

# Transfer pricing and its effect on financial reporting and taxation

## Diploma Thesis

**Thesis supervisor:**

**doc. Ing. Hana Bohušová, Ph.D.**

**Kateryna Pryma**

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## Declaration

I hereby declare that, this thesis entitled: **Transfer pricing and its effect on financial reporting and taxation**

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**Abstract**

Pryma K. Transfer pricing and its effect on financial reporting and taxation. Diploma thesis. Brno: Mendel University, 2017.

The diploma thesis deals with the impact of transfer pricing on financial reporting and taxation for the companies operating under different accounting systems (US GAAP and IFRS). In theoretical part examined various methods of transfer pricing used in the United States, OECD-member countries and main considerations taken into account for the determination of arm's length range and transfer prices. In practical part shown the differences in approaches to transfer pricing in the USA and countries of pan-European area considering the connection with financial reporting and taxation.

**Keywords**

Transfer pricing, arm's length range, arm's length test, arm's length standard, methods of transfer pricing, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Internal Revenue Service Regulations.





## **Abstrakt**

Pryma K. Převodní ceny a jejich vliv na účetní výkaznictví a zdanění. Diplomová práce. Brno: Mendelova Univerzita, 2017.

Diplomová práce se zabývá dopadem převodních cen na účetní výkaznictví a zdanění, společností vykazujících v rámci různých systémů účetního výkaznictví (US GAAP a IFRS). Teoretická část se zabývá aplikací různých metod pro určení převodních cen využívaných ve Spojených státech amerických, členských zemích OECD a hlavními faktory uvažovanými při určování tržního odstupu a převodních cen. Praktická část je zaměřena na kvantifikaci rozdílů při určování převodních cen v USA a v evropských zemích a jejich návaznost na účetní výkaznictví.

## **Klíčová slova**

Převodní ceny, rozsah tržního odstupu, test tržního odstupu, princip tržního odstupu, metody určení převodních cen, OECD pokyny pro určení převodních cen pro nadnárodní společnosti a daňové správce, interní regulace příjmů.



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# 1 Introduction, objectives and methodology of the thesis

## 1.1 Introduction

In the light of globalization, there is no country, industry and nation, which was not touched by its positive or negative externalities. Multinational corporations are key players in the changing economic environment and because of their ambiguous role in globalization process, the relationship between multinationals and states are becoming more and more complex. One of the aspects of current interest is referred to taxation of the international corporations and particularly income tax. Tax authorities of different countries try to receive, what they consider a fair value from income tax, while multinationals adopt tax optimization strategies.

Despite allocating subsidiaries in different countries with various tax and legal requirements, multinational enterprises get involved in a variety of transactions within a group to which they belong. Such transactions can be of different character and nature: companies, for example, may exchange goods or services, provide financial resources and get involved in research and development projects. Number of companies involved may also vary from case to case and, thus, their weight for the whole transaction. Generally, it is expected, that all the complexity of such transactions will be reflected through the prices. On the other hand, this assumption is valid in all cases only for independent companies. Entities belonging to the same group may create other kind of agreements and make other price-related decisions than independent enterprises. Charging price, which will be higher or lower than certain level will shift higher portion of income to certain party of a transaction and therefore to certain jurisdiction, where this party is located. Thence, multinational companies and governments pay a lot of attention to problem of transfer pricing, because it determines allocation of profits between the jurisdictions in which they operate.

Main threats of such an approach towards pricing policy are distortion of competition, higher tax burden on ordinary citizens and decrease of the resources needed for government to perform its functions.

Many countries use OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and even non-member countries use transfer pricing legislation based on OECD Transfer Pricing Guidelines. The United States of America, on the other hand, builds their legislation on the basis of Treasury Regulations, Revenue Procedures, IRS Notices and CSA regulations. In spite of global tendency to harmonization of laws, convergence of business linkages, the economic realities of world largest economies are not the same.

## 1.2 Objectives of the thesis

The objective of this work is to review transfer pricing issue from dimensions of managerial accounting and taxation. Binding relationship of accounting and transfer pricing is a problem which does not have complex resolve in legislation acts and rarely is reviewed from the point of view of managerial accounting.

Because of the linkage of transfer pricing problem to accounting practices one of the partial objectives is to evaluate significance of the effect made by IFRS and US GAAP standards in transfer pricing issue and define key differences between these world major approaches. The convergence of the accounting standards started in 21<sup>st</sup> century creates a background for unification of main world known approaches to the reporting, however since the process has not yet been completed, small differences in accounting can result in significantly different results for arm's length range computation and transfer price determination.

The objectives would be resolved through the calculation of arm's length range for the companies from the USA and OECD-member states. Then key areas in which differences arise would be studied and vector of their impact on arm's length range would be determined. Thereat consequences of those differences would be examined, in particularly their reflection in managerial accounting and taxation through the specifications of standards used – US GAAP and IFRS.

## 1.3 Methodology and outline of the thesis

For the purpose of writing the beginning of theoretical part of this paper were used descriptive and historical methods with an aim of providing the overview of historical background of transfer pricing issue, main circumstances for the development of existing legislative prescriptions in transfer pricing. Synthesis and analysis were used for presenting approaches to arm's length range determination of OECD-member states and the USA and for defining functions of transfer pricing in financial reporting and taxation.

Comparison method was used for underlining existing differences between legislative requirements of the USA and OECD-members to arm's length determination. Also, there were examined two case studies (Roche case and Shell case) for presenting more insight of practical application of aggregated and separate test approaches to tested transactions.

Next part was dedicated to methods of transfer pricing set by the OECD and US legal authorities, for which descriptive and analogy methods were used. First was made the examination of OECD methods of transfer pricing, which can also be used in the United States: comparable uncontrolled price, resale price, cost plus, transactional net margin, transactional profit split methods. Then specific for the USA methods were examined: comparable profits, comparable uncontrolled transaction, services cost, comparable uncontrolled services price, gross services margin, cost of services plus, income, acquisition price, market capitalization, residual profit split and unspecified methods. Some of specific American transfer pricing

methods have a linkage to OECD methods on the basis of the requirements for the comparison criteria and way how these methods are applied (ex. such linkages between methods CUT and CUP, usage of CUP and CUT methodologie in acquisition price method, etc.).

Practical part of the thesis contained determination of arm's length range for companies from the USA and pan-European area. Dataset was selected on the basis of Orbis database, a product of Bureau Van Dijk containing information of over 200 million private companies around the world. The information contained in database is provided by regulatory and other sources. Another source of the information for this section were financial statements of the particular enterprises, published at their websites. For arm's length range computation were selected automotive companies-resellers and therefore resale price method was applied. For the purpose of this part analysis and statistical methods were used. For the companies presenting their financial statements in accordance with legal compliance accounting model (Continental European model) was made approximation of cost of sales figures.

The last part of the thesis is concentrated on the aspects of transfer pricing practice of companies, which present their financial statements in accordance with IFRS and US GAAP and reflection of the key differences in their financial statements. For the purpose of this section historical and descriptive methods were used for the reflection of the processes in accounting standards of world's major markets, analysis and statistical methods for the indication of primary distinctions presented between US GAAP and IFRS (numerical data was based information received from Orbis database and financial statements of the companies published at their websites) and method of comparison for outlining peculiarities brought by the different accounting systems.

## **2 Transfer pricing and its functions in financial reporting and taxation of multinational corporations**

### **2.1 Transfer pricing issue**

A “transfer price” is referred to in tax legislation as a price at which one company supplies something to another associated company. That which is supplied can be presented by any type of property, loans, financial instruments, etc. (Green, 2008). Because of its direct effect on income declared by the entities, transfer pricing becomes of a major interests of tax authorities, since it will determine which jurisdiction will tax those incomes, and corporations, which can determine their structure and functionality in a specific jurisdiction and will tend to develop their businesses in profit-seeking manner. When transactions between independent companies are reviewed, all of them will be acting in their best interest while setting up the prices and contractual terms, however with related companies the lead role will be playing the interest of one, common, owner. This expected fragility in the behaviour of the entities with common ownership is considered to be the key to why transfer pricing is a taxation issue (Green, 2008).

Transfer pricing problem is generally associated with multinational business organizations and transactions performed between affiliated units of such organizations. Despite the fact, that East India Company operating from 1600 used to be referred to as the first international company in the world, transfer pricing problems evolve much later, along with increasing number of businesses, which extend their multinational network at the period of 1970-1980s (Green, 2008). First implemented transfer pricing legislation took place in the USA in the early 1990s and afterwards adopted by other countries.

At the present time, most of the countries use Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Currently, organization is presented by 35-member countries, nonetheless Transfer Pricing Guidelines are acknowledged by numerous other states.

Transfer price is defined by OECD as a “price, adopted for book-keeping purposes, which is used to value transactions between affiliated enterprises integrated under the same management at artificially high or low levels in order to affect an unspecified income payment or capital transfer between those enterprises” (OECD, 2003). Aforesaid transactions comprise of tangible or intangible property transfers, loans and guarantees granting, goods and services exchange. Whereas analogous activities take place between independent enterprises, they are considered to be influenced by market forces, which will drive both companies to increase of their own profits. But it is presumed, that in transactions between associated firms, the impact of market forces can be weakened, on the grounds that profits from



both firms will be collected by the same owner. Thus, manipulation of the profits based on various tax requirements in different countries may take place. As Gareth Green remarks, the reason why governments and multinationals care so much about transfer pricing is, that it determines how the profits of a multinational corporations are split between the jurisdictions in which they operate. This in turn determines which country gets to tax those profits, and this may affect the global tax burden of the multinational (Green, 2008). OECD Guidelines also stress, that tax administrations should not automatically assume that affiliated companies manipulate with their prices, moreover G. Green believes that multinational companies often do not have enough of time and resources to plan their prices in the way to achieve such high "tax-efficiency", nevertheless they ought to be consistent with arm's length principle. If tax authorities consider another price as more relevant for the examined transaction, they have a right to adjust reported taxable income or loss (Green, 2008).

## **2.2 Arm's length standard**

The key principle used for the purpose of international taxation of associated enterprises and evaluation of the relationship between them is arm's length standard.

The origin of this term seems to be quite unclear. It is presumed that its use likely have started in the US Treasury around the year 1930. In official documentation, it appeared the first time in 1935. According to the Hubert Hamaekers, it was developed in the treaties for the avoidance of double taxation, which became a significant problem after the First World War. The term itself is associated with the name of Mitchell B. Carroll, who was an advisor to the US Treasury and later on a chairman of the Fiscal Committee of the League of Nations at that period (Hamaekers, 2002).

At the present time, arm's length principle is defined as a valuation principle concerning financial and commercial business activities of affiliated enterprises. The core idea of it is that such activities should be evaluated as if they were taking place between independent companies acting in own best interest (OECD, 2007).

Considering factors, which may lead companies to distortion of arm's length principle, it should be mentioned, that there are not only tax considerations influencing business decision-making. Other circumstances, such as specific requirements of entities within multinational enterprise group (MNE group), especially if reporting of this group is not done on consolidating basis, or governmental pressure of specific countries (OECD, 2010).

OECD Guidelines state the reasons for arm's length principle application as: establishing broad parity of tax treatment between affiliated and independent firms and in that way restoring fair competition level between them, since neither of the firm receives tax or any other commercial advantages and disadvantages, as well as removing tax considerations from the process of business decision-making,

which will lead to increase of international investments and commerce (OECD, 2010).

### **2.3 Legislation: OECD countries and USA**

Despite the fact, that OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations is main document used in OECD countries and not-member countries build their tax legislation concerning transfer pricing in line with this act, it was not always being that way. The first document suggested by OECD was introduced in 1979 and it was called Transfer Pricing and Multinational Enterprises, albeit it was used as a major transfer pricing act in OECD-member countries, the USA faced with certain drawbacks with implementation its principals. As analysed by Lorraine Eden, tax-free transfer of the ownership of USA intangible assets together with tax holiday in Puerto Rico and tax sparing in USA caused considerable increase of foreign direct investment in Puerto Rico. American government saw tax avoidance as a main reason for that type of transactions. Therefore, new section (936) to tax code was comprised and adjustments to the sections (351 and 367) concerning tax-free transactions were made. Congress still assumed underpayment of royalties and licence fees for intangible assets transfers and in 1986 was introduced additional requirement, that payments to affiliated parties for licenced or transferred intangible asset should be commensurate with the income (CWI) from these assets. The main purpose of CWI legislation was to ensure, that US multinational enterprises receive a fair and taxable return on their assets after passing them to associated companies abroad. The main concern was in intangible assets, which value is hard to estimate at the moment of transfer, but which can yield high, not initially predicted, incomes after some period. Thus, the focus should be made on the amount of income, that such an asset yields, instead of initial valuation of the asset at the time of purchase (Eden, 1998). Hence, in 1988 United States Department of the Treasury and United States Internal Revenue Service (IRS) published a White Paper (A Study of Intercompany Pricing). Such actions of the USA were treated as a step aside from the agreed consensus (arm's length principle) and as a try to concentrate incomes of multinational companies in their American affiliates at the expense of other countries. After that OECD acted a mediator to the conflict and in July 1995 introduced Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Green, 2008). It should be mentioned that in the present moment USA relevant regulations in respect to transfer pricing are presented by Treasury Regulations (sections 1.482, 1.6662, 1.6038A and 1.6038C), Revenue Procedures (Rev. Proc. 99-32, Rev. Proc. 2006-9, Rev. Proc. 2006-54 and Rev. Proc. 2007-13), IRS Notices and CSA regulations (Ernst & Young, 2016).

The IRS acknowledges its transfer pricing regulations to be fully consistent with the OECD Guidelines. However, for domestic purposes it is considered that OECD Guidelines cannot be directly applicable. But, if taxpayers pursue competent authority relief from double taxation or a bilateral APA, the OECD Guidelines are

relevant and may be used to demonstrate compliance with international principles (Ernst & Young, 2016).

## 2.4 Arm's length test

Hence, arm's length standard is a rule which must be applied for each transaction taking place between associated companies (controlled transaction). In order to examine whether the transfer price of a controlled transaction complies with this standard, arm's length test can be applied. In economic theory distinguish two types of arm's length tests: empirical and hypothetical. *Empirical* test is based on the prices in transactions which took place in reality between independent companies. *Hypothetical* test is based on the prices which assumed to be agreed on in independent transactions; thus, in hypothetical test real transactions are not observed, but assumptions about the prices are made on the basis of rationalism and reasoning. There are 2 methods used to perform arm's length test, namely aggregated and separate arm's test (Wittendorff, 2010).

OECD Guidelines states that aggregate test should be used for closely linked or continuous transactions. As such transactions can be considered supply of the goods or services on the basis of long-term contract, supply of product lines, rights for usage of intangible property, providing licencing of manufacturing know-how and the provision of key components, transactions which go through several associated companies. It is stressed that transaction can be tested in aggregate only in case if any element cannot be valued separately from the others (OECD, 2010).

On the other hand, in US law (Treas. Reg. section 1.482) under aggregate approach should be tested related products, product lines, cost-sharing arrangements' contributions, etc. Transactions with intangible property are covered by aggregation rule as well. Also under this rule fall cases of many transactions with the same product or different products transfer under the single transaction, transactions comprised by several contracts that serve as single unit, supplies of integrated or related products, transfers to the single legal entity. In case if a company handling many controlled transactions, the arm's length test can be replaced by using sampling or other relevant statistical techniques. Also for such an enterprise sample of own controlled transactions may serve as a basis for other controlled transactions (U.S. Government Publishing Office. 26 CFR § 1.482-1).

By OECD Guidelines it is assumed that affiliated companies perform package deals on a regular basis with each other. Package deal normally is classified as coherent business unit and should be an object for aggregated testing, however at the circumstances when a transaction possesses some unique characteristics or specific terms of the agreement and relevant aggregate test cannot be made, then separate tests should be applied (OECD, 2010).

US legislation presumes application of separate arm's length tests in case of transactions to which correspond more than one transfer pricing method. Approach should be chosen on the basis of the decision which of them will provide

more reliable measure in accordance with arm's length standard (Wittendorff, 2010).

In economic literature, as well as between tax practitioners, it is prevailing practice to review real business cases illustrating a pattern of those two different types of test application. One of them is a *Roche case*. The preliminary decision on it was made on 2 of April 2008. This case took place in Australia at Administrative Appeals Tribunal between Australian Taxation Office and Roche Products Pty Limited ("Roche Australia"), which actually was a subsidiary of a multinational pharmaceutical company based in Switzerland (Roche Holdings Limited). Australian branch was created in order to develop pharmaceutical business activities at the territory of Australia for its Swiss parent-company. Roche Australia acquired from Roche Holdings Limited and group of related companies three divisions, namely, Ethical Pharmaceutical Division, Consumer Division and Diagnostics Division. The tax authorities made adjustments to the transaction, stating that since there was no comparable transaction in Australia, each function performed by the divisions can be compared to the company from similar activity. And then aggregated return should be considered as the one used for the calculation of the transfer prices. Mr Justice Downes, who was making a decision on this case did not agree that aggregated approach should be taken. Separate companies suggested for the benchmarking belonged to different sectors (because of the lack of comparable companies in the similar industry) and it was assumed that the level of income generated by the division of a multiple-purpose company is different from the income generated by those single-purpose enterprise, so such a separate test cannot be applied (Wittendorff, 2010, PricewaterhouseCoopers).

Another case presenting a different approach is *Shell case* (RÅ 1991, ref. 107) at Supreme Administrative Court of Sweden between Swedish subsidiary of Shell corporation (Svenska Shell) and tax authorities. Despite the fact, that the case took place in the USA it is contemplated with OECD Guidelines. Svenska Shell purchased a crude oil from associated U.K. trading company on CIF terms (cost, insurance and freight). The same as in previous case at that period of time when transaction occurred there was lack of comparative transactions. Yet there was available FOB price (free on board) for crude oil and the price of freight. Thus, under this circumstances it was considered separate test to be applied since it yields more accurate evaluation of the transaction (Wittendorff, 2010).

## 2.5 Application of arm's length standard

Application of arm's length principle is based on the comparison of the conditions in transaction between separate companies and affiliated ones. In order to determine if a transaction can be considered relevant for the comparison, there should not be any differences in economic circumstances which would materially influence the outcome of the transaction. Main reason to take uncontrolled transactions for analogy is that companies involved in them will follow their own best interest and will search for the best price. Such prices are used by tax authorities for mak-

ing decision on arm's length standard, depend on the economic characteristics of the deal certain adjustments to those prices can be made in order to move them closer to the reality in which controlled transaction took place. OECD define the following attributes of comparability factors, such as: specific characteristics of goods or services, contractual terms, functions performed by the parties, business strategies of the parties and their economic conditions (OECD, 2010).

Characteristics of property or services include quality, physical characteristics of the goods, functions performed by the product, availability, ordered volume, nature of the services, type of property and form of transaction, benefits which receiver expects to obtain (OECD, 2010).

Functional analysis compares functions performed by the parties in controlled and uncontrolled transactions, identifies their nature, evaluates risks allocation, frequency of the performed functions. Functional analysis should take into account type of assets or technologies used by the parties (OECD, 2010).

Contractual terms define the division or risks, benefits and responsibilities between parties. It is assumed that in uncontrolled transactions party will take higher risk over the area where it has higher control. Also, it is generally believed that for independent enterprises contracts are tailored up to their interests and can be changed only if those interests change. It should be admitted that information about contractual terms in uncontrolled transactions is limited or frequently not available, thus comparison will highly depend on the type of transaction and transfer pricing method (OECD, 2010).

Even for the transactions involving same goods or services prices will vary in different countries. It can be explained by economic conditions prevailing, such as size of the market, level of competition, competitive positions of buyers and sellers, transportation costs, consumer purchasing power, costs of the factors of productions, time period of the transaction, stage of the economic cycle, etc. So, if MNE group performs transactions between countries with similar markets, it is considered appropriate to perform multiple-country comparability analysis. However, whether MNE group performs variety of transactions between heterogeneous markets the same approach is not considered reliable (OECD, 2010).

US Treasury Regulations, on the other hand, provide slightly different list of comparability factors. They include: functions performed by the companies, contractual terms, risks undertaken, economic conditions and object of transaction, i.e. property or service (U.S. Government Publishing Office. 26 CFR § 1.482-1).

Because of the difficulties in determining if transactions were arm's length, complications in determining approach, which should be used for arm's length tests as well as difficulties in determining comparable transactions, hard administration process, arm's length standard was acutely criticised.

## **2.6 Global formulary apportionment**

OECD Guidelines also confer non-arm's length approach, which is called global formulary apportionment.

The substance of the approach is in allocation of the globally earned profits of the international corporation between its subsidiaries in different countries on the basis of a certain predetermined formula. The allotment should be based on the combination of sales, assets, costs and payroll (OECD, 2010).

It must be conceded that this approach is not in use for international taxation purposes and transfer pricing at the present time. This method is used by the USA and Canada for income distribution across sub-national boundaries. The US began using this approach in the end of the 19<sup>th</sup> century with a purpose of transcontinental railroad companies' taxation (European Commission, 2005). There were intentions to implement it within the EU in 2001, however it was not adopted in the end.

The advocates of global formulary apportionment stress such advantages of the method as higher administrative convenience, certainty for taxpayers, greater level of accuracy with respect to economic reality and lower level of costs for taxpayers (because less documentation is needed under this method) (OECD, 2010). Another benefit suggested by the system is that it eliminates risk of companies shift their incomes to low-tax countries, since the global income will be taking into the account and then distribution will be made on the basis of the level of economic activity of the company in the particular country. In the US, it was also expected that such an approach will lead to raising government revenue and as a result will enable reduction of the tax rate (Clausing, Avi-Yanah, 2007).

The critics of the approach state difficulties in its implementation: in order to achieve the efficient work of global formulary apportionment and not to cause issue with double taxation, all countries should come to the agreement on the way of the calculation of the aggregated tax base for the international corporation as well as the weight which should be used for the potential allotment. The hesitancy of such an agreement to be made was based on the fact, that countries will not come to the common formula: each will be pushing to maximization of own profit and, also there will be a risk if unify formula is stated, that the companies will manipulate with their production factors in order to shift major part of the income to low-tax countries. As other weakness of the system was stated insensitivity to real economic conditions, on the point of assigning profits to the subsidiary which actually incurs losses: since formula is based on the combination of sales, assets, cost and payroll, there may be cases when portion of aggregated profits will be allocated to such a subsidiary, even if it has losses because of unfavourable economic conditions in the country. Another challenge is adjustments to movements in exchange rate: strengthening of the currency will increase a portion of corporate income allocated to the country, while for long-term prospective it always weakens the position of the particular entity at the international market, because its products are becoming more and more expensive. It is also counterfeited that costs of taxpayers and tax administrations in fact will not go down, moreover, they will grow due to the fact, that in global formulary apportionment system the data collection and validation will have to include entire MNE group, which is nearly impossible to manage for a single tax jurisdiction of specific country. Hence, global formulary

apportionment can work effectively and efficiently only if applied to the whole MNE group, equally in all countries, which require extremely high level of cooperation and openness of the countries in the field of taxation and harmonization of certain tax and accounting provisions (OECD, 2010).

## **2.7 Key internal and external stakeholders of transfer pricing policies**

Since transfer pricing has been one of the most important international tax issues for many years, there are many interested parties taking part in determination and correct application of transfer price policies. These key stakeholders can be divided into two main categories: internal, who directly deal with transfer pricing issues, such as corporates' tax departments, Chief Financial Officers, operations personnel, accounting and legal departments, and external, who do not directly participate in determining particular prices for controlled transactions, but take active part in creation and application of transfer pricing legislation, for example, government, independent auditors, tax advisors (Heimert, 2010).

Company's tax department is accountable for setting transfer pricing policies in the company which are in line with effective legislation, assuring enterprise compliance with these policies, preparing necessary documentation demonstrating that compliance, preparing documents required by tax authorities. Tax departments consider transfer pricing for tax planning purposes, tax and business restructuring. One of the goals set for tax departments is to maximize tax efficiency, which can be met by optimizing prices and other terms of transactions. At the same time tax efficiency for the company should not cross the line of legal requirements of a particular country, where it operates. In case of controversies with tax jurisdictions, corporate's tax department takes active part in dispute resolution (Heimert, 2010).

Chief Financial Officers (CFOs) concerns about transfer pricing include affects which it makes on financial reporting and cash-management. Depends on the fact if a country in which company is located has territorial tax system (so incomes generated by foreign subsidiaries are not subject for taxation there) or foreign tax credit system (in which income generated abroad is counted for tax purposes, however if taxes have been imposed in a foreign state, they will deduct tax liability in the parent company country), it will have material impact on overall taxes paid, earnings recognition and distribution. For example, under US generally accepted accounting principles (GAAP) if company reinvests abroad its income which was generated in other countries by its foreign subsidiaries, that income can deduct their tax liability in the USA. However, if such an income is repatriated back to the USA and is to be distributed in a form of dividends, it must be included into taxable income and will be a subject to taxation. Thus, CFOs should consider possible negative consequences prior to outset of intra-group cash movements.

Operational personnel may face a controversy in case if their compensations are linked to their performance, especially to the level of sales. Also, if any capital

allocation decisions are made on the basis of the reported profit by the subsidiary, it will create an incentive to affect this profit, which may be in contradiction with what is better for the whole MNE (Heimert, 2010).

Accounting and internal audit departments of the company are responsible for providing accurate financial reporting and assure correct implementation of transfer pricing policies. They also provide necessary transfer pricing analysis and can make substantial transfer pricing adjustments in order to conform with existing policies and legislation (Heimert, 2010).

Internal and external legal counsels, and corporate legal departments bear responsibility to construct contracts, consult other departments about transfer pricing and participate in transfer pricing disputes (Heimert, 2010).

Government authorities are focused on the transfer pricing practices of the companies because it has direct influence on their income. Thus, they constitute legal requirements and perform monitoring and control over the enterprises in order to assure that these requirements are met.

Independent auditors evaluate of their client's tax provision is set up at sufficient level, they should confirm that financial statements of the company are free from material misstatements and that internal controls work appropriately (Heimert, 2010).

Tax planning and compliance advisors are also stakeholders in transfer pricing matters. Since corporations not always are able to manage with complexity of transfer pricing issues, they hire such external specialists, who assist them to establish and support transfer pricing policies, perform necessary analysis and control (Heimert, 2010).

## **2.8 Functions of transfer pricing in financial reporting and taxation**

Based on the fact, that transfer pricing is applied to majority of transactions between affiliated companies within different types of economic activities, including sales of tangible and intangible property, providing financial services, it has significant impact on the figures presented in financial reports of the companies.

One of the major issues concerning transfer pricing which arise during preparation of financial statements is uncertain tax position. Under US GAAP (ASC 740) and IFRS (IAS 37) tax benefit and tax reserves recognized by the company require a significant level of judgment beforehand the final result of the transactions is known. The assessment concerning transfer pricing should include considerations of the relevant legislation. At times, even when transactions can be classified at arm's length and properly documented, there still may take place some hesitation of the management of the company, that tax authorities will come to another amount for transfer prices used. For such a situation, reserves should be created, albeit the size of such a reserve is a subject of judgments and estimates of the company. Another challenge for the reporting is constant monitoring for any changes which may occur during tax examination by the governmental authorities itself:



any recommendations and changes to the current reporting system should be reviewed and analysed, reserves should be reassessed (USGAAPPlus).

Both US GAAP and IFRS systems state principle of deferred tax assets and liabilities but the way of recognition of tax assets is different. Under US GAAP (ASC 740-10-30) full amount of deferred tax asset is recognized, then it should be reduced by a valuation allowance, reduction is based again on the judgment of likelihood that deferred tax asset fully or partially will be recognized. Under IFRS (IAS 12) there is no valuation allowance taken in estimation of deferred tax assets, but the tax assets are recognized if it is more likely that they will be used. The issue with transfer pricing can arise at the business units for which intercompany transactions conclude the significant part of their revenues or costs. In such a unit transfer prices applied will be considered by tax authorities as one of the main determinant of losses, which will naturally lead to a growth of deferred tax assets. Besides by US GAAP also specified that need for valuation allowance can be overcome if company can prove sufficient income to be received in the future, such income can be generated from intra-corporate transactions if transfer prices are adjusted (USGAAPPlus).

Transfer pricing will affect reporting of foreign incomes, generated by subsidiaries abroad when reported in home-country. Both US GAAP and IFRS require a recognition of a deferred tax related to all undistributed earnings. Thus, due to differences in legislation, associated companies' reporting may face an issue accurately disclose amounts of foreign tax due, foreign tax credit, foreign tax reserves, taxable income, outside basis deferred tax differences (USGAAPPlus).

When business restructuring takes place in MNE, significant parts of the assets and business functions are shifted between enterprises of MNE. In such processes transfer pricing will play a leading role as such cross-border redeployments will bear tax consequences for both parties, recipient and giver. Restructuring in its turn may subsequently cause a change in tax status of the business unit (from non-taxable to taxable or opposite). Crucially important will be also valuation of the assets acquired in business combinations (USGAAPPlus).

In order to be able to make more objective business decisions and also upon the request of other stakeholders (investors, creditors, etc.) management of the companies often require preparation of financial statements of subsidiaries in addition to consolidated financial statements of MNE. While in consolidated reports intercompany transactions may not be shown in details, in separate reports they must be adequately disclosed. In this case, transfer pricing will play a key role with respect to the taxable income and costs of those transactions (USGAAPPlus).

Among other effects transfer pricing has on the reporting should be mentioned the necessity to reflect corporate transfer's policies in estimated annual effective tax rate (under US GAAP), accounting estimates and assertions and income tax disclosures (PricewaterhouseCoopers, USGAAPPlus).

## 3 Evaluation of methods of transfer pricing and their appliance

### 3.1 Selection of the method

Transfer pricing method can be defined as an approach used for a purpose of setting up a transfer price for a particular controlled transaction. There is no method, which is suitable for all types of transactions.

OECD Guidelines divide transfer pricing methods for two groups: traditional transaction methods and transactional profit methods.

Traditional transaction methods include:

- Comparable uncontrolled price method (CUP)
- Resale price method
- Cost plus method

Transactional profit methods consist of:

- Transactional net margin method (TNMM)
- Transactional profit split method

In addition to methods, specified by OECD, US regulations stipulate additional methods which are used in the USA in majority of cases for sales of services and intangible assets.

The guidance for choosing a specific method is to adopt the one, which will be the most sufficient for a particular type of transactions. OECD Guidelines also state that traditional transaction methods and transactional profit methods are both equally pertinent, though traditional transaction methods are preferred over transactional profit methods. Further it is stated that among all traditional transaction methods CUP method is to be preferred (OECD, 2010).

Transactional profit methods were considered as methods of last resort prior to 2010. Nowadays it is stated that transactional profit methods prove to be more reliable in controlled transactions where both parties have considerable commitments or when they have some unique roles in the transactions. These methods can also be used in some specific cases when there is lack of information about comparable transactions, thus the application of traditional methods cannot be considered as reliable. At the same time Guidelines stress that application of the transactional profit methods should not be misused on the basis of a fact, that data concerning uncontrolled transaction are limited. Also, the document provides advice for tax authorities not to misuse these methods based on the fact, that enterprise receives lower than average or higher than average profits as it will cause under-taxing or over-taxing of the businesses. By OECD is not forbidden application of other methods, which are not described by OECD, if it is needed to satisfy arm's length standard. Such alternative methods should not be used to substitute

OECD-defined methods and must be supported by relevant explanation why OECD-recognised method was not used (OECD, 2010).

It is not required to use more than one method, since different transfer pricing methods may lead to different results, however for difficult cases flexible approach may be used, which means conjunction of different methods can be applied in order to reach the conclusion satisfying all parties involved (OECD, 2010).

Table 3.1. Methods of transfer pricing applicable to types of property

<b>Type of property</b>	<b>OECD countries</b>	<b>USA</b>
Tangible goods	CUP, Resale Price, Cost Plus, TNMM, Transactional Profit Split	CUP, Resale Price, Cost Plus, CPM, Profit Split, and unspecified methods
Intangible goods	CUP, Resale Price, Cost Plus, TNMM, Transactional Profit Split	Comparable Uncontrolled Transaction (CUT), CPM, Profit Split, and unspecified methods
Services	CUP, Resale Price, Cost Plus, TNMM, Transactional Profit Split	Services Cost, Comparable Uncontrolled Services Price, Gross Services Margin, Cost of Services Plus, CPM, Profit Split, and unspecified methods
Transfers to CSAs	CUP, Resale Price, Cost Plus, TNMM, Transactional Profit Split	CUT, Income, Acquisition Price, Market Capitalization, Residual Profit Split and unspecified methods

Source: OECD, 2010; Ernst & Young, 2016

### **3.2 Comparable uncontrolled price method**

CUP method is the one, which has a priority over all others under the OECD Guidelines. Under CUP method price of property or services used in controlled transaction is compared to the price in uncontrolled transaction. For an acceptable comparison can be taken transactions between unrelated companies as well as between the examined MNE enterprise and independent company. Any differences between these prices may indicate, that transaction does not meet arm's length standard. Direct comparison is made when material circumstances of the case are the same. When transactions have differences, which could cause material effect on the pricing, reasonable accurate adjustments should be made. Even minor differences may cause change of the price in the businesses of certain nature. So, while comparing transactions, attention should be paid not only to similarity of products or services transferred, but to the functions of the companies involved (OECD, 2010).

### 3.3 Resale price method

Resale price method starts with a price at which property obtained from affiliated party is resold to the independent company. This price is then decreased by the resale price margin (gross margin) and received amount is considered as transfer price for the examined transaction. Thus, for arm's length test resale price margins are compared. As appropriate comparable transaction can be used other uncontrolled transactions of the inspected reseller as well as comparable transactions between independent enterprises. The same as for the CUP method OECD Guidelines state, that direct comparison can be made in case of no differences which could have material effect on the gross margin, either if such differences took place, accurate adjustments should be made. Nevertheless, under CUP method commonly adjustments are more required. It is stressed, that in comparing gross margins, differences in products have smaller effect than in comparing prices. In contrast, other attributes of comparability will receive higher weight. Functions performed by the enterprises, strategies followed by the management, risks taken – all those factors will have increased effect on resale margins in compared transactions. Other invocations for usage of this method is time, which passed between purchase of property by reseller and selling of that property to the third party, since the longer time passed, the higher is likelihood of changing commercial circumstances in the market. Substantial contribution of the reseller also makes comparison more problematic, considering the fact, that final price now should include contribution of both affiliated parties to the finished product. Any special arrangements, like exclusive rights to sell, which frequently take place between associated companies, may also affect resale prices charged (OECD, 2010).

### 3.4 Cost plus method

In cost plus method arm's length price is calculated by adding appropriate cost plus mark up to the aggregated costs of goods sold bared by the associated entity. As comparable transactions can be used uncontrolled transactions of the examined supplier, as well as uncontrolled transactions between independent parties. Priority is given to the first technique (OECD, 2010).

The same as in CUP and resale price method, comparison can be made directly between transactions if there are no material differences between them, or, if such differences exist, after reasonable accurate adjustments. Similarly to resale price method, cost plus method requires fewer adjustments and in majority of cases, they are concerned not type of the product, but functions performed by the parties, risks undertaken, specifics in costs accounting, business circumstances in which compared entities function. It is acceptable not to make adjustments to the compared mark ups if differences are caused by efficiencies and inefficiencies of the entities, which is commonly reflected through supervisory, general and administrative expenses (OECD, 2010).

In this method given a detailed explanation of costs, taken into the account for the calculation of arm's length price. They include direct costs of producing goods or services, indirect costs closely related to the final products or services traded and operating expenses. It is stressed that cost plus method uses mark ups computed only after direct and indirect production costs. In order to evaluate historical costs which faced certain changes within the period examined (i.e. raw materials, labour, transportation), it is admissible to use their average values. Companies using this method may affect the prices by making agreements of bearing certain supply or purchase costs by one of the parties. Thus, in such situations more comprehensive examination of functions performed by each enterprise is required (OECD, 2010).

Also in some cases producers of goods or services may use only marginal costs (variable costs) claiming that their goods cannot be sold at foreign market at a higher price. For justification of this approach other transactions of similar product in that market held by the examined company should be inspected (OECD, 2010).

OECD Guidelines provides some types of the transactions where it will be the most appropriate to use cost plus method, such as providing services, trading of semi-finished goods, where affiliated companies have joint facilities or long-term buy-and-supply agreements and to research and development projects handled by associated enterprises (OECD, 2010).

### **3.5 Transactional net margin method**

This method examines the net profit relative to the particular base, such as assets, costs, sales, etc. The method is similar to the cost plus and resale price methods. For arm's length test it is preferable to make a comparison of net profit indicator between inspected entity and independent one. Even though if such an internal comparable is not available, the similar transaction between unrelated companies can be used. Transactional net margin method is allowed to be used if it is clearly defined, that only one partner makes a unique valuable contribution in respect to the examined transaction. If both parties have significant unique impact, it is advised to use transactional profit split method. At the same time Guidelines stress, that lack of unique contribution involved, does not mean, that transactional net margin method is the one, which reflects arm's length. Transactional net margin approach can be used for individual and aggregated transactions (OECD, 2010).

OECD Guidelines provide the analysis of strength and weaknesses of the method. Brief review on those strong and weak points of the method are presented in the Table 3.2.

Table 3.2. Transactional net margin method: strengths and weaknesses

<b>Strengths</b>	<b>Weaknesses</b>
Net profit indicators used by the method are less affected by differences in transactions, for example particular differences in functions performed by the companies.	It is required to provide detailed guidance on comparability, which will need more detailed examination of other entities likewise factors, which may have influenced net profit indicators, while having less impact on price or gross margins.
In some countries data about net profit margins is more available for the checking authorities.	In order to apply this method to related party an enterprise may need some insights about profits attributable to similar uncontrolled transactions. It is likely that such a data will not be available to the entity in the period when transaction occurs, yet controlling authorities may have more information regardless such transactions from other taxpayers.
Procedure of the testing is simplified by the fact, that only one party is examined, thus, there is no need to examine all inter-related parties and impact of their activities.	When only one of the associated parties is tested, the factors, which do not have impact on transfer pricing, but do have it on net profits may be omitted.
	Under transactional net margin approach it can be difficult to reckon relevant adjustment. Typically, it occurs when it is arduous to trace back a transfer price, like in case of trading when both affiliated enterprises buying and selling from and to each other.

Source: OECD, 2010

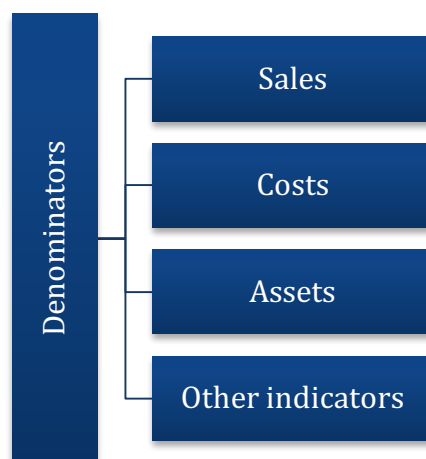
One of the stages for transactional net margin method application, the same as for other methods, is comparability analysis. For a comparison of the controlled and uncontrolled transactions measurement consistency should be assured. There is a following pattern taking into the account for inspection: prices are affected by differences in products, gross margins by differences in functions of the entities, while net profits – by neither of them. For net profits criteria of higher impact will be the sector of the economy in which enterprises operate (because different sectors have different levels of profitability), competitive position on the market, fixed costs absorption, structure of the costs, threat of new entrants to the market, effi-

ciency of the management, business strategy, availability of substitutes in the market, cost of capital, stage in the business life-cycle (OECD, 2010).

In order to determine the most appropriate net profit indicator it is required to compute net profit and further its weighting. To net profit can be included only items of operating nature which directly or indirectly are related to the controlled transaction. Costs and revenues not attributable to the transaction must be excluded the same as non-operating, exceptional and extraordinary items. There are some exceptions to this rule, depending on circumstances of the case or undertaking risks by parties, but generally those figures would be rather excluded. OECD Guidelines also review some specific elements which may impact net profits and, thus, should be reflected in calculations. Such elements include: special credit terms which have an influence on sales prices, foreign exchange gains and losses and any hedging performed by an examined company (if they are of trading nature, borne by a tested party), receiving advance payments. Start-up and termination costs inclusion is a subject of evaluation for every particular case. Some specifications of accounted items between compared enterprises (for example amortization and depreciation) also remain a subject to the decision whether include them or not into calculation of the net profit, which depends on individual circumstances of the case and their influence on net profit (OECD, 2010).

Next important step is to choose denominator for weighting net profit. It should reveal risk allocation and at the same time it ought to have high level of independence from controlled transaction. The last criterion means, that it would be valueless to weight net profit against costs or revenues controlled by the associated company, as those items are part of what needs to be tested for consistency with arm's length (OECD, 2010).

The following weights are suggested for use in the calculation of net profit indicators:



Net profit divided by sales, or net profit margin, is to be used for purchases made with resale purposes. Uncontrolled activities should not be included into the calculations, unless they are closely linked to the transaction either immaterial for the comparison. Also, the same accounting principles should be applied to dis-

counts, rebates, foreign exchange gains and losses in tested company and comparable one (OECD, 2010).

Net profit is weighted to costs in cases when those costs represent a value of functions performed, risks undertaken by parties and specific assets used. It is considered appropriate to use actual, standard or budgeted costs, depend on circumstances of the particular businesses and ability to track those costs or make precise estimations (in case of budgeted costs). In most situations only operating costs attributable to the transaction are to be taking into the account (OECD, 2010).

Net profit is weighted to assets in asset-intensive activities and in capital-intensive financial activities. Mostly operating assets should be used for computation (operating fixed assets, operating intangible assets, operating capital assets), for financial activities investments and cash balances are also used. It is up to the subjective judgment which exactly value of the asset to use. In light of different factors book value, adjusted book value, market value or any other possible valuation may produce the most reliable result (OECD, 2010).

In specific cases Guidelines allow to user other independent denominators, certainly if such a data can be obtained for a reliable comparable transaction. As such other indicators can be used number of employees, time, distance, weight of products, etc. (OECD, 2010).

### 3.6 Berry ratios

In 2010 another indicator for a proper transfer pricing testing was added by OECD – Berry ratio. It is named after American economist Charles Berry, who first used it for transfer pricing purposes. The ratio was recognised in the US transfer pricing legislation from the early 1990s (PricewaterhouseCoopers, 2014).

Berry ratio calculated as following:

$$\text{Berry Ratio} = \frac{\text{Gross Profit}}{\text{Operating Expenses}}$$

For its application required proportionality between functions performed and operating expenses, controlled enterprise should not perform significant functions, functions performed should not be materially affected by the value of products. Berry ratio is also sensitive to the classification of the expenses performed by the companies. It is most used when affiliated company perform intermediary or resale activities, especially between other companies from the same MNE group. This indicator may be in use when resale price method is inappropriate to apply due to the absence of uncontrolled transactions (OECD, 2010). Despite the logic of the method and its inclusion to OECD Guidelines, it often requires additional reasoning for proving legitimacy of its application in front of checking authorities (PricewaterhouseCoopers, 2014).



### 3.7 Transactional profit split method

The transactional profit split method makes a division of profits (or losses) between enterprises involved in the transaction, aiming to eliminate the impact of factors which exists between associated companies and which would not affect independent enterprises. Profits are to be allocated at the same level as they would have been between independent enterprises engaged in the transaction. The same as net margin method it can be used for both: individual and aggregated transactions.

Strengths and weaknesses analysis provided by OECD is presented in the Table 3.3.

Table 3.3. Transactional profit split method: strengths and weaknesses

<b>Strengths</b>	<b>Weaknesses</b>
Can be used when both parties are highly involved into the object of a transaction and/or have unique valuable contribution to it.	Method is difficult to apply due to the fact that all participants in the transaction should be examined and it becomes challenging to obtain certain data from foreign affiliates.
Division of profits can be made on the basis of such an apportionment of independent enterprises. When external data is not available division can be made on the basis of evaluation of functions performed or risks undertaken.	When division of profits is made on the basis of comparison with independent enterprises involved in similar transaction for profit split method such an external data proved to be less sufficient, than for other methods.
The method can take into account unique, distinct conditions presented between associated enterprises and missed between independent ones.	Method require the same accounting practices towards revenues and costs from all affiliated companies (or if it is not the case – proper adjustments). Adjustments should be made about currencies as well.
Method examines both parties of the transaction and because of the special approach to the roles each company had, profits are divided in the way that neither of companies has extreme profit result.	Difficulties also occur with identifying operating costs related to the controlled transaction from costs arising from other activities.

Source: OECD, 2010

Transactional profit split approach should assure consistency in allocation of risks and in functional analysis of enterprises, determining profits and split factors, split approach and provide reliable measurements. Guidelines also state, that approach to key indicators in this method should be set beforehand of the transac-

tion and that enterprises should have sufficient argumentation regarded choosing transactional profit split method instead of any other (OECD, 2010).

There are various approaches which can be used for allocation of profit between enterprises involved into the transaction. Two of them are presented by OECD, however it is stressed that they are not exhaustive or mutually exclusive (OECD, 2010).

The first way is to carry contribution analysis, which is mainly based on functions performed by the companies, risks undertaken and other valuable contributions made by each party (OECD, 2010).

Another way is to perform residual analysis. It consists of two stages: first one – to divide profits related to the transfer of non-unique objects or functions of the transaction, second part – to divide residual profits based on specific factors affecting the case (OECD, 2010).

The first step in method application is to determine combined profits to be split, which reflect all profits gained by the affiliated companies in the controlled transaction. In order to find out the amount of combined profits one should start with identifying transactions to which the method is to be applied, then level of aggregation should be determined, parties taking part in the transaction should be spotted. Considering that accounting standards have high impact on the determination of the profits under this method, the accounts of the parties involved in the transaction should be put in the same system and currencies should be converted to one. It is conceded that under transactional profit split method can be used both, projected and actual profits - so-called, *ex ante* and *ex post* (OECD, 2010).

Then, allocation key for profit sharing should be specified. Two main criteria for allocation key are: it must be independent relatively to company's transfer pricing and it should be supported by information of the comparable transactions. Also, period which is taken into the account should be stated, because of time lags existing between activities performed and final value created. Allocation key can be set as a certain percentage or some variable. Generally, factors having the main impact on value creation in the transaction are chosen as a basis for profits distribution. Asset-based or capital-based allocation keys are used when parties mainly contribute to the transaction by their tangible or intangible assets or capital employed. Cost-based allocation keys can be used for activities which have solid interrelationship between certain expenses and profits (for some types of businesses it can be marketing or research and development expenses). It should be admitted, that for cost-based keys it is important that all related parties perform costs classification in the same manner (OECD, 2010).

In arm's length test for transactional profit split method comparable uncontrolled transactions ought to be used, however in cases when they are lacking, internal data is to be taken (OECD, 2010).

### 3.8 Comparable profits method

Due to the US regulations while profit split method assures allocation of profits between enterprises on the basis of their contribution, comparable profits method seeks profit distribution between associated parties on the basis of profit level indicators typical for the examined type of business activity under analogous circumstances between independent enterprises. Arm's length result is calculations are based on the amount of operating profit earned by tested party in a controlled transaction if its profit level indicator would be equal to profit level earned by the independent company in alike transaction (U.S. Government Publishing Office. 26 CFR § 1.482-5).

Profit level indicators should be derived from uncontrolled comparable transactions on the basis of multiple years' data (minimum of three years including taxable year). In addition, they cannot be based solely on internal data as it is considered not to be objective enough for transfer pricing purposes.

Profit level indicators may include:

- Return on capital employed

$$\text{Return on capital employed} = \frac{\text{Operating profit}}{\text{Operating assets}}$$

- Financial ratios:

$$\text{Ratio A} = \frac{\text{Operating profit}}{\text{Sales}}$$

$$\text{Ratio B} = \frac{\text{Gross profit}}{\text{Operating expenses}}$$

- Other indicators.

Special attention should be paid to the measurement of what is denominator in these indicators, accounting standards and applied classification differences between the companies may worsen reliability of comparable profit method (U.S. Government Publishing Office. 26 CFR § 1.482-5).

Under this method greater attention is paid resources employed, risks assumed and as a result – functions performed by the companies.

If any factors, differentiating tested and independent company, have material impact on the profit indicators, proper adjustments should be made (U.S. Government Publishing Office. 26 CFR § 1.482-5).

This method is often compared to TNMM (Wittendorff, 2010).

### 3.9 Comparable uncontrolled transaction method

Comparable uncontrolled transaction (CUT) method reconciles the transfer price charged in controlled transaction with comparable uncontrolled transaction. This method is in use for transfers of intangible property, thus, the main attention get type and similarity of the property, contractual terms and economic conditions (U.S. Government Publishing Office. 26 CFR § 1.482-5).

Comparability analysis for the intangible property under this method requires from the intangibles:

- Be used in the same industry or market, with the same products or services.
- Have similar net present value of benefits to be realized.

Lots of scrutiny require characteristics of intangibles, such as terms of the transfer and rights which receives a buyer, stage of development of product, additional post-purchase services to be received, uniqueness of the property, period of time for which it can be used, functions performed by the parties involved in the transaction, risks undertaken (U.S. Government Publishing Office. 26 CFR § 1.482-3).

Thus, comparable uncontrolled transaction method is such an alternative for comparable uncontrollable price method with a usage in transactions concerning intangible property and cost sharing arrangements and having accent on specifications of those transactions.

### 3.10 Services cost method

This method was first suggested by IRS and Treasury Department in 2006 as a replacement of simplified cost based method (IRS, 2007). Services cost method (SCM) is defined by IRS as a method for which “covered services” and low mark-up services can be charged at the cost level (IRS, 2013). Thus, service cost method checks if a price lies in arm’s length by reference to total costs of services provided with no mark-up.

The full list of the covered services is presented in the Appendix 3.1. As low mark-up services treated the services for which median comparable mark-up on total services cost is up to 7%. The method cannot be applied to services, which can contribute to key competitive advantage and receiving of which can be one of the factors of success or failure of the company. Treas. Reg. Sec. 1.482-9(b) also provides a list of excluded activities, to these services should not be applied services cost method (U.S. Government Publishing Office. 26 CFR § 1.482-9):

- Manufacturing
- Production
- Extraction, exploration, or processing of natural resources
- Construction
- Reselling, distribution, acting as a sales or purchasing agent, or acting under a commission or other similar arrangement

- Research, development, or experimentation
- Engineering or scientific
- Financial transactions, including guarantees
- Insurance or reinsurance.

Method also covers shared services arrangements between several companies. In case of those, total services costs should be allocated among the parties on the basis of reasonably anticipated benefits to be received by each of them.

In order to apply services cost method, it is crucially important that companies make detailed books of account and records of the costs related to the services.

In case of application the method to cost sharing arrangements, consistent allocation should be made within the years when the method is applied (U.S. Government Publishing Office. 26 CFR § 1.482-9).

### **3.11 Comparable uncontrolled services price method**

This method by its substance is very akin to CUP and CUT methods. It assures, that the sum of money charged for the services provided in the controlled transaction corresponds to the sum of money charged by non-related companies in similar circumstances. Immense effect on comparability will be made by the similarities between the services provided, intangible property used, differences in contractual terms and economic conditions of the enterprises. Adjustments should be made in case of some differences between controlled and uncontrolled transactions which could have material effect on the amount of money charged for the services. Reliability of the method decreases if material differences between transactions increase and reliable adjustments cannot be made (U.S. Government Publishing Office. 26 CFR § 1.482-9).

Main factors which require adjustments under comparable uncontrolled services price method are: quality of services, usage of intangibles, contractual terms, risks, any measurements of the provided services, i.e. quantity, duration, etc., geographic market, availability of substitutes on the market, additional arrangements between renderer and recipient (U.S. Government Publishing Office. 26 CFR § 1.482-9).

### **3.12 Gross services margin method**

Under gross services margin method transfer prices are reconciled regarding whether gross profit margins earned in controlled transactions are arm's length with gross profit margins earned in alike transactions between independent companies. This method is commonly in use when a controlled entity provides services for a transaction between associated and independent firms, when services provided to affiliated company in connection to another transaction, which will take place between this affiliated company and independent one or when two associat-

ed enterprises are involved in rendering services to the independent party (U.S. Government Publishing Office. 26 CFR § 1.482-9).

As a comparable transaction for this method can serve a transaction between tested company or other member of the same MNE group and independent one, which tested company provides with agent services or performs intermediary's functions. As such transactions are not applicable independent transactions may be used (U.S. Government Publishing Office. 26 CFR § 1.482-9).

Appropriate gross services profit is calculated as following:

$$\begin{aligned} & \textit{Gross services profit} \\ & = \textit{Uncontrolled price} \times \textit{Uncontrolled gross profit margin} \end{aligned}$$

If the examined enterprise performs agent or intermediary functions and there is applicable data from independent distributor, which earns the profit as a percentage of goods resold, this percentage can be used as uncontrolled gross services profit margin (U.S. Government Publishing Office. 26 CFR § 1.482-9).

Comparability under this method significantly depends on similarity of services provided, risks undertaken, usage of intangible property (if any), specific terms of the contract and geographic market. It is also stressed that material difference in degree of reliability of the method can be made by inconsistency in accounting practices of the controlled and independent entity (U.S. Government Publishing Office. 26 CFR § 1.482-9).

### 3.13 Cost of services plus method

Under cost of services plus method is assured that the prices in controlled and uncontrolled transaction are arm's length through the means of gross services profit mark-up earned by tested and independent enterprise. The most common is to use this method when a controlled entity provides services to other entities of the same MNE group as well as independent companies. Arm's length price in this method is represented by the sum of gross services profit and comparable transactional costs of the same controlled entity, where:

- Gross services profit is a result of multiplication of comparable transactional costs and gross services profit mark-up.
- Gross services mark-up is a percentage of comparable transactional costs in uncontrolled transaction.
- Comparable transactional costs are costs incurred for providing services, typically that are salaries, usage of materials and economic circumstances. They also include cost of acquiring tangible assets, which are used or transferred along with the services. In some cases it is not needed to include total costs which were bore in the process of rendering a service, subset of costs can be used (U.S. Government Publishing Office. 26 CFR § 1.482-9).

It is stressed in Regulations, that comparability under this method is essentially effected by similarity of services, duration and quantity of services, level of risks, usage of intangible property (if any) and contractual terms. The preference in arm's length test is given to transactions between the tested company and independent one, however when such transactions are not available – comparable transaction can be found between uncontrolled enterprises. Reliability of the method can be affected by cost structure, efficiency of the company, tax accounting period, differences in accounting practices between enterprises (U.S. Government Publishing Office. 26 CFR § 1.482-9). Generally, this method is not used for contingent-payment arrangements (U.S. Government Publishing Office. 26 CFR § 1.482-5).

### **3.14 Income method**

Income method is the first method to be reviewed, which is used only for such a specific type of transaction as cost sharing arrangement. Cost sharing arrangement (CSA) is an arrangement by which entities of a controlled MNE group share costs and risks occurred in a development process of shared intangible property on the basis of their reasonably anticipated benefits, so-called, RAB shares (U.S. Government Publishing Office, 2011).

Despite the fact, that such type of arrangements is common between international companies, the final regulations were released by the IRS not long ago, on 16 December 2011 new final regulations (Treas. Reg. Section 1.482-7) replaces temporary, which were in use from 5 January 2009 (Ernst & Young, 2011).

The income method makes the assessment if price is in line with arm's length standard in respect to best realistic alternative, which could be taken by the entity instead of being involved in a controlled transaction. Thus, comparable amount will be a present value of best feasible alternative for the entity involved in the controlled transaction. As best realistic alternative can be considered license deal with uncontrolled licensor, which will take all the responsibility of developing a particular intangible property. For another partner best realistic alternative will be to take all the risks for developing intangible asset and license it to an uncontrolled licensee. This method can be applied to CSA which involve only one Payee (entity which takes risks to develop an intangible asset). For CSA involving more than one Payee residual profit split method should be used (U.S. Government Publishing Office. 26 CFR § 1.482-7).

### **3.15 Acquisition price method**

This method applies CUP or CUT method in order to determine if the amount charged in a CSA is arm's length to the acquisition price for stock or asset of the entire entity or its portion (target) as a result of uncontrolled transaction. For arm's length test under this method used adjusted acquisition price, which is defined as a price of acquisition of the target increased by the amount of its liabilities

and decreased by the amount of its tangible assets (as well as other resources, rights and capabilities, which are not covered by platform contribution transaction) attributable to target on the date of the acquisition (U.S. Government Publishing Office. 26 CFR § 1.482-7).

### 3.16 Market capitalization method

Market capitalization method applies CUP or CUT method in order to determine if the amount charged in a CSA is arm's length on the basis of an average market capitalization of a controlled entity whose stocks are traded regularly on the established securities market (U.S. Government Publishing Office. 26 CFR § 1.482-7).

In this method:

- Average market capitalization is an average of daily market capitalizations over 60-days period (starting before the transaction and ending at the date of the transaction).
- Daily market capitalization is calculated only at days of active trade of the stocks of the company in the market and equal to:

$$\text{Daily Market Capitalization} = \text{Outstanding Shares} \times \text{Adjusted Closing Price}$$

Arm's length price is given as adjusted average market capitalization. Adjusted average market capitalization is computed as an average market capitalization increased by the amount of liabilities that controlled entity has on the date of a transaction and decreased by the amount of its tangible assets (as well as other resources, rights and capabilities, which are not covered by platform contribution transaction) (U.S. Government Publishing Office. 26 CFR § 1.482-7).

### 3.17 Residual profit split method

This method checks the allocation of aggregated operating profit or loss is arm's length with the regard to the contribution of the individual entity to that profit or loss. The share of contribution of each entity is determined on the basis of risks undertaken, functions performed and resources used. Arm's length charge is calculated as a present value of anticipated residual profits or losses decreased by market returns for routine contributions, operating cost contributions, cost contributions (U.S. Government Publishing Office, 2011).

### 3.18 Unspecified methods

By unspecified methods are generally understood methods, which are not described by the US Regulations but can evaluate whether the transaction is in line with arm's length standard. Such methods should be consistent with specified methods and general principles determined in Regulations. Unspecified methods should provide realistic comparison and reliability to such a comparison can be



reduced if it takes internal, rather than external data for arm's length testing (U.S. Government Publishing Office. 26 CFR § 1.482-9).

## 4 Arm's length principle application

### 4.1 Arm's length principle application for the companies reporting under US GAAP

According to Treas. Reg. Sec. 1.482-1 arm's length range can be derived from the outcomes of all uncontrolled comparables for which all material differences were identified and sufficient adjustments to eliminate the effect of those differences were applied.

In cases when there is no uncontrolled comparables available, the arm's length range is determined from the results of all uncontrolled comparables which possess similar level of comparability and reliability. It is advised valid statistical method to be applied for such results, which will lead to higher level of reliability. The aim is to achieve 75 percent probability of a result higher than the lower range of the range and 75 percent probability of a result lower than the upper end of the range.

Treasury regulations state, that interquartile range is a suitable statistical method to be applied in those cases, nevertheless any different statistical method is admitted if it provides more credible measure.

Interquartile range is determined as the range from the 25<sup>th</sup> to 75<sup>th</sup> percentile of the results of uncontrolled comparables (USTransferPricing, 26 CFR § 1.482).

For determination of arm's range for American companies Orbis database was used. It is a product of Bureau Van Dijk, which contains information of over 200 million private companies around the world. The database information is provided by regulatory and other sources.

The aim for the search was to define comparables for resale price method for motor vehicles dealers in the USA.

The search will be made only among very large and large companies (see Appendix 4.1 for examining inclusion criteria). All financial data from the database will be presented in USD, recalculated from the original currency by the respective exchange rate at the date of report: reports of American companies are presented in USD, reports prepared under IFRS reporting standards belong to companies of different countries of pan-European area, which have different currencies (i.e. GBP, EUR, etc.) and, thus, for the better comparison their data will also be presented in USD.

For the search of the companies reporting under US GAAP following filters in database were applied:

Location – United States of America.

Accounts type & availability – Local GAAP (under other categories fall companies reporting under IFRS and with "Accounting practice unknown", although it can be expected that American companies which were put in a category "Accounting practice unknown" make reports under US GAAP, however under current selection in this group were companies presenting limited financial data (consolida-

tion code – LF) and thus, they had very few financial indicators and could not be used for the further analysis).

Status – Active companies.

Industry – (4511) Sale of cars and light motor vehicles, (4519) Sale of other motor vehicles.

BvD Independence indicator – A+, A, A-.

As a complementary indicator for this filter should be used Ownership data, excluding companies, which have subsidiaries with share in them over 25%, which means that company is not independent by itself but also does not have own dependent subsidiaries.

Category of companies: Very large companies, Large companies.

Also by tax authorities are often used companies with unconsolidated accounts only (consolidation code U1), however for the particular search application of such a filter will significantly cut the number of comparables.

The screenshot shows the Orbis database search interface. At the top, there are navigation tabs: Search, Saved searches, Favourites, and History. Below this is a search bar with options for Grouped view, Alphabetical List, and Find a criterion. A sidebar on the left lists various filters such as Company name, Identification numbers, Status, Legal form, Year of incorporation, Location, Contact information, Industry, Intellectual property, Directors, Auditors & other advisors, and Ownership data. A second sidebar on the right lists filters like Financial data, Number of employees, Global ratios, National scores, Accounts type & availability, Stock data, Earnings estimates & brokers recommendations, Category of companies, Updated reports, Custom data, and All companies. Below the sidebar is a checkbox for 'Default home page'. The main area displays a 'SEARCH STRATEGY' table with 7 criteria and a resulting table of 8 companies. The search strategy table includes columns for criteria, 'Step result', and 'Search result'. The resulting table shows the total number of companies for each step and the final total of 8 companies.

Criteria	Step result	Search result
1. All active companies and companies with unknown situation	1,794,262	1,794,262
2. World region/Country/Region in country: United States of America	317,714	310,770
3. Accounting practice: Local GAAP (Generally Accepted Accounting Principles)	1,138,084	25,466
4. Status: Active companies	1,751,448	23,480
5. NACE Rev. 2 (Primary codes only): 4511 - Sale of cars and light motor vehicles, 4519 - Sale of other motor vehicles	31,867	22
6. BvD Independence indicator: A+, A, A-	169,336	8
7. Category of companies: Very large companies, Large companies	2,025,469	8
<b>TOTAL</b>		<b>8</b>

Boolean search: 1 And 2 And 3 And 4 And 5 And 6 And 7

Refresh

View list of results

BUREAU VAN DIJK

Picture 4.1. Selection procedure in Orbis database (USA)

Source: Orbis - Bureau van Dijk

The result of the search was the following:

+ Show search strategy											
Companies with edited data are displayed in blue Modify											
	Company name	Country ISO Code	NACE Rev. 2 Core code (4 digits)	Cons. code	Last avail. year	Operating revenue (Turnover) th USD Last avail. yr	Number of employees Last avail. yr	BvD Indic.	GUO - Name	Add	
1.	<input checked="" type="checkbox"/> <a href="#">AUTONATION INC</a>	US	4519	C1	2016	21,609,000	26,000	A+	AUTONATION INC		
2.	<input checked="" type="checkbox"/> <a href="#">CARMAX INC</a>	US	4519	C1	2015	15,149,675	22,429	A+	CARMAX INC		
3.	<input checked="" type="checkbox"/> <a href="#">GROUP 1 AUTOMOTIVE INC</a>	US	4519	C1	2016	10,887,612	13,500	A+	GROUP 1 AUTOMOTIVE INC		
4.	<input checked="" type="checkbox"/> <a href="#">ASBURY AUTOMOTIVE GROUP, INC.</a>	US	4519	C1	2016	6,527,800	7,900	A+	ASBURY AUTOMOTIVE GROU...		
5.	<input checked="" type="checkbox"/> <a href="#">CAMPING WORLD HOLDINGS, INC.</a>	US	4519	C1	2016	3,526,706	n.a.	A-			
6.	<input checked="" type="checkbox"/> <a href="#">KAR AUCTION SERVICES, INC.</a>	US	4519	C1	2016	3,150,100	17,400	A+	KAR AUCTION SERVICES, IN...		
7.	<input checked="" type="checkbox"/> <a href="#">AMERICA'S CAR-MART, INC.</a>	US	4519	C1	2016	506,517	1,420	A+	AMERICA'S CAR-MART, INC.		
8.	<input checked="" type="checkbox"/> <a href="#">HOLIDAY RV SUPERSTORES INC</a>	US	4519	C1	2002	77,879	171	A-	HOLIDAY RV SUPERSTORES ...		

Picture 4.2. Results of the selection procedure in Orbis database (USA)

Source: Orbis - Bureau van Dijk

Before more detailed analysis concerning profit margins earned by the companies, should be made more careful consideration whether they can be considered as comparables for benchmark in resale price method application.

Seven of these companies have as core US SIC code of their activity is 551 Motor vehicle dealers (new and used). However, the company HOLIDAY RV SUPERSTORES INC should be excluded from the analysis since its core activity is different (US SIC 556 Recreational vehicle dealers) and, in addition, its latest report date is - 31.12.2002, on the basis of this fact the Securities and Exchange Commission ("Commission") impose the sanctions on this entity and revoked its securities registration in order to protect the investors: company continued to trade its stocks on over-the-counter markets without reporting to the Commission (U.S. Securities and Exchange Commission, 2013).

CAMPING WORLD HOLDINGS, INC. has in its portfolio activities other than resale of vehicles, that is why its financial data needed to be adjusted and gross profit and sales values were taken only from sales of new and used vehicles. It was done by using data in their financial report, where the enterprise separately specified sales and gross profits for different categories of goods and activities. Respective part of Statement of Income and calculations are presented in Appendix 4.2.

For further examination peer analysis will be performed, in order to evaluate how close the remained seven companies are in terms of their financial position during the reviewed period.

In accordance with American transfer pricing experts, important indicators for resale price method include inventory levels, turnover rates, operating expenses, sales (Levey, Wrappe, Chung, 2007) For peer analysis will be including the following indicators: turnover, net income, cash flow, total assets, capital and operating profit margin (this indicator is less influenced by differences in functions and types of products) (UN, 2011).

Operating profit margin is calculated as following:

$$\text{Operating Profit Margin} = \frac{\text{EBIT}}{\text{Sales}}$$

Data for analysis was taken from Orbis database (Analysis - Peer analysis - Compare companies).

Table 4.1. Peer analysis of the American companies

2016						
Comparable companies	Turnover, th USD	Net Income, th USD	Cash flow, th USD	Total assets, th USD	Capital, th USD	Operating profit margin, %
AUTONATION INC	21 609 000	430 500	575 800	10 060 000	1 200	4,11%
CARMAX INC	15 149 675	623 428	760 788	14 459 911	97 356	4,32%
GROUP 1 AUTOMOTIVE INC	10 887 612	147 065	231 137	4 461 903	257	3,12%
ASBURY AUTOMOTIVE GROUP, INC	6 527 800	167 200	197 900	2 336 100	400	4,56%
CAMPING WORLD HOLDINGS, INC	3 526 706	191 661	216 356	1 563 765	195	8,01%
KAR AUCTION SERVICES, INC.	3 150 100	222 400	463 000	6 557 600	1 400	15,84%
AMERICA'S CAR-MART, INC.	506 517	11 556	15 764	406 296	527	-7,74%
2015						
Comparable companies	Turnover, th USD	Net Income, th USD	Cash flow, th USD	Total assets, th USD	Capital, th USD	Operating profit margin, %
AUTONATION INC	20 862 000	442 600	588 400	9 548 200	1 200	4,17%
CARMAX INC	14 268 716	597 358	712 531	13 198 201	104 435	4,39%
GROUP 1 AUTOMOTIVE INC	10 632 505	93 999	228 800	4 396 716	257	2,62%
ASBURY AUTOMOTIVE GROUP, INC	6 588 300	169 200	198 700	2 294 100	400	4,58%
CAMPING WORLD HOLDINGS, INC	3 333 261	178 530	202 631	1 338 105	-	7,34%
KAR AUCTION SERVICES, INC.	2 690 600	214 600	427 400	5 771 500	1 400	15,88%
AMERICA'S CAR-MART, INC.	472 569	29 450	33 280	399 897	527	-1,65%
2014						
Comparable companies	Turnover, th USD	Net Income, th USD	Cash flow, th USD	Total assets, th USD	Capital, th USD	Operating profit margin, %
AUTONATION INC	19 108 800	418 700	526 700	8 399 700	1 600	4,29%
CARMAX INC	12 574 299	492 586	594 497	11 707 157	110 843	3,91%
GROUP 1 AUTOMOTIVE INC	9 937 889	93 004	176 868	4 141 492	257	3,04%
ASBURY AUTOMOTIVE GROUP, INC	5 867 700	111 600	138 000	2 182 000	400	4,89%
CAMPING WORLD HOLDINGS, INC	2 673 953	125 156	149 757	1 163 168	-	6,92%
KAR AUCTION SERVICES, INC.	2 417 000	169 300	365 900	5 351 500	1 400	15,63%
AMERICA'S CAR-MART, INC.	434 504	21 089	24 374	363 297	525	-4,13%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

From the data in peer analysis can be stated, that AUTONATION INC and CARMAX INC are the largest companies from the selection, therefore, depend on the characteristics of the company to which resale price method should be applied for arm's length determination, they should be either excluded, either adjusted for increasing comparability. The same should be applied to AMERICA'S CAR-MART, INC, as an outsider in this list.

In accordance with Treasury Regulations for arm's length range determination under resale price method the reference to gross profit margin should be made (U.S. Government Publishing Office. 26 CFR § 1.482-3).

Gross profit margin is calculated as following:

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}}$$

Multiple year data will be used and average gross profit margin for 3 years will be computed.

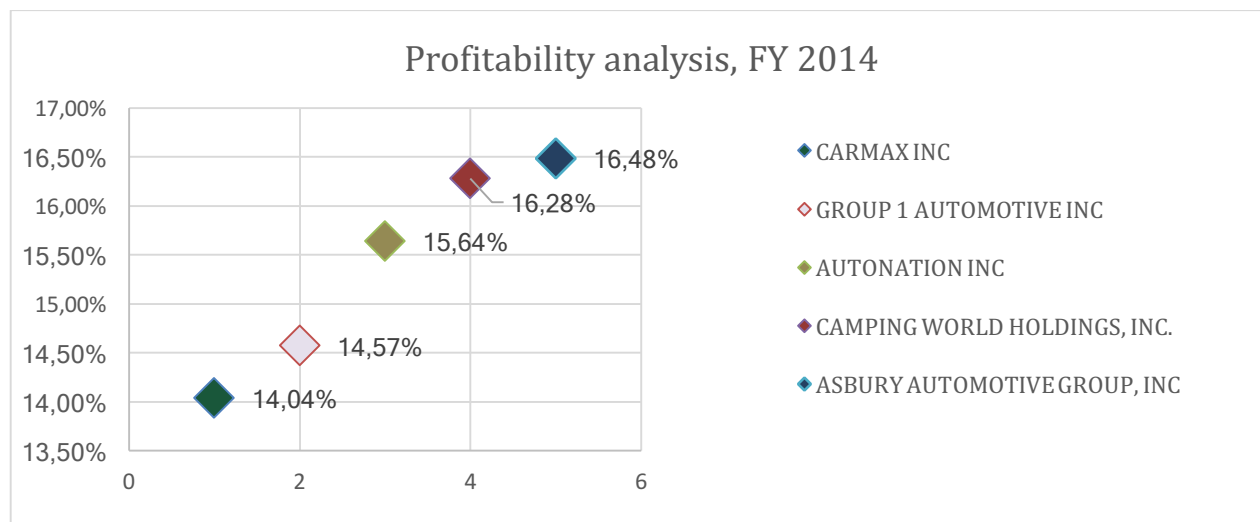
Table 4.2. Gross profit margin, FY 2014

<b>Comparable companies</b>	<b>Gross profit</b>	<b>Sales</b>	<b>Gross profit margin</b>
AUTONATION INC	2 988 700	19 108 800	15,64%
CARMAX INC	1 750 612	12 574 299	13,92%
GROUP 1 AUTOMOTIVE INC	1 447 938	9 937 889	14,57%
ASBURY AUTOMOTIVE GROUP, INC.	967 200	5 867 700	16,48%
KAR AUCTION SERVICES, INC.	1 045 700	2 417 000	43,26%
AMERICA'S CAR-MART, INC.	183 185	434 504	42,16%
CAMPING WORLD HOLDINGS, INC.	301 995	1 855 006	16,28%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

For further analysis under resale price method companies KAR AUCTION SERVICES, INC. and AMERICA'S CAR-MART, INC. will be excluded due to the specifications in their activities: KAR AUCTION SERVICES, INC. mainly provides auction services for used cars (Kar Auction Services, 2015) and AMERICA'S CAR-MART, INC. sells used autos only and in addition it performs supplementary services before automobiles resale (i.e. repairing, licensing, etc.), it must be also admitted, that around 13% of its sales are represented by wholesales to third parties, sales of service contracts and payments for protection plan (America's Car-Mart, 2016). Such additional activities have impact on their gross profit margins as presented in Table 4.2, Table 4.3, Table 4.4.

Chart 4.1. Profitability analysis, FY 2014



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

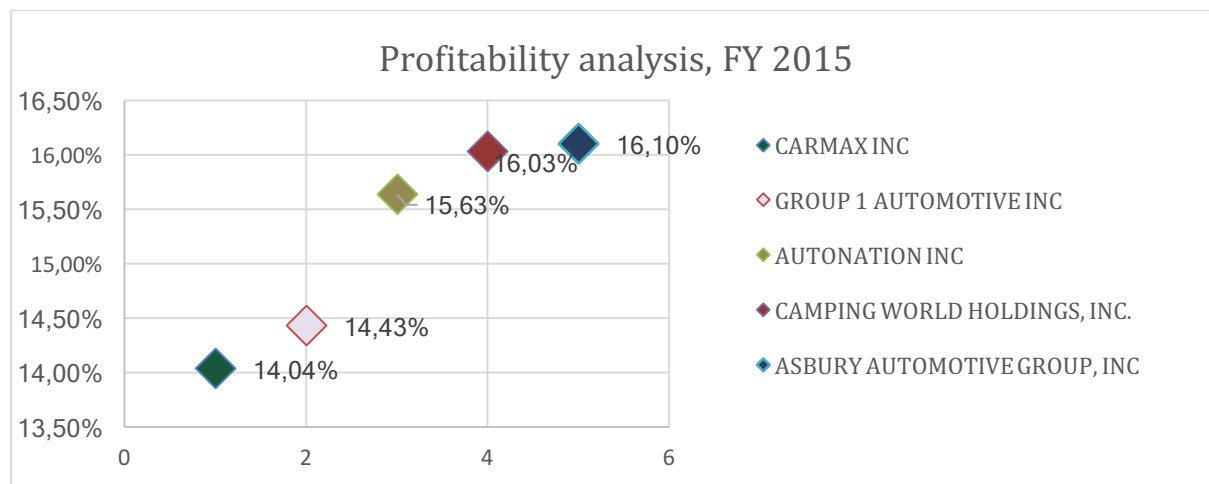
Gross profit margins for the year 2015 are presented in the Table 4.3.

Table 4.3. Gross profit margin, FY 2015

Comparable companies	Gross profit	Sales	Gross profit margin
AUTONATION INC	3 261 500	20 862 000	15,63%
CARMAX INC	2 002 700	14 268 716	14,04%
GROUP 1 AUTOMOTIVE INC	1 533 972	10 632 505	14,43%
ASBURY AUTOMOTIVE GROUP, INC.	1 060 800	6 588 300	16,10%
KAR AUCTION SERVICES, INC.	1 142 100	2 690 600	42,45%
AMERICA'S CAR-MART, INC.	200 123	472 569	42,35%
CAMPING WORLD HOLDINGS, INC.	386 772	2 412 864	16,03%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Chart 4.2. Profitability analysis, FY 2015



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

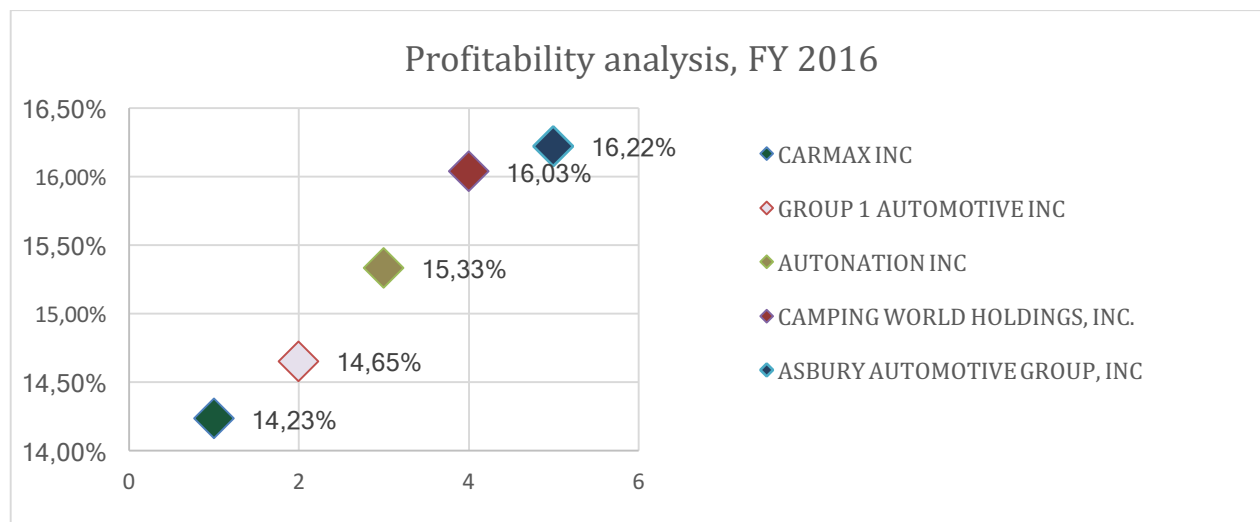
Table 4.4. Gross profit margin, FY 2016

Comparable companies	Gross profit	Sales	Gross profit margin
AUTONATION INC	3 313 200	21 609 000	15,33%
CARMAX INC	2 156 120	15 149 675	14,23%
GROUP 1 AUTOMOTIVE INC	1 595 069	10 887 612	14,65%
ASBURY AUTOMOTIVE GROUP, INC.	1 058 700	6 527 800	16,22%
KAR AUCTION SERVICES, INC.	1 322 700	3 150 100	41,99%
AMERICA'S CAR-MART, INC.	201 631	506 517	39,81%
CAMPING WORLD HOLDINGS, INC.	412 428	2 572 075	16,03%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies



Chart 4.3. Profitability analysis, FY 2016



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

As given by the IRS example calculations of multiple year data for resale price method average margin will be computed. Average margin will be calculated as general average as given by the Treasury Regulations example.

Table 4.5. Average gross profit margins for 3 years

Comparable companies	Gross profit margin 2014	Gross profit margin 2015	Gross profit margin 2016	Average margin
AUTONATION INC	15,64%	15,63%	15,33%	15,54%
CARMAX INC	13,92%	14,04%	14,23%	14,06%
GROUP 1 AUTOMOTIVE INC	14,57%	14,43%	14,65%	14,55%
ASBURY AUTOMOTIVE GROUP, INC.	16,48%	16,10%	16,22%	16,27%
CAMPING WORLD HOLDINGS, INC.	16,28%	16,03%	16,03%	16,11%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Some countries argue whether general or weighted average should be used, because in case of some fluctuations in business cycle, they would produce different average margin values (European Commission, 2016; Ernst & Young, 2015; Deloitte, 2015; KPMG, 2015). In case of significant increase or decrease in sales for some one year, ordinary average will produce a lower result comparatively to weighted average which is more sensitive to such changes.

In the studied period (2014-2016) there were no significant changes in vehicles selling industry and, thus both averages provide with approximately same results (Table 4.6).

Table 4.6. Comparison of gross profit averages for 3 years using ordinary and weighted average

Comparable companies	Average margin	Weighted average margin	Differences
AUTONATION INC	15,54%	15,53%	↑ 0,01%
CARMAX INC	14,06%	14,07%	↓ -0,01%
GROUP 1 AUTOMOTIVE INC	14,55%	14,55%	→ 0,00%
ASBURY AUTOMOTIVE GROUP, INC	16,27%	16,26%	↑ 0,01%
CAMPING WORLD HOLDINGS, INC	16,11%	16,10%	↑ 0,02%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

For calculation of arm's length range interquartile range (IQR) will be used. In accordance with IRS it is a range between 25<sup>th</sup> and 75<sup>th</sup> percentile (IRS, 2013).

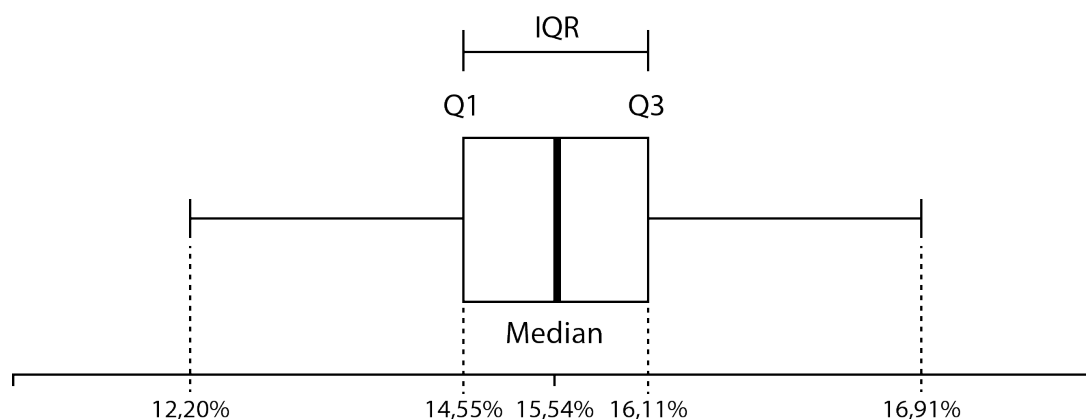
Thus, the values of quartiles and IQR are presented in the Table 4.7.

Table 4.7. Quartiles and IQR values

Value	2016	2015	2014	Average
Minimum value	14,23%	14,04%	13,92%	14,06%
Q1(25th percentile)	14,65%	14,43%	14,57%	14,55%
Median	15,33%	15,63%	15,64%	15,54%
Q3 (75th percentile)	16,03%	16,03%	16,28%	16,11%
Maximum value	14,65%	14,43%	14,57%	14,55%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

So, within the period 2014-2016 the arm's length range for profit margin for vehicle dealers lies between 14,55% and 16,11%.



Picture 4.3. Arm's length range for the companies reporting under US GAAP, FY 2014-2016

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

## 4.2 Arm's length principle application for the companies reporting under IFRS

For the calculation of arm's length range in IFRS countries was also used Orbis database with the filtering of the following characteristics:

- Location – European Union [28], Norway, Switzerland
- Accounts type & availability – IFRS
- Status – Active companies
- Industry – (4511) Sale of cars and light motor vehicles, (4519) Sale of other motor vehicles
- Category of companies: Very large companies, Large companies.
- BvD Independence indicator – A+, A, A-
- Ownership data: exclude subsidiaries (thus, the companies presented in a list do not have subsidiaries either if they do, the share in such a subsidiary is not higher than 25%).
- Consolidation code: U1 (companies with unconsolidated accounts only).

Some missing data was also taken from financial statements presented by the companies at their websites.

Selection of the region, so-called pan European area, was made on the basis of benchmark studies, which support the hypothesis that this area can be considered as one market area for the purpose of transfer pricing (European Commission, 2004, 2016).

The screenshot shows the Orbis database search interface. At the top, there are navigation tabs for Search, Saved searches, Favourites, and History. Below this is a search bar with a 'Find a criterion' button and a text input field. The main area is divided into two columns of expandable menu items. The left column includes: Company name, Identification numbers, Status, Legal form, Year of incorporation, Location, Contact information, Industry, Intellectual property, Directors, Auditors & other advisors, and Ownership data. The right column includes: Financial data, Number of employees, Global ratios, National scores, Accounts type & availability, Stock data, Earnings estimates & brokers recommendations, Category of companies, Updated reports, Custom data, and All companies. Below the menus is a 'Default home page' checkbox. The 'SEARCH STRATEGY' section is highlighted in blue and contains a list of 9 criteria with checkboxes and a 'TOTAL : 62' result count. The criteria are: 1. All active companies and companies with unknown situation (1,799,134); 2. World region/Country/Region in country: European Union [28], Norway, Switzerland (636,349); 3. Accounting practice: IFRS (International Financial Reporting Standards) (98,112); 4. Status: Active companies (1,756,255); 5. NACE Rev. 2 (Primary codes only): 4511 - Sale of cars and light motor vehicles, 4519 - Sale of other motor vehicles (31,944); 6. BvD Independence indicator: A+, A, A- (169,733); 7. Category of companies: Very large companies, Large companies (2,030,200); 8. Consolidation code: U1 (companies with unconsolidated accounts only) (993,075); 9. Exclude subsidiaries: Def. of the UO: min. path of 50.01%, known or unknown shareh. Subs. owned by a company included in the group that are GUO or shareh. (min 25, max 100); (incl. subs. with unknown %) (62). At the bottom of the search strategy section, there is a 'Boolean search' field with the text '9 From (1 And 2 And 3 And 4 And 5 And 6 And 7 And 8)', a 'Refresh' button, and a 'View list of results' button. The footer of the interface reads 'BUREAU VAN DIJK'.

Picture 4.4. Selection procedure in Orbis database (pan-European area)

Source: Orbis - Bureau van Dijk

The result of the search was presented by 62 companies, several companies, which appeared in the search, however, presented limited financial information, which did not include data about their sales activities and they will have to be excluded from the further comparison.

For the analysis three last available years would be examined: the period from 2013 till 2015.

Peer analysis for the years 2013 – 2015 is presented in Appendix 4.3. On the basis of peer analysis information it should be admitted, that companies CARCLASSE - COMÉRCIO DE AUTOMÓVEIS, S.A. and VEHINTER SA have turnover, cash flow and total assets more than 100% higher than average value for the companies of this group, thus, for further determination of arm's length range these companies will be excluded.

In accordance with OECD Guidelines resale price method is applied by the reference to resale price margin (OECD, 2010).

$$\text{Resale Price Margin} = \text{Sales} - \text{COGS}$$

Which can be also expressed as relative value from sales and thus, is identical to gross profit margin calculated under US GAAP.

It should be stressed, that majority of companies selected for benchmark are from Spain and Portugal, where it is more common to use legal compliance accounting model (Continental European model). Consequently, information concerning cost of sales and profit margin is not reflected in their financial statements

and would be estimated on the basis of values presented in financial statements prepared with usage of full disclosure model (Anglo-Saxon or Anglo-American model) by the companies of the same size, operating in the same industry and at the same period of time (Appendix 4.4).

In the same fashion estimation of cost of sales is done for the selected companies, received values and computed resale price margin are presented in the Tables 4.8-4.10.

Table 4.8. Resale price margin, FY 2013

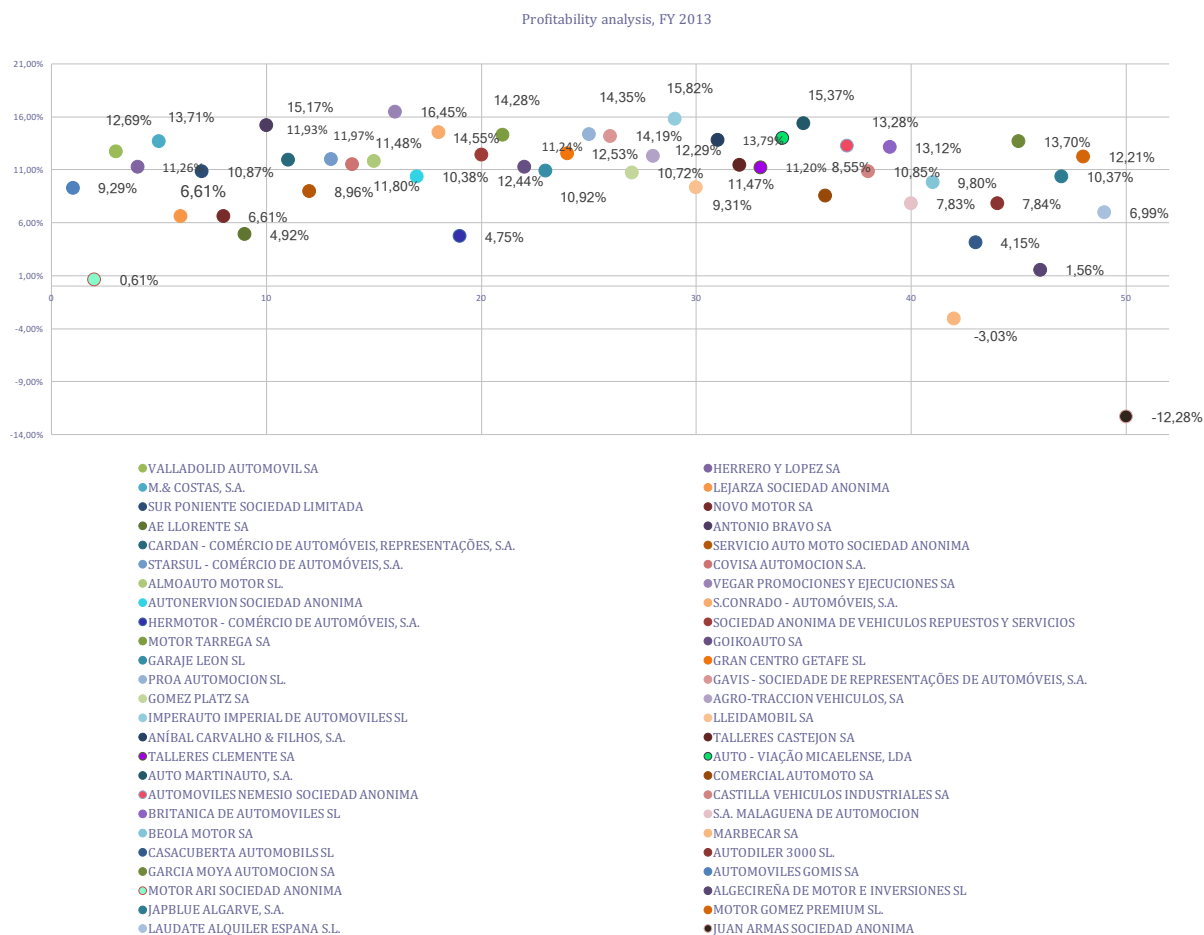
<b>Comparable companies</b>	<b>COGS</b>	<b>Sales</b>	<b>Resale price margin</b>
AUTOMOVILES GOMIS SA	48 647	44 126	9,29%
MOTOR ARI SOCIEDAD ANONIMA	42 970	42 706	0,61%
VALLADOLID AUTOMOVIL SA	42 804	37 373	12,69%
HERRERO Y LOPEZ SA	35 207	31 243	11,26%
M.& COSTAS, S.A.	35 086	30 276	13,71%
LEJARZA SOCIEDAD ANONIMA	32 157	30 030	6,61%
SUR PONIENTE SOCIEDAD LIMITADA	31 632	28 194	10,87%
NOVO MOTOR SA	26 009	24 290	6,61%
AE LLORENTE SA	24 223	23 032	4,92%
ANTONIO BRAVO SA	23 179	19 663	15,17%
CARDAN - COMÉRCIO DE AUTOMÓVEIS, REPRESENTAÇÕES, S.A.	22 993	20 251	11,93%
SERVICIO AUTO MOTO SOCIEDAD ANONIMA	21 818	19 863	8,96%
STARSUL - COMÉRCIO DE AUTOMÓVEIS, S.A.	21 862	19 244	11,97%
COVISA AUTOMOCION S.A.	20 766	18 381	11,48%
ALMOAUTO MOTOR SL.	20 524	18 102	11,80%
VEGAR PROMOCIONES Y EJECUCIONES SA	20 414	17 056	16,45%
AUTONERVION SOCIEDAD ANONIMA	20 351	18 238	10,38%
S.CONRADO - AUTOMÓVEIS, S.A.	19 899	17 004	14,55%
HERMOTOR - COMÉRCIO DE AUTOMÓVEIS, S.A.	17 653	16 815	4,75%
SOCIEDAD ANONIMA DE VEHICULOS REPUESTOS Y SERVICIOS	19 052	16 682	12,44%
MOTOR TARREGA SA	19 125	16 394	14,28%
GOIKOAUTO SA	17 394	15 438	11,24%

GARAJE LEON SL	17 233	15 350	10,92%
GRAN CENTRO GETAFE SL	16 573	14 496	12,53%
PROA AUTOMOCION SL.	16 420	14 064	14,35%
GAVIS - SOCIEDADE DE REPRESENTAÇÕES DE AUTOMÓVEIS, S.A.	16 402	14 074	14,19%
GOMEZ PLATZ SA	15 745	14 057	10,72%
AGRO-TRACCION VEHICULOS, SA	16 047	14 075	12,29%
IMPERAUTO IMPERIAL DE AUTOMOVILES SL	15 072	12 688	15,82%
LLEIDAMOBIL SA	14 440	13 095	9,31%
ANÍBAL CARVALHO & FILHOS, S.A.	14 987	12 920	13,79%
TALLERES CASTEJON SA	14 241	12 607	11,47%
TALLERES CLEMENTE SA	14 158	12 572	11,20%
AUTO - VIAÇÃO MICAELENSE, LDA	14 056	12 089	14,00%
AUTO MARTINAUTO, S.A.	13 848	11 720	15,37%
COMERCIAL AUTOMOTO SA	12 796	11 702	8,55%
AUTOMOVILES NEMESIO SOCIEDAD ANONIMA	12 221	10 598	13,28%
CASTILLA VEHICULOS INDUSTRIALES SA	11 787	10 508	10,85%
BRITANICA DE AUTOMOVILES SL	12 069	10 485	13,12%
S.A. MALAGUENA DE AUTOMOCION	11 662	10 749	7,83%
BEOLA MOTOR SA	11 419	10 300	9,80%
MARBECAR SA	9 570	9 860	-3,03%
CASACUBERTA AUTOMOBILS SL	10 087	9 669	4,15%
AUTODILER 3000 SL.	10 703	9 864	7,84%
GARCIA MOYA AUTOMOCION SA	10 917	9 421	13,70%
ALGECIREÑA DE MOTOR E INVERSIONES SL	10 033	9 877	1,56%
JAPBLUE ALGARVE, S.A.	10 846	9 721	10,37%
MOTOR GOMEZ PREMIUM SL.	10 480	9 201	12,21%
LAUDATE ALQUILER ESPANA S.L.	6 401	5 954	6,99%
JUAN ARMAS SOCIEDAD ANONIMA	4 087	4 589	-12,28%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Some companies have negative profit margins, one of them (MARBECAR SA) at the same time declared profits. This fact can be explained that profit margin reflects the relationship between income and costs, and these companies happen to have higher cost of sales than income from sales.

Chart 4.4. Profitability analysis, FY 2013



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Table 4.9. Resale price margin, FY 2014

Comparable companies	COGS	Sales	Resale price margin
MOTOR ARI SOCIEDAD ANONIMA	49 053	55 032	10,87%
VALLADOLID AUTOMOVIL SA	40 232	45 391	11,36%
AUTOMOVILES GOMIS SA	38 790	43 760	11,36%
HERRERO Y LOPEZ SA	33 871	37 948	10,74%
M.& COSTAS, S.A.	32 080	36 563	12,26%
LEJARZA SOCIEDAD ANONIMA	28 262	29 638	4,64%
SUR PONIENTE SOCIEDAD LIMITADA	25 909	28 436	8,89%
GARAJE LEON SL	23 713	25 477	6,92%
CARDAN - COMÉRCIO DE AUTOMÓVEIS,	22 934	26 442	13,27%

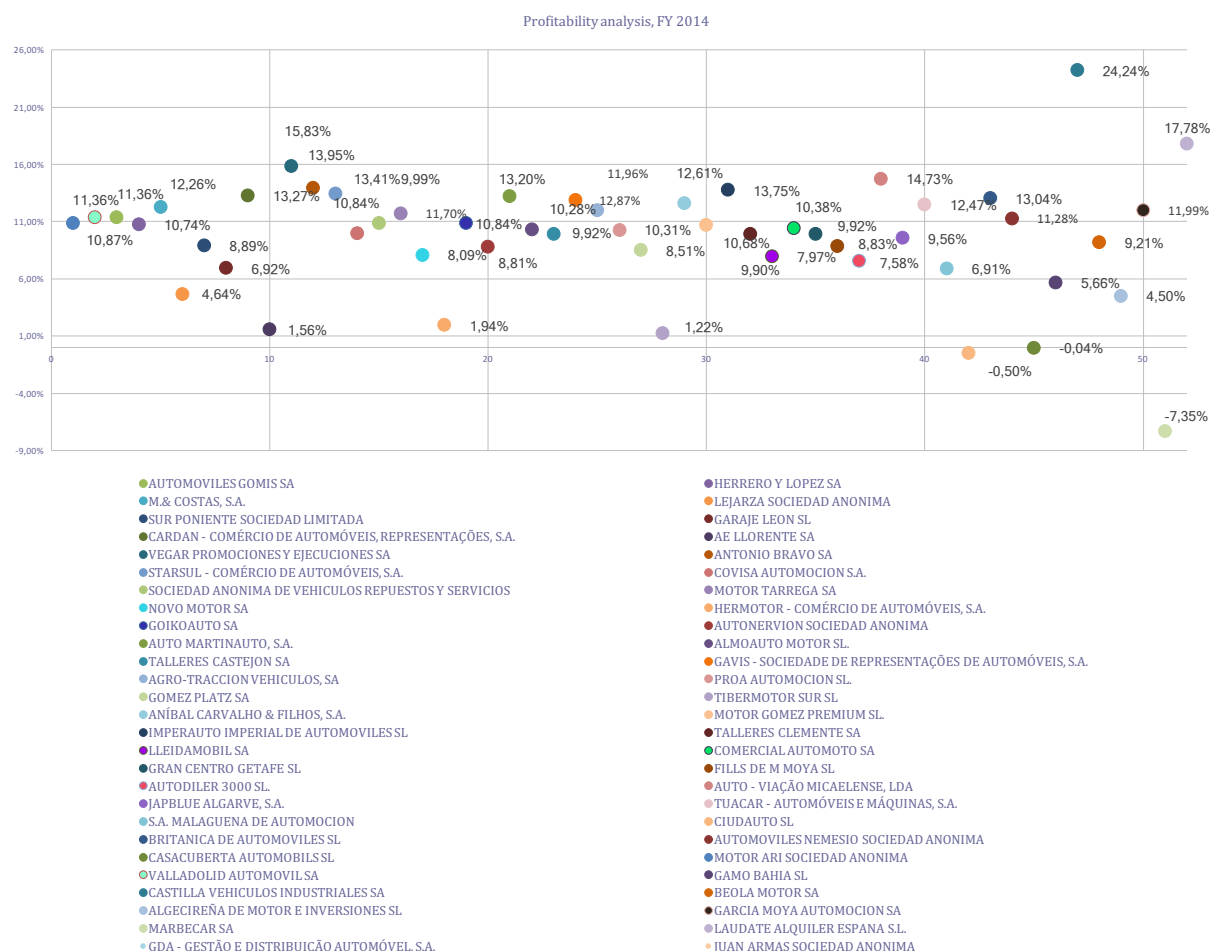
REPRESENTAÇÕES, S.A.			
AE LLORENTE SA	22 261	22 613	1,56%
VEGAR PROMOCIONES Y EJECUCIONES SA	19 608	23 295	15,83%
ANTONIO BRAVO SA	19 070	22 163	13,95%
STARSUL - COMÉRCIO DE AUTOMÓVEIS, S.A.	19 317	22 309	13,41%
COVISA AUTOMOCION S.A.	19 571	21 743	9,99%
SOCIEDAD ANONIMA DE VEHICULOS REPUESTOS Y SERVICIOS	19 111	21 435	10,84%
MOTOR TARREGA SA	18 540	20 996	11,70%
NOVO MOTOR SA	18 797	20 450	8,09%
HERMOTOR - COMÉRCIO DE AUTOMÓVEIS, S.A.	17 953	18 308	1,94%
GOIKOAUTO SA	17 364	19 475	10,84%
AUTONERVION SOCIEDAD ANONIMA	17 818	19 539	8,81%
AUTO MARTINAUTO, S.A.	16 216	18 682	13,20%
ALMOAUTO MOTOR SL.	15 858	17 675	10,28%
TALLERES CASTEJON SA	15 600	17 318	9,92%
GAVIS - SOCIEDADE DE REPRESENTAÇÕES DE AUTOMÓVEIS, S.A.	15 415	17 693	12,87%
AGRO-TRACCION VEHICULOS, SA	15 049	17 093	11,96%
PROA AUTOMOCION SL.	14 868	16 577	10,31%
GOMEZ PLATZ SA	14 753	16 125	8,51%
TIBERMOTOR SUR SL	15 879	16 075	1,22%
ANÍBAL CARVALHO & FILHOS, S.A.	14 027	16 051	12,61%
MOTOR GOMEZ PREMIUM SL.	14 047	15 726	10,68%
IMPERAUTO IMPERIAL DE AUTOMOVILES SL	13 507	15 660	13,75%
TALLERES CLEMENTE SA	13 904	15 432	9,90%
LLEIDAMOBIL SA	13 330	14 485	7,97%
COMERCIAL AUTOMOTO SA	12 010	13 402	10,38%
GRAN CENTRO GETAFE SL	11 958	13 275	9,92%
FILLS DE M MOYA SL	11 277	12 370	8,83%
AUTODILER 3000 SL.	11 385	12 319	7,58%
AUTO - VIAÇÃO MICAELENSE, LDA	10 533	12 353	14,73%
JAPBLUE ALGARVE, S.A.	10 982	12 143	9,56%
TUACAR - AUTOMÓVEIS E MÁQUINAS, S.A.	10 557	12 062	12,47%
S.A. MALAGUENA DE AUTOMOCION	10 878	11 686	6,91%
CIUDAUTO SL	11 307	11 251	-0,50%
BRITANICA DE AUTOMOVILES SL	9 820	11 293	13,04%
AUTOMOVILES NEMESIO SOCIEDAD ANONIMA	9 849	11 101	11,28%



CASACUBERTA AUTOMOBILS SL	9 879	9 876	-0,04%
GAMO BAHIA SL	9 736	10 320	5,66%
CASTILLA VEHICULOS INDUSTRIALES SA	8 123	10 721	24,24%
BEOLA MOTOR SA	9 647	10 625	9,21%
ALGECIREÑA DE MOTOR E INVERSIONES SL	9 230	9 665	4,50%
GARCIA MOYA AUTOMOCION SA	9 178	10 429	11,99%
MARBECAR SA	9 209	8 578	-7,35%
LAUDATE ALQUILER ESPANA S.L.	4 948	6 018	17,78%
GDA - GESTÃO E DISTRIBUIÇÃO AUTOMÓVEL, S.A.	4 384	5 593	21,61%
JUAN ARMAS SOCIEDAD ANONIMA	4 196	4 426	5,20%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Chart 4.5. Profitability analysis, FY 2014



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

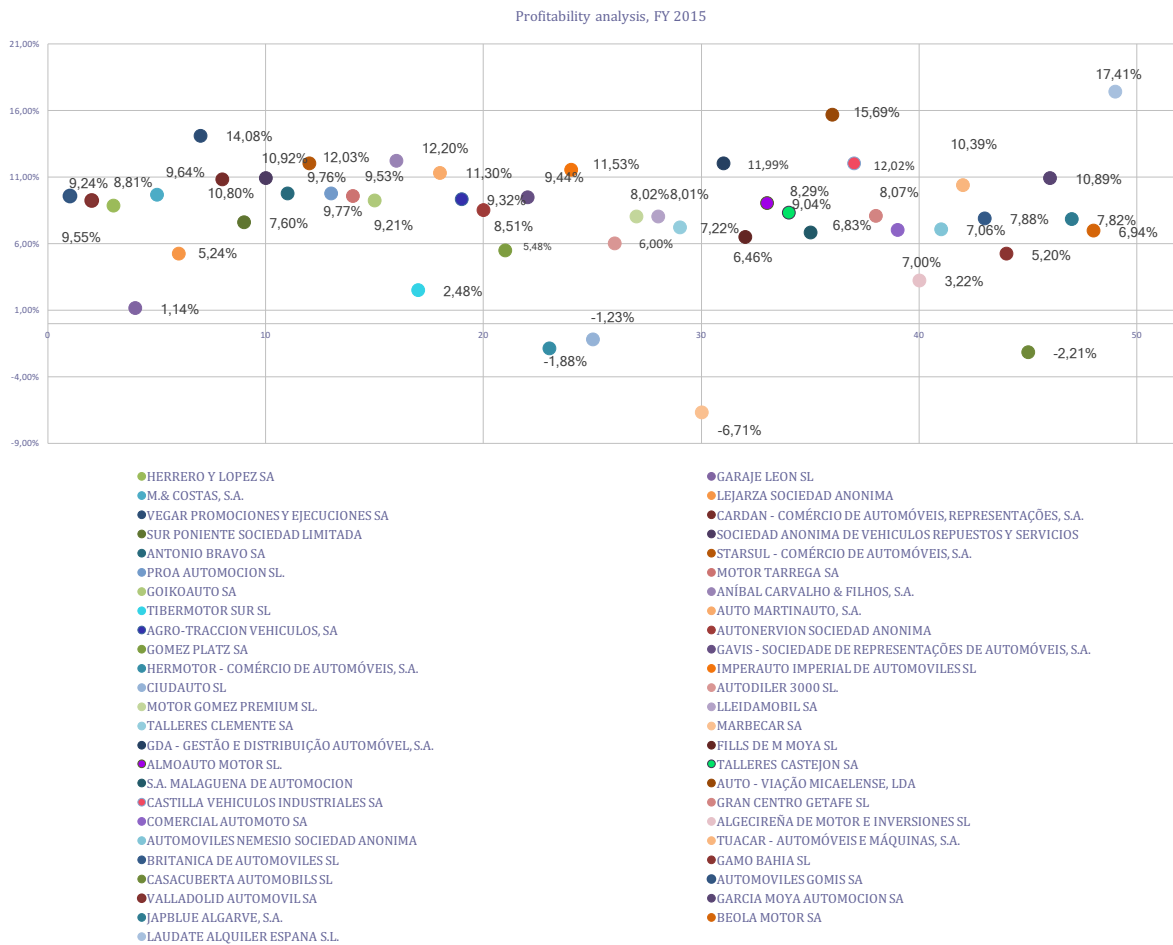
Table 4.10. Resale price margin, FY 2015

<b>Comparable companies</b>	<b>COGS</b>	<b>Sales</b>	<b>Resale price margin</b>
AUTOMOVILES GOMIS SA	43 815	48 441	9,55%
VALLADOLID AUTOMOVIL SA	38 803	42 751	9,24%
HERRERO Y LOPEZ SA	36 412	39 930	8,81%
GARAJE LEON SL	34 933	35 334	1,14%
M.& COSTAS, S.A.	34 376	38 041	9,64%
LEJARZA SOCIEDAD ANONIMA	28 586	30 168	5,24%
VEGAR PROMOCIONES Y EJECUCIONES SA	22 314	25 972	14,08%
CARDAN - COMÉRCIO DE AUTOMÓVEIS, REPRESENTAÇÕES, S.A.	23 337	26 163	10,80%
SUR PONIENTE SOCIEDAD LIMITADA	22 479	24 327	7,60%
SOCIEDAD ANONIMA DE VEHICULOS REPUESTOS Y SERVICIOS	21 601	24 248	10,92%
ANTONIO BRAVO SA	21 538	23 869	9,76%
STARSUL - COMÉRCIO DE AUTOMÓVEIS, S.A.	21 310	24 224	12,03%
PROA AUTOMOCION SL.	20 957	23 225	9,77%
MOTOR TARREGA SA	20 525	22 688	9,53%
GOIKOAUTO SA	18 998	20 926	9,21%
ANÍBAL CARVALHO & FILHOS, S.A.	18 048	20 555	12,20%
TIBERMOTOR SUR SL	19 899	20 406	2,48%
AUTO MARTINAUTO, S.A.	16 785	18 924	11,30%
AGRO-TRACCION VEHICULOS, SA	16 821	18 551	9,32%
AUTONERVION SOCIEDAD ANONIMA	16 717	18 272	8,51%
GOMEZ PLATZ SA	16 571	17 533	5,48%
GAVIS - SOCIEDADE DE REPRESENTAÇÕES DE AUTOMÓVEIS, S.A.	16 468	18 185	9,44%
HERMOTOR - COMÉRCIO DE AUTOMÓVEIS, S.A.	15 730	15 439	-1,88%
IMPERAUTO IMPERIAL DE AUTOMOVILES SL	14 330	16 197	11,53%
CIUDAUTO SL	16 103	15 907	-1,23%
AUTODILER 3000 SL.	14 756	15 697	6,00%
MOTOR GOMEZ PREMIUM SL.	13 993	15 212	8,02%
LLEIDAMOBIL SA	13 870	15 078	8,01%
TALLERES CLEMENTE SA	13 086	14 104	7,22%
MARBECAR SA	13 003	12 185	-6,71%
GDA - GESTÃO E DISTRIBUIÇÃO	12 534	14 241	11,99%

AUTOMÓVEL, S.A.			
FILLS DE M MOYA SL	12 665	13 540	6,46%
ALMOAUTO MOTOR SL.	12 324	13 549	9,04%
TALLERES CASTEJON SA	12 205	13 309	8,29%
S.A. MALAGUENA DE AUTOMOCION	12 317	13 220	6,83%
AUTO - VIAÇÃO MICAELENSE, LDA	10 727	12 723	15,69%
CASTILLA VEHICULOS INDUSTRIALES SA	11 001	12 503	12,02%
GRAN CENTRO GETAFE SL	11 373	12 371	8,07%
COMERCIAL AUTOMOTO SA	11 352	12 206	7,00%
ALGECIREÑA DE MOTOR E INVERSIONES SL	10 615	10 968	3,22%
AUTOMOVILES NEMESIO SOCIEDAD ANONIMA	10 742	11 558	7,06%
TUACAR - AUTOMÓVEIS E MÁQUINAS, S.A.	10 454	11 666	10,39%
BRITANICA DE AUTOMOVILES SL	10 446	11 340	7,88%
GAMO BAHIA SL	10 056	10 608	5,20%
CASACUBERTA AUTOMOBILS SL	10 224	10 003	-2,21%
GARCIA MOYA AUTOMOCION SA	10 070	11 300	10,89%
JAPBLUE ALGARVE, S.A.	10 210	11 076	7,82%
BEOLA MOTOR SA	9 761	10 488	6,94%
LAUDATE ALQUILER ESPANA S.L.	6 598	7 989	17,41%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Chart 4.6. Profitability analysis, FY 2015



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Average values of resale price margins presented in Appendix 4.5. Comparing the differences between general average and weighted average data, it can be concluded that differences are not significant and general average will be used for further analysis (the same as it was used for American companies).

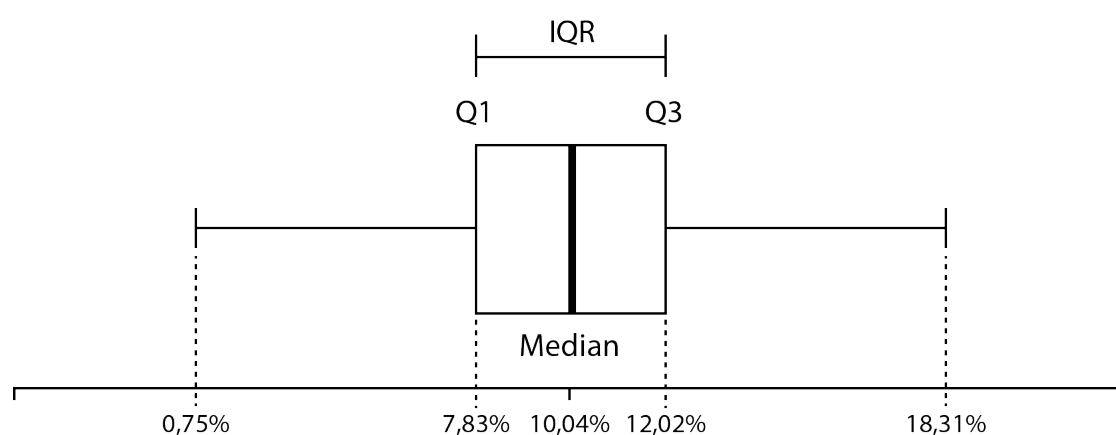
The values of quartiles and IQR for the companies reporting under IFRS located in the EU are presented in the Table 4.11.

Table 4.11. Quartiles and IQR values for EU companies

Value	2015	2014	2013	Average
Minimum value	-6,71%	-7,35%	-12,28%	-8,78%
Q1(25th percentile)	6,83%	8,00%	8,65%	7,83%
Median	8,51%	10,35%	11,25%	10,04%
Q3 (75th percentile)	10,39%	12,42%	13,24%	12,02%
Maximum value	17,41%	24,24%	16,45%	19,37%

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Graphical view of the received values is shown in the Picture 4.5.



Picture 4.5. Arm's length range for the companies reporting under IFRS, FY 2013-2015

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Therefore, the arm's length range for the EU automobiles dealers in the FY 2013 was between 8,65% and 13,24%, in the FY 2014 between 8,00% and 12,42% and in the FY 2015 between 6,83% and 10,39%.

The tendency in the USA as well as in the EU shows, that interquartile range values are decreasing within the period, which means that difference in price margins earned by vehicle resellers is tend to decrease, which is a general tendency in automotive industry. At the same time margins earned by the European companies are lower than ones achieved by the American.

## **5 Transfer pricing practice under US GAAP and IFRS, its effect on financial statements**

After computing arm's length calculations in the previous part, it can be examined into more details how different factors can impact the arm's length range and, therefore, arm's length and transfer price achieved in accordance with IFRS and US GAAP.

### **5.1 History of unification of financial accounting standards**

There were numerous steps made for harmonization of accounting standards applied by world's major markets.

It is considered, that convergence process of IFRS and US GAAP started from the year 2002 (the Norwalk Agreement) – the process is aimed to achieve high quality global standards in the accounting and to remove existing differences between IFRS and US GAAP (IFRS).

Main players in the convergence process are International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB).

International Accounting Standards Board developed from International Accounting Standards Committee (IASC) founded in 1973 after reorganization in 2001, and as of 2013 the International Financial Reporting Standards (IFRSs) as well as previously issued International Accounting Standards (IASs) developed by the IASB are either required or permitted in the European Union countries and over 100 countries outside the EU (FASB).

Financial Accounting Standards Board was founded in 1973 in the USA. It is independent, private-sector, not-for profit organization, which is responsible for the developing of financial accounting and reporting standards in the United States – US GAAP (FASB).

The IASB and the FASB have been working on the convergence of the US GAAP with IFRS, however the final decision on the changes to be done is up to the Securities and Exchange Commission, which despite its support of the convergence process has not yet decided about incorporation of IFRS (FASB).

Even though, it can be stated, that there are a lot of similarities between US GAAP and IFRS, there are still certain differences and they have specific impact on arm's length range and transfer pricing.

### **5.2 Accounting for costs implication in financial statements**

In this sections will be reviewed key distinctions in the approach of US GAAP and IFRS concerning the case reviewed in the previous part (resale price method for arm's length calculations in automotive resale industry).

The significant differences in the results of transfer pricing computation may occur due to the accounting for costs under IFRS and US GAAP. As it was men-

tioned previously, certain transfer pricing methods are more sensitive to costs classification and computation of the cost of sales than others. To such methods (which can be used by OECD-member countries as well as the USA) belong cost plus method, resale price method, transactional net margin method and transactional profit split method.

Cost of sales is calculated as a following:

$$\begin{aligned} \text{Cost of sales} &= \text{Beginning Inventory} + \text{Cost of goods purchased} \\ &\quad - \text{Ending inventory} \end{aligned}$$

In managerial accounting as well as in IFRS (IAS 2) and US GAAP (ASC 330-10-30-8) absorption costing is required for the accounting of inventories (Bellandi, 2012).

For more structured analysis expenses included into the cost of goods would be divided into two main groups:

- material expenses (i.e. inventory)
- other expenses (i.e. labour).

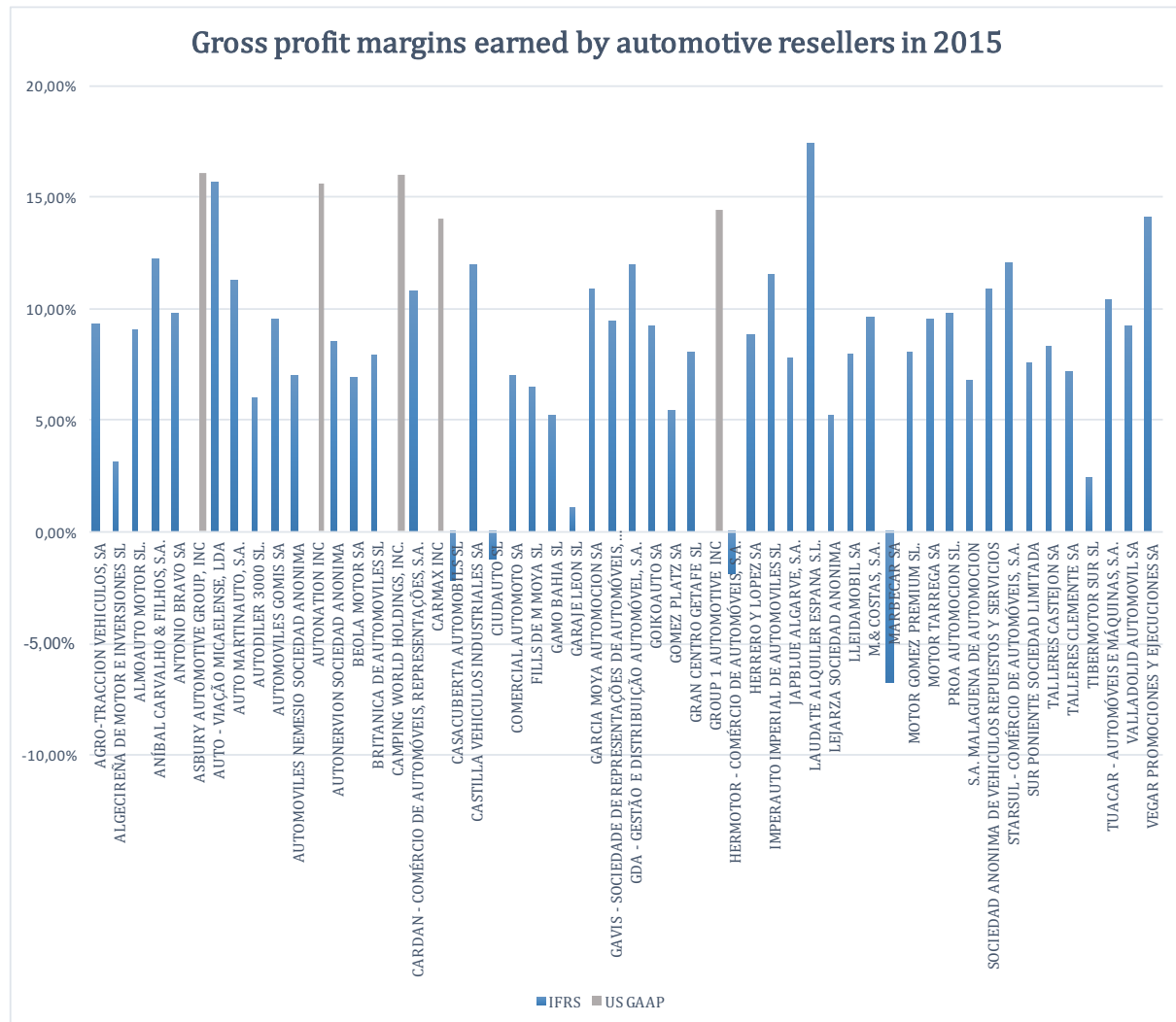
One of the main differences in inventory costing between US GAAP and IFRS lies in cost methodology: while FIFO and weighted average methodologies are allowed in both accounting standards, LIFO is only permitted in US GAAP and is precluded from the IFRS.

It should also be underlined, that for companies using LIFO for income tax purposes it is required to use this methodology for book accounting or reporting purposes (PricewaterhouseCoopers, 2015). Thus, inventory measurement reflected in the balance sheet prepared in line with one or another standard will be effected by the specific requirements given to the companies by US GAAP and IFRS.

Usage of LIFO will lead to lower value of ending inventory (due to the fact, that inflation causes increase of prices during the time and later received inventory is sold quicker, while inventory purchased earlier stays), which in its turn leads to higher gross profit margin.

Comparison of gross profit margins achieved by companies reporting under IFRS and US GAAP is presented in Chart 5.1. (for better comparison only one year 2015 will be reviewed).

Chart 5.1.



Source: Orbis, Bureau van Dijk; Annual reports of respective companies

Chart 5.1. demonstrates that gross profit margins achieved by the American companies are higher than margins earned by the companies from pan-European area.

Such a tendency is presented in all examined years and, thus, arm's length range of profit margins received for American companies was between 14,55% and 16,11% and for European companies between 7,83% and 12,02%.

Other significant factor which may cause the differences in inventory accounting and reporting is that reversals of write-downs are prohibited in US GAAP while in IFRS they are required in case when such recoveries reach subsequent amount. As a result, such a consideration leads to higher earnings volatility under IFRS accounting (PricewaterhouseCoopers, 2015).

Another characteristic which may require distinct approach and has an impact on financial statements of the companies is employee benefits accounting,



especially in the areas of pension, postretirement and postemployment benefits. One of specifications mentioned, can be, that remeasurements of benefit plans are immediately recognized in other comprehensive income (OCI) under IFRS, while under US GAAP gains or losses occurred due to such remeasurements are reflected in the income statement and the recognition may take place either immediately or in the future. On the other hand, prior service costs under IFRS are recognized in profit or loss when amendments to benefit plan take place, while under US GAAP these costs are recognized in OCI and then amortized in the future periods. Certain differences may arise from approach to classification of defined benefit plan and defined contribution plan. Another feature in IFRS presentation is that it is not required to reflect various components of pension cost at net amount, while it is mandatory under US GAAP (PricewaterhouseCoopers, 2015).

It can be reviewed the impact of employee benefits expenses on gross profit using the example of ASBURY AUTOMOTIVE GROUP, INC., which present detailed overview of their expenses in annual financial report (Table 5.1).

Table 5.1. Selling, General, and Administrative Expense

For the Year Ended December 31,						
	2016, mln USD	% of Gross Profit	2015, mln USD	% of Gross Profit	Increase (Decrease), mln USD	% of Gross Profit Increase (Decrease)
As Reported:						
Personnel costs	\$ 343.1	32.4%	\$ 334.6	31.5%	\$ 8.5	0.9%
Sales compensation	112.0	10.6%	115.5	10.9%	(3.5)	(0.3)%
Share-based compensation	12.0	1.1%	10.0	0.9%	2.0	0.2%
Outside services	78.3	7.4%	77.4	7.3%	0.9	0.1%
Advertising	34.0	3.2%	40.1	3.8%	(6.1)	(0.6)%
Rent	29.9	2.8%	31.3	3.0%	(1.4)	(0.2)%
Utilities	15.5	1.5%	16.7	1.6%	(1.2)	(0.1)%
Insurance	15.9	1.5%	11.8	1.1%	4.1	0.4%
Other	91.8	8.7%	92.5	8.7%	(0.7)	-%
Selling, general, and administrative expense	\$ 732.5	69.2%	\$ 729.9	68.8%	\$ 2.6	0.4%
Gross profit	\$ 1,058.7		\$ 1,060.8			

Source: Annual reports of ASBURY AUTOMOTIVE GROUP, INC.

According to the information presented by the company: "The increase (in selling, general and administrative expenses) was due primarily to increased per-

sonnel costs, which was a result of higher employee benefit costs, and higher insurance expense, which includes expenses associated with hail storm damage incurred at certain of dealerships during 2016” (Asbury Automotive Group, 2016). Therefore, by including employee benefits into income statement companies decrease their gross profit, which leads to the same effect as accounting for inventory – gross profit margin increases and it leads to higher value of margins earned for arm’s length calculation.

### **5.3 Revenue recognition accounting implication on financial statements**

In the examined case of computation of the resale price transfer pricing method, one of the most important sections used from the income statement was Sales part. There are different approaches to sales of goods measurement under US GAAP and IFRS: in the first case there is no specific model of measurement assigned to the sale of goods (when application is done not to the construction contracts), while in the second – sales may be recognised continuously by the means of the percentage-of-completion method (PricewaterhouseCoopers, 2015). Different sales recognition criteria may lead to mismatch in the periods when sales under similar contractual terms are recognized under US GAAP and IFRS.

It should also be admitted, that for American companies components of net benefit costs should be presented in the income statement at net amount, likewise they can be assigned to separate lines (such as cost of goods sold, other operating expenses as it was in financial statements from the previous section). Such an approach is similar to IFRS: all components can be allocated as items prior to net income, still components can also be reflected separately (PricewaterhouseCoopers, 2015).

### **5.4 Income statement and statement of comprehensive income presentation**

The primary source of the information related to resale price method of transfer pricing reviewed in the previous part was Income statements of the companies. Thus, it cannot be eliminated to analyse the core features of income statements prepared under different frameworks.

First of all, US GAAP allows two types of the presentation:

- on the basis of the functions
- separating operating and nonoperating activities.

On the other hand, IFRS allows presentation of the expenses:

- on the basis of the functions
- on the basis of the nature.

At the same time under US GAAP it is allowed to present depreciation separately, if doing so companies should specify in the section of cost of sales, that it is presented “exclusive depreciation” (PricewaterhouseCoopers, 2015).

If any future reclassification takes place, under US GAAP such a reclassification should be reflected either on the face of financial statements or in notes (ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other), while under IFRS such items should be reported separately from those which most likely will not be reclassified, companies are also required to show the effect of this change on tax due, all these items may be reflected in the statement of profit or loss and other comprehensive income or in the footnotes (IAS 1). Also, entities may present the effect on each component of equity and if they do so, this impact will be reflected either in the statement of changes in equity or in the footnotes (PricewaterhouseCoopers, 2015).

## **5.5 Limitations of the effects on financial statements examined**

It should be stressed, that examined effects on financial statements reviewed in this part will be of most significance for the entities analysed in the previous section, specifically automotive resellers, to which resale price method of transfer pricing calculation was applied. There are other distinctions between US GAAP and IFRS requirements to financial statements and their particular items, which were not reviewed, but will have crucial impact on other types of entities and on other types of controlled transactions (for example differences in sales of services recognition, construction contracts arrangements, nonfinancial and financial assets specifications, etc.). Therefore, in each particular case, different aspects in financial frameworks will play leading role and gain higher impact on financial statements prepared by the companies.

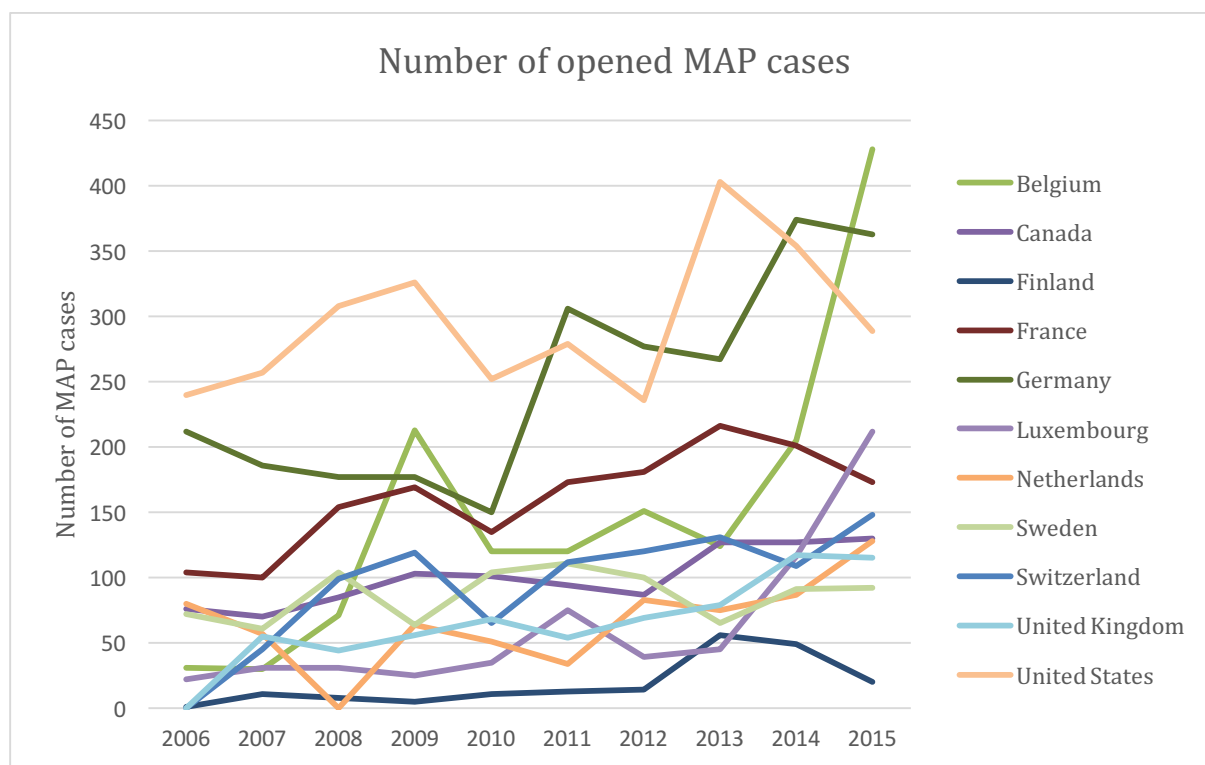
## 6 Discussions

Transfer pricing issue is very actual due to the increasing effect of globalization and challenges with which face governments of most of the countries, especially economic growth. Despite the fact, that transfer pricing has legal background existing for decades, there are still unresolved questions in this field. As a result, companies cannot be absolutely certain in correctness of transfer pricing strategy as well as governments cannot be assured, that they receive their fair value through the taxation of income. Recent tax authorities' disputes with world most-known companies warm up the interest to the taxation problem even more.

In respect to transfer pricing issue, OECD provides statistics about the number of new opened Mutual Agreement Procedure (MAP) cases – disputes in which government representatives cooperate with a purpose of tax disputes resolution (OECD, 2007).

In the following charts presented countries-leaders in MAP cases.

Chart 6.1. Number of opened MAP cases by country



Source: OECD, 2015

It should be admitted, that the overall tendency of number of cases – growing, and it is generally the same for other OECD-member states.

It should be mentioned, that in 2013 OECD developed G20 BEPS (Base Erosion and Profit Shifting) project consisting of 15 actions with an aim to close main loopholes in tax legislations of different countries allowing tax practices, which are considered harmful and unfair. Actions 8-10 of BEPS Plan are referred to transfer pricing. Their main aim is “to assure that transfer pricing practices are in line with value creation” (OECD, 2013). Three main areas of these actions are:

- Intangibles
- Risks and capital
- Other high risk transactions

Mainly these actions are oriented on the development of legal background for transfer pricing practices in these three areas, which will remove existing uncertainty.

It was determined by OECD that these aspects create the most significant impact on international taxation. The realization BEPS plan is reviewed as a higher priority assignment for all involved parties. From 2016 reporting of OECD on various taxation disputes changed its format and is reviewed from the point of separate actions.

It can be assumed, that actions of OECD along with the development of convergence process between IFRS and US GAAP may bring up new cycle of development in transfer pricing practices and optimize transfer pricing legal basement in the areas which now cause uncertainty and volatility in approaches of different states. Further development of the legislation setting more clear requirements after BEPS actions are realized will have positive impact on transfer practice as well as international taxation and will probably help to find a balance between interests of the business firms at international arena as well tax authorities and governments, accusing them in unfair tax practices. Cooperation with countries beyond OECD borders will be crucially important, since corporations locate their subsidiaries not on the basis of belonging of a certain state to particular international organization but on cost benefit analysis of possible outcomes for the firm.

## 7 Conclusions

The aim of this thesis was to review transfer pricing issue from dimensions of managerial accounting and taxation through the prism of different accounting practices – IFRS and US GAAP.

The issue of transfer pricing is very actual and because of the great involvement into it of different states, it is not so easy to come to common solution satisfying all parties involved – multinationals and authorities of different countries. On the basis of the research done, there could be defined three main areas of transfer pricing issue reflected in this work. First of all, that are challenges referred to the accounting arising from the application of different reporting standards – IFRS and US GAAP. Despite the fact, that these standards have certain similarities and steps are taken by the IASB and FASB for their convergence, there are still valuable differences, which have impact on transfer pricing practices applied by the companies and tax authorities. Second, it should be admitted that even if transfer pricing issue is not completely new, there are still gray areas in transfer pricing ruling having significant impact on the determination of transfer price and arm's length range. Unclearity of the application of certain transfer pricing rules gets its reflection in financial reporting of the enterprises and their financial position, which then in their turn local governments attempt to solve and it leads to further mismatch of transfer pricing rules application among different countries. And third, is the impact of transfer pricing practices used by the companies on taxation, which has bilateral character for the parties involved: from one side, companies can apply tax optimization strategies resulting for them in higher profits, which then bring higher satisfaction of shareholders and provide entities with resources for developing of their businesses, making investments, researches, and, thus, impact economic growth, from another – governments want to make sure that they receive fair value of incomes through the taxation and therefore will assure that they will be able to meet their obligations to the nation in form of procuring high-quality public goods and services, as well as insure rule of law, which in case of transfer pricing problem means, that tax obligations of the multinationals will not be shifted on citizens and that the level of competition among companies in the country will remain at the adequate level.

- Impact of different accounting standards

First of all, the main aspect, which cannot be omitted is the approach to standards and legislation perceived by the USA and OECD-member states. The same as US GAAP has rule-based character, American legislation dealing with transfer pricing also has such a disposition. Oppositely, according to OECD Transfer Pricing Guidelines one has higher range for personal judgment as long as it can be reasonably justified.

While computing arm's length range for USA and pan-European area, it was cognized, that margins earned by the American automotive resellers are higher than ones achieved by the companies operating under IFRS. In the examined case

arm's length range of profit margins achieved by American companies on average were 5% higher than ones earned by the companies reporting under IFRS. As was further examined the one of the reasons was lying in differences concerning cost recognition in IFRS and US GAAP. For automotive resellers studied in this work the areas of differences were in accounting for inventories and employee benefits. In the USA for inventory measurement it is allowed to use LIFO (last in, first out) method. Usage of LIFO will lead to lower value of ending inventory (due to the fact, that inflation causes increase of prices during the time and later received inventory is sold quicker, while inventory purchased earlier stays) and consequently to lower cost of sales, which in its turn leads to higher gross profit margin. Other significant factor which may cause the differences in inventory accounting and reporting is that reversals of write-downs are prohibited in US GAAP while in IFRS they are required in case when such recoveries reach subsequent amount. As a result, such a consideration leads to higher earnings volatility under IFRS accounting. Another is employee benefits accounting affecting cost recognition and presentation, especially related to postretirement, postemployment and pension benefits. Under IFRS remeasurements of benefit plans are immediately recognized in other comprehensive income (OCI), while under US GAAP gains or losses occurred due to such remeasurements are reflected in the income statement and the recognition may take place either immediately or in the future. On the other hand, prior service costs under IFRS are recognized in profit or loss when amendments to benefit plan take place, while under US GAAP these costs are recognized in OCI and then amortized in the future periods. Certain differences may arise from approach to classification of defined benefit plan and defined contribution plan.

It should also be stressed, there are certain differences in presentation requirements in financial statements. For profit margin calculation the great interest is Sales section of income statement. It should be admitted, that there are different approaches to sales of goods measurement under US GAAP and IFRS: while in US GAAP there is no specific model of measurement assigned to the sale of goods (when application is done not to the construction contracts), in IFRS – sales may be recognised continuously by the means of the percentage-of-completion method. Different sales recognition criteria may lead to mismatch in sales values under similar contractual terms under US GAAP and IFRS. Presentation of income statement (on the basis of functions or separately operating and nonoperating activities under US GAAP and on the basis of functions or nature under IFRS) may also cause certain unclarity for transfer pricing and arm's length range calculation.

Despite the fact, that for the purpose of this work resale price method was employed, differences in accounting for costs will play an important role for other transfer pricing methods as well. To such methods (which can be used by OECD-member countries as well as the USA) belong cost plus method, resale price method, transactional net margin method and transactional profit split method. On the other hand, less sensitive to accounting for costs methods may face some other issues arising from application of different accounting systems, which will impact arm's length range and transfer pricing computation results.

It should be stated, that coexisting of different accounting standards in world's major markets having active trade between each other creates a big complication for the transfer pricing and international taxation. The importance of convergence process should be stressed. There were numerous steps done, however the convergence was not yet completed. It will make better off the positions of the states in international tax when International Accounting Standard Board and Financial Accounting Standard Board will finally come up to the closure of convergence process and unified effective and efficient standard will be created.

- Unclarity in transfer pricing ruling

While working on the practical part of these thesis there were certain points, where personal judgment had to be used on the grounds of bilateral character of the requirements given by transfer pricing ruling. It should be admitted, that the requirements to arm's length range determination and calculation of transfer prices given by the American legislation has more authoritative character and gives less scope for personal judgment and personal considerations. Also, there provided various examples of different transfer pricing methods application, which can be used as a direct guidance. At the same time, OECD Transfer Pricing Guidelines, as a main standard used internationally and creating a basis for transfer pricing practice even besides the borders of OECD member-states, provides entities and tax authorities with higher level of flexibility in the application of different methods as well as in particular aspects of calculation.

In the case reviewed main questions which emerged were concerning the usage of multiple year data. It is stated, that multiple year data analysis improves the accuracy of the results, at the same time it is not stated that it is mandatory. Another question which arise was about number of years used for multiple data analysis. In Internal Revenue Service Regulations usually used three-year period, but for most of the methods it is not stated as obligatory practice.

Another point, which was not clearly defined, was about usage of averages. It is not prescribed in Guidelines whether weighted average or ordinary average should be used. Because of that different countries solve this question in their own way, what cause another pluralism in approach to transfer pricing.

These and other issues are reviewed at the EU Joint Transfer Pricing Forum in presence of European Commission, where suggestions from different countries for the improvement of current legislation are given.

As shown by OECD statistics on Mutual Agreement Procedures – the number of cases resulting in tax disputes have tendency to rise. It can be explained by the higher fraction of international transaction as well as wrong implication of ruling by these growing number of multinationals. Without solving the problem of unclarity in the existing legislation, the number of cases will tend to increase in line with increasing number of international transactions brought by the globalization processes. The issues created by gray areas in transfer pricing legislation can be eliminated in some areas after the successful implementation of Base Erosion and Profit Shifting plan. However, except the problems reviewed in BEPS plan other questions should be clarified. It means, that there should be made further steps for



improvement of transfer pricing ruling. It can be done through the cooperation of European Commission and OECD. At the same time, should be kept in mind, that international business relations go far beyond the borders of OECD member states. Despite the fact, that many states build their transfer pricing legislation on the basis of OECD Guidelines, while not being a part of OECD it is not mandatory for them to do so and they have rights to change rules in certain areas creating more and more differences in application of arm's length standard and calculation of transfer prices. Assurance of use by OECD and its partners of the same approaches to transfer pricing would compose an important step in international taxation.

- Impact of differences in taxation

From the point of view of taxation, it is considered, that the main issue concerning transfer pricing which arise during preparation of financial statements is uncertain tax position, since under both, US GAAP (ASC 740) and IFRS (IAS 37), tax benefit and tax reserves recognized by the company require certain level of assertion before the final result of the transactions is known. Tax authorities have rights to reassess level of income stated by the entity and existing transfer pricing approach used by it. For such an instance entities create reserves, but the amount of them is a subject to judgments and estimations of the company.

Another challenge may be created by this uncertainty in deferred tax accounting. Both US GAAP and IFRS systems state principle of deferred tax assets and liabilities, however it is required for tax authorities to match with the company in calculations of those values. Potential difficulties may arise for the companies having higher fraction of intra-group transactions in their portfolio and reporting losses since transfer prices may be seemed by tax authorities as a main reason for those losses.

Transfer pricing will also impact reporting of foreign incomes reported by parent companies. US GAAP and IFRS require a recognition of a deferred tax related to all undistributed earnings. Thus, due to differences in legislation, associated companies' reporting may face an issue in accurate disclosure of the amounts of foreign tax due, foreign tax credit, foreign tax reserves, taxable income, outside basis deferred tax differences.

Restructuration of the company may also lead to transfer pricing disputes due to the manner how certain property is distributed between different business units, also it may change a tax status of the entity: from non-taxable to taxable or opposite. Valuation of assets acquired in business combinations will also lead to more careful examination.

Among other effects transfer pricing has on the reporting should be mentioned the necessity to reflect corporate transfer's policies in estimated annual effective tax rate (under US GAAP), accounting estimates and assertions and income tax disclosures.

High risk of uncertain tax position created by transfer pricing issue can be reduced by the steps taken into BEPS plan as well as by further cooperation on different levels between states in the improvement and development of common pri-

orities and treatment of transfer pricing and its reflection in taxation of multinational corporations.

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# Appendices



## Appendix 1.1 List of OECD Member countries

The following is a list of the current Member countries of the Organisation and the dates on which they deposited their instruments of ratification.

<b>Country</b>	<b>Date</b>
AUSTRALIA	7 June 1971
AUSTRIA	29 September 1961
BELGIUM	13 September 1961
CANADA	10 April 1961
CHILE	7 May 2010
CZECH REPUBLIC	21 December 1995
DENMARK	30 May 1961
ESTONIA	9 December 2010
FINLAND	28 January 1969
FRANCE	7 August 1961
GERMANY	27 September 1961
GREECE	27 September 1961
HUNGARY	7 May 1996
ICELAND	5 June 1961
IRELAND	17 August 1961
ISRAEL	7 September 2010
ITALY	29 March 1962
JAPAN	28 April 1964
KOREA	12 December 1996
LATVIA	1 July 2016
LUXEMBOURG	7 December 1961

MEXICO	18 May 1994
NETHERLANDS	13 November 1961
NEW ZEALAND	29 May 1973
NORWAY	4 July 1961
POLAND	22 November 1996
PORTUGAL	4 August 1961
SLOVAK REPUBLIC	14 December 2000
SLOVENIA	21 July 2010
SPAIN	3 August 1961
SWEDEN	28 September 1961
SWITZERLAND	28 September 1961
TURKEY	2 August 1961
UNITED KINGDOM	2 May 1961
UNITED STATES	12 April 1961

Source: OECD

## Appendix 3.1 Services, that are eligible for treatment as specified covered services

The following categories of services are eligible for treatment as specified covered services under Temp. Treas. Reg. § 1.482-9T(b)(4)(i):

<b><i>Payroll:</i></b>	
1.	Compiling and posting employee time and other information needed to calculate periodic compensation to employees. Computing employees' time worked, production, and commissions. Computing and posting wages and deductions to appropriate accounting records. Preparing paychecks, travel reimbursement and expense reimbursement.
2.	Preparing payroll tax forms (such as the preparation of Forms 940, 941 and W-2 in order to comply with U.S. requirements or similar requirements under another country's laws).
3.	Administering garnishment and other wage withholding orders.
4.	Other activities similar to those specified in paragraphs (1) through (3).
<b><i>Premiums for Unemployment, Disability and Workers Compensation:</i></b>	
5.	Processing employees' unemployment insurance premiums, disability premiums and workers compensation premiums.
6.	Other activities similar to those specified in paragraph (5).
<b><i>Accounts Receivable:</i></b>	
7.	Compiling, analysing and recording current credit data and other financial information regarding individuals or firms (including preparing reports with this information for use in decision making).
8.	Compiling and recording billing, accounting and other numerical data for billing purposes. Preparing billing invoices for services rendered or for delivery or shipment of goods.
9.	Locating and notifying customer(s) of delinquent accounts by mail (either electronic or otherwise) or telephone to solicit payment. Receiving payment from customers and posting payment to customer accounts. If customer fails to respond, preparing statements to credit department, initiating repossession proceedings or service disconnection. Keeping records of collection activities and status of accounts.
10.	Other activities similar to those specified in paragraphs (7) through (9).
<b><i>Accounts Payable:</i></b>	
11.	Compiling information and records to draw up purchase orders for procurement of materials and services.
12.	Making payment to vendors and posting payment to status of accounts.
13.	Other activities similar to those specified in paragraphs (11) and (12).

<b><i>General Administrative:</i></b>	
14.	Performing clerical and administrative functions such as drafting correspondence, scheduling appointments, and organizing and maintaining paper and electronic files.
15.	Performing data entry through use of a keyboard or scanning device, including verifying data and preparing materials for printing.
16.	Using a word processor/computer or typewriter to generate (without substantial modification) letters, reports, forms, or other material from another person's rough draft, corrected copy, or voice recording.
17.	Performing duties relating to office management systems and procedures, such as answering telephones, bookkeeping, typing, word processing, office machine operation, and filing.
18.	Operating any of the following office machines: photocopying, scanning and facsimile machines.
19.	Providing interoffice service/document delivery, including mailroom services, document management, and graphics, video, and website preparation.
20.	Other activities similar to those specified in paragraphs (14) through (19).
<b><i>Corporate and Public Relations:</i></b>	
21.	Planning and executing a public relations program or corporate communication policy, including the distribution of internal and external corporate communications, but not to include specific advertising and/or marketing of a product or service.
22.	Other activities similar to those specified in paragraph (21).
<b><i>Meeting Coordination and Travel Planning:</i></b>	
23.	Coordinating activities of staff and convention personnel to make arrangements for group meetings and conventions.
24.	Negotiating airline, rental car, and hotel contracts.
25.	Assisting in travel arrangements, including providing a system for reservations and ticket purchases.
26.	Managing motor pool and fleet.
27.	Other activities similar to those specified in paragraphs (23) through (26).
<b><i>Accounting and Auditing:</i></b>	
28.	Gathering and reviewing information in accounting records for use in preparing financial statements.
29.	Computing, classifying, and recording numerical data to maintain accurate and complete financial records, performing any combination of calculating, posting, and verifying duties to obtain primary financial data for use in maintaining accounting records, checking the accuracy of figures, calculations, and postings pertaining to business transactions recorded by other workers; and calculating investment performance and net asset values of investments.

30.	Consolidating legal entity financial results per country for use in statutory financial statements and tax returns and consolidating worldwide results by business area for use in management accounting.
31.	Developing a company-wide accounting manual that prescribes accounting policies and methods to be used and providing related advice.
32.	Performing operational and financial internal audits.
33.	Preparing government census and related forms required by a service recipient's home country.
34.	Preparing reports required by escheat laws required by a service recipient's home country.
35.	Completing import/export documentation and arranging for customs payment.
36.	Overseeing audits by customs authorities.
37.	Other activities similar to those specified in paragraphs (28) through (36).
<b><i>Tax:</i></b>	
38.	Processing tax payments according to prescribed laws and regulations.
39.	Gathering information from accounting records and including that information in the preparation of income, property, sales/use, VAT, excise and other tax returns.
40.	Overseeing audits conducted by tax authorities.
41.	Providing tax advice to businesses to ensure compliance with tax laws, including access to electronic research and tax compliance software.
42.	Reviewing local country tax provisions for purposes of inclusion in the consolidated world-wide provision and preparation of the world-wide tax provision.
43.	Negotiating advance pricing agreements and other local incentives that benefit the consolidated organization.
44.	Other activities similar to those specified in paragraphs (38) through (43).
<b><i>Health, Safety, Environmental and Regulatory Affairs:</i></b>	
45.	Developing company health, safety, and environment standards, monitoring compliance with such standards, and training affected personnel.
46.	Gathering information and preparing documentation relating to eligibility for or compliance with laws and regulations governing contracts, licenses and permits.
47.	Gathering information, verifying data and preparing documentation relating to compliance with laws and regulations governing financial and securities institutions and financial and real estate transactions. Examining and verifying correctness of, or establishing authenticity of records.
48.	Providing security services ( <i>e.g.</i> , executive protection or global headquarters security).
49.	Providing common health risk management systems development, clinical services, industrial hygiene, alcohol and drug testing services (laboratory analyses done by third parties), and advice to business management on health issues.

50.	Providing guidance and support operations, integrity management support implementation, coaching, and conducting operations integrity management assessments, development and implementation of safety behaviour based programs, and incident reporting and accident investigations.
51.	Providing strategies, resources, and training for effective crisis preparedness and response.
52.	Other activities similar to those specified in paragraphs (45) through (51).
<b><i>Budgeting:</i></b>	
53.	Compiling data for use by cost estimators in determining cost projections and in preparing budget estimates, including verifying information for completeness, accuracy, and conformance with internal procedures and regulations.
54.	Compiling data to prepare budget and accounting reports for management.
55.	Other activities similar to those specified in paragraphs (53) and (54).
<b><i>Treasury Activities:</i></b>	
56.	Establishing bank accounts and lock boxes for use by controlled parties, including overdraft facilities and lines of credit.
57.	Providing staff and facilities to hedge currency exposures that arise from operations in the normal course of business. This paragraph does not apply to banks (including investment banks), insurance companies, investment companies, similar entities that provide financial services to the public, and investment funds (including hedge and private equity funds).
58.	Coordinating investment activities in connection with short-term management of cash generated from operations in the normal course of business. This paragraph does not apply to related-party factoring activities, or to banks (including investment banks), insurance companies, investment companies, similar entities that provide financial services to the public, and investment funds (including hedge and private equity funds).
59.	Other activities that are ancillary to the activities specified in paragraphs (56) through (58).
<b><i>Statistical Assistance:</i></b>	
60.	Compiling data for use in statistical studies.
61.	Other activities similar to those specified in paragraph (60).
<b><i>Staffing and Recruiting:</i></b>	
62.	Providing staffing support that includes creating job announcements, determining eligibility, evaluating qualifications of candidates, conducting background checks on final candidates, verifying references, developing performance evaluation procedures and forms, and conducting exit interviews for departed employees.
63.	Coordinating with temporary employment agencies, applicants, and management throughout the recruiting process.
64.	Providing information to applicants regarding open positions, the application and recruiting process, and employment policies.

65.	Providing administrative support that includes sourcing and processing resumes, arranging interview schedules for open positions, preparing offer letters, and entering new employee information into the human resource system.
66.	Establishing and maintaining employee files relating to payroll, performance and other personnel issues.
67.	Assisting with new employee orientations and paperwork.
68.	Implementing recruiting plan and locating potential candidates by working with professional search firms, colleges, universities and professional associations. Organizing and attending job fairs and other recruitment events.
69.	Developing recruiting and marketing materials and assisting in developing and maintaining content for recruiting website.
70.	Analysing recruiting data and review all job analysis, promotion and placement products.
71.	Posting job opening advertisements in appropriate markets through publications, journals and other media.
72.	Managing company-wide job postings and employee referral program.
73.	Administering a compensation policy, including grading and determining salary ranges for positions.
74.	Other activities similar to those specified in paragraphs (62) through (73).

***Training and Employee Development:***

75.	Assisting in training of personnel including assessing development and training needs, creating and conducting internal development and training programs and communicating training opportunities to personnel.
76.	Arranging for management training on employment law compliance, employer liability avoidance, interviewing, hiring, terminations, promotions, performance reviews, safety, and sexual harassment.
77.	Developing and implementing plans regarding career-development and succession.
78.	Developing and implementing a job evaluation process including procedures and forms.
79.	Other activities similar to those specified in paragraphs (75) through (78).

***Benefits:***

80.	Developing and implementing employee compensation and benefits including healthcare, life insurance, 401(k), pension, worker's compensation, unemployment, dental, profit sharing, employee incentive compensation, and employee assistance programs.
81.	Providing benchmarking studies for compensation and other benefit programs.
82.	Providing guidance and direction to employees regarding elections for benefits, applications for benefits and receipt of benefits (including providing as-

	sistance to employees in completing all necessary forms).
83.	Arranging annual benefit enrollment meetings and employee benefit seminars.
84.	Processing employee benefits inquiries and complaints, and reconciling billing issues.
85.	Coordinating with hospitals, physicians, insurers, employees, and beneficiaries to facilitate proper and complete utilization of benefits for all employees.
86.	Other activities similar to those specified in paragraphs (80) through (85).
<b><i>Information and Technology (IT) Services:</i></b>	
87.	Supporting company-wide computer systems including those used in connection with operations, accounting, manufacturing, customer service, human resources, payroll, and email.
88.	Formulating guidelines with respect to the use of IT systems.
89.	Maintaining and repairing IT systems.
90.	Providing telecommunications facilities.
91.	Providing technical assistance and training to users of computer systems and other information technology devices. Answering questions or resolving technical problems relating to computer systems and other information technology devices in person, via telephone or from remote location. Providing assistance concerning the use of computer hardware and software, including printing, installation, word processing, electronic mail, and operating systems, as well as disaster recovery back-up services.
92.	Maintaining and testing existing computer databases (including implementing security measures to safeguard computer databases), but not to include analyzing user needs or developing hardware or software solutions (such as systems integration, website design, writing computer programs, modifying general applications software, or recommending the purchase of commercially available hardware or software).
93.	Supporting an organization's existing local area network (LAN), wide area network (WAN), and Internet system or a segment of a network system, regular maintenance of network hardware and software, monitoring network to ensure network availability to all system users and performing necessary maintenance to support network availability, supervising other network support and client server specialists (including implementing network security measures), but not to include analyzing user needs or developing hardware or software solutions (such as systems integration, website design, writing computer programs, modifying general applications software, or recommending commercially available software).
94.	Other activities similar to those specified in paragraphs (87) through (93).
<b><i>Legal Services:</i></b>	
95.	General legal services performed on behalf of the taxpayer by in-house legal counsel, including but not limited to, drafting, negotiating and review of con-



	tracts or agreements, legal documents, and opinions, representation and advocacy before courts, administrative agencies, arbitrators, legislatures, or other bodies, preparing advice in respect of structuring and reorganization, acquisition, and divestment transactions, and maintaining corporate books and records. Support and administrative functions associated with the above activities (legal research, secretarial, filing and document retrieval, etc.).
96.	Other activities similar to those specified in paragraph (95).
<b><i>Insurance Claims Management:</i></b>	
97.	Securing insurance coverage for general, product, and worker's compensation liability, property loss, business interruption, and other business risks.
98.	Coordinating with third party insurers, with respect to insurance policies, including preparing claims for submission to such third party insurers.
99.	Other activities similar to those specified in paragraphs (97) and (98).
<b><i>Purchasing:</i></b>	
100.	Planning and executing procurement of services and material pursuant to company standard for support functions.
101.	Other activities similar to those specified in paragraph (100).

Source: IRS, 2007

## Appendix 4.1 Orbis database company size categories

The criteria for a company to be included in one of the categories below are always based on values expressed in EUR (values in USD are given for information purposes only and may vary depending on current exchange rate).

<b>Very large companies (VL)</b>		
companies are considered to be very large when they match at least one of the following conditions:		
Operating Revenue	>=	100 million EUR (130 million USD)
Total assets	>=	200 million EUR (260 million USD)
Employees	>=	1,000
Listed		

Companies with ratios Operating Revenue per Employee or Total Assets per Employee below 100 EUR (130USD) are excluded from this category. Companies for which Operating Revenue, Total Assets and Employees are unknown but have a level of Capital over 5 million EUR (6.5 million USD) are also included in the category.

<b>Large companies (L)</b>		
companies are considered to be large when they match at least one of the following conditions:		
Operating Revenue	>=	10 million EUR (13 million USD)
Total assets	>=	20 million EUR (26 million USD)
Employees	>=	150
Not Very Large		

Companies with ratios Operating Revenue per Employee or Total Assets per Employee below 100 EUR (130 USD) are excluded from this category. Companies for which Operating Revenue, Total Assets and Employees are unknown but have a level of Capital comprised between 500 thousand EUR (650 thousand USD) and 5 million EUR (6.5 million USD) are also included in the category.

## Appendix 4.2 CAMPING WORLD HOLDING Sales

(\$ in thousands)	Fiscal Year Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
<b>Consolidated Statements of Income Data:</b>			
Revenue:			
Consumer Services and Plans	184,773	174,600	174,600
Retail			
New vehicles	1,866,182	1,606,465	1,174,816
Used vehicles	705,893	806,399	680,190
Parts, services and other	540,019	507,810	482,254
Finance and insurance, net	229,839	190,820	135,140
Subtotal	3,341,933	3,111,494	2,472,400
Total revenue	3,526,706	3,286,094	2,634,998
Gross profit:			
Consumer Services and Plans	105,501	92,851	88,533
Retail			
New vehicles	261,648	227,309	168,427
Used vehicles	150,780	159,463	133,568
Parts, services and other	250,833	232,821	220,527
Finance and insurance, net	229,839	190,820	135,140
Subtotal	893,100	810,413	657,662
Total gross profit	998,601	903,264	746,195

Source: CAMPING WORLD HOLDING

From this data figures for sales and gross profit from sale of new and used vehicles are the following:

	Gross profit	Sales
2016	414,428	2,572,075
2015	386,772	2,412,864
2014	301,995	1,855,066



2014						
Comparable companies	Turnover, th USD	Net Income, th USD	Cash flow, th USD	Total assets, th USD	Capital, th USD	Operating profit margin, %
CARCLASSE - COMÉRCIO DE	134 617	682	2 373	89 884	6 192	2,83%
VEHINTER SA	90 972	1 771	1 909	36 048	175	2,41%
MOTOR ARI SOCIEDAD ANONIMA	56 308	344	1 067	26 759	78	n.a.
VALLADOLID AUTOMOVIL SA	45 774	234	1 432	12 226	1 182	1,10%
AUTOMOVILES GOMIS SA	43 931	102	484	20 406	1 634	0,64%
HERRERO Y LOPEZ SA	38 804	447	697	14 702	947	1,81%
M.& COSTAS, S.A.	36 903	426	574	17 213	1 821	2,19%
LEJARZA SOCIEDAD ANONIMA	31 431	361	443	23 512	1 459	-1,26%
SUR PONIENTE SOCIEDAD	29 640	75	284	27 103	8 522	1,70%
GARAJE LEON SL	26 864	82	176	17 907	146	0,70%
CARDAN - COMÉRCIO DE AUTOMÓVEIS, REPRESENTAÇÕES, AE LLORENTE SA	26 468	89	254	16 006	1 287	2,49%
VEGAR PROMOCIONES Y EJECUCIONES SA	25 454	348	481	7 841	190	1,78%
VEGAR PROMOCIONES Y EJECUCIONES SA	23 620	1 340	1 657	17 756	73	6,67%
ANTONIO BRAVO SA	22 492	141	289	19 521	163	4,65%
STARSUL - COMÉRCIO DE AUTOMÓVEIS, S.A.	22 367	73	404	14 645	1 821	2,82%
COVISA AUTOMOCION S.A.	22 294	4	188	13 942	1 084	n.a.
SOCIEDAD ANONIMA DE VEHICULOS REPUESTOS Y	21 851	202	350	10 406	73	1,60%
MOTOR TARREGA SA	21 135	64	530	11 031	436	1,29%
NOVO MOTOR SA	20 743	625	407	15 790	88	n.a.
HERMOTOR - COMÉRCIO DE AUTOMÓVEIS, S.A.	20 653	261	349	9 137	303	2,45%
GOIKOAUTO SA	20 075	185	345	12 276	730	2,74%
AUTONERNIVON SOCIEDAD ANONIMA	19 645	325	107	7 692	791	-2,08%
AUTO MARTINAUTO, S.A.	18 698	337	445	9 584	1 093	2,40%
ALMOAUTO MOTOR SL.	18 322	316	354	3 159	607	2,69%
TALLERES CASTEJON SA	17 811	64	284	11 586	305	1,47%
GAVIS - SOCIEDADE DE REPRESENTAÇÕES DE AUTOMÓVEIS, S.A.	17 721	212	321	9 302	997	2,11%
AGRO-TRACCION VEHICULOS, SA	17 426	255	461	9 539	102	2,87%
PROA AUTOMOCION SL.	17 211	67	332	16 555	2 944	2,89%
GOMEZ PLATZ SA	16 785	21	32	5 449	498	1,13%
TIBERMOTOR SUR SL	16 141	28	79	5 530	553	1,63%
ANÍBAL CARVALHO & FILHOS, S.A.	16 056	147	239	8 512	364	1,68%
MOTOR GOMEZ PREMIUM SL.	16 006	52	76	6 418	728	1,26%
IMPERAUTO IMPERIAL DE AUTOMOVILES SL	15 964	176	239	7 028	109	4,88%
GRUPO NUNEZ MOTOR GAB	15 664	88	43	7 753	n.a.	n.a.
TALLERES CLEMENTE SA	15 659	9	126	5 092	686	0,08%
LLEIDAMOBIL SA	15 027	41	163	6 950	77	0,18%
COMERCIAL AUTOMOTO SA	13 601	69	120	5 181	1 007	0,63%
GRAN CENTRO GETAFE SL	13 426	104	36	6 240	765	-0,23%
FILLS DE M MOYA SL	13 022	143	284	7 429	292	2,68%
AUTODILER 3000 SL.	12 777	126	56	3 786	1 124	-0,28%
AUTO - VIAÇÃO MICAELENSE, LDA	12 388	426	1 318	13 369	3 028	4,32%
JAPBLUE ALGARVE, S.A.	12 143	383	276	8 564	607	-1,78%
TUACAR - AUTOMÓVEIS E MÁQUINAS, S.A.	12 077	103	184	6 763	607	1,62%
S.A. MALAGUENA DE AUTOMOCION	11 811	410	367	4 422	657	-3,69%
CIUDAUTO SL	11 563	66	113	5 366	139	2,27%
BRITANICA DE AUTOMOVILES SL	11 498	330	425	7 246	36	3,96%
AUTOMOVILES NEMESIO SOCIEDAD ANONIMA	11 388	178	249	7 044	984	2,74%
CASACUBERTA AUTOMOBILS SL	11 251	94	142	2 892	73	1,35%
GAMO BAHIA SL	11 075	54	244	6 907	609	1,15%
CASTILLA VEHICULOS INDUSTRIALES SA	11 058	260	413	12 405	182	17,88%
BEOLA MOTOR SA	10 993	221	324	8 370	80	1,29%
ALGECIREÑA DE MOTOR E INVERSIONES SL	10 574	57	199	5 165	730	1,93%
GARCIA MOYA AUTOMOCION SA	10 477	91	200	4 226	292	1,42%
MARBECCAR SA	10 405	18	71	3 610	146	0,49%
LAUDATE ALQUILER ESPANA S.L.	6 461	550	n.a.	36 822	4	14,84%
GARANTIA TECNICA DEL	9 769	277	307	5 932	n.a.	n.a.
GDA - GESTÃO E DISTRIBUIÇÃO AUTOMÓVEL, S.A.	5 593	539	551	3 877	607	11,78%
JUAN ARMAS SOCIEDAD ANONIMA	4 541	121	521	26 206	567	n.a.
RAHN CORAUTO SA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
S.CONRADO - AUTOMÓVEIS, S.A.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
VEMOTOR CANARIAS	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
SERVICIO AUTO MOTO SOCIEDAD ANONIMA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
GARAGE VICTORIA SA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
INNOVACIONES DEL	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
RAHN JAPON SA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

2013						
Comparable companies	Turnover, th USD	Net Income, th USD	Cash flow, th USD	Total assets, th USD	Capital, th USD	Operating profit margin, %
CARCLASSE - COMÉRCIO DE AUTOMÓVEIS,	119 817	276	2 098	93 482	7 033	2,67%
VEHINTER SA	90 098	870	1 049	37 475	199	1,05%
AUTOMOVILES GOMIS SA	48 867	- 1 366	- 876	23 868	1 856	-3,62%
MOTOR ARI SOCIEDAD ANONIMA	44 338	- 6 023	- 5 044	32 006	89	-10,53%
VALLADOLID AUTOMOVIL SA	43 143	22	255	18 781	1 343	0,60%
HERRERO Y LOPEZ SA	35 934	13	306	18 026	1 076	0,23%
M. & COSTAS, S.A.	35 544	264	460	20 026	2 069	2,26%
LEJARZA SOCIEDAD ANONIMA	33 680	- 647	314	23 161	1 658	-2,32%
SUR PONIENTE SOCIEDAD LIMITADA	32 788	34	261	29 712	13 390	1,33%
NOVO MOTOR SA	27 221	- 875	- 500	18 523	99	-2,40%
AE LLORENTE SA	26 522	82	251	7 617	216	0,35%
ANTONIO BRAVO SA	23 447	65	263	17 532	186	3,77%
CARDAN - COMÉRCIO DE AUTOMÓVEIS, REPRESENTAÇÕES, S.A.	22 994	- 765	- 559	18 311	1 462	-1,06%
SERVICIO AUTO MOTO SOCIEDAD	22 469	- 707	- 600	13 467	663	-1,44%
STARSUL - COMÉRCIO DE AUTOMÓVEIS, S.A.	21 827	- 712	- 315	15 816	2 069	-1,17%
COVISA AUTOMOCION S.A.	21 428	55	269	13 883	1 231	1,56%
ALMOAUTO MOTOR SL.	21 117	274	304	2 573	690	1,63%
VEGAR PROMOCIONES Y EJECUCIONES SA	20 684	1 052	1 448	17 662	83	5,38%
AUTONERVION SOCIEDAD ANONIMA	20 426	- 421	- 150	10 104	898	-2,46%
S.CONRADO - AUTOMÓVEIS, S.A.	19 918	- 237	- 32	42 267	6 895	2,04%
HERMOTOR - COMÉRCIO DE AUTOMÓVEIS, SOCIEDAD ANONIMA DE VEHICULOS	19 613	151	238	7 432	344	1,62%
REPUESTOS Y SERVICIOS	19 462	232	403	11 334	83	1,64%
MOTOR TARREGA SA	19 150	41	527	13 463	495	1,76%
GOIKOAUTO SA	17 950	- 27	156	12 648	829	1,30%
GARAJE LEON SL	17 848	187	264	13 604	166	1,31%
GRAN CENTRO GETAFE SL	16 797	76	235	10 277	869	0,96%
PROA AUTOMOCION SL.	16 657	56	355	18 695	3 344	3,11%
TIBERMOTOR SUR SL	16 612	36	92	5 526	n.a.	n.a.
GAVIS - SOCIEDADE DE REPRESENTAÇÕES DE AUTOMÓVEIS, S.A.	16 406	79	257	8 457	1 133	1,56%
GOMEZ PLATZ SA	16 347	13	34	4 740	565	1,32%
AGRO-TRACCION VEHICULOS, SA	16 313	21	285	10 093	116	0,99%
GRUPO NUNEZ MOTOR GAB	16 115	- 15	140	9 614	n.a.	n.a.
IMPERAUTO IMPERIAL DE AUTOMOVILES SL	15 352	339	395	7 745	124	5,16%
LLEIDAMOBIL SA	15 007	8	182	7 600	87	-0,13%
ANÍBAL CARVALHO & FILHOS, S.A.	14 987	35	131	7 174	414	1,07%
TALLERES CASTEJON SA	14 664	40	253	12 660	346	1,34%
TALLERES CLEMENTE SA	14 368	- 60	87	5 685	779	-0,41%
AUTO - VIAÇÃO MICAELENSE, LDA	14 091	166	1 641	15 464	3 439	1,55%
AUTO MARTINAUTO, S.A.	13 862	485	507	9 729	1 241	2,98%
COMERCIAL AUTOMOTO SA	13 014	- 370	- 158	5 682	1 144	-3,18%
AUTOMOVILES NEMESIO SOCIEDAD	12 561	245	325	5 851	910	3,18%
CASTILLA VEHICULOS INDUSTRIALES SA	12 334	- 29	253	16 871	206	2,24%
BRITANICA DE AUTOMOVILES SL	12 272	171	278	7 670	41	1,96%
S.A. MALAGUENA DE AUTOMOCION	11 781	- 379	- 310	5 426	746	-4,70%
BEOLA MOTOR SA	11 708	- 9	108	8 933	91	-0,96%
MARBECA SA	11 343	21	81	4 085	166	0,25%
CASACUBERTA AUTOMOBILS SL	11 157	50	112	3 089	83	0,56%
AUTODILER 3000 SL.	11 056	- 363	- 291	3 420	1 277	-2,38%
GARCIA MOYA AUTOMOCION SA	10 995	154	266	5 190	332	1,67%
ALGECIREÑA DE MOTOR E INVERSIONES SL	10 938	- 520	- 373	5 610	829	-3,62%
JAPBLUE ALGARVE, S.A.	10 846	- 721	- 605	10 324	690	-2,85%
MOTOR GOMEZ PREMIUM SL.	10 678	31	54	6 906	827	1,12%
LAUDATE ALQUILER ESPANA S.L.	7 800	644	n.a.	10 398	4	12,41%
JUAN ARMAS SOCIEDAD ANONIMA	4 543	- 446	36	30 433	644	-15,91%
RAHN CORAUTO SA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
VEMOTOR CANARIAS	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
GARAGE VICTORIA SA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
INNOVACIONES DEL MEDITERRANEO	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
RAHN JAPON SA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Orbis, Bureau van Dijk; Annual reports of respective companies

## Appendix 4.4 COGS approximation

For approximation of COGS will be used data of the companies-representatives of the same industry, size, within the same period of time, which presented their information about COGS.

The value of EBIT will be used for COGS approximation:

$$EBIT = Revenues - COGS - Other operating expenses$$

From here value of COGS and Other operating expenses is:

$$COGS + Other operating expenses = Revenues - EBIT$$

These values for the financial year 2015 are presented in the following table:

Company name	Country	Cons. code	Operating revenue (Turnover) th USD	COGS th USD	Other operating expenses th USD	Operating P/L [=EBIT] th USD
<b>THE CAR PEOPLE LIMITED</b>	GB	U1	266 264	246 066	11 741	8 457
<b>BAS GROEP B.V.</b>	NL	U1	80 277	59 549	17 216	3 512
<b>HIGHBRIDGE CARAVAN CENTRE LIMITED</b>	GB	U1	59 429	52 153	3 478	3 798
<b>GRASSICK'S GARAGE LIMITED</b>	GB	U1	49 238	45 317	3 936	-15
<b>PREMIER AUTOMOTIVE LIMITED</b>	GB	U1	43 714	40 245	3 051	418
<b>CAR WORLD (CAMBS) LTD</b>	GB	U1	38 536	35 099	2 079	1 358
<b>DENNIS HORTON &amp; SON LTD</b>	GB	U1	38 211	34 224	3 442	545
<b>SPARSHATTS OF FAREHAM LIMITED</b>	GB	U1	37 251	33 195	3 355	701
<b>TRIDENT GARAGES LIMITED</b>	GB	U1	36 502	32 801	3 070	631
<b>RODGERS OF PLYMOUTH LIMITED</b>	GB	U1	34 930	31 587	3 091	252
<b>JUNCTION 17 CARS LIMITED</b>	GB	U1	22 919	20 954	906	1 059
<b>ΑΓΚΡΙΠΑΝ - ΣΠΥΡΟΣ Δ. ΠΑΝΤΕΛΕΗΜΟΝΙΤΗΣ Α.Ε.Β.Ε.</b>	GR	U1	19 609	13 158	6 257	194
<b>URA VENTURES LIMITED</b>	GB	U1	18 743	12 749	2 568	3 426
<b>BODGIT AND SCARPER ENTERPRISES LIMITED</b>	GB	U1	17 049	15 478	1 085	486
<b>WITHAM GARAGE LTD</b>	GB	U1	266 264	14 170	11 741	966

Then COGS + Other operating expenses will be calculated, and adjustment for the weighted average difference with original COGS amount will be made:

Company name	COGS + Other operating exp., th USD	Difference, th USD	Adjusted cost of sales, th USD	Difference after adjustment, th USD	Significance of the difference, %
<b>THE CAR PEOPLE LIMITED</b>	257 807	-11 742	235 000	10 979	4,46%
<b>BAS GROEP B.V.</b>	76 765	-17 215	69 974	-10 449	-17,55%
<b>HIGHBRIDGE CARAVAN CENTRE LIMITED</b>	55 631	-3 478	50 710	1 425	2,73%
<b>GRASSICK'S GARAGE LIMITED</b>	49 253	-3 935	44 896	406	0,90%
<b>PREMIER AUTOMOTIVE LIMITED</b>	43 296	-3 049	39 466	767	1,91%
<b>CAR WORLD (CAMBS) LTD</b>	37 178	-2 081	33 889	1 196	3,41%
<b>DENNIS HORTON &amp; SON LTD</b>	37 666	-3 443	34 334	-123	-0,36%
<b>SPARSHATTS OF FAREHAM LIMITED</b>	36 550	-3 356	33 317	-135	-0,41%
<b>TRIDENT GARAGES LIMITED</b>	35 871	-3 071	32 698	90	0,28%
<b>RODGERS OF PLYMOUTH LIMITED</b>	34 678	-3 090	31 610	-34	-0,11%
<b>JUNCTION 17 CARS LIMITED</b>	21 860	-905	19 926	1 022	4,88%
<b>ΑΓΚΡΙΠΑΝ - ΣΠΥΡΟΣ Δ. ΠΑΝΤΕΛΕΗΜΟΝΙΤΗΣ Α.Ε.Β.Ε.</b>	19 415	-6 256	17 697	-4 545	-34,54%
<b>URA VENTURES LIMITED</b>	15 317	-2 568	13 962	-1 218	-9,55%
<b>BODGIT AND SCARPER ENTERPRISES LIMITED</b>	16 563	-1 086	15 098	374	2,41%
<b>WITHAM GARAGE LTD</b>	15 270	-1 100	13 919	246	1,73%

Weighted average difference between COGS and COGS + Other operating expenses in 2015 was 8,813% and third column of the table was calculated as multiplication COGS + Other operating expenses by 0,9119. Columns with differences represent monetary value (in th USD) of the variation of estimated value of cost of sales from COGS declared by the company.

Higher difference for ΑΓΚΡΙΠΑΝ - ΣΠΥΡΟΣ Δ. ΠΑΝΤΕΛΕΗΜΟΝΙΤΗΣ can be explained by the specific of their products – this company mostly sells automotive for agriculture. Despite this company other differences can be considered as not significant in aggregate.

In the same fashion were made calculations for the years 2014 and 2013. Weighted average differences for these years were 11,140% (multiplier 0,8886) and 12,856% (multiplier 0,8714) respectively.



Results of the calculations and original data are presented below:

- For the FY 2014

Company name	Ctry	Cons. code	Year	Operating revenue (Turnover) th USD	COGS th USD	Other operating expenses th USD	Operating P/L [=EBIT] th USD
THE CAR PEOPLE LIMITED	GB	U1	2014	264 128	244 064	12 170	7 892
ΘΕΟΧΑΡΑΚΗΣ, ΝΙΚ. Ι., Α.Ε.	GR	U1	2014	125 709	93 251	27 819	4 639
BAS GROEP B.V.	NL	U1	2014	81 858	62 293	16 501	3 063
HIGHBRIDGE CARAVAN CENTRE LIMITED	GB	U1	2014	58 769	51 191	3 395	4 183
GRASSICK'S GARAGE LIMITED	GB	U1	2014	55 766	50 968	4 417	379
TRIDENT GARAGES LIMITED	GB	U1	2014	40 684	36 501	4 039	144
DENNIS HORTON & SON LTD	GB	U1	2014	40 120	36 028	3 492	602
PREMIER AUTOMOTIVE LIMITED	GB	U1	2014	37 483	34 123	2 735	624
RODGERS OF PLYMOUTH LIMITED	GB	U1	2014	35 980	32 396	3 204	379
CAR WORLD (CAMBS) LTD	GB	U1	2014	34 944	31 273	2 681	990
SPARSHATTS OF FAREHAM LIMITED	GB	U1	2014	32 967	28 838	3 332	797
WALKER MOTORS LIMITED	GB	U1	2014	26 852	25 092	1 264	496
ΑΓΚΡΙΠΑΝ - ΣΠΥΡΟΣ Δ. ΠΑΝΤΕΛΗΜΟΝΙΤΗΣ Α.Ε.Β.Ε.	GR	U1	2014	21 963	15 445	8 411	-1 893
URA VENTURES LIMITED	GB	U1	2014	18 906	13 865	2 644	2 397
BODGIT AND SCARPER ENTERPRISES LIMITED	GB	U1	2014	17 197	15 613	1 036	548
WITHAM GARAGE LTD	GB	U1	2014	15 093	12 972	1 129	992

Company name	COGS + Other operating exp., th USD	Difference, th USD	Adjusted cost of sales, th USD	Difference after adjustment, th USD	Significance of the difference, %
THE CAR PEOPLE LIMITED	256 236	-12 172	227 692	-16 372	-6,71%
ΘΕΟΧΑΡΑΚΗΣ, ΝΙΚ. Ι., Α.Ε.	121 070	-27 819	107 583	14 332	15,37%
BAS GROEP B.V.	78 795	-16 502	70 017	7 724	12,40%
HIGHBRIDGE CARAVAN CENTRE LIMITED	54 586	-3 395	48 505	-2 686	-5,25%
GRASSICK'S GARAGE LIMITED	55 387	-4 419	49 217	-1 751	-3,44%

<b>TRIDENT GARAGES LIMITED</b>	40 540	-4 039	36 024	-477	-1,31%
<b>DENNIS HORTON &amp; SON LTD</b>	39 518	-3 490	35 116	-912	-2,53%
<b>PREMIER AUTOMOTIVE LIMITED</b>	36 859	-2 736	32 753	-1 370	-4,01%
<b>RODGERS OF PLYMOUTH LIMITED</b>	35 601	-3 205	31 635	-761	-2,35%
<b>CAR WORLD (CAMBS) LTD</b>	33 954	-2 681	30 172	-1 101	-3,52%
<b>SPARSHATTS OF FAREHAM LIMITED</b>	32 170	-3 332	28 586	-252	-0,87%
<b>WALKER MOTORS LIMITED</b>	26 356	-1 264	23 420	-1 672	-6,66%
<b>ΑΓΚΡΙΑΝ - ΣΠΥΡΟΣ Δ. ΠΑΝΤΕΛΗΜΟΝΙΤΗΣ Α.Ε.Β.Ε.</b>	23 856	-8 411	21 198	5 753	37,25%
<b>URA VENTURES LIMITED</b>	16 509	-2 644	14 670	805	5,81%
<b>BODGIT AND SCARPER ENTERPRISES LIMITED</b>	16 649	-1 036	14 794	-819	-5,24%
<b>WITHAM GARAGE LTD</b>	14 101	-1 129	12 530	-442	-3,41%

- FY 2013

Company name	Ctry	Cons. code	Year	Operating revenue (Turnover) th USD	COGS th USD	Other operating expenses th USD	Operating P/L [=EBIT] th USD
<b>THE CAR PEOPLE LIMITED</b>	GB	U1	2013	214 322	198 332	10 077	5 912
<b>BAS GROEP B.V.</b>	NL	U1	2013	93 880	71 714	17 468	4 698
<b>ΘΕΟΧΑΡΑΚΗΣ, ΝΙΚ. Ι., Α.Ε.</b>	GR	U1	2013	93 192	61 565	32 554	-927
<b>GRASSICK'S GARAGE LIMITED</b>	GB	U1	2013	58 825	53 868	4 642	315
<b>HIGHBRIDGE CARAVAN CENTRE LIMITED</b>	GB	U1	2013	55 270	49 738	2 801	2 730
<b>TRIDENT GARAGES LIMITED</b>	GB	U1	2013	43 660	39 210	4 260	191
<b>RODGERS OF PLYMOUTH LIMITED</b>	GB	U1	2013	32 620	29 092	3 307	221
<b>PREMIER AUTOMOTIVE LIMITED</b>	GB	U1	2013	29 523	27 019	2 052	452
<b>CAR WORLD (CAMBS) LTD</b>	GB	U1	2013	27 460	24 822	1 954	685
<b>WALKER MOTORS LIMITED</b>	GB	U1	2013	24 911	22 844	1 225	842
<b>URA VENTURES LIMITED</b>	GB	U1	2013	19 745	14 493	2 819	2 432
<b>BODGIT AND SCARPER ENTERPRISES LIMITED</b>	GB	U1	2013	16 419	14 679	1 232	509
<b>ΑΓΚΡΙΑΝ - ΣΠΥΡΟΣ Δ.</b>	GR	U1	2013	15 250	10 329	7 449	-2 528

**ΠΑΝΤΕΛΗΜΟΝΙΤΗΣ  
Α.Ε.Β.Ε.**

<b>WITHAM GARAGE LTD</b>	GB	U1	2013	14 482	12 474	1 126	882
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And, thus, results of the COGS computation are the following:

Company name	COGS + Other oper- ating exp., th USD	Difference, th USD	Adjusted cost of sales, th USD	Difference after ad- justment, th USD	Significance of the difference, %
<b>THE CAR PEOPLE LIM- ITED</b>	208 410	-10 078	181 617	-16 715	-8,43%
<b>BAS GROEP B.V.</b>	89 182	-17 468	77 717	6 003	8,37%
<b>ΘΕΟΧΑΡΑΚΗΣ, ΝΙΚ. Ι., Α.Ε.</b>	94 119	-32 554	82 019	20 454	33,22%
<b>GRASSICK'S GARAGE LIMITED</b>	58 510	-4 642	50 988	-2 880	-5,35%
<b>HIGHBRIDGE CARA- VAN CENTRE LIMITED</b>	52 540	-2 802	45 786	-3 952	-7,95%
<b>TRIDENT GARAGES LIMITED</b>	43 469	-4 259	37 881	-1 329	-3,39%
<b>RODGERS OF PLYM- OUTH LIMITED</b>	32 399	-3 307	28 234	-858	-2,95%
<b>PREMIER AUTOMO- TIVE LIMITED</b>	29 071	-2 052	25 334	-1 685	-6,24%
<b>CAR WORLD (CAMBS) LTD</b>	26 775	-1 953	23 333	-1 489	-6,00%
<b>WALKER MOTORS LIMITED</b>	24 069	-1 225	20 975	-1 869	-8,18%
<b>URA VENTURES LIM- ITED</b>	17 313	-2 820	15 087	594	4,10%
<b>BODGIT AND SCARPER ENTERPRISES LIM- ITED</b>	15 910	-1 231	13 865	-814	-5,55%
<b>ΑΓΚΡΙΠΑΝ - ΣΠΥΡΟΣ Δ. ΠΑΝΤΕΛΗΜΟΝΙΤΗΣ Α.Ε.Β.Ε.</b>	17 778	-7 449	15 492	5 163	49,99%
<b>WITHAM GARAGE LTD</b>	13 600	-1 126	11 852	-622	-4,99%

On the basis of the comparison to the original value of COGS and estimated value, it can be assumed, that for the majority of companies in automotive resell industry the estimated values are accurate and computed multipliers can be applied to other companies for the purpose of assessment of cost of sales.

## Appendix 4.5 Average values of resale price margins

Company name	margin 2015	margin 2014	margin 2013	Average	Weighted average	Differences
AUTOMOVILES GOMIS SA	9,55%	11,36%	9,29%	10,07%	10,02%	↑ 0,04%
VALLADOLID AUTOMOVIL SA	9,24%	11,36%	12,69%	11,10%	11,10%	↓ -0,01%
HERRERO Y LOPEZ SA	8,81%	10,74%	11,26%	10,27%	10,22%	↑ 0,05%
GARAJE LEON SL	1,14%	6,92%	10,92%	6,33%	5,19%	↑ 1,14%
M.& COSTAS, S.A.	9,64%	12,26%	13,71%	11,87%	11,81%	↑ 0,05%
LEJARZA SOCIEDAD ANONIMA	5,24%	4,64%	6,61%	5,50%	5,53%	↓ -0,03%
VEGAR PROMOCIONES Y EJECUCIONES SA	14,08%	15,83%	16,45%	15,45%	15,36%	↑ 0,09%
CARDAN - COMÉRCIO DE AUTOMÓVEIS, REPRESENTAÇÕES, S.A.	10,80%	13,27%	11,93%	12,00%	12,01%	↓ -0,01%
SUR PONIENTE SOCIEDAD LIMITADA	7,60%	8,89%	10,87%	9,12%	9,26%	↓ -0,14%
SOCIEDAD ANONIMA DE VEHICULOS REPUESTOS Y SERVICIOS	10,92%	10,84%	12,44%	11,40%	11,34%	↑ 0,06%
ANTONIO BRAVO SA	9,76%	13,95%	15,17%	12,96%	12,92%	↑ 0,05%
STARSUL - COMÉRCIO DE AUTOMÓVEIS, S.A.	12,03%	13,41%	11,97%	12,47%	12,46%	↑ 0,01%
PROA AUTOMOCION SL	9,77%	10,31%	14,35%	11,47%	11,26%	↑ 0,21%
MOTOR TARREGA SA	9,53%	11,70%	14,28%	11,84%	11,70%	↑ 0,13%
GOIKOAUTO SA	9,21%	10,84%	11,24%	10,43%	10,37%	↑ 0,06%
ANÍBAL CARVALHO & FILHOS, S.A.	12,20%	12,61%	13,79%	12,87%	12,79%	↑ 0,08%
TIBERMOTOR SUR SL	2,48%	1,22%	n.a.	1,85%	1,93%	↓ -0,08%
AUTO MARTINAUTO, S.A.	11,30%	13,20%	15,37%	13,29%	13,09%	↑ 0,20%
AGRO-TRACCION VEHICULOS, SA	9,32%	11,96%	12,29%	11,19%	11,12%	↑ 0,07%
AUTONERVION SOCIEDAD ANONIMA	8,51%	8,81%	10,38%	9,23%	9,26%	↓ -0,03%
GOMEZ PLATZ SA	5,48%	8,51%	10,72%	8,24%	8,14%	↑ 0,10%
GAVIS - SOCIEDADE DE REPRESENTAÇÕES DE AUTOMÓVEIS, S.A.	9,44%	12,87%	14,19%	12,17%	12,09%	↑ 0,08%
HERMOTOR - COMÉRCIO DE AUTOMÓVEIS, S.A.	-1,88%	1,94%	4,75%	1,60%	1,75%	↓ -0,15%
IMPERAUTO IMPERIAL DE AUTOMOVILES SL	11,53%	13,75%	15,82%	13,70%	13,65%	↑ 0,05%
CIUDAUTO SL	-1,23%	-0,50%	n.a.	-0,87%	-0,93%	↑ 0,06%
AUTODILER 3000 SL	6,00%	7,58%	7,84%	7,14%	7,01%	↑ 0,13%
MOTOR GOMEZ PREMIUM SL	8,02%	10,68%	12,21%	10,30%	10,09%	↑ 0,21%
LLEIDAMOBIL SA	8,01%	7,97%	9,31%	8,43%	8,43%	↑ 0,01%
TALLERES CLEMENTE SA	7,22%	9,90%	11,20%	9,44%	9,46%	↓ -0,02%
MARBEAR SA	-6,71%	-7,35%	-3,03%	-5,70%	-5,73%	↑ 0,03%
GDA - GESTÃO E DISTRIBUIÇÃO AUTOMÓVEL, S.A.	11,99%	21,61%	n.a.	16,80%	14,70%	↑ 2,10%
FILLS DE M MOYA SL	6,46%	8,83%	n.a.	7,65%	7,59%	↑ 0,05%
ALMOAUTO MOTOR SL	9,04%	10,28%	11,80%	10,38%	10,56%	↓ -0,18%
TALLERES CASTEJON SA	8,29%	9,92%	11,47%	9,89%	9,93%	↓ -0,03%
S.A. MALAGUENA DE AUTOMOCION	6,83%	6,91%	7,83%	7,19%	7,18%	↑ 0,02%
AUTO - VIAÇÃO MICAELENSE, LDA	15,69%	14,73%	14,00%	14,80%	14,78%	↑ 0,03%
CASTILLA VEHICULOS INDUSTRIALES SA	12,02%	24,24%	10,85%	15,70%	15,37%	↑ 0,34%
GRAN CENTRO GETAFE SL	8,07%	9,92%	12,53%	10,17%	10,40%	↓ -0,23%
COMERCIAL AUTOMOTO SA	7,00%	10,38%	8,55%	8,64%	8,70%	↓ -0,05%
ALGECIREÑA DE MOTOR E INVERSIONES SL	3,22%	4,50%	1,56%	3,09%	3,08%	↑ 0,01%
AUTOMOVILES NEMESIO SOCIEDAD ANONIMA	7,06%	11,28%	13,28%	10,54%	10,58%	↓ -0,04%
TUACAR - AUTOMÓVEIS E MÁQUINAS, S.A.	10,39%	12,47%	n.a.	11,43%	11,45%	↓ -0,02%
BRITANICA DE AUTOMOVILES SL	7,88%	13,04%	13,12%	11,35%	11,38%	↓ -0,03%
GAMO BAHIA SL	5,20%	5,66%	n.a.	5,43%	5,43%	↑ 0,00%
CASACUBERTA AUTOMOBILS SL	-2,21%	-0,04%	4,15%	0,63%	0,65%	↓ -0,01%
GARCIA MOYA AUTOMOCION SA	10,89%	11,99%	13,70%	12,19%	12,18%	↑ 0,01%
JAPBLUE ALGARVE, S.A.	7,82%	9,56%	10,37%	9,25%	9,25%	↓ 0,00%
BEOLA MOTOR SA	6,94%	9,21%	9,80%	8,65%	8,68%	↓ -0,04%
LAUDATE ALQUILER ESPANA S.L.	17,41%	17,78%	6,99%	14,06%	14,25%	↓ -0,19%