was around 55.

1. Differences in TP documentation:
    1. less than 15%: 32%
    2. 15% – 30%: 50%
    3. more than 30%: 18%

2. "Important service arrangements":
    1. only management and IT: 13%
    2. the above and toll manufacturers and commissionaires: 28%
    3. the above and contract manuf. and LRD's: 59%

3. Local TP files should be based on:
    1. local tax returns of tested party 16%
    2. local GAAP of tested party 26%
    3. local GAAP one sided, group GAAP two sided 43%

4. taxpayer can choose 15%

4. Discounts go:
    1. between Gross sales and Net sales: 69%
    2. into Costs of goods sold: 31%

5. In TP Catalyst Operating revenue is:
    1. Gross sales: 65%
    2. Gross sales minus Excise duties: 14%
    3. Net sales: 22%

6. The upper quartile is:
    13. 25: 60%
    14. 8: 40%

Here are what I believe to be the right answers (and why).

1. It will be the lower end of 15% – 30% due to CbCR, group structures, organizational charts, the five top products and their supply chains and the reconciliation of TP numbers to financial reports. This is a pity, we have the opportunity to get away from the template driven copy and paste work of large consultants and get above 30% effectiveness and efficiency driven changes. However, the OECD has itself to blame because there is no reconciliation between BEPS Action 13, Annex I and II and:
    1. (the new) chapter I.D, chapter III and chapter VI of the Transfer pricing guidelines; or
    2. the 5 comparability factors, the 9 comparability steps and the 6 risk control steps.

It would be nice if the OECD places references to these different chapters in BEPS Action 13, Annex I and II. However, it will be difficult to do so in a meaningful way without changing the current structures of Annex I and II.

2. I don't know what "Important service arrangements" are and I find it difficult to figure out from the context of BEPS Action 13, Annex II. I would like to think it is an overview of all important intercompany arrangements, whether they include the transfer of goods or not. However the transfer of a good is a sale, not a service.

3. The taxpayer can choose the accounts it uses for local files. No one could give me a definitive legal reference saying you cannot. I find taxpayers' and consultants' argument that one should use local GAAP, because the local statutory accounts are the first thing the tax auditor looks at in an audit, not to match the responses I have received from tax auditors themselves.

4. Discounts are between Gross sales and Net sales in TP Catalyst (I checked with Bureau Van

Dijk), but I could not find the answer in the documentation itself.

5. I do not know what Operating revenue in TP Catalyst is. I could not find any definition in the documentation. It feels like it should be Gross sales, but considering the ratio’s it is used in, one may hope for it to be Net sales instead.

6. The answer is 8. Interquartile is a statistical term with a relatively fixed definition (there is some discussion about whether to include or exclude “the figure in the middle” when dealing with an odd number of elements).

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