

# Framework and Best Practices for Reporting on Transfer Pricing Benchmarking Study

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# Key Consideration

- Legislative Framework
- Best practices to follow for reporting on transfer pricing benchmarking study

# Legislative Framework

- Taxing Authorities & Tax Law covering TP provisions
- OECD guidelines and using that as reference unless relevant tax law has overriding provision
- Documentation requirement by virtue of tax rule 10D
- Pricing Methods, if any, prescribed by tax laws to follow
- Return / Certificate requirement and its deadline
- Penalties and provision for penalty relief
- Transfer Pricing assessment completion timeline

# Need for the TP Study

- In most countries, the law requires companies beyond a particular threshold to maintain detailed documentation beyond the transfer pricing report.
- The detailed documentation should include explanation of the transaction, justification of the Arms Length Price (ALP), comparative analysis / benchmarking of the ALP using one or multiple methods.
- With the increasing levels of reporting standards, CbCR and CRS, tax authorities are equipped with more public information than before.

# Broad steps for TP Study

- Scope
- Identification of Associated Enterprises (AE's)
- Identification of transactions with AE's
- Information about the company and the AE's, the industry, the business model, any specific / unique features
- Detailed explanation on the benchmarking process
  - Transaction flow
  - Selection of the appropriate method
  - FAR analysis
  - Comparables
  - Adjustments, if required
  - Conclusion
- Disclaimer

# Scope

- Like all assignments, this is the crucial step
- Before defining the scope of the Transfer Pricing Study, one should understand the company, the industry, the competition, to be able to estimate the availability of public information.
- Inquire with the company about the process to arrive at the price for transactions with AE's before the transaction is undertaken – this will assist in determining the quantum of time expected to be taken
- Fix responsibilities with the company about who is responsible to provide the information about the industry, competition etc, since this can significantly alter the time spent on conducting the study

# Identification of Associated Enterprises

- Different countries have different tests to determine which entities classifies as an Associated Enterprises – though principles are always based on management and control
- Large companies already have systems to identify AE's with respect to each of the country they operate in, but for other clients especially family owned enterprises, one may need to apply the test to various entities to determine whether they are AE's or not.
- The complex corporate structures can make it difficult to identify an AE – so ensure that this is appropriately addressed

# Identification of transactions with AE's

- Once AE's are determined – all transactions however small or big should be covered in the benchmarking analysis – including reimbursement of expenses without mark-ups?
- Again, large companies have systems in place to identify all transactions with AE's but one should cross verify these and the amounts with the disclosures on related party transactions in the financial statements.
- Reconciliation should be prepared, as back up papers, if there are any differences in the amounts reported in the financial statements v/s. amounts in the TP study



# Information about the company, industry, competition, unique features

- Though the information is general, one will be surprised about how little information may be available in the public domain, hence this step becomes difficult, hence the best source for this information is always be the company.
- Avoid filling pages with irrelevant information, but capture the essence.
- Any particular company or industry trend should definitely be captured.
- Any unique features about the company or its products or the transaction with AE's should definitely be captured.

# Benchmarking Process

This is the main part of the process and for each and every transaction, there should be detailed explanations about:

- Transaction flow
- Selection of the appropriate method
- FAR analysis
- Comparables
- Adjustments, if required
- Conclusion

# Transaction Flow

- Should give a detailed view of the flow of goods / services / transaction
- Should also give a detailed view of the flow of money / compensation for the above goods / services / transaction
- Discuss and decide whether to display the entire chain of the transactions if it goes through multiple group entities or whether to restrict to the transaction chain between the company and its AE – keep CbCR and CRS in mind.
- Should elaborate any unique features of the transaction that are not generally observed – e.g. patents, technical know-how, mining rights etc. – these help to justify the ALP later
- This is also a good stage to determine which entity is going to be the tested party for determining comparables.

# Selection of the appropriate method

- Should have a brief description of all the methods
- Should include detailed discussion about the rejection of an inappropriate method as well as selection of an appropriate method. Generally tax authorities do not like the appropriate method chosen out of compulsion of not finding another appropriate method, hence should include genuine and convincing reasons for selection of an appropriate method
- The rejection or selection of a method should also be logical keeping in mind the public domain knowledge and tax authorities having access to transfer pricing studies of competitors or other companies in a similar industry.

# FAR Analysis

- Functions – Assets – Risks (FAR) analysis is one the most important step in the benchmarking process since it gives a detailed analysis of which entity should be compensated, in terms of profit margin, for carrying out the transaction based on the functions they perform, the assets they use or invest in and the risks they undertake.
- Should be based on the actual facts of the transactions and not on generic / assumption basis and should be the most logical step of the entire study
- Should highlight uniqueness or differences when compared to probable comparables or general business practices since these could help to make adjustments to comparable ALP's

# Comparables

- Determine the tested party
- Determine whether national or international comparables should be used and availability of data / information
- If using comparable database – the search process should be:
  - Broad sector comparables
  - Broad industry comparables
  - Add Competitors (according to the company)
  - Availability of the data (for the respective year) filter
  - Turnover Filter
  - Specific filters, if any e.g. geographic filter, owned v/s. hired
  - Comparability filter

# Adjustments, if required

- Based on the most appropriate method for determining the ALP and the comparison of the comparable ALP with the company's ALP, determine whether the ALP is comparable.
- If they are comparable, then no further adjustments should be required.
- If there is a variance between the comparable ALP and the company's ALP, determine the reasons for the difference and if it relates to the difference in the FAR of comparables and the company. The reasons should be explained at length before an adjustment is made to the comparables ALP, otherwise the tax authorities may not allow the adjustment.
- The adjusted comparable ALP should tie in with the Company's ALP

# Conclusion

- For each transaction, the conclusion should summarize the process of arriving at the ALP, and if any adjustment was made to the comparable ALP then this should be explained once again.
- A final conclusion at the end of all the transactions, should have a summary table giving a bird's eye view of each transaction and whether the company's ALP ties in with the comparable ALP for each of these transactions.
- Should include any special features of the company, the AE or the transaction e.g. if the company or the AE is a Joint Venture, one can mention that since a third party is already involved in one leg of the transaction, it should be assumed that the transactions are at ALP.



# Disclaimer

- In most countries, the TP Study / benchmarking process is an internal document of the company and may only be asked to be produced by the tax authorities if required. Hence a Disclaimer can be counter-productive and cannot be exhaustive.
- A separate disclaimer should be signed and accepted by the client specifically stating that the company is responsible for the information given by the company and it has been relied upon while drafting the TP Study / benchmarking process.

**THANK YOU!**

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