

Transfer pricing validation requirements to be relaxed (1) (1/23/18)

This article provides an overview of alternative ways of obtaining market comparables, relaxed requirements for transfer pricing (TP) validation, and safe-harbour solutions recommended by the OECD guidelines, as well as their practical application in countries that have adopted such rules for TP analysis.

Proposals for amending the Taxes and Duties Act change the current TP rules in section 15.2 to relax the requirements for preparing TP documentation and to allow taxpayers to revise their entire TP documentation every three years. This will not, however, release them from the annual obligation to verify and prove that arm's length prices are used in their related-party transactions.

Since neither the current TP rules nor the proposed amendments deal with ways the taxpayer should obtain necessary information for TP validation, an agreement has been reached with the Finance Ministry to discuss ways of amending other rules and regulations in order to relax the requirements for TP validation using solutions recommended by the OECD guidelines.¹

Scope for obtaining market comparables for TP validation

Procedures for selecting and applying TP methods to determine the arm's length price of a product, service, an intangible or any other subject matter in controlled transactions taking place after 2017 are laid down by the Cabinet of Ministers' Regulation No. 677 of 14 November 2017,² which provides that a benchmarking study can be based on either –

- internal comparables, i.e. the taxpayer's own data about prices, markups or margins applied in their transactions with unrelated parties, or
- external comparables, i.e. publicly available data about prices, markups or margins applied in comparable transactions between unrelated parties.

Conducting a benchmarking study and documenting evidence of arm's length prices may involve processing a large amount of facts and making informed judgements. This may raise questions and place a significant administrative and financial burden on the taxpayer, in particular where a related party provides so-called low value-adding intragroup services. The publicly available comparables are often not enough to support the price of a controlled transaction, and the specialist databases that offer such information are expensive.

So the taxpayer will either buy access to such a database and conduct a benchmarking study on their own or, most frequently, hire an external service provider that has such access. In either case the taxpayer faces an increased cost of preparing TP documentation.

In answering questions about ways of obtaining market comparables, the Finance Ministry has recognised that the proposed amendments fail to specify how taxpayers are to obtain information in support of their transfer prices and has agreed to discuss ways of amending the rules and regulations (e.g. Cabinet Regulation No. 677) to relax the requirements for TP validation based on the following solutions recommended by the OECD guidelines updated in 2016:

- adopting the safe-harbour rules (Chapter IV, section E);

- relaxing the TP treatment of low value-adding intragroup services (Chapter VII, section D).

(to be continued)

¹Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

² Rules for applying provisions of the Corporate Income Tax Act