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TRANSFER PRICING PROCESS

Pricing of intragroup transactions

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ABSTRACT

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<p>Companies that are part of an intragroup are required to price the intragroup transactions according to the arm's length principle. The purpose of this thesis was to gain knowledge of pricing methods within transfer pricing and how to perform the comparability analysis that shows that the transfer pricing applied is according to the arm's length principle.</p> <p>The theoretical part of this thesis discusses the OECD instructions of transfer pricing methods and the comparability analysis required in relation to the transfer pricing method selected. The thesis is restricted to the pricing of products, services, intangible assets and financing within the intragroup of Company X and give suggestions for corrections that needs to be made based on the knowledge acquired.</p> <p>The goal of this thesis was achieved and suggestions for the update of the transfer pricing for the different types of transactions have been outlined. This thesis shows the transfer pricing methods that can be applied for intragroup transactions and how to perform the comparability analysis for the transfer pricing method applied.</p>		
Key words International pricing, comparability analysis, OECD, transfer pricing.		

ABSTRACT
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1 INTRODUCTION

This thesis will investigate the topic of transfer pricing and the different types of transfer pricing methods that can be applied for intragroup transactions. The pricing in an intragroup with international subsidiaries is regulated by the national tax authorities as well as internationally by the Organisation for Economic Co-operation and Development (OECD) regulations. This thesis will give an understanding of how to set the price for the different products, services, intangible assets and financing that occur within an intragroup.

The thesis will be conducted for the intragroup of Company X who has subsidiaries internationally. The company name and the pricing principles applied for their transactions will not be published and kept confidential between the thesis author and the supervisor. The aim of the thesis is to comply pricing principles for the intragroup of Company X that can be used as a basis when pricing the different types of transactions. The thesis will investigate transfer pricing methods and what is required in demonstrating the arm's length principle through the comparability analysis.

Transfer pricing is required to be documented and is closely monitored within a company's financial reporting. The transfer pricing is closely checked for accuracy to ensure that the profits are based on the arm's length principle and that the associated taxes are paid accordingly. Up to 60 % of goods and services that are sold internationally are done within intragroups as opposed to between unrelated companies. There are tax advantages in relation to multinational transfer pricing which means that the regulatory authorities imply that transfer pricing should be according to market price and not for tax avoidance. The transaction of goods and services from one country to another within an interrelated company can allow a company to avoid tariffs. The international tax laws are regulated by OECD. (Investopedia, 2017)

In order to conclude a successful research, clear research questions are of importance. The research questions are determined in the beginning of the research process to work as a path for the research project. The research questions need to be well structured to generate new insights and meet the standards and requirements of the degree program. (Saunders, Lewis & Thornhill 2007, 30) The research questions within this thesis is what pricing methods are nationally and internationally accepted for transfer pricing, how can the transfer pricing method selected be demonstrated to be according to arm's length principle through the comparability analysis and how should the intragroup of Company X correct its

transfer pricing process to comply to the information retrieved from the study. The research method applied is to study the guidelines by OECD of the approved transfer pricing methods and instructions for comparability analysis. Thereafter will the transactions for intragroup of Company X be analyzed and suggestions for modifications will be given in order for the transfer prices to correspond to the national and international regulations.

The research objective gives the research project a clear structure and will be retrieved from the research questions. (Saunders, Lewis & Thornhill 2007, 32) The research objective is to identify the different transfer pricing methods and identify the comparability analysis process in order to make an analysis of the pricing principles applied within the intragroup of Company X. The aim of the thesis is to gain the required knowledge of pricing methods and how to make the required comparable analysis in order for intragroup of Company X prices to conform to the national and international regulations. This thesis is a practice-based thesis with the aim to create pricing principles for the different types of transactions that occur within the intragroup of the case company. The objective is to gain a thorough understanding of transfer pricing methods and comparability in order to be able to apply them within the intragroup of Company X.

The study will be limited to the legislation and guidelines given by the Finnish tax authorities and the guidelines given by OECD for transfer pricing updated in beginning of 2017. The focus will be on the different pricing methods available and the comparability analysis required in the documentation. Besides the pricing being according to the arm's length principle, the intragroup needs to have the required information for the comparability analysis in order to be able to present in the documentation the explanations and calculations that demonstrate that the transfer price is according to the arm's length principle.

The outline of the study consists of a general overview of transfer pricing, the different pricing methods and the requirements in relation to comparability. The transactions within the intragroup of Company X will be presented and discussed in relation to the literature review hereafter suggestions for corrections will be given of how the operations and pricing needs to be changed in order to conform to the OECD guidelines.

2 TRANSFER PRICING

The principles of transfer pricing are outlined in the guide for transfer pricing published by OECD. Transfer pricing is the pricing of internal transactions between companies that are part of the same intragroup. Transfer pricing needs to comply with the arm's length principle which means that internal prices need to be based on current market prices. An intragroup is obliged to have documented the transfer pricing in order to show tax authorities that the transfer prices are based on market prices. The transfer pricing documentation needs to be prepared for each taxation year and ready within six months of closing the intragroups financial year. (Verohallinto 2017a)

2.1 Pricing of intragroup transactions

Transfer pricing is important as up to 60 % of work trade concerns transactions within intragroups. The different types of transactions within intragroups are sales of products, services, intangible assets and financing. The transfer price of the intragroup transaction is decided within the intragroup, but the transfer price is regulated by different countries' tax regulations and the market price. (Valtioneuvoston Kanslia 2014) A company within an intragroup is assessed in taxation as separate company (Verohallinto 2017a). Costs are deductible in the taxation of the Finnish intragroup if the costs are allocated from the acquisition of income or for the retention of costs or loss for the Finnish intragroup company in question (Kukkonen & Walden 2016, 181).

When setting the transfer price for the sales of products, services, intangible assets and financing the objective is to validate that the intragroup company that sells and the intragroup company that buys will accumulate a corresponding profit that would accrue to an independent non-related company within a similar market situation. For the sales of products, the pricing and other terms and conditions need to take into account the different sales related activities that the selling company performs as well as the type of risks that the two intragroup carries within the transaction. The activities and risks performed by the two companies within the intragroup need to be related to the result that the company is expected to make. The impact of the activities and risks on the intragroup companies profit naturally differ depending on different industries and different market areas. (Verohallinto 2017b)

The marketing activities of the sales company is needed to be taken into account for the pricing of the product or service. The sales company does not necessary own the intangible assets, but the marketing activities performed can have a significant impact on the value of the intragroup brand. Using unique immaterial assets within the operations may lead to being unable to select a comparable as the comparable transactions with independent parties are not comparable. (Verohallinto 2017b) Establishing a transfer pricing process that is comprehensive is difficult as there are imperfections in the market and the divisional managers needs to have freedom to buy and sell outside the intragroup in order to be able to engage within the bargaining process. A centrally controlled market transfer price can cause friction and bad feeling within the intragroup. Simultaneously incurring a misallocation of resources needs to be taken into account as the subsidiaries have the freedom to control their division. (Druly 2016, 365-366)

The transfer price needs to be fair for the intragroup transaction and conform to the arm's length principle as a not compliant price may be taxed as a distribution of assets. (Raunio, Romppainen, Ukkola & Kotiranta 2018, 161) Transfer pricing regulations are applied for both national and international transactions within the intragroup. In practice is the international intragroup transactions of interest for the tax authorities as national intragroup transfer pricing errors is not affecting the tax revenues. In Finland companies within the same intragroup with at least 9/10 ownership ratio are able to adjust the taxable income with group contribution which means that the transfer pricing does not principally matter. In despite the national transfer prices needs to also conform to the arm's length principle. The challenge in pricing intragroup transactions is to define and demonstrate to the authorities that the transfer price applied conform to a pricing that would have been agreed between two independent parties. (Raunio et al. 2018, 163-164)

2.2 Associated enterprises

Transfer pricing concerns pricing within an intragroup which means that the companies are associated enterprises. Associated enterprises are usually formed by companies that are part of the same intragroup, but the most important aspect of associated enterprises is related to control in form of ownership or right to appoint company's board of directors. Companies are associated enterprises when one party has control of the other party or a third party has alone or together with the person's close circle authority of the other party. Authority can be related to more than half ownership of capital, over half ownership of stocks, the right to appoint over half of the members of the company's board or the control can be performed in another way. The third party in relation to authority can also be a natural person alone or

together with close associates. (Jaakkola, Laaksonen, Nikula, Palmu, Paronen, Sandelin & Vasenius 2012, 31)

2.3 The arm's length principle

The arm's length principle is the pricing principle needed to be applied within intragroup transactions. The arm's length principle means that the same pricing and conditions should be applied as if the transaction would be between independent non-associated parties. The tax authorities' viewpoint on the arm's length principle is that the taxable income is accumulated and accounted within the country where the taxable income is generated. For taxation purposes the pricing methods applied needs to be internationally approved where the pricing and terms and conditions are equivalent to non-related companies. The pricing and terms and conditions within an intragroup is usually made centrally within the corporation. (Verohallinto 2017b) Transactions within an intragroup need to apply to similar market conditions that would be applied for transactions between independent parties. (Jaakkola et al. 2012, 26)

2.4 OECD instructions

For guidance and interpretation of the arm's length principle, OECD transfer pricing guidelines is recommended to be used as reference. The OECD transfer pricing guidelines are internationally accepted and an important interpretation source for the application of the arm's length principle. In addition to the OECD transfer pricing guidelines the intragroup need to take into account the national legislation for the different countries where the intragroup companies are registered. Tax authorities can reassess income tax and make income tax adjustments for companies where there is a deviation in applying the arm's length principle. Income tax adjustments will be made as if the arm's length principle would have been applied. (Verohallinto 2017b) OECD have instructions of how the transfer pricing documentation should be outlined. The OECD transfer pricing instructions include different methods available of pricing the intragroup transactions and comparing that the transfer price is according to arm's length principle. (Jaakkola et al. 2012, 47)

OECD guidelines is an attempt to provide worldwide consensus of pricing of intragroup transactions internationally. OECD guidelines wants to ensure that the intragroup companies are not using transfer

prices for the purpose of manipulating taxation. Multinational companies act aggressively to minimize global taxes and aggressive tax planning needs to be replaced with firmer rules. (Druly 2016, 371-373)

3 TRANSFER PRICING METHODS

OECD has defined five pricing methods that can be used to apply the arm's length principle. The transfer pricing methods are comparable uncontrolled price method (CUP), resale price method, cost plus method, transactional net margin method (TNMM) and transactional profit split method. (Jaakkola et al. 2012, 73) The transfer pricing methods by OECD are divided into traditional transaction methods and transactional profits methods. The traditional transaction methods are comparable uncontrolled price method, resale price method and cost plus method. Transactional profits methods are transactional net margin method and transactional profit split method. When choosing the transfer pricing method for the intragroup transaction the best suitable method for the situation should be chosen. The prioritized method is the comparable uncontrolled price method and recommendations are to choose a traditional transaction method instead of a transactional profit method. (Jaakkola et al. 2012, 48) The transfer pricing method chosen is affected by the companies within the intragroup transaction and the functions and risks related to the transaction. When choosing the transfer pricing method, the intragroup need to analyze the strengths and weaknesses of the different transfer pricing methods and what information is available for comparability and how reliable the information is. (Jaakkola et al. 2012, 73)

The five transfer pricing methods given in the OECD transfer pricing guidelines are not required to be used as long as the intragroup is applying a pricing method that is according to the arm's length principle and the method selected is justified in the transfer pricing documentation. (Raunio et al. 2018, 166-167)

3.1 Comparable uncontrolled price (CUP) method

The comparable uncontrolled price method, also called the CUP method, is the primarily recommended pricing method in applying transfer price for intragroup transactions. The CUP method compares the prices used by independent companies (external control) or prices that are used by the intragroup company and an independent party (internal control) for a comparable transaction. The CUP method can be applied for transactions where sufficient comparative information for transactions are available. In order for the transaction to be comparative the market, product, production chain phase, sales volumes and other circumstances need to be as similar as possible to the comparable business. Even though the CUP method is the primarily recommended pricing method, in practice is the application minimal as it is difficult to find suitable control objects. (Jaakkola et al. 2012, 48-49)

In practice the intragroup needs to estimate whether there are similar transactions with an independent party and with the associated party. The intragroup can sell the same products to external customers and within the intragroup, but these transactions are seldom comparable as the selling company's operations, risks, difference in sales volumes, buyers difference in market area and different position within the supply chain differ between the external customer and the intragroup company. If the differences between the business operations cannot on a computational basis be recalculated can the CUP method not be applied. Finding a suitable comparable is difficult as third party transactions are not usually available for geographic and business secrecy reasons. Without sufficient comparable prices the CUP method is complicated to be applied in practice. The CUP method is reliable when independent parties sells exactly the same product with similar terms and conditions as the transaction within the intragroup. (Jaakkola et al. 2012, 76) The comparable uncontrolled price method can best be applied for transactions where the company buys similar products from a third party or sell the same product to a non-related company and to a company within the intragroup. (Verohallinto 2017b)

In merger situations where a previous independent company that the intragroup has previously had business operations with is merged into the intragroup the CUP method can especially be applied. The reasons for this is that in case there is no change in business operations or risks and the business operations continue under former conditions, there are strong reasons to assume that the transfer price is according to the arm's length principle and the former independent companies' business transactions is a suitable comparable. With time the transfer price for the business operations for these kinds of situations needs to be re-evaluated as the business operations or operating environment for two intragroup companies change. (Jaakkola et al. 2012, 77)

The application of the CUP method has traditionally been applied with reserve as when small differences has appeared in analyzing the business operations with internal and external controllable the application of the CUP method has been abandoned. The internal and external controllable and the information retrieved from the comparable analysis should not be rejected in case some comparable criteria is partially unfulfilled. Even though the transactions are not completely comparable the CUP method can be applied despite small differences. Problems occur also in finding suitable comparable transactions when applying other transfer pricing methods. (Jaakkola et al. 2012, 77-78) For certain types of transactions, the external controllable for the comparable analysis is easily accessible. Such transactions are financial instruments, raw materials and intellectual property rights of licensing as public information is available for comparability. (Jaakkola et al. 2012, 262-263)

The CUP method is optimal to be applied for intragroup transaction where a perfectly competitive market exists. For intragroup transactions that are based on the CUP method the intragroup companies are able to represent the real economic contribution to the total intragroup profits. The CUP method applies divisional profits that would likely be similar to profits in external companies and the profitability is therefore comparable to similar companies that operates in the same type of business. (Druly 2016, 359-361)

3.2 Resale price method

The resale price method is applied when a sales margin is reduced from the final resale price to the external customer. The sales margin normally belongs to the reseller within the intragroup. The resale price method can be used when the reseller within the intragroup is not adding value to the product before it is sold to the external customer. The resale price method is not applicable if the products features are changed essentially before resale to external customer. The transfer pricing method is typically used in intragroup operations with international sales- and marketing companies. The sales margin charged by the intragroup sales company is defined by the activities and risks performed. The more activities and risks that are performed by the intragroup sales company, the bigger the sales margin should be. (Jaakkola et al. 2012, 49)

The sales margin need to apply to the arm's length principle and compared to the sales margin that the intragroup sales company earns when selling products purchased from external suppliers (Jaakkola et al. 2012, 78). The earned gross profit for the intragroup transaction can be compared to the gross profit earned from sales from an independent transaction (Jaakkola et al. 2012, 263). If no comparable is available of external suppliers, the sales margin needs to be compared to independent suppliers with similar operations and risks. The level of sales margin is based on the principle that a supplier that performs numerous functions and carries many risks receive a higher sales margin in comparison to a supplier with minor functions and risks. If the intragroup sales company improves the features of the product significantly, incorporate the product into own product or service or carry a significant risk that is not normally associated with resale then the resale price method should be applied cautiously. The sales margin that the intragroup sales company receives will vary in practice dependent on the product and industry. The sales margin varies from a couple of percentage to up to 50 % dependent on the type of product, training of staff, responsibilities to authorities and resources required for the presentation and

sales of products. The business operations of the intragroup sales company and the comparable chosen needs to be analyzed thoroughly for the comparable analysis in order to be comparable. Problems that occur with the resale price method is that there is a lack of sufficient and comparable financial information for the external comparable as sales margins are usually not reported by most companies. (Jaakkola et al. 2012, 78-79)

3.3 Cost plus method

The cost plus method adds an appropriate profit margin to the costs that are related to the transaction sold within the intragroup. The cost plus method is especially suitable for pricing semi-finished products or services, long-term supply contracts and internal services within the intragroup (Jaakkola et al. 2012, 80). The most essential part within the cost plus method is to determine the correct cost base and the acceptable profit margin. (Jaakkola et al. 2012, 49) The costs related to the product or service sold within the intragroup is used as a basis and a profit margin is added. The profit margin added is affected by the business operations, risks and market circumstances. The profit margin applied should be compared to an independent party for a similar situation. For reviewing the comparable the operations, risks and circumstances where the business operates needs to be taken into consideration. (Jaakkola et al. 2012, 80)

The correct cost base is an essential part within the cost plus method. To acquire knowledge of costs related to the delivery of a product or service there is need to know the costs of the cost object. A cost object can be the cost for operating a department or cost of a product or service provided where the resources used for delivering this product or service is measured. Costs can be classified according to category by type of expense or by cost behavior. The cost is then assigned to the correct cost object. (Druly 2016, 29)

The essential part within the cost plus method is to define the correct cost base and acceptable profit margin. The definition of the cost base is in practice bringing difficulties. The idea is that the company should be able to cover the costs in the long run. The price of the transaction sold to the market is not dependent on the costs of the company but dependent on other factors such as demand and supply when looking at the price short-term. The comparability of the cost base is important, and the cost base can be adjusted to be comparable with the company analyzed. (Jaakkola et al. 2012, 80) If the intragroup sales company has other operations and risks than the intragroup transaction, the costs related to the operations

and risks needs to be distinguished from the cost base and the compensation received for the other transactions should be defined separately. Separating the costs is usually easy but the distribution of the indirect costs can be tedious. The same problem applies to the comparable where the dividing cost base and profit margin for the different operations is difficult in case there is no information available of the company of how it divides its costs within the operations. (Jaakkola et al. 2012, 80)

For the comparability analysis of the cost plus method the internal comparable is more reliable than the external comparable. An internal comparable have a more correct cost base of the production costs and there is better assurance of the comparability of the cost base. For an external comparable the information available is usually the operating profit level instead of the direct and indirect production costs. In such case the transactional net margin method is better applicable. The profit margin in the cost plus method cannot be compared to an external comparable profit margin in their profit and loss statement as the profit and loss statement does not separately include the sales revenues for a specific product or service but includes the sales revenues and the direct, indirect and overhead costs. (Jaakkola et al. 2012, 81-82)

The cost plus method is usually applied within intragroup administration, agent, R&D or contract manufacturing services. The cost base is covered by the intragroup direct and indirect costs related to internal services and the overhead costs related to the operations. The cost base can also be smaller and only cover the direct and indirect costs for producing the service. In such case the profit margin should be a bit higher to cover also the overhead costs related to the operations. The service providers' operations are usually assisting where the service provider does not bear a big risk. The company needs however to be consistent in regard to the costs related to the services. The risk for the service not giving the financial benefit expected is on the purchaser of the service. The profit margin applied within the cost plus method is usually only a few percentage points depending on the cost base used. (Jaakkola et al. 2012, 82-83)

3.4 Transactional net margin (TNMM) method

The transactional net margin (TNMM) method aims to define the operating profit of the company's operations for the intragroup transaction and compare it with independent companies operating profit for comparable operations. The key figures of the intragroup company need to be compared to the key figures of an external comparable. The comparability analysis needs to ensure that the independent company used as comparable has similar operations and risks as the intragroup company. The comparability

analysis needs to include depending on the situation a variety of key figures such as profit margin, profit margin of total costs and return on capital. The operating profit is compared to criteria that are comparable for the transaction such as costs, sales revenues or total sum of balance sheet. (Jaakkola et al. 2012, 83)

The TNMM method is best suitable for transactions where the intragroup company produce routine based products or services and the other company within the intragroup is responsible for more challenging operations, take more relevant risks or uses valuable intellectual property rights within the business operations. Routine based products or services can be transactions with little added value. If both intragroup companies perform challenging business operations, take essential risks or uses valuable intellectual property rights then the transactional profit split method is more suitable. (Jaakkola et al. 2012, 83-84)

The strength of the TNMM method is that in practice the pricing method is the most commonly used in comparability analysis (Jaakkola et al. 2012, 264). The positive aspect of the TNMM method is that the key figures compared have a lower degree on impact on the pricing in comparison to the CUP method. Another positive aspect is that only one company within the intragroup is compared as the financial information available can be complicated and difficult to interpret. The third positive aspect is that information available of operating profit levels is usually easily accessible when comparable companies are taken from data banks. The negative aspect of the TNMM method is that the operating profit level can be influenced by factors that is not applicable for pricing of an independent comparable. Key figures such as EBIT can be more sensitive to fluctuation in volumes of sales as fixed costs usually do not fluctuate to the same extent. (Jaakkola et al. 2012, 84-85)

The TNMM method is a transactional profit method and it is recommended to choose a traditional transaction method over a transactional profit method (Jaakkola et al. 2012, 48). The TNMM method is usually used when no other pricing method is suitable or when there is a problem with finding a suitable comparable. The intragroup needs to justify the application of the TNMM method for the intragroup transactions operations and risks. The key figures used as comparable need to be calculated consistently for the intragroup company and the comparable. The same principles should be applied when choosing the pricing method as when choosing the key figures. (Jaakkola et al. 2012, 85-86)

For calculation of the operating profit level the revenues and costs that are directly and indirectly related to the intragroup transfer pricing transaction should be taken into account. The revenues and costs that

are not related to the operations should be deducted if they are substantially affecting the comparability. (Jaakkola et al. 2012, 86)

3.5 Transactional profit split method

The transactional profit split method is defined by the profits made by the transactions within the intragroup companies. The profits are shared between the intragroup companies in an economically acceptable way. The profits need to be shared on the same basis as independent companies would split profits in corresponding operations. For the transactional profit split method there is a need to evaluate the business operations and the two intragroup companies' assets, risks and share of the business operations. The transactional profit split method can be applied when both parties possess valuable intangible assets and the business operations are closely linked together. (Jaakkola et al. 2012, 50)

The transactional profit split method shares the profit of the two intragroup companies evenly. The problem with the transactional profit split method are the difficulties and workload related to comparison of the economical information from the business operations of both parties. The overall profit that the intragroup parties receive from the business operations needs to be determined. Therefore, is there a need to distinguish the transactions from the other business operations of the intragroup companies. In order for the application of the transactional profit split method to be reliable the intragroup companies usually agree beforehand of accounting principles applied for determining the distribution of the profit. (Jaakkola et al. 2012, 91)

In the OECD transfer pricing guidelines there are two different approaches for the split of the profit between the two intragroup companies. Contribution analysis, where the parties input is the basis for the analysis or residual analysis, where the parties residual profit is the basis for the analysis. In the contribution analysis the compound profits are shared between the parties in the ratio of how they have accomplished the business operations functions, carried the accompanied risks or how the operations have committed their capital of the transactions that are being analyzed. In the residual analysis there are two parts, first the arm's length compensation is defined for the routine business operations for each party. Secondly is the residual profit or loss from the business operations split between the parties in the same way as the parties have contributed to the operations in terms of business operations, carried accompanied risks or how they have committed their capital of the transactions that are being analyzed. (Jaakkola et al. 2012, 91)

The transactional profit split method can be applied and is usually justified when there is shown to be a strong dependence between costs and transaction value. When the transactional profit split method is based upon costs the basis for the split of the costs needs to be defined precisely beforehand and be consistent for both intragroup companies. The time period of the costs analyzed needs to be defined as it has a significant effect of the sharing of the profit. (Jaakkola et al. 2012, 92)

4 COMPARABILITY ANALYSIS

The comparability analysis has an important part within the process of choosing the transfer pricing method. The aim of the comparability analysis is to prove that the intragroup transfer price is according to arm's length principle. (Jaakkola et al. 2012, 257) The objective with the comparability analysis is to find a reasonable estimate of the arm's length principle based on reliable information available. Transfer pricing requires judgement on both the part of the tax administration and taxpayer as it is not considered an exact science and therefore is there a need to question if the outcome is reasonable with regards to all the information in the transfer pricing documentation and not to focus on the details. (Jaakkola et al. 2012, 257-258)

The comparability analysis can be made from two viewpoints; as an outcome testing of the results for the purpose of the documentation or for evaluation beforehand of the transfer pricing applying to the arm's length principle. When the comparability analysis is made as an outcome testing the results are already known and the analyzer is trying to find suitable comparable for the purpose of the documentation. When the comparability analysis is made for price setting the analysis is made for planning purposes where available realized or available budget information is used as comparable information. (Jaakkola et al. 2012, 267) For the price setting the price is evaluated based on the arm's length principle and one of the intragroup companies is used as comparator. The comparator is usually the sales company within the transaction where it's information is used as the basis for the evaluation. The price, terms and conditions applied within the sales transaction need to be determined as if the transaction would have been performed with a non-related company. (Verohallinto 2017b)

The applied price for the transaction should prove to be according to arm's length principle with calculations that shows the basis for the pricing within the intragroup. The calculations can consist of financial statement of the company that is evaluated. If the cost plus method is used, the costs for the party that is being tested and the arm's length profit margin that is derived from the comparative object's information. In addition, the financial and balance statements of the party tested should be presented in order to show the effect of the method that has been used. The application of the other methods available should also be investigated. (Verohallinto 2017b)

The process of choosing the appropriate transfer pricing method includes finding the most reliable comparable for the comparability analysis. When uncontrolled transactions have a lesser degree of comparability they need to be eliminated. For the comparability analysis there are limitations for availability of information and the search for comparable data can require a lot of work. In order for the process of the comparability to be transparent the authorities should be able to assess the reliability of the comparable that have been used in the comparability analysis. (OECD 2017, 147-148)

For the comparability analysis there is a need for comparable to compare the intragroup transaction with. The comparable can be a party within the intragroup transaction, internal comparable, or an independent party, external comparable. (OECD 2017, 155) Independent of if the company uses an internal or external comparable for their comparability analysis the most essential part is that the intragroup transfer pricing comparability of arm's length principle is compared to either an internal or external comparable. (Raunio et al. 2018, 167)

4.1 Internal comparable

The comparability analysis is made with an internal comparable when one party of the comparability analysis is the company for which the transfer pricing is examined. (Raunio et al. 2018, 167) Within the OECD nine-step comparability analysis process the fourth step is to review existing comparables. Internal comparables can be closer to the transaction in comparison to an external comparable. Performing the financial analysis can be easier and more reliable as the standards are similar and the information available can be more complete and less costly available. Internal comparables are however not always more reliable and the internal comparable needs to satisfy the five comparability factors similar to an external comparable. In case a product or service is sold to an intragroup company and an external supplier, the volume sold and the similarity in the product or service needs to be taken into account. In case there are big differences, the transaction with the external supplier is not a reliable comparable. (OECD 2017, 155-156)

4.2 External comparable

For an external comparable the comparability analysis is made of two independent parties. (Raunio et al. 2018, 167) For finding a potential external comparable there are various sources of information available. However, when there is an available reliable internal comparable there is no need to search for an external comparable. Commercial databases can be used as source of information for external comparables. The limitations with commercial databases is that they rely on publicly available information, are not available in all countries and do not include same type of information for all companies. As the commercial databases are compiled and presented for non-transfer pricing processes there is a need to use the information with care. The commercial databases are used to compare results of companies instead of transactions as these are rarely available. Commercial databases should be used with the objective to identify reliable comparable information. The reliability of the information needs to be taken into account when using an commercial database. In addition to commercial databases there are proprietary databases that have been developed and maintained by advisory firms. The proprietary databases are based on a more limited portion of the market than the commercial databases and if used the tax administration may request access to the database for the review for transparency reasons. (OECD 2017, 156-157) In Finland can the trade register be used as a commercial database as the financial reports from Finnish companies are available there. (Raunio et al. 2018, 167)

4.3 OECD nine-step process of comparability analysis

In the process of defining the transfer price according to the arm's length principle the transfer pricing method applied should be comparable. The comparability analysis is a comparison of the intragroup transaction with pricing of a similar transaction agreed between independent parties. OECD transfer pricing guidelines has a nine-step process that gives an example of how the comparability analysis can be performed. (Raunio et al. 2018, 164) The process of comparability analysis is used to test the arm's length principle. When setting the transfer price, the idea is to have the same proceedings for several years. The transfer price needs to comply to the arm's length principle on a yearly basis and therefore the price needs to be updated and with proceedings of setting the transfer price that takes into account the comparability analysis makes the process of updating the transfer price easier. In practice the setting of transfer price and the comparability analysis are made simultaneously where the intragroup has a preliminary understanding setting the price while the comparability analysis reinforce the preliminary pricing or lead to a change in transfer pricing method used. (Raunio et al. 2018, 166-167)

OECD has created a nine-step process that can be followed when performing a comparability analysis. The nine-step process of comparability analysis is considered an accepted good practice but also other processes for comparability analysis are accepted as the outcome of reliable comparable is more important than the process. (OECD 2017, 148-149)

OECD nine-step process of comparability analysis:

- Step 1: Determination of years to be covered
- Step 2: Broad-based analysis of the taxpayer's circumstances
- Step 3: Understanding the controlled transaction 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 comparable, if any
- Step 5: Determination of available sources of information on external comparable where such external comparable 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
- Step 7: Identification of potential comparable 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 comparability factors set forth in Section D.1 of Chapter I
- 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 (OECD 2017, 148-149)

Although the OECD nine-step process of comparability analysis is outlined as a step-by-step process, in practice is the process not linear. Repetition in steps 5 to 7 might be needed to reach a satisfactory conclusion. The examination of available sources of information may influence the selection of transfer pricing method. In case there is not possible to find information of comparables there is a need to select another transfer pricing method. (OECD 2017, 149) The choice of transfer pricing method is usually affected by the comparable information available. The transfer pricing method selected is usually the

transactional net margin method as the other transfer pricing methods available have been rejected because of inadequate available information or incomparability of the comparable information available. The choice of transfer pricing method needs to take into account that the comparability of information needs to be relative and not an absolute concept. (Jaakkola et al. 2012, 265)

5 TRANSFER PRICING FOR INTRAGROUP OF COMPANY X

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5.1 Transfer pricing process

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5.2 Intragroup transactions

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5.2.1 Products

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5.2.2 Services

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5.2.3 Intangible assets

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5.2.4 Financing

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5.3 Transfer pricing methods selected within the intragroup

The choice of transfer pricing method needs to be in line with the intragroup objectives while simultaneously being according to the arm's length principle from a taxation point of view. (Jaakkola et al. 2012, 123) Within an intragroup it is important to look at the business units and the effectiveness of all the business units within the intragroup. The profit earned by business unit selling products or services within the intragroup is a cost for the business unit within the intragroup who buys the product or service. This means that the profits reported by the different companies within the intragroup is directly affected by the transfer price applied. Transfer prices that are incorrectly set within an intragroup pose a risk that the profitability measurements are wrong which can lead to wrong business decisions. (Jaakkola et al. 2012, 127)

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5.4 Comparability analysis

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5.5 Development of the intragroup transfer pricing process

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6 CONCLUSION

The information retrieved from this thesis has given extensive knowledge within the field of transfer pricing and what pricing methods are available and how the intragroup can prove through the comparability analysis that the pricing applied for the intragroup transaction is according to the arm's length principle. The thesis has developed my knowledge to analyze the different types of transactions that occur within an intragroup and correct the pricing in order to correspond to the arm's length principle. The transfer pricing documentation is usually put together once a year, but the transfer pricing process needs to be continuous as the transfer prices need to be updated on a continuous basis and in case of any errors in the calculations or a negative effect on a subsidiary profit and loss statement the pricing need to be updated to better correspond to the current market situation and be in accordance to the arm's length principle. In order to be able to analyze the different types of transactions within the intragroup and the transfer pricing of these transactions there is a need to have the theoretical knowledge of the different transfer pricing methods available and how the comparability analysis can be performed for the transfer pricing method chosen.

Transfer pricing is a topic that is of importance for international business operations in order for an intragroup to conform to national and international regulations. The guidelines are updated on a continuous basis and working with an intragroups' transfer pricing requires updated information of pricing methods. In addition, the person that performs the comparability analysis needs a thorough understanding of the business operations, how to perform the comparability analysis as well as where a suitable internal or external comparable can be found. Further research within the topic of transfer pricing can be made within transfer pricing documentation to acquire knowledge of how to document the transfer pricing method selected and the comparability analysis performed.

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