



ARM'S LENGTH RANGE

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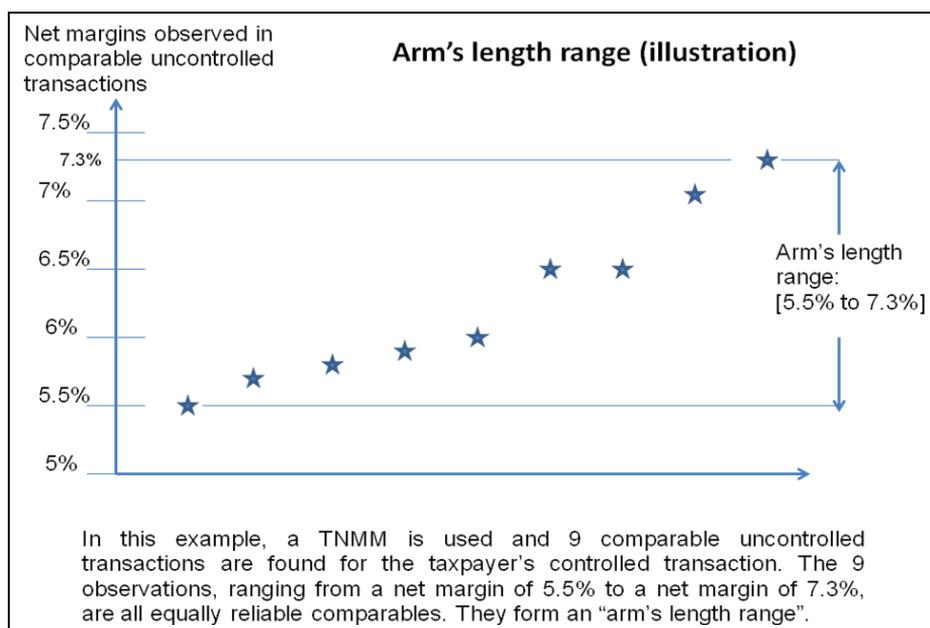
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Introduction

1. Chapters I and III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter the "TPG") contain extensive guidance on comparability analyses for transfer pricing purposes. The notion of arm's length range is discussed at paragraphs 3.55-3.66 of the TPG.

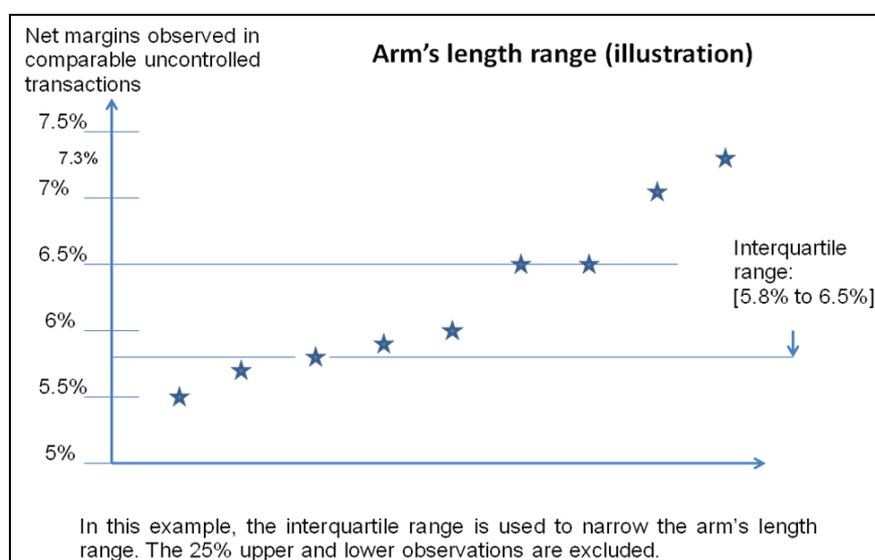
A. Determining an arm's length range

2. In some cases it will be possible to apply the arm's length principle to arrive at a single figure (e.g. price or margin) that is the most reliable to establish whether the conditions of a transaction are arm's length. However, because transfer pricing is not an exact science, there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable. In these cases, differences in the figures that comprise the range may be caused by the fact that in general the application of the arm's length principle only produces an approximation of conditions that would have been established between independent enterprises. It is also possible that the different points in a range represent the fact that independent enterprises engaged in comparable transactions under comparable circumstances may not establish exactly the same price for the transaction.



3. In some cases, not all comparable transactions examined will have a relatively equal degree of comparability. Where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated.

4. It may also be the case that, while every effort has been made to exclude points that have a lesser degree of comparability, what is arrived at is a range of figures for which it is considered, given the process used for selecting comparables and limitations in information available on comparables, that some comparability defects remain that cannot be identified and/or quantified, and are therefore not adjusted. This is often the case in practice where the comparables are extracted from a database. In such cases, if the range includes a sizeable number of observations, statistical tools that take account of central tendency to narrow the range (*e.g.* the interquartile range or other percentiles) might help to enhance the reliability of the analysis.

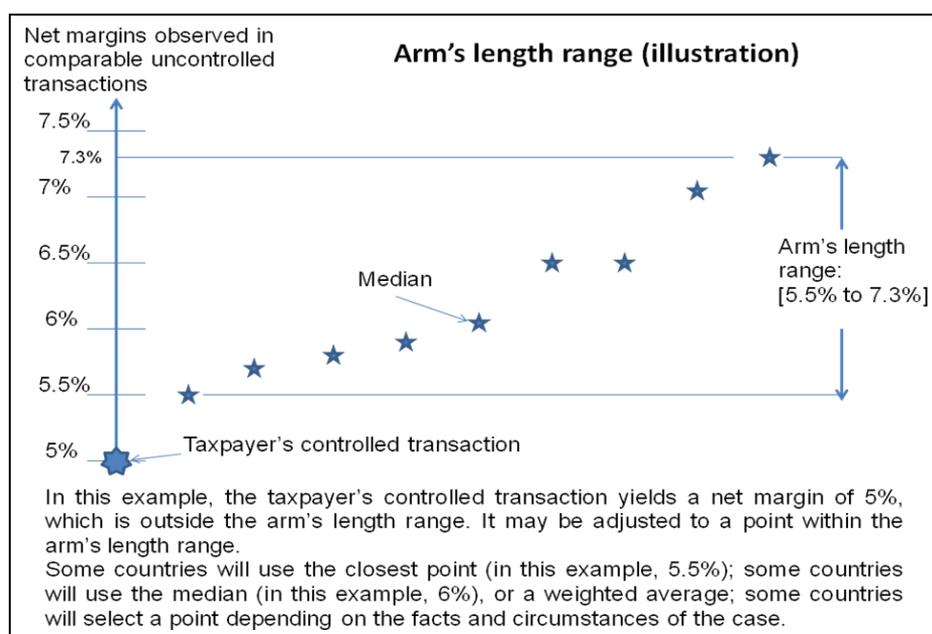


B. Selecting the most appropriate point in the range

5. If the relevant conditions of the controlled transactions (*e.g.* price or margin) are within the arm's length range, no adjustment should be made.

6. If the relevant conditions of the controlled transaction (*e.g.* price or margin) fall outside the arm's length range asserted by the tax administration, the taxpayer should have the opportunity to present arguments that the conditions of the controlled transaction satisfy the arm's length principle, and that the result falls within the arm's length range (*i.e.* that the arm's length range is different from the one asserted by the tax administration). If the taxpayer is unable to establish this fact, the tax administration must determine the point within the arm's length range to which it will adjust the conditions of the controlled transaction.

7. In determining this point, where the range comprises results of relatively equal and high reliability, it could be argued that any point in the range satisfies the arm's length principle. Where comparability defects remain, it may be appropriate to use measures of central tendency to determine this point (for instance the median, the mean or weighted averages, etc., depending on the specific characteristics of the data set), in order to minimise the risk of error due to unknown or unquantifiable remaining comparability defects.



C. Extreme results: comparability considerations

8. Extreme results might consist of losses or unusually high profits. Where one or more of the potential comparables have extreme results, further examination would be needed to understand the reasons for such extreme results. The reason might be a defect in comparability, or exceptional conditions met by an otherwise comparable third party. An extreme result may be excluded on the basis that a previously overlooked significant comparability defect has been brought to light, not on the sole basis that the results arising from the proposed "comparable" merely appear to be very different from the results observed in other proposed "comparables".

9. An independent enterprise would not continue loss-generating activities unless it had reasonable expectations of future profits. Simple or low risk functions in particular are not expected to generate losses for a long period of time. This does not mean however that loss-making transactions can never be comparable. In general, all relevant information should be used and there should not be any overriding rule on the inclusion or exclusion of loss-making comparables. Indeed, it is the facts and circumstances surrounding the company in question that should determine its status as a comparable, not its financial result.

10. Generally speaking, a loss-making uncontrolled transaction should trigger further investigation in order to establish whether or not it can be a comparable. Circumstances in which loss-

making transactions/ enterprises should be excluded from the list of comparables include cases where losses do not reflect normal business conditions, and where the losses incurred by third parties reflect a level of risks that is not comparable to the one assumed by the taxpayer in its controlled transactions. Loss-making comparables that satisfy the comparability analysis should not however be rejected on the sole basis that they suffer losses.

11. A similar investigation should be undertaken for potential comparables returning abnormally large profits relative to other potential comparables.