The Final Regulations

The most noteworthy feature of the 1993 regulations in comparison to earlier versions of the regulations under section 482 was the emphasis on **comparability, and the resulting flexibility**

- Section **1.482-1(c)(2)(i)** discusses the role of comparability under the best method rule.
- The results of **identical transactions** between unrelated parties under **identical circumstances** provide the most objective basis for determining the true taxable income of a controlled taxpayer.
- The regulations contemplate use of uncontrolled transactions that are **comparable**, rather than identical, to the controlled transaction.

- Section **1.482-1(c)(2)(ii)** discusses data and assumptions: **completeness** and **accuracy** of data, **reliability** of assumptions, and **sensitivity** of results to deficiencies in data and assumptions.

- Completeness and accuracy of data defines the ability to **identify** and **quantify** **material differences**.

- There are several differences between Section **1.482-1(d)(2)** and its counterpart in the 1993 regulations (§ 1.482-1T(c)(2)(i)). One of them, the definition of comparability in the final regulations contemplates the use of so-called **"inexact" comparables under all methods**. The 1993 regulations only contemplated the use of such analyses under the CPM.

- Section **1.482-1(d)(3)** discusses the five factors that affect comparability: **functions**, **contractual terms**, **risks**, **economic conditions** and **property or services**.

- Section **1.482-1(d)(4)** sets forth rules for certain special circumstances affecting comparability.

- Section **1.482-1(d)(4)(i)** describes the extent to which market share strategies will be respected.

- Section **1.482-1(d)(4)(ii)** addresses certain issues presented by differences in geographic markets.

- Section **1.482-1(d)(4)(iii)** describes certain transactions that are not ordinarily accepted as comparables. Transactions not in the ordinary course of business, and transactions arranged with a principal purpose of establishing an arm's length result, ordinarily will not constitute comparable transactions for purposes of section 482.

Comparability.

(1) *Standard of comparability.*

In order to be considered comparable to a controlled transaction, an uncontrolled transaction need not be identical to the controlled transaction, but must be sufficiently similar that it provides a reliable measure of an arm's length result. If there are material differences between the controlled and uncontrolled transactions, adjustments must be made **if the effect** of such differences on prices or profits **can be ascertained** with sufficient accuracy to improve the reliability of the results.

(2) *Factors for determining comparability.*

(i) *Functional analysis*.

(A) Research and development;

(B) Product design and engineering;

(C) Manufacturing, production and process engineering;

(D) Product fabrication, extraction, and assembly;

(E) Purchasing and materials management;

(F) Marketing and distribution functions, including inventory management, warranty administration, and advertising activities;

(G) Transportation and warehousing; and

(H) Managerial, legal, accounting and finance, credit and collection, training, and personnel management services.

(ii) *Contractual terms*

(*1*) The form of consideration charged or paid;

(*2*) Sales or purchase volume;

(*3*) The scope and terms of warranties provided;

(*4*) Rights to updates, revisions or modifications;

(*5*) The duration of relevant license, contract or other agreements, and termination or renegotiation rights;

(*6*) Collateral transactions or ongoing business relationships between the buyer and the seller, including arrangements for the provision of ancillary or subsidiary services; and

(*7*) Extension of credit and payment terms.

(iii) *Risk*-

(*1*) Market risks, including fluctuations in cost, demand, pricing, and inventory levels;

(*2*) Risks associated with the success or failure of research and development activities;

(*3*) Financial risks, including fluctuations in foreign currency rates of exchange and interest rates;

(*4*) Credit and collection risks;

(*5*) Product liability risks; and

(*6*) General business risks related to the ownership of property, plant, and equipment.

(iv) *Economic conditions*. (Affect the prices or the profit)

(A) The similarity of geographic markets;

(B) The relative size of each market, and the extent of the overall economic development in each market;

(C) The level of the market (e.g., wholesale, retail, etc.);

(D) The relevant market shares for the products, properties, or services transferred or provided;

(E) The location-specific costs of the factors of production and distribution;

(F) The extent of competition in each market with regard to the property or services under review;

(G) The economic condition of the particular industry, including whether the market is in contraction or expansion; and

(H) The alternatives realistically available to the buyer and seller.

(v) *Property or services.*

Evaluating the degree of comparability between controlled and uncontrolled transactions requires a comparison of the property or services transferred in the transactions.

Data and assumptions.

Whether a method provides the most reliable measure of an arm's length result also depends upon

(A) *Completeness and accuracy of data.*

(B) *Reliability of assumptions.*

(C) *Sensitivity of results to deficiencies in data and assumptions.*

Sample Selection Criteria

- SIC code

- Geographic region

- Primary business (retail, manufacturing)

- Significant intangibles (R&D screening)

- Sales size

- Consistent loss

- Other quantitative screening criteria

- Qualitative screening (reading 10K)

COMPUSTAT
  (Source:http://www.standardpoor.com/)

- Among many company financial databases, Standard and Poor's COMPUSTAT (North America) and COMPUSTAT (Global) databases are the most popular among transfer pricing economists because of the unique feature of **standardized financial information** and the accompanying Microsoft Windows based analytical application software, Research Insight.

- To standardize the COMPUSTAT (North America) company data, Standard and Poor's collects data following the guidelines of the Financial Accounting Standards Board (**FASB**), SEC and U.S. Generally Accepted Accounting Principals and Procedures (**GAAP**).

- To standardize the international data for the COMPUSTAT (Global), Standard and Poor's examines financial statements from a variety of countries, identifies commonly used items regardless of their geographic location, business activity or accounting practices, and normalizes data according to **local accounting principles**, **disclosure methods** and **data item definitions**.

- The COMPUSTAT (North America) database includes approximately **10,000 active companies, 9,000 inactive companies**, and 900 Canadian companies. It includes basic company information such as company name, address and officer information, and industry and geographic segment information. It also includes annual and quarterly fundamental financial data items, items specific to the financial service industry, prices, dividends and earnings information. The time length for annual information is 20 years and 12 years for quarterly information.

- The COMPUSTAT (Global) Database includes approximately **12,000 companies** in 70 countries around the world. Its annual information goes back 12 years. It includes monthly currency cross-translation tables for more than 110 currencies. It also includes country overviews from Standard & Poor's DRI Economic sector information.

- Research Insight is a 32-bit Windows software application designed for screening COMPUSTAT databases and generating financial reports. Research Insight can screen the market for companies that meet key criteria and compare companies against their peers and indices. It can also create customized reports and charts integrating key financial measures for current or historic time periods. Other notable features of Research Insight are: users can change any data value and add forecasting values into the future, import information from an ASCII file, and export report results and concepts. It also interacts directly with Microsoft Excel software through its macro application module.

GLOBAL RESEARCHER (SEC)

(Source: http://www.bvdep.com/)

- GLOBAL RESEARCHER (SEC) published by Primark Corporation and Bureau van Dijk Electronic Publishing is a database program with public company data based on the documents filed with the U.S. Securities and Exchange Commission (SEC). Even though it does not have sophisticated numerical analytical functions like the ones that Research Insight has, **search and report functions are very easy and user friendly**. It also searches text strings from its database. This text search function is especially useful for quick screening of company data.

- The drawbacks of this database are that the financial data are **not standardized** and the text documents are limited. It includes business and financial information on over **12,000 public companies** in the United States. These companies are domestic and foreign companies listed on the national, regional and over-the-counter U.S. stock exchanges. It also contains up to 15 years of annual and quarterly financial statement data.

- Some of the information that this database provides are: (1) company profile such as SIC codes, description of business, product and geographic segments, auditors, (2) financial statements such as balance sheets, income statement, cash flow statements and footnotes, (3) financial ratios and growth rates, (4) security and stock data, (5) directors, officers, institutional and insider ownership and subsidiaries, (6) full text of president's letter, management discussion and auditor's report, and (7) list of SEC filings.

GLOBAL RESEARCHER (Worldscope)

GLOBAL RESEARCHER (Worldscope) is an international version of GLOBAL RESEARCHER (SEC). It includes somewhat standardized financial data to allow cross border comparison of companies worldwide. This facilitates comparison between companies within and across national boundaries. The database includes approximately **25,000 companies** (of which 10,000 are from the US) in more than 50 countries in developed and emerging markets. These companies represent over 90% of global market capitalization. Furthermore, the database has information up to 18 years.

AMADEUS, FAME and JADE

(Source: http://www.bvdep.com/)

Bureau van Dijk publishes three other useful CD-ROM based, foreign company databases. They are AMADEUS, FAME and JADE. These databases have a much more extensive set of financial data for foreign companies than Worldscope. Each one covers a different geographic region. AMADEUS covers **European countries,** FAME covers **Great Britain** and JADE covers **Japan**. All three databases can be searched by numerous search criteria, including SIC and gross sales ranges.

Unfortunately, the financial data in these three databases is according to the accounting standards set forth by the countries they operate in. Thus companies' financial data are not comparable across countries. In addition, except AMADEUS, for each company, there is no narrative, even a short one paragraph one as in Worldscope, to describe a company and the functions it performs.

AMADEUS (Analyse MAjor Databases from EUropean Sources)

- It includes financial data of **4 million** European companies, including Eastern Europe. The database contains up to 10 years of historical consolidated and unconsolidated annual accounts. There are over 100 search criteria, including detailed uniform 7 digit activity codes and a primary activity code. Ownership information and a trade description in the local language and in English are also available.

JADE (Japanese Accounts and Data on Enterprises)

It includes financial data of **100,000 Japanese companies.** More than 100 search criteria can be used to search companies and these searched data can be converted in any 10 available foreign currencies.

The database include detailed historical annual accounts and financial ratios, identification number (teikoku number, long-term bank of Japan number, security code), industry classification, address and phone number, legal form, and credit scoring.

FAME

- This database contains information on **public and private** companies in the UK and Ireland. It includes up to 10 years of information for **550,000 companies.**

MOODY'S MANUALS AND HANDBOOKS
(Source: http://www.fisonline.com/)

- Moody's Investors Service publishes annually and updates its databases weekly. Moody's various manuals provide information on over **25,000 U.S. and non-U.S. corporate entities** and over 17,000 municipal and government securities.