

Transfer pricing comparability data and developing countries

World Bank Group comments on OECD paper dated 11 March 2014

The availability of comparables is an issue that strikes at the heart of the arm's length principle. The dearth of comparable information necessary to apply the arm's length principle has long been recognized as a challenge for both tax administrations and taxpayers in developing countries. However, it is not only a developing country issue, it is also an (increasingly) important issue for developed countries.¹ It is in this regard therefore that the World Bank Group welcomes the OECD's initial paper "Transfer pricing comparability data and developing countries (11 March 2014)" (herein "OECD paper") as a preliminary step toward the timely development of widely accepted practical solutions to address this issue.

The OECD paper proposes "four sets of possible approaches to addressing the concerns over the lack of data on comparable expressed by developing countries". The comments and suggestions of the World Bank Group in relation to each are set out below.

1. Expanding access to data sources for comparables

The three actions proposed in the OECD paper concerning "expanding access to data sources for comparables" can, in our view, be grouped into two distinct categories. The first, being the two actions aimed at increasing the availability of information concerning potential comparables and the second being the action aimed at increasing developing country access to existing sources of comparable data (i.e. commercial databases).

As regards to the first, understanding the reasons for limited coverage of developing countries in commercial databases and supporting the evaluation and (where appropriate) the implementation of public access to statutory accounts both have merit, including beyond transfer pricing. However, the World Bank Group is concerned that these two actions will not result in timely solutions and further, that the practical impact in many countries may be negligible, particularly in smaller markets and or markets where the number of independent economic operators is limited.² Furthermore, from our discussions with government representatives and private sector

¹ In many developed countries there is also a dearth of local comparability data, particularly in smaller economies. Furthermore, taxpayers located in developed countries that transact with affiliates in developing countries face the same issue as their developing country counterparts in cases where the developing country affiliate is the 'tested party'.

² An analysis of the Bureau van Dijk ORBIS database reveals that of the 18,761,817 records in the ORBIS database for the 30 Eastern Europe and Central Asian countries for 2011, less than 10% (1,844,710(9.83%)) meet Bureau van Dijk's independence indicators of A+,A,A-,B+,B,B-. Whilst it must be acknowledged that this observation is likely skewed by lack of public information concerning ownership, it does provide insight into the role that market factors, as distinct from public access to statutory accounts and coverage by commercial database providers, can play vis-à-vis the existence of domestic comparables. For example, the number of independent economic operations in a developing country may be limited due to the size of the market, the dominance MNE groups and regional/local players in the market and or high levels of state ownership.

participants, and as has been elaborated on in previous papers by OECD and others,³ it is clear that there are multiple elements (including implementation cost and relative priority) and stakeholders to be considered before a country decides to implement rules that require the filing and public availability of statutory accounts. Thus, while availability of information for transfer pricing compliance purposes is a laudable objective, it is not and should not be, the main consideration.

The second action - increasing access to commercial databases for developing countries – is necessary to help overcome the resource constraints faced by many developing countries. However we are of the view that merely providing access to these databases will not directly address the issue. In many, if not most, developing countries information concerning domestic comparables in the commercial databases is minimal or simply does not exist. For example, an analysis of available data in Bureau van Dijk ORBIS database for 2011 for 30 Eastern European and Central Asian Economies reveals for that 10 of those countries have less than 10 company records that meet the absolute basic criteria necessary for potential use in application of the arm’s length principle (see table 1), and this is before any further comparability factors are considered. More than half of these countries have either recently introduced or are in the process of introducing transfer pricing legislation based on the arm’s length principle.

Table 1 - Country groupings based on number of records meeting minimum criteria

Number of records that meet minimum standard for possible application of arm’s length principle (2011)	Countries	#
≤ 10	Turkmenistan, Macedonia FYR, Kosovo, Kyrgyzstan, Albania, Georgia, Tajikistan, Armenia, Uzbekistan, Azerbaijan	10
10-1,000	Moldova, Belarus, Montenegro, Kazakhstan, Croatia	5
1,000-5,000	Lithuania, Serbia, Bosnia & Herzegovina, Slovenia, Turkey	5
5,000-10,000	Latvia, Hungary	2
10,000-100,000	Ukraine, Slovakia, Estonia, Poland, Czech Republic, Bulgaria	6
100,000 +	Romania, Russian Federation	2

Source: Analysis of Bureau van Dijk ORBIS database (accessed: 17 December 2013)

As there is a lack of domestic comparables for developing countries in the commercial databases, and given that steps to increase the availability of such data will take considerable time and expense and may in many instances have negligible impact, it is our view that in order to address the issue of lack of comparability data, facilitation of access to commercial databases must be coupled with **widely adopted, practical and implementable guidance on the use of foreign comparables.**

³ See for example: OECD Task Force on Tax and Development (2012), Report to the ‘Transparency in Financial Reporting’ Sub Group of the OECD Informal Task Force on Tax and Development on Central registration and public availability of statutory accounts in developing countries, available at http://www.oecd.org/ctp/tax-global/2.%20Final_report_to_Sub_Group.pdf.

2. More effective use of data sources for comparables

The World Bank Group has been working with numerous developing countries on implementation of transfer pricing legislation and related capacity building. Based on this experience, and our ongoing dialogue with practitioners in these countries, the issue of effective use of the data sources that are available, and namely, the use of foreign comparable is a, if not the, immediate priority. In our work with developing countries, we have observed the concern over this issue and the lack of guidance in relation thereto as an obstacle to effective implementation of transfer pricing legislation at both the policy and administrative levels. It is also of major concern for private sector participants in data-scarce economies who seek certainty as to the practical application of transfer pricing legislation. A recent survey conducted by the World Bank Group of 50 practitioners, covering 25 countries in Eastern Europe and Central Asia, highlighted that more 57% regularly rely on foreign comparables. This is despite there being a lack of any adequate guidance on the use of foreign comparables in practice at the country level, regionally or internationally. Practical experience and anecdotal evidence suggests that the situation is similar, if not worse, in other parts of the world.

The current guidance on the use of foreign comparables in both the OECD Transfer Pricing Guidelines and the United National Practical Manual is insufficient given the practical realities of data availability. No specific guidance is given as to the relevant criteria for the selection of foreign comparables or as regards the types of adjustments that may be required to be made to account for market differences. As noted above, while this is a major issue for developing countries, it is also an issue for developed countries. The lack of policy guidance on this issue increases the risk that cases will be dealt with on a discretionary or ad-hoc basis. This is something many developing country tax authorities are actively working to combat in all aspects of tax policy and administration. In addition, the ambiguity created by the lack of widely adopted guidance on this issue undermines the principles of consistency and certainty that we aim to promote in developing countries seeking to improve the business-enabling environment for investors.

While we acknowledge that the selection and adjustment of foreign comparable is a very complex topic, we are of the view that the need for practical guidance on this issue can no longer be ignored. Nor can it be considered addressed by the more long term initiatives elaborated on in the paper. To address this issue, we recommend that the timely development of practical guidance on the use of foreign comparables, including their selection and adjustments for market difference, should be an immediate priority of the OECD. To have the desired impact however, it is noted that such guidance must be the subject of wide spread agreement and be implementable in practice. Its development must therefore must involve representatives of the countries most affected (data scarce developing countries) and the private sector.

3. Approaches to reducing reliance on direct comparables

The World Bank Group is supportive of the analysis of different practices and approaches for reducing the reliance on ‘direct comparables’. We stress however the importance of approaches being developed that are implementable in practice, particularly in low capacity environments. And furthermore, we encourage the development of approaches and guidance that increase, rather than decrease, the level of certainty for tax administrations and taxpayers alike.

As regards safe harbors and specific approaches to selected transaction types, we recognize the potential for application of such approaches and therefore encourage the provision of further analysis, discussion and guidance in relation thereto. However we take this opportunity to again stress the importance of developing widely accepted, practical solutions with broad coverage, which transaction-specific solutions such as safe harbors and or legislative approaches do not necessarily provide. As such, it is our view that the development of guidance on the use of foreign comparables should be the immediate priority.

4. Advance pricing agreements and mutual agreement proceedings

While the World Bank Group supports additional guidance on tools that can help avoid or resolve disputes including advance pricing agreements (herein “APAs”), we are of the view that this is a distinct issue which should not be considered as significant part of the solution of the issue of the dearth of comparability data. Judging by the numbers of APAs concluded, even in developed countries, and the level of capacity required in the tax authority to engage in APA negotiations, we expect that APAs can only address a small sub-set of transfer pricing cases.

The issue of dearth of comparability data is too wide spread and too far reaching to be resolved through individual agreements. Widely accepted, practical solutions with broad coverage are needed (see above). Furthermore, as the negotiation of such agreements should in so far as is possible be based on principles and the consistent application of the law, practical guidance on the more effective use of existing data sources for comparables and on approaches to reducing the reliance on direct comparables is a necessary prerequisite to their use in data scarce economies.

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