

Questions and answers on the Note published by the Spanish Tax Administration State Agency on several issues relating to the arm's length range in transfer pricing

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On 24 February, the Spanish Tax Administration State Agency published a [Note on several issues relating to the arm's length range in transfer pricing](#).

In said Note, the Finance and Tax Inspection Department of the Spanish Tax Administration State Agency analyses certain problematic issues that arise when a range of values is used, both by the taxpayers and the Administration, to determine a market value that satisfies the arm's length principle. To this end, the Note has been drawn up on the basis of Spanish corporate income tax legislation, the OECD Transfer Pricing Guidelines and the EU Joint Transfer Pricing Forum Guidelines.

Firstly, the Spanish Tax Administration State Agency establishes the possibility of valuing controlled transactions using a single figure, although it acknowledges that a range of values is most commonly used.

According to the Spanish Tax Administration State Agency, a full range of values may be used provided that all the results are of high reliability and relatively equal, after ruling out observations with a lesser degree of comparability or making the relevant comparability adjustments.

In this case, any point within the range satisfies the arm's length principle and,

therefore, no adjustment shall be made if the value declared by the taxpayer falls within the range. If the result of the transaction falls outside the range, the adjustment shall take the value of the controlled transaction to the value which, within the range, is closest to the former.

The Spanish Tax Administration State Agency continues that, in practice, however, the range does not usually comprise results of high reliability and relatively equal and existing comparability defects remain. Once the least comparable results have been eliminated and faced with comparability defects remaining that cannot be identified or quantified (and cannot, therefore, be adjusted), the range of values between the 1st and 3rd quartile (interquartile range) shall be used.

In this respect, the Spanish Tax Administration State Agency highlights that when external databases (benchmarking) are used in the selection of comparables, this is most usually the situation we are facing. It also indicates, in general, that a high dispersion in the range of values is usually indicative of comparability defects.

In this case, where comparability defects remain, if the value declared by the taxpayer falls within the interquartile range, no adjustments shall be made. If, on the



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other hand, the value declared by the taxpayer falls outside the range, a general adjustment shall be made to the median.

Having stated the above, it should be borne in mind that in order to adjust the value of the median, the Administration, taking into account the circumstances of the case, must make reference to the existence of such comparability defects.

The above applies, except where, after an exhaustive analysis of the facts and circumstances of the case, there is justification for choosing another specific point within the range, the burden of proof falling on the party that wishes to use this other point.

In this article, we analyse in detail the most frequently asked questions in this respect

Can we apply the full range of results?

One positive aspect of the Note is that the Spanish Tax Administration State Agency acknowledges the possibility of applying a full range of values without having to always resort to the interquartile range. In this case, the full range of values is valid. If we are within the range, no adjustment shall be made and if we are outside the range, the adjustment shall be made to the nearest point within the range.

However, this option is limited to the results being of high reliability and relatively equal.

There are no comparability guidelines for understanding when we are dealing with comparables of high reliability or what aspects could determine insurmountable comparability defects which make it impossible to apply the full range.

There are also no comparability guidelines on what is understood by relatively equal results or what level of dispersion would determine the non-application of the full range. It should be borne in mind that the dispersion of results in the market varies greatly depending on the sector or activity being analysed. The Spanish Tax

Administration Tax Agency merely indicates that a “high dispersion” may be considered as indicative of the existence of comparability defects. But what is a “high dispersion”?

On the other hand, this option would appear to be almost ruled out automatically in the event of conducting a benchmarking analysis using external databases as per the interpretation of the Tax Administration State Agency, which would lead us, in practice, to having to apply the interquartile range in the majority of cases.

If I fall within the interquartile range of results in the benchmarking analysis, could the median be adjusted?

In principle, no. The Note is clear in the sense that within the interquartile range, no adjustment shall be made. Without doubt another very positive aspect.

If I fall outside the interquartile range of results in the benchmarking analysis, to what value can I be adjusted?

In this case the adjustment would not be to the nearest point within the range (e.g. the lower quartile) but to the median insofar as it may be understood that the benchmarking analysis has comparability defects.

It should be stated, in this respect, that the Note establishes the obligation of the Administration to refer to the comparability defects existing in the benchmarking analysis. We consider, in this respect, that the Administration would have the burden of proving in a duly attested manner and demonstrating the existence of such comparability defects in order to apply the median used in the benchmarking analysis conducted by the taxpayer.

In practice, we are observing that very often the mention by the Administration is generic, without excessive justification by the Inspectorate. This, in practice, leads to the Inspectorate considering in a



quasi-automatic manner that any benchmarking analysis using external databases would have comparability defects.

On our part, we consider that in relation to the benchmarking analysis, the possibility should remain open for the taxpayer to be able to justify that the comparables used are of high reliability and defend the application of a full and narrow range as representative of the market value. We also consider that for the application of the interquartile range, the Inspectorate should prove the comparability defects in a duly attested manner.

In this respect, the kind of quasi-automatic application by the Inspectorate of the median applied in the benchmarking studies flatly contradicts the stance adopted by the National High Court in its judgement of 6 March 2019 in which it established that the adjustment, in these cases, should be made to the 1st quartile given that the comparability defects in the benchmarking study conducted by the taxpayer were considered as not having been proven. For further information about this judgement please refer to the PwC Tax & Legal Services online publication, [Periscopio A vueltas con la comparabilidad de resultados en materia de precios de transferencia \(only available in Spanish version\)](#).

In relation to the quantitative aspects and in the same vein assuming comparability defects in the comparability study, the Note establishes that, when we are within the interquartile range, any point is valid. However, this is not the case when we are not. In this second case, when we are outside the interquartile range, any point within the range is not valid and, therefore, the adjustment shall be made to the median.

The above, besides seeming clearly contradictory, also entails obvious inconsistency in the regularisation to which

a taxpayer may be exposed to over the years, which could give rise to unjust and unfair consequences in relation to the regularisation to which different taxpayers could be exposed.

In relation to the regularisation of the same taxpayer over the years, the example provided in the Note will suffice. A taxpayer obtains profitability of 2.1% in 2017 and 3% in 2018, being the interquartile range verified between 2.5% and 7% with a median of 4%. According to the example, the median of 4% in 2017 should be adjusted and no adjustment should be made in 2018.

Attention is drawn to the actual inconsistency generated in the taxpayer, in 2018 the taxpayer is alright with 3%. However, in 2017, the adjustment takes the tax base of the taxpayer to 4% starting from 2.1%. It is possible that in 2017 there were business reasons for falling below the range, but the adjustment takes the profitability of the taxpayer to a level that is higher than that in 2018 (when for 2018, the profitability level of 3% is correct and valid). And what if the taxpayer had obtained profitability of 2.6% in 2017 or even 2.6% each year? (resulting in a joint result for 2017-2018 very similar to the one declared). There would not have been any adjustment then.

In relation to the unjust and unfair consequences of the regularisation relating to other taxpayers, the situation is just as incongruous. If the taxpayer undergoing an inspection obtains 2.1%, the adjustment is to 4% and, therefore, they have to pay tax on the difference. If another taxpayer obtains 2.6% they are not subject to an adjustment.

It seems that the adjustment has the effect of penalizing the taxpayer that falls below the range (or affording them discriminatory treatment) and what is worse, competition between the different companies that operate in the market might be altered in an unjustified manner.





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Could an adjustment be made to the upper part of the range of results in the benchmarking analysis?

Yes. As we have already mentioned above, the Note leaves open the possibility of resorting to a specific point within the range if this is justified taking into account the functional level. Issues concerning the use of the range and positioning within the same will be preceded, obviously, by relevant discussions on the intensity or added value of the functions carried out by the companies, their assets and risks assumed. In this respect, the judgement of the National High Court delivered on 26 February 2018 should be taken into account. In said judgement, the regularisation of the results of the taxpayer to the upper part of the interquartile range was confirmed as a result of considering that the functions and risks assumed by the same exceeded the actual levels of the comparables used in the benchmarking study conducted.

And what happens if the profitability in Spain is higher than the range of results in the benchmarking analysis?

Well, taking into account criteria of complete regularisation and reciprocity, it seems that when the adjustment is contrary

to the interests of the Spanish Tax Administration the adjustment should be made following the same principles.

In the event that of having profitability in Spain subject to analysis that is higher than the range of results in the benchmarking analysis, would it make sense to adjust the median? Would the Spanish Tax Administration State Agency accept this?

Final reflexion

This article is only intended to bring to light some of the most frequent questions that might arise in the application of arm's length ranges and use of specific points within the same in the transfer pricing analysis carried out by companies, in particular, as a result of the reading of the aforementioned Note recently published by the Spanish Tax Administration State Agency. The issue, as has been observed, is not entirely without controversy and will therefore require special attention with regard to analysing and contrasting the results of controlled transactions and how the same are documented. Likewise, it would be advisable to have updated transfer pricing policies in order to avoid any possible adjustments in the event of an inspection.