

State Revenue Service challenges credibility of comparable data – everything is relative 2/2/23



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Taxpayers involved in cross-border transactions with related parties widely use globally recognised methods of analysis to show that their prices match market values. Selecting the most accurate method depends on the economic substance of a transaction and on the availability of credible information. Having limited access to a comparable data set often becomes an insurmountable obstacle to applying a particular method. This article explores some problems with data use, as well as international practice and potential solutions where the comparable uncontrolled price (CUP) method is used.

Latvian practice

Under paragraph 13 of the Cabinet of Ministers' Rule No. 677, the CUP method involves comparing the price applied in a related-party transaction:

- with the price of a comparable transaction between the related party and a party unrelated to it, or with the price of a comparable transaction between other unrelated parties; or
- if this is sufficiently comparable, with aggregated publicly available information on the prices of comparable transactions between unrelated parties and other factors driving prices under comparable conditions.

This analysis may be based on both internal and external comparable data depending on availability. If a company makes comparable transactions with related and unrelated parties, the prices applied in its controlled transactions may be supported by those of its uncontrolled transactions, and that will be internal comparable data.

The external comparable data category includes prices applied in transactions between other unrelated parties or aggregated in publicly available information sources. It's particularly appropriate for transfer pricing purposes to use the CUP method based on external comparables where the company is involved in intragroup financing (loan and investment) transactions, intangible property (licensing) transactions, or purchases and sales of exchange-traded commodities (grain, oil, coffee, natural gas, precious metals, cattle etc). For transactions like these it's easy to find publicly available and credible information on comparable prices, using data published by central banks on interest rates applied in financing transactions, or specialist databases offering information on financing or intangible asset transactions with various companies.

A high degree of data credibility is the CUP method's main advantage, and selecting this method for transfer pricing analysis would become decisive for many taxpayers if the publicly available comparable data was not limited and if the Latvian State Revenue Service (SRS) did not take such a strict stance that limits taxpayers' ways to obtain credible data even further.

The initial impression is that such data might be fast and easy to obtain because a number of official company websites regularly publish accurate price lists for goods and services where an external user may easily obtain necessary information on current market prices, compare those with prices applied in

controlled transactions, and make any necessary changes to their pricing policy to adapt to the market conditions.

In Latvia, however, this approach is quite risky because the SRS has stated repeatedly that the CUP method involves comparing a company's prices with those of identical transactions that have taken place. The SRS emphasises that the pricing information available from company websites is not equivalent to the prices of completed transactions. In other words, a price offer merely has the characteristics of a provisional transaction, but that is not a transaction actually completed, even though it's fully comparable with the Latvian company's transaction. The pricing landscape is also distorted by later discounts, which are not reflected in the publicly available sources at the time of analysis, making the data less credible.

International practice

A few European countries have seen different cases where the tax authority willingly relies on information that a company provides on the prices of goods and services as long as the data is objective, transparent and discoverable, and the company regularly makes only binding offers to its customers, so the prices are fixed, discounts or any other price reductions are not possible, and there is evidence to prove such consistent behaviour.

The Supreme Administrative Court of the Czech Republic has recently published its ruling on a case involving exorbitant marketing costs that a Czech taxpayer incurred in placing advertisements at city stadiums and major sports grounds. In this case it was the national tax authority that based its opinion on publicly available pricing information and evidence it received from the stadium owners about non-application of discounts, which is not a trade secret, to determine accurate market prices of advertising services and challenge the Czech company's unreasonable spending on advertising in the chain of transactions between related parties. The tax authority's approach was recognised as appropriate for the situation.

Lessons learned

The Czech tax authority's proactive steps in examining the published pricing policy and gathering discoverable information from the stadium owners through business negotiations show that for comparability purposes it's still possible to use pricing data that is readily available from public information sources if the price offers may be proved to always match the prices of completed transactions.

At the same time, we should critically assess whether the additional evidence obtained through negotiations might be considered secret comparable data, which the Czech tax authority was able to obtain by assigning discoverable information status to the information which the stadium owners provided in good faith (this would not have been possible if the tax authority had not asked for additional information).