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Transfer Pricing Policy Review

Outside Evidence Work

Abstract

Anvis Group's transfer pricing policy generally complies with the OECD Transfer Pricing Guidelines (2010). In order to effectively limit the administrative burden associated with identifying and maintaining the required outside evidence a transactional net margin approach is chosen. Ultimately, the arm's length operating profit is employed to arrive at appropriate gross profit margins.

Several TP Catalyst studies (Bureau von Dijk) were conducted to identify contract services and contract R&D comparables. The present paper documents the econometric analyses conducted to arrive at the final arm's length ranges used for transfer pricing policy purposes.

Author:
Dr. Steffen R. Möckel
Diplom-Volkswirt / Economist

Contact:
Konkordiastrasse 2
40129 Düsseldorf

Tel.: +49 211 9304209
Mob.: +49 15774 111022

e-mail: dr.s.moeckel@contrabass.biz
www.contrabass.biz

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1 Final arm's length ranges and their application

1.1 General provisions

Anvis Group's transfer pricing system for intra-group services and contract R&D relies on the transactional net margin method. At budget, the arm's length transfer price for these services is determined using a profit mark-up consistent with the mid-point of the respective interquartile range. The actual result is regularly reviewed (at least after 6 months). A transfer pricing adjustment is made whenever the respective service entity's actual profit is not within the corresponding arm's length range. The adjustment is made to the range's upper or lower bound whatever is closest to the actual result achieved.

The adjustment is a retro-active adjustment ensuring that the actual results are within the arm's length range. This is largely consistent with Anvis Group's current practice. In order to charge each recipient with the actual cost incurred on its behalf/the actual benefits received, Anvis Deutschland GmbH (AVS002) issues already debit or credit notes.

As outlined below, the arm's length ranges reflect period averages. Accordingly, a transfer pricing adjustment back to the closest upper or lower bound can be based on period averages as well. In order to limit the transfer pricing related worklaod the comparison will be based on the respective Anvis entities' annual data.

The arm's length ranges are to be reviewed regularly.

- just adding new data (effectively employ a moving average approach)
- conduct a completely new comparables search
- recalculate the necessary comparability adjustments

Bureau van Dijk's *tp catalyst* primarily provides convenient access to a comprehensive database (Amadeus) of European companies. The data available cover:

- trade and business descriptions
- industry classifications (e.g. NACE, ...)
- financial data presented in a global standard format and a common currency (e.g. K€) for several years
- ownership information including and a corresponding independence index
- management / directors

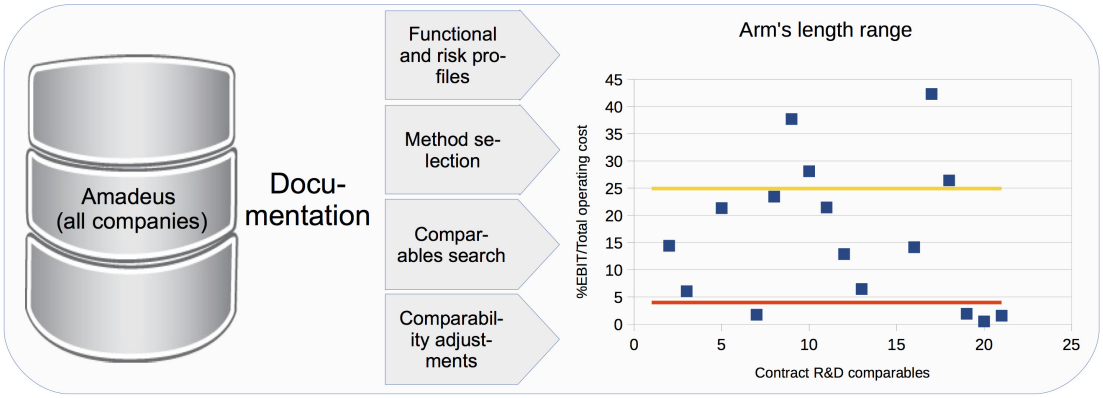

Figure 1: Bureau van Dijk's *tp catalyst*'s major features

In addition to providing access to company data, *tp catalyst* effectively supports the transfer pricing related outside evidence work (Figure 1). It allows to define the tested party's functional and risk profile. The corresponding segmented financial data can be keyed in and made avaialble for further analysis - in particular for determining comparability adjustments as and when required. With respect to comparables search *tp catalyst* provides a full audit trail from the universe of potential comparables to the finally accepted set of functionally comparable companies used to determing the selected profit level indicator's arm's length range.

2 Industry code based and keyword based searches define the universe of potential comparables

The search criteria are derived from Anvis Group's service companies' functional and risk profile.

3 The contract service comparables

4 The contract R&D comparables

4.1 The universe of potential contract R&D comparables

The transfer pricing keyword based search identified 211 potential contract R&D comparables (see Table 2).These 211 potential comparables stem from a base population of more than 3 Mio. active European companies with 3 consecutive years of

Major Service Activity	Functions performed	Risks assumed
Contract R&D	The product engineering ranges from • product specification • product development • production of samples	The risk exposure is limited as the plants cover the cost (including possible budget overruns)

Table 1: Anvis Service companies - functional and risk profile

financial data (covering the 3 year period 2011 - 2013).The transfer pricing specific keywords used were:

- testing and analysis
- laboratory, research, and r&d.

Bureau von Dijk's *tp catalyst* offers a set of standardized transfer pricing related keywords which cover a wide range of functions to be considered when determining an affiliated entity's functanal and risk profile. Obviously, these keywords are not a full representation of the comprehensive R&D functions Anvis Group's service companies provide. Activities such as product engineering and/or product development are not explicitly taken into account. According to Figure 2 most of the

Selection Summary

	Criterion	Excl./Incl.	No per step	Result
1.	Companies with at least 3 consecutive years of accounts and latest year for analysis 2013	Inclusion	3,203,924	3,203,924
2.	Active companies only	Inclusion	3,146,243	3,146,243
3.	World region: All European countries	Inclusion	3,203,924	3,146,243
4.	Items available for all years: Operating Revenue (Turnover), Costs of Goods Sold, Gross Profit, Operating P/L (EBIT), Costs of Employees	Inclusion	23,205	23,134
5.	TP Keywords: Testing / analysis / laboratory / research / r&d	Inclusion	24,168	310
6.	Operating Revenue (thEUR): from 2,000 to 50,000	Inclusion	235,779	211
	The companies resulting from the search match all the activity criteria		**Total**	**211**
	Note: access to European companies - All companies, with consolidated accounts sourced from local registry filings preferred			

Table 2: Universe of potential contract R&D comparables employing transfer pricing keywords

companies within the universe of potential comparables do not qualify as potential

comparable due to the lack of meaningful financial data throughout a minimum base period of 3 years. The additional size criterion, which requires the potential comparable contract R&D companies to report annual sales between €2 Mio and €50 Mio eliminates fewer companies from further review.

In order to assess the sensitivity of the order of magnitude of the universe of po-

Selection Summary

	Criterion	Excl./Incl.	No per step	Result
1.	Companies with at least 3 consecutive years of accounts and latest year for analysis 2013	Inclusion	3,203,924	3,203,924
2.	Active companies only	Inclusion	3,146,243	3,146,243
3.	World region: All European countries	Inclusion	3,203,924	3,146,243
4.	Items available for all years: Operating Revenue (Turnover), Costs of Goods Sold, Gross Profit, Operating P/L (EBIT), Costs of Employees	Inclusion	23,205	23,134
5.	Text search: "Contract R&D" OR "research and development" OR "product engineering" OR "anti-vibration"	Inclusion	188,038	1,541
6.	Exclude companies with no activity description	Inclusion	2,162,199	1,444
7.	Operating Revenue (thEUR): from 2,000 to 50,000	Inclusion	235,779	900
	The companies resulting from the search match all the activity criteria		**Total**	**900**
	Note: access to European companies - All companies, with consolidated accounts sourced from local registry filings preferred			

Table 3: Universe of potential contract R&D comparables employing general keywords

tential comparables with respect to the search approach an alternative search has been conducted. The analysis takes into account the following keywords:

- contract R&D, product development
- product engineering or anti-vibration

Table 3 shows that a keyword search not limited to the specific transfer pricing keywords leads to a substantially larger universe of potential comparables of 900 firms. The additional selection criteria already discussed were not changed. The increase in the sizes of the universe is, therefore, attributable to the change in keywords only.

With the various industry codes (e.g. Statistical classification of economic activities in the European Communities - NACE) *tp catalyst* offers another way for defining the universe of potential contract R&D comparables.

So far, the criteria used to arrive at the universe of potential comparables focus on functions, the relevant markets, and the the size of the operations. However,

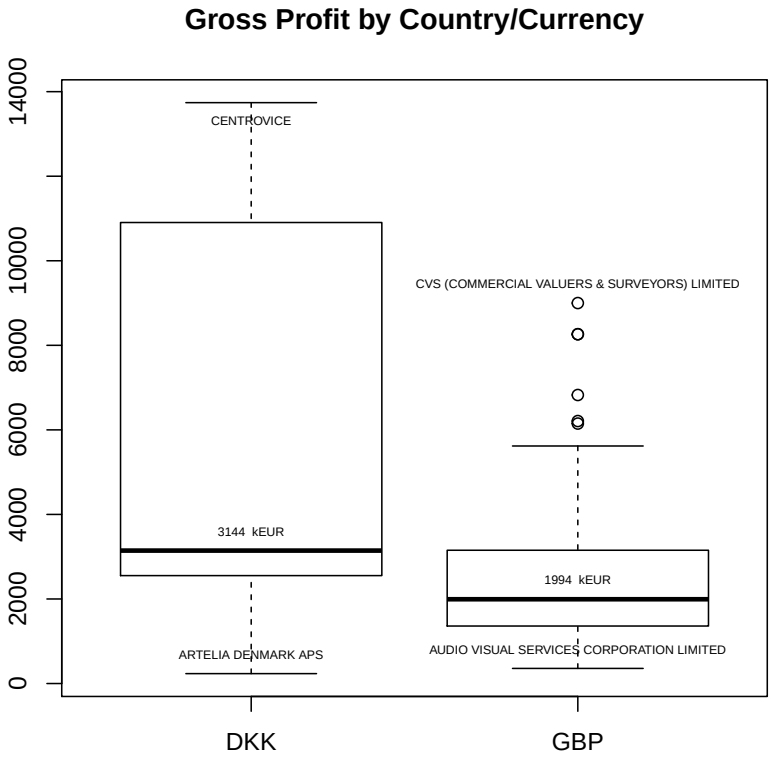

Figure 2: Test

Selection Summary

	Criterion	Excl./Incl.	No per step	Result
1.	Companies with at least 3 consecutive years of accounts and latest year for analysis 2013	Inclusion	3,203,924	3,203,924
2.	Active companies only	Inclusion	3,146,243	3,146,243
3.	World region: All European countries	Inclusion	3,203,924	3,146,243
4.	Items available for all years: Operating Revenue (Turnover), Costs of Goods Sold, Gross Profit, Other Operating Expenses, Operating P/L (EBIT), Costs of Employees	Inclusion	22,905	22,835
5.	NACE Rev. 2 primary codes: 7112 - Engineering activities and related technical consultancy, NACE Rev. 2 primary codes: 7120 - Technical testing and analysis, NACE Rev. 2 primary codes: 7219 - Other research and experimental development on natural sciences and engineering, NACE Rev. 2 primary codes: 7410 - Specialised design activities, NACE Rev. 2 primary codes: 7490 - Other professional, scientific and technical activities nec	Inclusion	122,353	665
6.	Operating Revenue (thEUR): from 2,000 to 50,000	Inclusion	235,779	335
	The companies resulting from the search match at least one of the activity criteria		**Total**	**335**
	Note: access to European companies - All companies, with consolidated accounts sourced from local registry filings preferred			

Table 4: Universe of potential contract R&D comparables based on NACE codes

5 Appendices

This sections provides supplementary information to the data sets used. The company information available was primarily retrieved from Bureau van Dijks *tp catalyst*. The Anvis license is limited to European companies included in the Amadeus all companies data base Bureau van Dijk maintains.

In order to faciliate a more detailed analysis, the results from the different searches were retrieved and uploaded in an R [1] database. *tp catalyst* provides detailed Excel output and R is able to read .csv data. The required .csv input files were, therefore, constructed from the respective Excel results.

5.1 Data used and integrity check

The retrieved financial and general data are stored in several R objects for further analysis (see Table 5 for contract R&D).

5.2 References

References

[1] R. C. Team. R: A language and environment for statistical computing, 2014.

R Object	Description	Years	Remarks
ContRaD_01	Initial set of financials (not fully retrieved) 2	5	Not used for policy purposes
ContRaD_01b	Revised initial sample. Search was adjusted to select contract R&D companies reporting salaries and wages.	5	Not used for policy purposes
ContRaD_02	Universe of potential comparables defined using special transfer pricing search keywords only	3 (2011 - 2013)	Part of the final contract R&D universe.
ContRaD_02b	Search criteria similar to ContRaD_02, however limited to a 5 year period.	5 (2009 - 2013)	Created to assess the reference period's impact on the universe.
ContRaD_03a	Universe of potential comparables based on NACE codes.	3 (2011 - 2013)	Part of the final contract R&D universe
ContRaD_03b	Search criteria similar to ContRaD_03a, however limited to a 5 year period.	5 (2009 - 2013)	Created to assess the reference periods's impact ont the universe.
ContRaD_04	Universe of potential comparables defined using general search keywords.	3 (2011 - 2013)	Part of the final contract R&D universe.
ContRaD_04b	Search criteria similar to ContRaD_04, however limited to a 5 year period.	5 (2009 - 2013)	Created to assess the reference period's impact on the universe.

Table 5: R data objects available for contract R&D analysis

R Object	Description	Years	Remarks
ContServ_01			
ContServ_02			
ContServ_03			

Table 6: R data objects available for contract services analysis