QATAR

TRANSFER PRICING GUIDELINES

ALOK K SAKSENA
Auditing & Accounting

Table of Contents

1. Introduction

In the present era of globalized commercialization, it is a universal phenomenon that MNCs have branches / subsidiaries / divisions operating in more than one country. In such a situation, it is common for MNCs to transfer/render goods/services from one tax jurisdiction to an associate entity located in another tax jurisdiction. While doing so, the MNC concerned has in mind the goal of minimizing tax burden and maximizing profits but the two tax jurisdictions/countries have also the consideration of countering the tax avoidance while making laws that govern such transactions. It is an internationally accepted practice that such ‘transfer pricing’ should be governed by the Arm’s Length Principle (ALP). In other words, the transaction between associates should be priced in the same way as a transaction between independent enterprises.

2. Transfer Pricing in Qatar

In November 2017, Qatar joined the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework on base erosion and profit shifting (BEPS), which was established to allow interested countries and jurisdictions to participate in the development of standards on BEPS-related issues. In doing so, Qatar committed to aligning with the emerging global consensus on shared international tax rules. The Inclusive Framework now has more than 135 members.

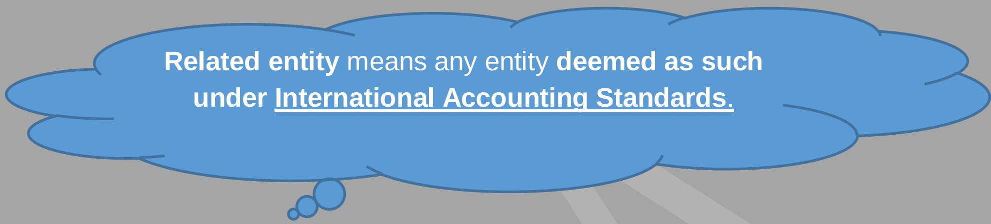
In 2018, Qatar introduced country-by-country reporting (CbCR) rules, to meet one of the minimum standards for members of the Inclusive Framework.

On 13 December 2018, Law No. 24 of 2018 was issued to promulgate a new income tax law. The new law replaces Law No. 21 of 2009 and is effective from 14 December 2018.

On 11 December 2019, Qatar’s General Tax Authority (GTA) published Executive Regulations (ER) relating to the implementation of Income Tax Law No. 24 of 2018 (Income Tax Law) which included transfer pricing provisions. The ER, published on 11 December 2019, is effective from 12 December 2019. The ER contains specific transfer pricing (TP) compliance and documentation requirements for entities in Qatar. Specifically, Qatar-based entities with related party transactions exceeding a prescribed revenue/asset threshold will need to file a TP form/questionnaire, master TP file and local TP file by the tax return filing deadline which are outlined below:

3. Basic Provisions

- Article (52) of the ER provides that, **any entity** (Reporting Entity) related to other entities (related entity) should **give proper consideration** to the **transfer pricing requirements** in:
  - determining the **pricing terms and other terms** governing the transactions between them and
  - in **reporting the income** derived from such transactions **in the relevant tax returns**.



- As per the **International Accounting Standard (IAS) 24: *"Related Party Disclosures"***, a **related party** is a **person (1)** or an **entity (2)** that is related to the reporting entity as depicted below:

- As per **IAS 24,** a **person or a close member of that person's family** is treated as "**related**" to a reporting entity if that person:
  - **has control or joint control** of the reporting entity;
  - **has significant influence** over the reporting entity; or
  - is a member of the **key management personnel** of the reporting entity or of a **parent** of the reporting entity.
- Further, an **entity** is treated as **"related"** to a reporting entity if any of the following conditions applies:
  - The entity and the reporting entity are **members of the same group** (which means that each parent, subsidiary and fellow subsidiary is related to the others).

        - One entity is an **associate** or **joint venture** of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
        - Both entities **are joint ventures of the same third party.**
        - One entity is a **joint venture of a third entity** and the other entity is an **associate of the third entity**.
        - The entity is a **post-employment benefit plan** for the benefit of **employees of** either the **reporting entity** or an entity **related to the reporting entity**. If the reporting entity is itself such a plan, the **sponsoring employers** are also related to the reporting entity.
        - The entity is **controlled or jointly controlled** by a $\boxed{\textbf{person}}$ identified above.
        - A person having control or joint control of the reporting entity has **significant influence** over the entity or is a **member of the key management personnel** of the entity (or of a parent of the entity).
        - The entity, or any member of a group of which it is a part, **provides key management personnel services** to the reporting entity or to the parent of the reporting entity.
    - **Close members of the family** of a person are those family members who may be expected to **influence, or be influenced by**, that person in their **dealings with the entity** and include:
        - that person's **children and spouse** or domestic partner;
        - **children** of that person's spouse or domestic partner; and
        - **dependants** of that person or that person's spouse or domestic partner.
- Further, IAS 24, has defined **Key management personnel** as the persons having **authority and responsibility** for **planning, directing and controlling the activities** of the entity, directly or indirectly, including any **director** (whether executive or otherwise) of that entity.
- **Control** means the **power to govern** the **financial and operating policies** of an entity so as to obtain benefits from its activities.
- **Joint control** means the **contractually agreed sharing of control** over an economic activity.
- **Significant influence** means the **power to participate in the financial and operating policy decisions** of an entity, but is **not control over those policies**. Significant influence may be **gained by share ownership, statute or agreement**.
- **An associate** means an entity over which an investor has significant influence being the **power to participate in the financial and operating policy decisions** of the investee (but not control or joint control).
- A **joint venture** is a **joint arrangement** whereby the **parties that have joint control** of the arrangement have **rights to the net assets** of the arrangement.
- As per **IAS 24,** following are **not related parties**:
    - two entities simply because they **have a director or other member of key management personnel in common** or because a **member of key management personnel of one entity has significant influence** over the other entity.

  - two **joint venturers** simply because they share joint control of a joint venture.
    - providers of finance
    - trade unions
    - public utilities &
    - departments and agencies of a government that does not control, jointly control or significant influence the reporting entity

    simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).
  - a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a **significant volume of business**, simply by virtue of the **resulting economic dependence**.
  - In the definition of a related party, an **associate** includes **subsidiaries of the associate** and a joint venture includes **subsidiaries of the joint venture**. Therefore, for example, **an associate's subsidiary and the investor** that has **significant influence** over the associate are related to each other.
- In considering each possible related party relationship, attention needs to be directed to the **substance of the relationship and not merely the legal form**.

4. Determination of Arm's Length Price (ALP)

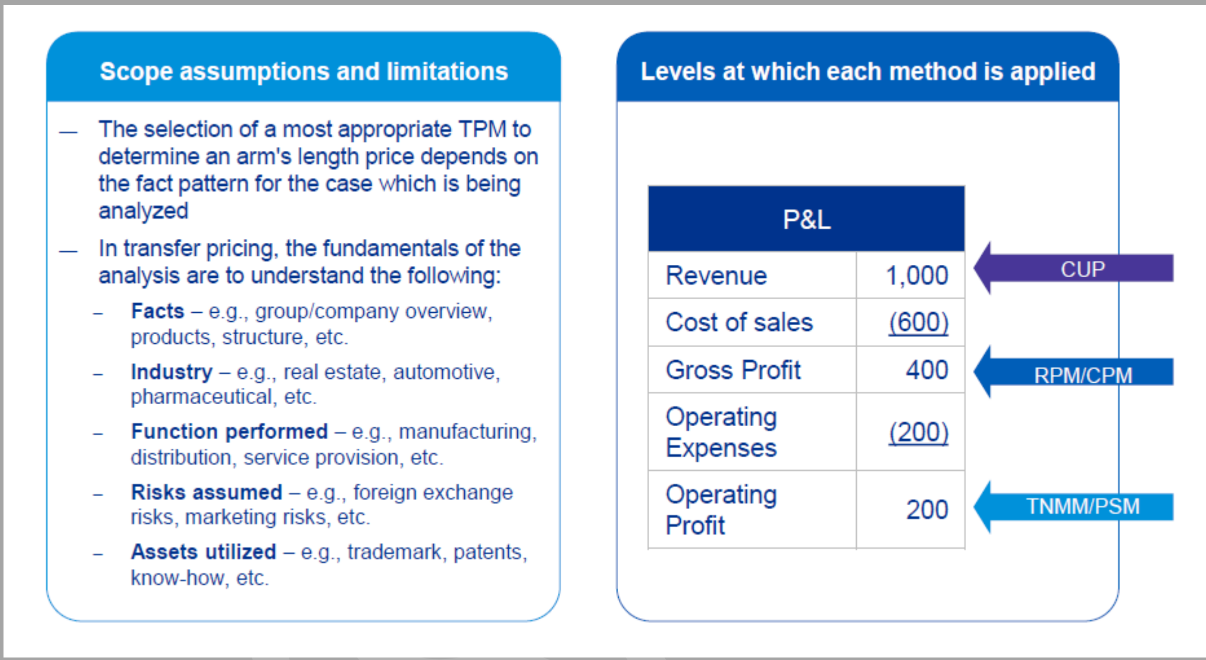
  - Article (51) provides for determination of ALP primarily as per **Unrelated Comparable Price method**.

Unrelated Comparable Price means the price of the service or goods which would have been applied should the transaction be **between unrelated parties.**

  - **If** the data required to apply the **Unrelated Comparable Price** method are **not available**, the taxpayer should **submit to the GTA an application to apply any other pricing method approved by OECD.**

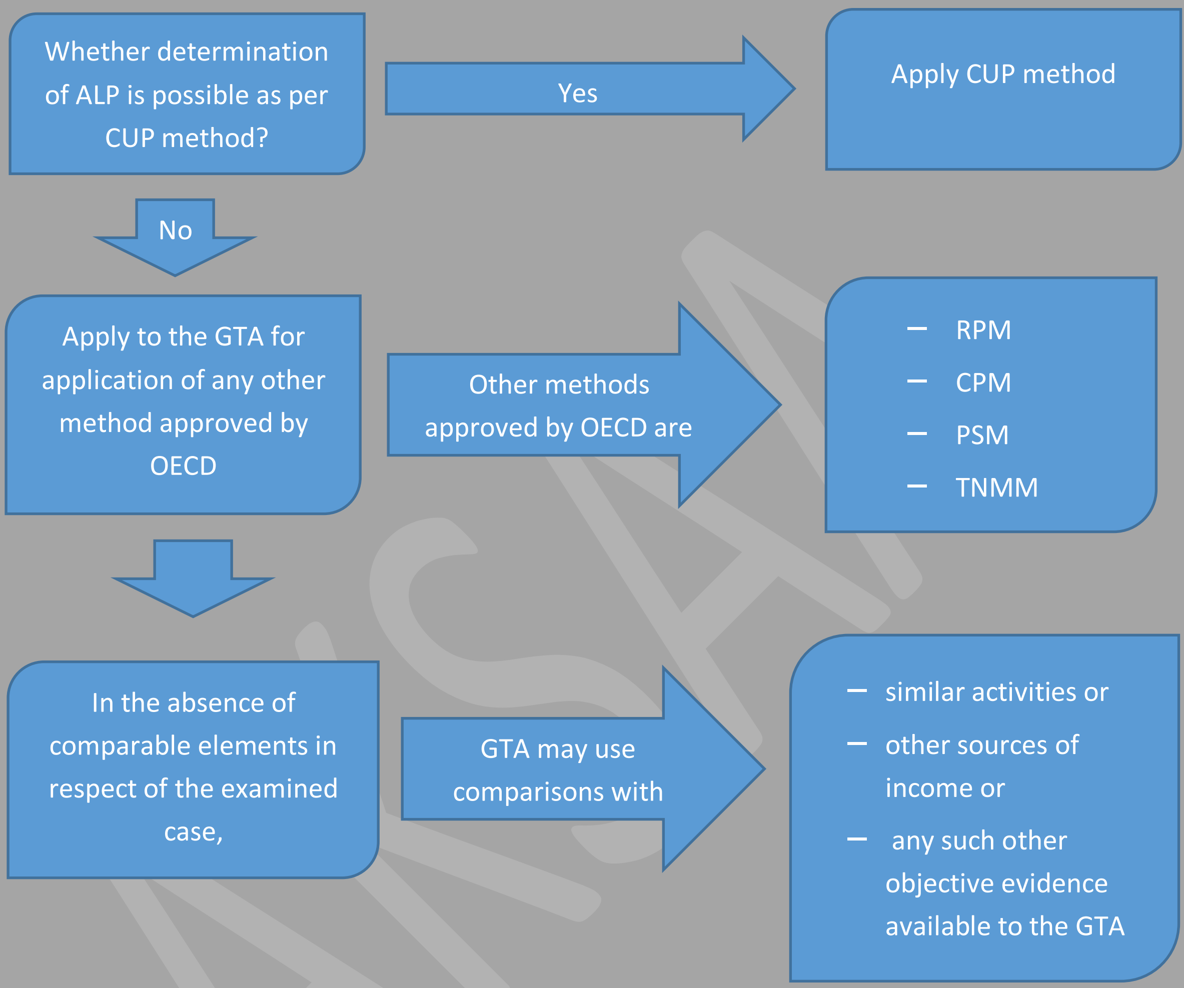
    - The OECD TP Guidelines have prescribed following five methods for determining ALP:
      - **Traditional transactional methods**
        - Comparable uncontrolled price method ("**CUP**")
        - Resale price method ("**RPM**") - commonly used for distributors
        - Cost plus method ("**CPM**") - commonly used for manufacturers / service providers

- **Profit based methods**
  - Profit split method ("**PSM**")
  - Transactional net margin method ("**TNMM**")



- In the absence of comparable elements in respect of the examined case, **the GTA may use comparisons with:**
  - similar activities or
  - other sources of income or
  - any such other objective evidence available to the GTA.
- Considering that this is the residual method of benchmarking, the extent of comparability is expected to be lower than as compared to that observed in the five specific methods. Also the filters would also not be as strict as those used under the five specific methods. The OECD guidelines may come handy in such situations depending upon the nature of transaction. However, in general, in such cases, **the GTA may use comparables available in the form of:**
  - Third party quotations;
  - Valuation reports;
  - Tender/Bid documents;
  - Documents relating to the negotiations;
  - Standard rate cards;
  - Commercial & economic business models; etc.

- The above list is only suggestive of what could be used by the GTA as a comparable. Technically, the nature of transaction would be the driving factor for search of comparables in such cases.



5. OECD Guidance on the different methods

- **Comparable uncontrolled price method**
  - The CUP method compares the **price** charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any **difference** between the two prices, this may indicate that the **conditions of the commercial and financial relations** of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.
  - An uncontrolled transaction is **comparable** to a controlled transaction (i.e. it is a comparable uncontrolled transaction) for purposes of the CUP method **if one of two conditions is met**:

- **none of the differences** (if any) between the transactions being compared or between the enterprises undertaking those transactions could **materially affect the price in the open market**; or,
- **reasonably accurate adjustments** can be made **to eliminate the material effects** of such differences.

- Where it is **possible to locate comparable uncontrolled transactions**, the CUP method is the **most direct and reliable** way to apply the arm's length principle. Consequently, in such cases the CUP method is **preferable over all other methods**.
- It may be **difficult to find** a transaction between independent enterprises that is **similar enough** to a controlled transaction such that no differences have a material effect on price. For example, a **minor difference** in the property transferred in the controlled and uncontrolled transactions **could materially affect the price** even though the nature of the business activities undertaken may be sufficiently similar to generate the **same overall profit margin**. When this is the case, some **adjustments will be appropriate**. The **extent and reliability of such adjustments** will affect the **relative reliability of the analysis** under the CUP method.
- In considering whether controlled and uncontrolled transactions are comparable, regard should be had to the **effect on price of broader business functions** other than just product comparability. Where differences exist between the controlled and uncontrolled transactions or between the enterprises undertaking those transactions, it may be difficult to determine reasonably accurate adjustments to eliminate the effect on price. The **difficulties** that arise in attempting to make reasonably accurate adjustments **should not routinely preclude the possible application of the CUP method**. **Practical considerations** dictate a more flexible approach to enable the CUP method to be used and to be supplemented as necessary by other appropriate methods, all of which **should be evaluated according to their relative accuracy**. Every effort should be made to adjust the data so that it may be used appropriately in a CUP method. As for any method, the **relative reliability of the CUP method** is affected by the **degree of accuracy with which adjustments can be made** to achieve comparability.
- The CUP method would **generally be an appropriate transfer pricing method for** establishing the arm's length price for **the transfer of commodities** between associated enterprises. The reference to "commodities" shall be understood to encompass **physical products for which a quoted price is used as a reference by independent parties in the industry to set prices in uncontrolled transactions**. The term "**quoted price**" refers to the price of the commodity in the relevant period obtained **in an international or domestic commodity exchange market**. In this context, a quoted price also includes **prices obtained from recognised and**

transparent price reporting or statistical agencies, or **from governmental price-setting agencies**, where such indexes are **used as a reference by unrelated parties to determine prices** in transactions between them.

- Under the CUP method, the arm's length price for commodity transactions may be determined by reference to comparable uncontrolled transactions and by **reference to comparable uncontrolled arrangements represented by the quoted price**. Quoted commodity prices generally reflect the agreement between **independent buyers and sellers** in the market on the price for a **specific type and amount of commodity**, traded under **specific conditions** at a **certain point in time**. A relevant factor in determining the appropriateness of using the quoted price for a specific commodity is the **extent to which the quoted price is widely and routinely used in the ordinary course of business** in the industry to negotiate prices for uncontrolled transactions comparable to the controlled transaction. Accordingly, depending on the **facts and circumstances of each case**, quoted prices can be considered as a reference for pricing commodity transactions between associated enterprises. Taxpayers and tax administrations should be **consistent in their application** of the **appropriately selected quoted price**.
- For the CUP method to be reliably applied to commodity transactions, the **economically relevant characteristics** of the controlled transaction and the uncontrolled transactions or the uncontrolled arrangements represented by the quoted price need to be comparable. For commodities, the economically relevant characteristics include, among others, the **physical features and quality** of the commodity; the **contractual terms** of the controlled transaction, such as **volumes** traded, **period** of the arrangements, the **timing and terms of delivery**, **transportation, insurance, and foreign currency terms**. For some commodities, certain economically relevant characteristics **(e.g. prompt delivery) may lead to a premium** or a **discount**. If the quoted price is used as a reference for determining the arm's length price or price range, the **standardised contracts which stipulate specifications on the basis of which commodities are traded** on the exchange and **which result in a quoted price** for the commodity may be relevant. Where there are differences between the conditions of the controlled transaction and the conditions of the uncontrolled transactions or the conditions determining the quoted price for the commodity that materially affect the price of the commodity transactions being examined, reasonably accurate adjustments should be made to ensure that the **economically relevant characteristics of the transactions are comparable**. **Contributions** made in the form of **functions performed, assets used and risks assumed** by other entities in the supply chain **should be compensated** in accordance with the guidance provided in these Guidelines.

- In order to assist tax administrations in conducting an informed examination of the taxpayer's transfer pricing practices, taxpayers should provide **reliable evidence and document**, as part of their transfer pricing documentation, the **price-setting policy** for commodity transactions, **the information needed to justify price adjustments** based on the comparable uncontrolled transactions or comparable uncontrolled arrangements represented by the quoted price and any other relevant information, such as pricing formulas used, third party end-customer agreements, premia or discounts applied, pricing date, supply chain information, and information prepared for non-tax purposes.
- A **particularly relevant factor** for commodity transactions determined by reference to the quoted price is the **pricing date**, which refers to the **specific time, date or time period** (e.g. a **specified range of dates over which an average price is determined**) selected by the parties to determine the price for commodity transactions. Where the taxpayer can provide **reliable evidence of the pricing date agreed by the associated enterprises** in the controlled commodity transaction at the time the transaction was entered into (e.g. **proposals and acceptances, contracts or registered contracts,** or **other documents setting out the terms of the arrangements** may constitute reliable evidence) and this is **consistent with the actual conduct** of the parties or with other facts of the case, tax administrations should determine the price for the commodity transaction by reference to the pricing date agreed by the associated enterprises. If the pricing date specified in any written agreement between the associated enterprises is inconsistent with the actual conduct of the parties or with other facts of the case, tax administrations may **determine a different pricing date consistent with those other facts of the case and what independent enterprises would have agreed in comparable circumstances (taking into considerations industry practices)**. When the taxpayer does not provide reliable evidence of the pricing date agreed by the associated enterprises in the controlled transaction and the tax administration cannot otherwise determine a different pricing date, tax administrations may deem the pricing date for the commodity transaction on the basis of the evidence available to the tax administration; this may be the **date of shipment as evidenced by the bill of lading or equivalent document** depending on the means of transport. This would mean that the price for the commodities being transacted would be determined by reference to the average quoted price on the shipment date, subject to any appropriate comparability adjustments based on the information available to the tax administration. It would be **important to permit resolution of cases of double taxation** arising from application of the deemed pricing date **through access to the mutual agreement procedure** under the applicable Treaty.

- The CUP method is a **particularly reliable method** where an **independent enterprise sells the same product** as is sold between two associated enterprises.
  - **Example 1** - an **independent enterprise** sells **unbranded <u>Colombian</u> coffee beans** of a **similar type, quality, and quantity** as those sold between two associated enterprises, assuming that the controlled and uncontrolled transactions occur **at about the same time**, at the **same stage in the production/distribution chain**, and **under similar conditions**. If the **only available uncontrolled transaction** involved **unbranded <u>Brazilian</u> coffee beans**, it would be **appropriate to inquire whether the difference in the coffee beans has a material effect on the price**. For example, it could be asked whether the **source of coffee beans commands a premium or requires a discount** generally in the open market. Such information may be obtainable **from commodity markets or may be deduced from dealer prices**. If this difference does have a material effect on price, **some adjustments would be appropriate**. If a reasonably accurate adjustment cannot be made, the **reliability of the CUP method** would be reduced, and it might be necessary to **select another less direct method instead**.
  - **Example 2** - One illustrative case where **adjustments may be required** is where the circumstances surrounding controlled and uncontrolled sales are identical, except for the fact that the controlled sales price is a **delivered price** and the uncontrolled sales are made **F.O.B. factory**. The differences in terms of **transportation and insurance** generally have a **definite and reasonably ascertainable effect** on price. Therefore, to determine the uncontrolled sales price, **adjustment** should be made to the price for the **difference in delivery terms**.
  - **Example 3** - As another example, assume a taxpayer sells **1000 tons of a product for $80 per ton** to an **associated enterprise** in its MNE group and at the same time sells **500 tons of the same product for $100 per ton** to an **independent enterprise**. This case requires an **evaluation of whether the different volumes should result in an adjustment** of the transfer price. The **relevant market should be researched** by analysing transactions in similar products **to determine typical volume discounts**.

- **Resale Price Method**
  - The resale price method begins with the **price at which** a product that has been purchased from an associated enterprise is **resold to an independent enterprise**. This price (the "resale price") is then **reduced by an appropriate gross margin** (the "resale price margin"), determined by reference to gross margins in comparable

uncontrolled transactions, representing the amount out of **which the reseller would seek to cover its selling and other operating expenses** and, in light of the **functions performed (taking into account assets used and risks assumed)**, make an **appropriate profit**. What is left after subtracting the gross margin can be regarded, after **adjustment for other costs associated with the purchase of the product** (e.g. customs duties), as **an arm's length price** for the original transfer of property between the associated enterprises.

- Thus, in a resale price method, the **resale price margin (i.e. the gross margin)** that the reseller earns from the controlled transaction is compared with the gross margin from comparable uncontrolled transactions.
- This **method is probably most useful** where it is applied to **sales and marketing operations** such as those typically **carried out by a distributor**. In some circumstances, the resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions (an "internal comparable"). In other circumstances (especially where reliable internal comparables are not available), the resale price margin may be determined by reference to the resale price margin earned by independent enterprises in comparable uncontrolled transactions ("external comparables").
  - **Example 1 -** Assume that there are **two distributors** selling the **same product** in the **same market** under the **same brand name**. **Distributor A** offers a **warranty**; **Distributor B offers none**. **Distributor A** is **not including the warranty as part of a pricing strategy** and so **sells its product at a higher price** resulting in a **higher gross profit margin** (if the costs of servicing the warranty are not taken into account) than that of **Distributor B**, which **sells at a lower price**. The two **margins are not comparable** until a **reasonably accurate adjustment** is made to account for that difference.
  - **Example 2 -** Assume that a **warranty is offered with respect to all products** so that the downstream price is uniform. **Distributor C performs the warranty function** but is, in fact, **compensated by the supplier through a lower price**. **Distributor D does not perform the warranty function** which is performed by the supplier (products are sent back to the factory). However, **Distributor D's supplier charges D a higher price** than is charged to Distributor C. **If Distributor C accounts for the cost of performing the warranty function as a cost of goods sold**, then the **adjustment in the gross profit margins for the differences is automatic**. However, **if the warranty expenses are accounted for as operating expenses**, there is a **distortion in the margins**

which must be corrected. The reasoning in this case would be that, **if D performed the warranty itself**, its **supplier would reduce the transfer price**, and therefore, **D's gross profit margin would be greater**.

- **Example 3** - A company sells a product **through independent distributors** in five countries in which it has no subsidiaries. The **distributors simply market the product** and do not perform any additional work. **In one country, the company has set up a subsidiary**. Because this particular market is of strategic importance, the company requires its subsidiary to **sell only its product and to perform technical applications for the customers**. Even if all other facts and circumstances are similar, **if the margins are derived from independent enterprises that do not have exclusive sales arrangements or perform technical applications** like those undertaken by the subsidiary, it is necessary to **consider whether any adjustments must be made** to achieve comparability.

- **The Cost Plus Method**
  - The cost plus method **begins with the costs incurred by the supplier** of property or services in a controlled transaction for property transferred or services provided to an associated enterprise. An **appropriate mark-up**, determined by reference to the mark-up **earned by suppliers in comparable uncontrolled transactions**, is then **added to these costs**, to make an appropriate profit **in light of the functions performed and the market conditions**. Such arm's length mark-up may be determined by reference to the mark-up that the same supplier earns in comparable uncontrolled transactions (an "internal comparable"), or by reference to the mark up that would have been earned in comparable transactions by an independent enterprise ("external comparable"). In general, the mark-up in a cost plus method will be computed **after direct and indirect costs** of production or supply, but **before the operating expenses** of the enterprise (e.g. overhead expenses).
  - In a cost plus method, the **mark-up on costs** that the manufacturer or service provider earns from the controlled transaction is compared with the mark-up on costs from comparable uncontrolled transactions.
  - This method probably is **most useful where**:
    - goods are sold by a **manufacturer that does not contribute valuable unique intangible assets or assume unusual risks** in the controlled transaction, such as may be the case under a contract or toll manufacturing arrangement; or

  - the controlled transaction is the **provision of services** for which the provider **does not contribute any valuable unique intangible assets or assume unusual risks**.

- **Example 1 - A** is a **domestic manufacturer of timing mechanisms** for mass-market clocks. A sells this product to its foreign subsidiary B. A earns a **5% gross profit mark** up with respect to its manufacturing operation. X, Y, and Z are **independent domestic manufacturers of timing mechanisms** for mass-market watches. X, Y, and Z **sell to independent foreign purchasers**. X, Y, and Z earn **gross profit mark ups** with respect to their manufacturing operations that range from **3% to 5%**. A accounts for **supervisory, general, and administrative costs as operating expenses**, and thus these costs are **not reflected in cost of goods sold**. The gross profit mark ups of X, Y, and Z, however, **reflect supervisory, general, and administrative costs as part of costs of goods** sold. Therefore, the **gross profit mark ups of X, Y, and Z must be adjusted** to provide accounting consistency.
- **Example 2 - Company C** in country D is a **100% subsidiary of company E**, located in country F. In comparison with country F, **wages are very low in country D**. At the **expense and risk of company E**, television sets are assembled by company C. All the **necessary components, know-how, etc. are provided by company E**. The purchase of the assembled product is **guaranteed by company E** in case the television sets fail to meet a certain quality standard. After the quality check, the television sets are **brought – at the expense and risk of company E – to distribution centres** company E has in several countries. The function of **company C can be described as a purely contract manufacturing function**. The risks company C could bear are eventual differences in the agreed quality and quantity. The **basis for applying the cost plus method will be formed by all the costs connected to the assembling activities**.
- **Example 3** - Company A of an MNE group agrees with company B of the same MNE group to carry out **contract research** for company B. **All risks** related to the research are **assumed by company B**. This company also **owns all the intangibles** developed through the research and therefore has also the **profit chances resulting from the research**. This is a **typical setup for applying a cost plus method**. **All costs for the research**, which the associated parties have agreed upon, **have to be compensated**. The **additional cost plus may reflect how innovative and complex the research** carried out is.

- **The Profit Split Method**

- The profit split method **first identifies the combined profits to be split for the associated enterprises** from the controlled transactions in which the associated enterprises are engaged. In some cases, the combined profits will be the total profits from the controlled transactions in question. In other cases, the combined profits will be a residual profit intended to represent the profit that cannot readily be assigned to one of the parties from the application of another transfer pricing method, such as the profit arising from valuable, unique intangibles. Note that the combined profits may be a loss in some circumstances.
- The profit split method then splits the combined profits between the associated enterprises **on an economically valid basis that approximates the division of profits that would have been anticipated between independent enterprises**. Where possible, this economically valid basis may be **supported by independent market data** (e.g. division of profits observed in uncontrolled joint-venture agreements). Most often, however, it will be supported by internal data. The **types of such internal data that may be relevant will depend on the facts and circumstances** of the case and may include, for example, **allocation keys relating to the respective sales, research and development expenses, operating expenses, assets or headcounts** of the associated enterprises. The splitting factor should **reflect the respective contributions of the parties to the creation of income** from the controlled transaction and be reasonably independent from transfer pricing formulation. This means that it should, **to the greatest extent possible, be based on objective data** (such as sales to unrelated parties), rather than on data relating to the remuneration of controlled transactions (such as sales to associated enterprises).

- **The Transactional Net Margin Method**
  - The transactional net margin method ("TNMM") **examines a net profit indicator**, i.e. a ratio of net profit **relative to an appropriate base (e.g. costs, sales, assets)**, that a taxpayer realises from a controlled transaction (or from transactions that are appropriate to aggregate) with the net profit earned in comparable uncontrolled transactions. The arm's length net profit indicator of the taxpayer from the controlled transaction(s) may be determined by reference to the net profit indicator that the same taxpayer earns in comparable uncontrolled transactions (internal comparables), or by reference to the net profit indicator earned in comparable transactions by an independent enterprise (external comparables).
  - In cases where the net profit is weighed to costs or sales, the TNMM operates in a manner similar to the cost plus and resale price methods respectively, except that it

compares the net profit arising from controlled and uncontrolled transactions (after relevant operating expenses have been deducted) **instead of comparing a gross profit** on resale or gross mark up on costs.

- Most often, the net profit indicator that is tested in a TNMM is the **operating profit (before interest, extraordinary items and income taxes)**.
- In general, it is observed that in applying a TNMM, the net profit is **weighted to costs for manufacturing and service activities**; **to sales for sales activities; and to assets for asset-intensive activities**.
- The selected **financial indicator** should be one that:
  - **Reflects the value of the functions performed** by the tested party (i.e. the party to the controlled transaction for which a financial indicator is tested), **taking account of its assets and risks**;
  - Is **reasonably independent** from transfer pricing formulation, i.e. it should be **based on objective data** (such as sales to unrelated parties), not on data relating to the remuneration of controlled transactions (such as sales to associated enterprises); and
  - Is **capable of being measured in a reasonably reliable and consistent manner** at the level of the controlled transaction and of the comparable uncontrolled transaction(s).
- **Functional comparability** is generally found to be **of greater importance than product comparability** in applying the transactional net margin method.
- **Example 1 -** By way of illustration, the **Example 1** under cost plus method above, **demonstrates the need to adjust the gross mark-up** arising from transactions in order **to achieve consistent and reliable comparison**. Such **adjustments may be made without difficulty where the relevant costs can be readily analysed**. Where, however, it is **known that an adjustment is required, but it is not possible to identify the particular costs for which an adjustment is required**, it may, nevertheless, be **possible to identify the net profit** arising on the transaction and **thereby ensure that a consistent measure is used**. For example, **if the supervisory, general, and administrative costs that are treated as part of costs of goods sold** for the independent enterprises X, Y and Z **cannot be identified so as to adjust the mark up in a reliable application of cost plus**, it may be **necessary to examine net profit indicators** in the absence of more reliable comparisons.
- **Example 2 -** A similar approach may be required when there are **differences in functions performed** by the parties being compared. Assume that the **facts are the same as in the Example 3 under Resale Price method above** except that it is the **comparable independent enterprises that perform the additional function of**

technical support and not the associated enterprise, and that these **costs are reported in the cost of goods sold but cannot be separately identified**. Because of product and market differences it may not be possible to find a CUP, and a resale price method would be unreliable since the gross margin of the independent enterprises would need to be higher than that of the associated enterprise in order to reflect the additional function and to cover the unknown additional costs. In this example, it may be more **reliable to examine net margins** in order to assess the difference in the transfer price that would reflect the difference in function. The use of net margins in such a case needs to take account of comparability and **may not be reliable if there would be a material effect on net margin as a result of the additional function or as a result of market differences**.

- **Example 3 -** Assume that the facts are the same as in **Example 1 under Resale Price method above**. However, the amount of the **warranty expenses incurred by Distributor A proves impossible to ascertain** so that it is not possible to reliably adjust the gross profit of A to make the gross profit margin properly comparable with that of B. However, if there are no other material functional differences between A and B and the **net profit of A relative to its sales is known**, it might be possible to apply the transactional net margin method to B by comparing the margin relative to A's sales to net profits with the margin calculated on the same basis for B.

- **Selection of the Most Appropriate Method**

  - The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. No one method is suitable in every possible situation, nor is it necessary to prove that a particular method is not suitable under the circumstances.
  - The selection process of the most appropriate method for a particular case should **take account of the following four criteria**:
    - The respective **strengths and weaknesses** of the methods;
    - The **appropriateness of the method** considered in view of the **nature of the controlled transaction**, determined in particular through **a functional analysis**;
    - The **availability of reliable information** (in particular on uncontrolled comparables) needed to apply the selected method and / or other methods; and
    - The **degree of comparability** between controlled and uncontrolled transactions, including the **reliability of comparability adjustments** that may be needed to eliminate material differences between them.

Each of these four criteria is discussed below:

- **The respective strengths and weaknesses of the methods -**
  - Each of the transfer pricing methods has strengths and weaknesses which should be considered in determining its appropriateness to the circumstances of the case.
  - **Comparable uncontrolled price method (CUPM)**
    - Where it is **possible to locate comparable uncontrolled transactions** to apply it, the **CUP method is the most direct and reliable** way to apply the arm's length principle. Consequently, in such cases the CUP method is preferable over all other methods.
    - However, **in practice, it is often difficult to find** a transaction between independent enterprises that is similar enough to a controlled transaction such that no differences have a material effect on price. For example, a minor difference in the property transferred in the controlled and uncontrolled transactions could materially affect the price even though the nature of the business activities undertaken may be sufficiently similar to generate the same overall profit margin.
    - Therefore, the CUP method is a particularly reliable method where an independent enterprise sells the same product as is sold between two associated enterprises (commodities for instance).

  - **Resale price method (RPM)**
    - The resale price method is probably **most useful where it is applied to marketing operations**. In making comparisons for purposes of the resale price method, **fewer adjustments are normally needed** to account for product differences than under the CUP method, because **minor product differences are less likely to have as material an effect on profit margins** as they do on price.

  - **Cost plus method (CPM)**
    - The cost plus method probably is **most useful where semi-finished goods are sold** between associated parties, where associated parties have concluded **joint facility agreements or long-term buy-and-supply arrangements**, or where the controlled transaction is the **provision of services**. As is the case under the resale price method, in determining whether a transaction is a comparable uncontrolled transaction for the purposes of the cost plus method, fewer adjustments may be necessary to

account for product differences under the cost plus method than the CUP method

- The cost plus method presents **some difficulties in proper application, particularly in the determination of costs**. Although it is true that an enterprise must cover its costs over a period of time to remain in business, those costs may not be the determinant of the appropriate profit in a specific case for any one year. While in many cases companies are driven by competition to scale down prices by reference to the cost of creating the relevant goods or providing the relevant service, there are other circumstances where there is no discernible link between the level of costs incurred and a market price (e.g. where a valuable discovery has been made and the owner has incurred only small research costs in making it).
- Another important aspect of comparability is **accounting consistency**. Where the accounting practices differ in the controlled transaction and the uncontrolled transaction, appropriate adjustments should be made to the data used to ensure that the same type of costs are used in each case to ensure consistency.

- **Profit split method (PSM)**
  - The main strength of the Profit split method is that it can offer a solution **for highly integrated operations** for which a one-sided method would not be appropriate.
  - A profit split method may also be found to be the most appropriate method in cases where **both parties to a transaction make unique and valuable contributions (e.g. contribute unique intangibles)** to the transaction, because in such a case independent parties might wish to share the profits of the transaction in proportion to their respective contributions and a two-sided method might be more appropriate in these circumstances than a one-sided method. In addition, in the presence of unique and valuable contributions, reliable comparables information might be insufficient to apply another method.
  - On the other hand, a profit split method would ordinarily not be used in cases where **one party to the transaction performs only simple functions and does not make any significant unique contribution** (e.g. contract manufacturing or contract service activities in relevant circumstances), as in such cases a profit split method typically would not be appropriate in view of the functional analysis of that party.

- Where comparables data are available, they can be relevant in the profit split analysis to support the division of profits that would have been achieved between independent parties in comparable circumstances. However, in those cases where there is no more direct evidence of how independent parties would have split the profit in comparable circumstances, the allocation of profits may be based on the division of functions (taking account of the assets used and risks assumed) between the associated enterprises themselves.
- Another strength of the profit split method is that it **offers flexibility by taking into account specific, possibly unique, facts and circumstances** of the associated enterprises that are not present in independent enterprises, while still constituting an arm's length approach to the extent that it reflects what independent enterprises reasonably would have done if faced with the same circumstances.
- A further strength of the profit split method is that it is **less likely that either party to the controlled transaction will be left with an extreme and improbable profit result**, since both parties to the transaction are evaluated. This aspect can be particularly important when analysing the contributions by the parties in respect of the intangible property employed in the controlled transactions. This two-sided approach may also be used to achieve a division of the profits from economies of scale or other joint efficiencies that satisfies both the taxpayer and tax administrations.
- A weakness of the profit split method relates to **difficulties in its application**. On first review, the profit split method may appear readily accessible to both taxpayers and tax administrations because it tends to rely less on information about independent enterprises. However, associated enterprises and tax administrations alike may have **difficulty accessing information from foreign affiliates**, especially where the foreign affiliate is the parent company or a sister company rather than a subsidiary of the taxpayer. In addition, it may be **difficult to measure combined revenue and costs** for all the associated enterprises participating in the controlled transactions, which would require stating books and records on a common basis and making adjustments in accounting practices and currencies. Further, when the profit split method is applied to operating profit, it may be **difficult to identify the appropriate operating expenses** associated with the transactions and to allocate costs between the transactions and the associated enterprises' other activities.

- **Transactional net margin method (TNMM)**
  - One strength of the TNMM is that **net profit indicators** (e.g. return on assets, operating income to sales, and possibly other measures of net profit) **are less affected by transactional differences** than is the case with price, as used in the CUP method. Net profit indicators also may be **more tolerant to some functional differences** between the controlled and uncontrolled transactions than gross profit margins. Differences in the functions performed between enterprises are often reflected in variations in operating expenses. Consequently, this may lead to a wide range of gross profit margins but still broadly similar levels of net operating profit indicators.
  - In addition, in some countries the **lack of clarity in the public data with respect to the classification of expenses in the gross or operating profits** may make it difficult to evaluate the comparability of gross margins, while the use of net profit indicators may avoid the problem.
  - Another practical strength of the TNMM is that, as with any one-sided method, it is necessary to examine a financial indicator for only one of the associated enterprises (the "tested" party). This can be practically advantageous when **one of the parties to the transaction is complex and has many interrelated activities** or when it is difficult to obtain reliable information about one of the parties.
  - There are also a number of weaknesses to the transactional net margin method. The net profit indicator of a taxpayer can be influenced by some **factors that would either not have an effect, or have a less substantial or direct effect, on price or gross margins** between independent parties. These aspects may make accurate and reliable determinations of arm's length net profit indicators difficult. Thus, it is important to pay particular attention at establishing comparability for the TNMM, as set forth in paragraphs 2.68-2.75 of the OECD Guidelines. [OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2017]
  - Application of any arm's length method requires **information on uncontrolled transactions that may not be available at the time of the controlled transactions**. This may make it particularly difficult for taxpayers that attempt to apply the TNMM at the time of the controlled transactions (although use of multiple year data may mitigate this concern). In addition, taxpayers **may not have access to enough specific information on the profits attributable to comparable uncontrolled transactions** to make a valid application of the method. It also may be **difficult to ascertain revenue and operating expenses related to the**

controlled transactions, to establish the net profit indicator used as the profit measure for the transactions.

- There may also be **difficulties in determining an appropriate corresponding adjustment** when applying the transactional net margin method, particularly where it is not possible to work back to a transfer price. This could be the case, for example, where the taxpayer deals with associated enterprises on both the buying and the selling sides of the controlled transaction. In such a case, if the transactional net margin method indicates that the taxpayer's profit should be adjusted upwards, there may be some uncertainty about which of the associated enterprises' profits should be reduced.

- **The appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis -**
  - The selected transfer pricing method should be **consistent with the functional analysis** of the controlled transaction. This issue is linked to the **choice of the "tested party(ies)"**, i.e. the party(ies) for which a financial indicator is tested.
    - In the **cost plus method**, the tested party is the **seller** (often, a manufacturer or service provider) and the tested financial indicator is the **mark-up on costs** of the seller.
    - In the **resale price method**, the tested party is the **buyer** (often, a distributor) and the tested financial indicator is the **resale margin** (i.e. gross margin).
    - In the **transactional net margin method**, the tested party can be either the **seller or the buyer**. In the former case, the tested financial indicator is generally the **net profit on costs** or the **net profit on assets**. In the latter case, the tested financial indicator is generally the **net profit on sales**.
    - In the **profit split method**, **both parties to the transaction are tested**. For this reason, the profit split method is often referred to as a **"two-sided method",** while the cost plus, resale price and TNMM are referred to as "one-sided methods". What is being tested in a profit split is the **division of profits** between the parties.
  - The choices of the transfer pricing method and of the tested party are intrinsically linked. As a general rule, **the tested party** is the one to which a

transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the **less complex functional analysis**.

- **The availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and / or other methods -**
  - The selection of the most appropriate transfer pricing method for a particular case will depend on the availability of reliable information to apply it, and in particular, on the availability of reliable comparables data.
  - For instance, as explained above, where it is possible to locate comparable uncontrolled transactions to apply it, the CUP method is the most direct and reliable way to apply the arm's length principle. However, in practice, it is often difficult to find a transaction between independent enterprises that is similar enough to a controlled transaction such that no differences have a material effect on price. Where no sufficiently reliable comparable is available to apply a CUP, another method will be selected.
  - Availability of reliable comparable data may also influence the determination whether to select a gross profit method (i.e. cost plus or resale price) or a net profit method (i.e. TNMM). In effect, it is not always the case that reliable information is available on comparables at the gross profit level to apply a cost plus or resale price.
  - On the other hand, it would not be appropriate to apply a transactional profit method merely because data concerning uncontrolled transactions are difficult to obtain or incomplete in one or more respects. Comparables data are imperfect in practice and the objective is not to set an unrealistic comparability standard.

- **The degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them -**

  - The selection of the most appropriate transfer pricing method for a particular case will also depend on the degree of comparability between the controlled transaction and the uncontrolled transactions used as comparables. This is because the objective is to use the most reliable comparables data, i.e. data of lesser comparability should be eliminated to the extent possible. It should however be kept in mind that comparables data will rarely be perfect, so that it is a matter of professional judgment to decide whether or not the available data are sufficiently reliable.

6. OECD Guidance on Comparability Analysis

- A comparison implies **examining** the **controlled transaction** under review and **the uncontrolled transactions that are regarded as potentially comparable**. The search for comparables is only part of the comparability analysis. It should be neither confused with nor separated from the comparability analysis. The search for information on potentially comparable uncontrolled transactions and the process of identifying comparables is dependent upon **prior analysis** of the **taxpayer's controlled transaction** and of the **economically relevant characteristics** or **comparability factors**. A **methodical, consistent approach** should provide some continuity or linkage in the whole analytical process, thereby maintaining a constant relationship amongst the various steps: from the **preliminary analysis** of the conditions of the controlled transaction, to the **selection of the transfer pricing method**, through to the **identification of potential comparables** and ultimately a **conclusion** about whether the controlled transactions being examined are consistent with the arm's length principle.
- As part of the process of selecting the most appropriate transfer pricing method and applying it, the **comparability analysis always aims at finding the most reliable comparables**. Thus, where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. This does not mean that there is a requirement for an exhaustive search of all possible sources of comparables as it is acknowledged that there are limitations in availability of information and that searches for comparables data can be burdensome.
- In order for the process to be transparent, it is considered a good practice for a taxpayer that uses comparables to support its transfer pricing, or a tax administration that uses comparables to support a transfer pricing adjustment, to provide **appropriate supporting information** for the other interested party (i.e. tax auditor, taxpayer or foreign competent authorities) to be able to assess the reliability of the comparables used.
- Below is a description of a **typical process that can be followed when performing a comparability analysis**. This process is considered an accepted good practice but it is not a compulsory one, and any other search process leading to the identification of reliable comparables may be acceptable as reliability of the outcome is more important than process (i.e. going through the process does not provide any guarantee that the outcome will be arm's length, and not going through the process does not imply that the outcome will not be arm's length).

Step 1: Determination of **years to be covered**.

Step 2: Broad-based **analysis of the taxpayer's circumstances**.

Step 3: **Understanding the controlled transaction(s)** under examination, based in particular on a **functional analysis**, in order **to choose the tested party** (where needed), the **most appropriate transfer pricing method** to the circumstances of the case, the **financial indicator** that will be tested (in the case of a transactional profit method), and to **identify the significant comparability factors** that should be taken into account.

Step 4: Review of existing **internal comparables**, if any.

Step 5: Determination of **available sources of information** on external comparables where such external comparables are needed taking into account **their relative reliability**.

Step 6: Selection of the **most appropriate transfer pricing method** and, depending on the method, determination of the **relevant financial indicator** (e.g. determination of the relevant net profit indicator in case of a transactional net margin method).

Step 7: Identification of **potential comparables**: determining the **key characteristics to be met** by any uncontrolled transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the following comparability factors:

- The **contractual terms** of the transaction
- The **functions performed** by each of the parties to the transaction, taking into account **assets used and risks assumed**, including how those functions relate to the **wider generation of value** by the MNE group to which the parties belong, the **circumstances surrounding the transaction, and industry practices**.
- The **characteristics of property** transferred or services provided.
- The **economic circumstances of the parties and of the market** in which the parties operate.
- The **business strategies** pursued by the parties

Step 8: Determination of and making **comparability adjustments** where appropriate.

Step 9: **Interpretation and use of data collected**, determination of the arm's length remuneration.

- In practice, this **process is not a linear** one. Steps 5 to 7 in particular might need to be carried out **repeatedly until a satisfactory conclusion is reached**, i.e. the most appropriate method is selected, especially because **the examination of available sources of information may in some instances influence the selection of the transfer pricing method**. For instance, in cases where it is not possible to find information on comparable transactions (step 7) and/or to make reasonably accurate adjustments (step 8), taxpayers might have to select another transfer pricing method and repeat the process starting from step 4.

- **Choice of the tested party**
  - When applying CPM/RPM/TNMM, it is necessary to **choose the party to the transaction for which a financial indicator (mark-up on costs, gross margin, or net profit indicator) is tested**. The **choice of the tested party should be consistent with the functional analysis** of the transaction. As a general rule, **the tested party is the one to which** a transfer pricing **method can be applied in the most reliable manner** and for which the **most reliable comparables can be found**, i.e. it will most often be the one that has the **less complex functional analysis**. This can be illustrated as follows –

    > Assume that company **A manufactures two types of products**, P1 and P2, that it **sells to company B, an associated enterprise** in another country. Assume that A is found to **manufacture P1 products using valuable, unique intangibles that belong to B** and following technical specifications set by B. Assume that in this P1 transaction, **A only performs simple functions** and does not make an valuable, unique contribution in relation to the transaction. The **tested party for this P1 transaction would most often be A**. Assume now that A is also **manufacturing P2 products for which it owns and uses valuable unique intangibles** such as valuable patents and trademarks, and for which **B acts as a distributor**. Assume that in this P2 transaction, **B only performs simple functions** and does not make any valuable, unique contribution in relation to the transaction. **The tested party for the P2 transaction would most often be B**.

- **Databases**
  - A common source of information that can be used to identify potential external comparables is **commercial databases**, which have been developed by editors who compile accounts filed by companies with the relevant administrative bodies and present them in an electronic format suitable for searches and statistical analysis. They can be a practical and sometimes cost-effective way of identifying external comparables and may provide the most reliable source of information, depending on the facts and circumstances of the case.

- A **number of limitations** to commercial databases are frequently identified. Because these commercial databases rely on publicly available information, they are **not available in all countries**, since not all countries have the same amount of publicly available information about their companies. Moreover, where they are available, they **do not include the same type of information for all the companies** operating in a given country because disclosure and filing requirements may differ depending on the legal form of the company and on whether or not it is listed. **Care must be exercised with respect to whether and how these databases are used,** given that they are compiled and presented for non-transfer pricing purposes. It is not always the case that commercial databases provide information that is **detailed enough to support the chosen transfer pricing method**. Not all databases include the same level of detail and can be used with similar assurance. Importantly, it is the experience in many countries that commercial databases are used to compare the results of companies rather than of transactions because **third party transactional information is rarely available**.
- It may be unnecessary to use a commercial database if reliable information is available from other sources, e.g. internal comparables. Where they are used, commercial databases should be used in an objective manner and genuine attempts should be made to use the databases to identify reliable comparable information.
- Use of commercial databases **should not encourage quantity over quality**. In practice, performing a comparability analysis using a commercial database alone may give rise to **concerns about the reliability of the analysis**, given the quality of the information relevant to assessing comparability that is typically obtainable from a database. To address these concerns, **database searches may need to be refined with other publicly available information**, depending on the facts and circumstances. Such a refinement of the database search with other sources of information is meant to promote quality over standardised approaches and is valid both for database searches made by taxpayers/practitioners and for those made by tax administrations.
- There are also proprietary databases that are developed and maintained by some advisory firms. In addition to the issues raised above for commercial databases that are more broadly commercialised, proprietary databases also raise a further concern with respect to their coverage of data if they are based on a more limited portion of the market than commercial databases. **When a taxpayer has used a proprietary database to support its transfer prices, the tax administration may request access to the database to review the taxpayer's results, for obvious transparency reasons**.

- **Foreign source or non-domestic comparables**
  - Taxpayers do not always perform searches for comparables on a country-by-country basis, e.g. in cases where there are insufficient data available at the domestic level and/or in order to

reduce compliance costs where several entities of an MNE group have comparable functional analyses. **Non-domestic comparables should not be automatically rejected just because they are not domestic**. A determination of **whether nondomestic comparables are reliable** has to be made on a case-by-case basis and by reference to **the extent to which they satisfy the five comparability factors**. Whether or not one regional search for comparables can be reliably used for several subsidiaries of an MNE group operating in a given region of the world depends on the particular circumstances in which each of those subsidiaries operates. Difficulties may also arise from **differing accounting standards**.

- **Selecting or rejecting potential comparables**
  - There are basically **two ways in which** the **identification of potentially comparable third party transactions** can be conducted.
  - The first one, which can be qualified as the **"additive" approach**, consists of the person making the search **drawing up a list of third parties** that are believed to carry out potentially comparable transactions. Information is then collected on **transactions conducted** by these third parties to confirm whether they are in effect acceptable comparables, based on the pre-determined comparability criteria. This approach arguably gives well focused results - all the transactions retained in the analysis are carried out by well-known players in the taxpayer's market. As indicated above, in order to **ensure a sufficient degree of objectivity** it is important that the process followed be **transparent, systematic and verifiable**. The "additive" approach may be used as the sole approach where the person making the search has knowledge of a few third parties that are engaged in transactions that are comparable to the examined controlled transaction. It is worth noting that the "additive" approach presents similarities with the approach followed when identifying internal comparables. In practice, an "**additive" approach may encompass both internal and external comparables.**
  - The second possibility, the **"deductive" approach**, **starts with a wide set of companies** that operate in the **same sector of activity**, perform **similar broad functions** and **do not present economic characteristics that are obviously different.** The **list is then refined** using selection criteria and publicly available information (e.g. from databases, Internet sites, information on known competitors of the taxpayer). In practice, the "deductive" approach **typically starts with a search on a database**. In addition, the "deductive" approach is not appropriate to all cases and all methods and the discussion in this section should not be interpreted as affecting the criteria for selecting a transfer pricing method.
  - In practice, both **quantitative and qualitative criteria** are used to include or reject potential comparables. Examples of qualitative criteria are found in **product portfolios and business strategies**. The most commonly observed quantitative criteria are -

- **Size criteria** in terms of **Sales, Assets or Number of Employees**. The size of the transaction in absolute value or in proportion to the activities of the parties might affect the relative competitive positions of the buyer and seller and therefore comparability.
- Intangible-related criteria such as ratio of **Net Value of Intangibles/Total Net Assets Value**, or ratio of **Research and Development (R&D)/Sales** where available: they may be used for instance to exclude companies with valuable intangibles or significant R&D activities when the tested party does not use valuable intangible assets nor participate in significant R&D activities.
- Criteria related to the **importance of export sales** (Foreign Sales/Total Sales), where relevant.
- Criteria related to **inventories in absolute or relative value**, where relevant.
- Other criteria to exclude third parties that are in particular **special situations** such as **start-up companies, bankrupted companies, etc**. when such peculiar situations are obviously not appropriate comparisons.

The **choice and application** of selection criteria depends on the **facts and circumstances of each particular case** and the above list is **neither limitative nor prescriptive**.

- One advantage of the **"deductive" approach** is that it is **more reproducible and transparent than the "additive".** It is also **easier to verify** because the review concentrates on the process and on the relevance of the selection criteria retained. On the other hand, it is acknowledged that the quality of the outcome of a "deductive" approach depends on the quality of the search tools on which it relies (e.g. quality of the database where a database is used and possibility to obtain detailed enough information). This can be a practical limitation in some countries where the reliability and usefulness of databases in comparability analyses are questionable.
- It would **not be appropriate to give systematic preference to one approach over the other** because, depending on the circumstances of the case, there could be value in either the "additive" or the "deductive" approach, or in a combination of both. The "additive" and "deductive" approaches are often not used exclusively. In a typical "deductive" approach, in addition to searching public databases it is common to include third parties, for instance known competitors (or third parties that are known to carry out transactions potentially comparable to those of the taxpayer), which may otherwise not be found following a purely deductive approach, e.g. because they are classified under a different industry code. In such cases, the "additive" approach operates as a tool to refine a search that is based on a "deductive" approach.
- The process followed to identify potential comparables is one of the most critical aspects of the comparability analysis and it should be **transparent, systematic and verifiable**. In

particular, the choice of selection criteria has a significant influence on the outcome of the analysis and **should reflect the most meaningful economic characteristics of the transactions** compared. Complete elimination of subjective judgments from the selection of comparables would not be feasible, but much can be done to increase objectivity and ensure transparency in the application of subjective judgments. Ensuring transparency of the process may depend on the extent to which the criteria used to select potential comparables are able to be disclosed and the reasons for excluding some of the potential comparables are able to be explained. Increasing objectivity and ensuring transparency of the process may also depend on the extent to which the person reviewing the process (whether taxpayer or tax administration) has access to information regarding the process followed and to the same sources of data.

- **Comparability adjustments**
  - The need to adjust comparables and the requirement for accuracy and reliability arises both for the general application of the arm's length principle and more specifically in the context of each method. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. Whether comparability adjustments should be performed (and if so, what adjustments should be performed) in a particular case is a matter of judgment that should be evaluated in light of the costs and compliance burden.
  - Examples of comparability adjustments include **adjustments for accounting consistency** designed to eliminate differences that may arise from differing accounting practices between the controlled and uncontrolled transactions; **segmentation of financial data** to eliminate significant non-comparable transactions; **adjustments for differences in capital, functions, assets, risks**.
  - The fact that comparability adjustments are found in practice does not mean that they should be performed on a routine or mandatory basis. Rather, the **improvement to comparability should be shown when proposing these types of adjustments** (as for any type of adjustment). Further, a significantly different level of relative working capital between the controlled and uncontrolled parties may result in further investigation of the comparability characteristics of the potential comparable.
  - Comparability adjustments should be **considered if (and only if) they are expected to increase the reliability of the results**. Relevant considerations in this regard include the **materiality of the difference** for which an adjustment is being considered, the **quality of the data** subject to adjustment, **the purpose of the adjustment** and the **reliability of the approach** used to make the adjustment.

- It bears emphasis that **comparability adjustments are only appropriate for differences that will have a material effect on the comparison**. Some differences will invariably exist between the taxpayer's controlled transactions and the third party comparables. A comparison may be appropriate despite an unadjusted difference, provided that the difference does not have a material effect on the reliability of the comparison. On the other hand, the **need to perform numerous or substantial adjustments to key comparability factors may indicate that the third party transactions are in fact not sufficiently comparable**.
- It is not always the case that adjustments are warranted. For instance, an adjustment for differences in accounts receivable may not be particularly useful if major differences in accounting standards were also present that could not be resolved. Likewise, sophisticated adjustments are sometimes applied to create the false impression that the outcome of the comparables search is "scientific", reliable and accurate.
- It is not appropriate to view some comparability adjustments, such as for differences in levels of working capital, as "routine" and uncontroversial, and to view certain other adjustments, such as for country risk, as more subjective and therefore subject to additional requirements of proof and reliability. The **only adjustments that should be made are those that are expected to improve comparability**.
- Ensuring the **needed level of transparency of comparability adjustments** may depend upon the **availability of an explanation** of any adjustments performed, the **reasons for the adjustments** being considered appropriate, how they were **calculated**, how they **changed the results for each comparable** and **how the adjustment improves comparability**.

- **Data from years following the year of the transaction**
  - Data from years following the year of the transaction may also be relevant to the analysis of transfer prices, but care must be taken to avoid the use of hindsight. For example, data from later years may be useful in comparing product life cycles of controlled and uncontrolled transactions for the purpose of determining whether the uncontrolled transaction is an appropriate comparable to use in applying a particular method. The conduct of the parties in years following the transaction will also be relevant in accurately delineating the actual transaction.

- **Multiple year data**
  - In practice, examining multiple year data **is often useful in a comparability analysis**, but it is **not a systematic requirement**. Multiple year data **should be used where they add**

value to the transfer pricing analysis. It would not be appropriate to set prescriptive guidance as to the number of years to be covered by multiple year analyses.

- In order to **obtain a complete understanding of the facts and circumstances surrounding the controlled transaction**, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price. For example, the use of data from past years will show whether a taxpayer's reported loss on a transaction is part of a history of losses on similar transactions, the result of particular economic conditions in a prior year that increased costs in the subsequent year, or a reflection of the fact that a product is at the end of its life cycle. Such an analysis may be **particularly useful where a transactional profit method is applied**. Multiple year data can **also improve the understanding of long term arrangements**.
- Multiple year data will also be **useful in providing information about the relevant business and product life cycles of the comparables**. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability. The **data from earlier years may show whether the independent enterprise engaged in a comparable transaction was affected by comparable economic conditions in a comparable manner,** or whether **different conditions in an earlier year materially affected its price or profit so that it should not be used as a comparable**.
- Multiple year data can also **improve the process of selecting third party comparables** e.g. by identifying results that may indicate a significant variance from the underlying comparability characteristics of the controlled transaction being reviewed, in some cases leading to the rejection of the comparable, or to detect anomalies in third party information.
- The use of multiple year data **does not necessarily imply the use of multiple year averages**. Multiple year data and averages can however be used in some circumstances to **improve reliability of the range**.

- **Compliance issues**
  - One question that arises when putting the need for comparability analyses into perspective is the **extent of the burden and costs that should be borne by a taxpayer** to identify possible comparables and obtain detailed information thereon. It is recognised that the cost of information can be a real concern, especially for small to medium sized operations, but also for those MNEs that deal with a very large number of controlled transactions in many countries.

- When undertaking a comparability analysis, there **is no requirement for an exhaustive search of all possible relevant sources of information**. Taxpayers and tax administrations should **exercise judgment to determine whether particular comparables are reliable**.
- It is a good practice for taxpayers **to set up a process to establish, monitor and review their transfer prices**, taking into account the size of the transactions, their complexity, level of risk involved, and whether they are performed in a stable or changing environment. Such a practical approach would **conform to a pragmatic risk assessment strategy or prudent business management principle**. In practice, this means that it may be **reasonable for a taxpayer to devote relatively less effort to finding information on comparables supporting less significant or less material controlled transactions**. For simple transactions that are carried out in a stable environment and the characteristics of which remain the same or similar, a detailed comparability (including functional) analysis may not be needed every year.
- Small to medium sized enterprises are entering into the area of transfer pricing and the number of cross-border transactions is ever increasing. Although the arm's length principle applies equally to small and medium sized enterprises and transactions, **pragmatic solutions may be appropriate in order to make it possible to find a reasonable response to each transfer pricing case**.

7. Compliances to be done by the reporting entity

- **For the purpose of tax calculation**, Article (53) of the ER requires the reporting entity to -
  - determine the prices of transactions with its related entities, **according to the arm's length pricing method**, based on the **information reasonably available to such entity** and
  - **assess such prices** at the time of the transaction and, in any event, **no later than the date set for filing the tax return** (i.e. 30th April of next year) for the tax period in which such transaction is made. (On 12 March 2020, the GTA has issued circular No. 5/2020 extending the deadline to submit income tax returns for the year ended 31 December 2019 by two months. As a result, the new deadline to submit income tax returns for the year ended 31 December 2019 is 30th June 2020.)
- As per Article (63), in calculating the tax due by the reporting entity, **profits which are indirectly transferred** to another related entity through an increase or decrease in the transaction prices agreed-upon between them or by any such other means **should be added to the taxable income**, by determining the profits indirectly transferred as compared to the profits that would have been derived had such entities not been related or any such other comparisons.
- The provisions of Article (63) **apply to transactions between**:
  - Any **entity resident** in Qatar **and an unrelated entity** in the following cases -

- If **either** entity **benefits from a preferential tax regime**.
- If the **other entity is resident in a non- cooperative State or territory**.

- The **entity and one of its Permanent Establishments, if either of them carries on an activity in the State**.

A state or territory is said to be non-cooperative if **no agreement** has been entered into with Qatar allowing for the **exchange of information** for tax purposes. Non-cooperative states and territories will be **determined by a decision of the Minister**.

- Article (54) requires the reporting entity to conduct the **functional analysis** contained in its **tax return** and **examine the comparable data** available thereto.

Functional analysis is used to –

⇒ describe the reporting entity's **position and economic role** with its related entities and

⇒ determine the **functions undertaken, risks assumed and intangible and tangible assets used**.

- As per Article (55), for applying the arm's length pricing method, **each reporting entity should update on a yearly basis,** the **financial data of comparable transactions** between
  - such **entity and an independent entity** or
  - **between two independent entities**.

- Article (55) also requires the reporting entity to p**erform a new search for comparable transactions** in **financial databases every 3 years**, if and **to the extent that the activity's circumstances remain unchanged.**

- Article (59) further requires the reporting entity -
  - to **confirm to the GTA that** its **transactions** with the related entities **satisfy the arm's length pricing method** and
  - **to provide** the GTA with **sufficient supporting documents.**
- As per Article (60), the GTA **may request the reporting entity to provide** all **information and documents in its possession** and required **for auditing its transfer pricing practices** with respect to its transactions with related entities, including:
  - Information and documents related to the **entity's operations and functions**.
  - Information and documents related to the **operations, functions, and financial results of the related entities** with which such entity transacted.
  - Information related to **potential benchmarking, including internal benchmarking** of related entities.
  - Documents related to the **unrelated comparable entities' operations and financial results and transactions** between them.
  - **Information and other documents available to the entity or the entities related** thereto.
- Article (61) provides that, **an entity's claim that other related entities are liable for complying** with transfer pricing provisions **will not be considered as a sufficient reason for the reporting entity not to provide the requested documents**. **Full documentation** of transactions between related entities **will not prevent the correction of their prices** if it is established that they were not based on arm's length principle.
- Article (62) requires the reporting entity **to maintain all transfer pricing information and documents** in respect of the transactions made with related entities, **in line with the requirements of the Law.**

8. Compliances to be done by the related entities

- Article (56) requires the **related entities** of the reporting entity to **provide the GTA** with the **information necessary for determining and assessing** the **relevant transfer pricing risks** and **auditing their transfer pricing practices within 30 days from the date of such request.** The GTA may provide the related entity with a transfer pricing **questionnaire** addressing areas determined by the GTA on the form prepared by the GTA to this end.
- The **related entity** of the reporting entity is also required to **submit, together with its tax return**, a **declaration of transfer pricing** using the form prepared by the GTA for this purpose, **if its total income or total assets** as shown in the balance sheet **equal or exceed the amount prescribed** by the GTA.
- The GTA may request the related entity, during the process of tax examination, **to complement the information provided** on the transfer pricing declaration or questionnaire **with additional information and instruments.**

9. Submission of Master file and a Local file

- Article (56) requires the **resident related entity to submit**, **within** the same **time limit prescribed for filing of tax return** or within any such **other time limit prescribed** by the GTA, **a Master file and a Local file on the forms used by OECD**, **unless the GTA uses its own forms**, if and to the extent that **one of the following conditions** is satisfied:
  - Such **entity's total revenues or total assets,** as shown in its financial statements**, equal or exceed the amount prescribed** by the GTA.

    OR
  - **One of the related entities is a resident outside of the State**.

PARTICULARS	TP DECLARATION	LOCAL FILE	MASTER FILE	CBC REPORT	CBC NOTIFICATION
Taxpayers	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**
Threshold?	Details awaited	Details awaited		Consolidated group revenue in FY19 of QAR 3 billion or higher	
Other remarks	To file a form together with the tax return	N/A	N/A	Applicable only to MNE	Applicable only to MNE
Due Date	4 months from the fiscal year end	To be communicated by the GTA		12 months from the reporting fiscal year end	At the latest at the reporting fiscal year end

- Article (56) authorizes the GTA **to use the information** available in the Master file and Local file in **assessing transfer pricing risks** and **in tax examination activities**.

MASTER FILE OBJECTIVES

- Explains an **MNE's transfer pricing policies in the context of its global economic, legal, financial and tax profile.**
- Provides an overview of the MNE group business, covering the following topics:
  - Description of the business and the value creation
  - Intangibles
  - Intra-group financial activities
  - Financial and tax positions

LOCAL FILE OBJECTIVES

- **Helps to demonstrate that the taxpayer has complied with the arm's length principle in its material intra-group transactions**
- **Should contain:**
  - Description of the management structure, business strategy, business restructurings, key competitors.
  - For each material category of controlled transactions under review: description, payments, relationship between counterparties, agreements, functional analysis, transfer pricing method and tested party, assumptions, comparability analysis, and arm's length conclusion, among others.
  - Financial information for local entities.

10. Implications

The new ERs require the Qatar-based entities to comply with several new TP requirements and the GTA is still expected to issue more guidance on these requirements and the due dates of submission of certain TP documentation. However, given that the ERs have been released and are therefore already in effect, it establishes a compliance obligation that Qatar based entities must undertake the required TP analysis to support their intercompany transactions. Consequently, Qatar-based entities need to start reviewing their TP policies and related party pricing/arrangements to ensure that they are able to comply with the new TP requirements once the deadline for submission is announced. Needless to say that, failure to comply with the new TP rules may result in the imposition of penalties under the Income Tax Law.

11. Disclaimer

This publication contains general information and expression of the views only and none of the author by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect user's finances or business.

None of the authors and their affiliates shall be responsible for any loss whatsoever sustained by any person who relies on this publication.