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INTERPRETATION OF LIBERIA INCOME TAX TRANSFER PRICING REGULATIONS-2016

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1.0 INTRODUCTION

1. This Practice Note outlines the Commissioner General's interpretation of the Liberia's legislation and regulations relating to transfer pricing.

2. The Practice Note is not intended to be a prescriptive or an exhaustive discussion of all potential transfer pricing issues that might arise in the course of business but provides guidelines and procedures that should be followed in determining the arm's length conditions for related party transactions within the context of the Liberian business environment.

    a. *Section 211, LRC and the Liberia Income Tax Transfer Pricing Regulations- 2016 broadly adopt the internationally accepted "Arm's Length Principle" for purposes of determining the income and associated expenditure for transactions between related persons. Accordingly, this Practice Note has been drafted in a manner broadly consistent with the Arm's Length Principle as laid out in Article 9 of the ATAF, OECD and UN Model Tax Conventions on Income and Capital; and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.*

    b. *Where there is inconsistency between this Practice Note and Article 9 of the OECD and UN Model Tax Conventions on Income and Capital or the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, the Practice Note, together with regulations as well as statutes of similar nature enshrined in the Liberia law, shall prevail.*

3. This Practice Note is meant for guidance only and does not in any way purport to replace the Section 211 LRC and the Transfer Pricing Regulations 2016. Where there is inconsistency between this Practice Note and Section 211 LRC and the Transfer Pricing Regulations 2016, Section 211 LRC as well as the Transfer Pricing Regulations-2016 shall prevail to the extent of the inconsistency.

4. Where a treaty in force between the jurisdictions of the parties to a controlled transaction, the provisions of that treaty will prevail over Section 211 LRC and the Transfer Pricing Regulations 2016 and this Practice Note.

2.0 FUNDAMENTAL FEATURES OF THE TRANSFER PRICING RULES

1. The Liberia Transfer Pricing rules apply the 'Arm's' Length Principle'. In relation to a controlled transaction, this means that the results of a transaction are consistent with the results that would have been realized in a comparable transaction between unrelated persons dealing in comparable conditions.

2. The Liberia statue and regulations require that taxable income of a person is calculated on the basis that the arm's length principle is applied in relation to all related party transactions.

3. In cases where the conditions of a transaction between related parties are not in accordance with the arm's length principle, then the taxpayer must make the appropriate adjustments to ensure that the taxable income of the person is calculated in accordance with the arm's length principle. There is further discussion on making adjustments in the Section 9 below.

4. Where a calculation of taxable profit is not in accordance with the arm's length principle, and the result is that the measure of taxable profit is understated, or a measure of taxable loss is overstated, then the Commissioner General shall make the necessary adjustment(s) to the calculation of taxable profit.

5. The most appropriate transfer pricing method must be used to determine arm's length conditions, or to test whether arm's length conditions have been applied. There is further discussion on these methods in Section 6 below.

6. Taxpayers who are within the scope of the rules are required to provide information about their transfer pricing in a 'transfer pricing return schedule' document that must be submitted to the Liberia Revenue Authority with the annual income tax return. In addition, taxpayers within the scope of the rules are required to keep documentation to demonstrate that their measure of taxable income accords with the arm's length principle. This documentation must be in place at the time that the income tax return is filed, and must be submitted to the Liberia Revenue Authority on request. Further details on documentation are provided in Section 10 below.

7. Taxpayers who do not maintain the required documentation, or that file a measure of taxable income that is not in accordance with the arm's length principle, may be subject to penalties, as described in Section 13 below.

3.0 SCOPE OF THE RULES

1. Section 211 LRC and the Regulations generally apply to transactions between related persons (i.e. 'controlled transactions'), including transactions between two related residents of Liberia.. The rules also apply to a transaction between two non-resident persons where the transaction involves a permanent establishment in Liberia of one of the non-residents.

2. A person in this context may be an individual, a legal person or a parthership.

3. Two persons are considered to be related where:

   a. *One person directly or indirectly controls the other, or*
   b. *The same person or persons directly or indirectly control both persons.*

4. A person controls another person where:
   a. *It owns, directly or indirectly,*
   b. *50% or more of the share capital of the person, or*
   b. *It has the practical ability to control the business decisions of the person.*

5. In this context, 'directly or indirectly' means control through an intermediary or series of intermediaries. For example, if A owns 51% of the share capital of B, and B owns 51% of the share capital of C, then A indirectly controls C.

6. The rights or powers attributed to a person includes the rights or powers of any family member or partners. This means that, for the purposes of determining whether two persons are related, one person's ownership of share capital, or a person's practical ability to control a person, may be attributed to another person. For example, an individual A controls Company B; and A's daughter controls Company C. In this case, A's power to control Company B is attributed to A's daughter. (And A's daughter's power to control Company C is attributed to A). This means that Companies B and C are controlled by the same person or persons, and thus are deemed to be related persons.

7. The practical ability to control the business decisions of the person refers to the ability to direct business strategy and policy, and to direct the management of the business. Broadly, in the context of a company, this means board-level decisions. For example, individual A holds no shares in Company B, but is appointed by the shareholders as a member of the Board of Directors of that Company, and, under the constitution of Company B, is able to make Important Board decisions without the support of other directors. In this case, A can be said to have the practical ability to control the business decisions of the Company B, and would be deemed to control Company B.

8. On the other hand, a company, Company X, may enter into a distribution agreement with an unrelated company, Company Y, under which Company X purchases goods from Company Y, and sells those goods to third party customers. The agreement might specify the retail price of the goods to be sold to third parties by Company X. In this case, the arrangement is a commercial arrangement between unrelated parties, X and Y, and does not give Y the practical ability to control the business decisions of X. Similarly, where one person purchases or sells exclusively or almost exclusively to a single unrelated person, this does not, by itself, create an ability of the former person to control the business decisions of the latter.

9. A transaction includes any form or agreement or arrangement that involves the transfer or goods or services, whether or not in written form, and whether or a price is paid or payable. The term 'goods or services' includes, but is not limited to, the transfer of goods, services, intellectual property rights, intangibles, leases and financial transactions.

10. [If relevant]. The practices described in this Practice Note should also be applied to the attribution of profit to a permanent establishment. In such cases, the practices are applied as if the permanent establishment is a separate entity, rather than a branch.

4.0 PRINCIPLE OF COMPARABILITY

1. The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the ATAF, OECD and UN Model tax conventions which form the basis of bilateral agreements between countries. The Article provides that;

   "Where conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any profits which would, have but for those conditions, have accrued to one of the enterprises, but, by reason of the conditions, have not so accrued, may be included in the profits of the enterprise and taxed accordingly"

2. The application of the arm's length principle is generally based on a comparison of the conditions in a controlled transaction (a transaction between two related parties) with the conditions in a comparable uncontrolled transaction (a transaction between independent, unrelated persons).

3. In this context, the term 'conditions' normally refers to the financial conditions of the transaction. Depending on the method employed, this will normally be a price, gross margin or profit split. However, the term 'conditions' can also address whether, between independent parties, a transaction would not have taken place at all, or a different

transaction would have taken place. This means that the arm's length condition, in respect of an actual transaction conducted by a person, may be that a transaction would not have taken place.

4. Comparable data may be drawn from non-related party transactions undertaken by either of the related parties that conduct the transaction being tested (an 'internal comparable') or by totally unrelated persons. For example, the resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions ("internal comparable") or the resale price margin earned by one or more independent person in comparable uncontrolled transactions ("external comparables").

5. In order for such comparisons to be useful, the economically relevant characteristics of the controlled and uncontrolled transactions must be sufficiently comparable.

6. To be sufficiently comparable means that: -
   a. *There are no significant differences between the two conditions which could materially affect the financial indicator (e.g. price or margin) being examined under the appropriate transfer pricing method, or*
   b. *If such differences exist, a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison. If suitable adjustments cannot be made, then the transactions cannot be considered comparable.*

7. When comparing a controlled transaction with a potentially comparable uncontrolled transaction, the factors that may be important when determining comparability include:
   a. *The characteristics of the property, goods or services transfer;*
   b. *The functions performed by the parties, taking into account assets used and the relative risks assumed by the parties to the related-party and non-related party transactions;*
   c. *The contractual terms of the transaction;*
   d. *The economic and market circumstances in which the transactions take place; and*
   e. *The business strategies pursued by the related parties or affiliates in relation to the transactions.*

8. The extent to which each of the above factors are significant in establishing comparability depends upon the nature of the controlled transaction and the transfer pricing method adopted. For example, when comparable uncontrolled price method is used, the characteristics of the property, goods or services transferred will be as important as the

other factors. Where other methods are employed, such characteristics may be less relevant.

9. In carrying out a comparability analysis, these factors are relevant in analyzing both the controlled transactions and the uncontrolled transactions.

10. It is recognized that information concerning comparables is often less than perfect. In some cases, information is scarce; in other cases, there may be uncertainties about the reliability of comparables. The significance of such issues will vary from case to case, and depend both on the nature of the controlled transaction and the method adopted. This issue is discussed further in Section 8 below.

11. As discussed in Section 7 below, the use of statistical techniques may be appropriate in cases where there are some uncertainties about the relative reliability of comparability data.

12. It is important that taxpayers and the tax administration both make efforts to identify the most reliable comparable data in each case, but it must also be borne in mind that perfectly reliable data is not always available, and that the use of less-than-perfect data may be inevitable, providing it is appropriate in the application of the chosen method and is likely to give rise to a sufficiently reliable indication of arm's length conditions.

13. The five comparability factors are discussed in-depth below.

I. Characteristics of the property or services

The OECD Transfer Pricing guidelines provides a non-exhaustive list of features which may be relevant in comparing two products:

a. In the case of transfers of tangible property;
   i. *The physical features of the property,*
   ii. *Its quality and reliability, and*
   iii. *The availability and volume of supply;*

b. In the case of the provision of services
   i. *The nature and extent of the services*

c. In the case of intangible property
   i. *The form of transaction (e.g. licensing or sale),*
   ii. *The type of property (e.g. patent, trademark, or knowhow),*
   iii. *The duration and degree of protection, and*

iv. *The anticipated benefits from the use of the property.*

The significance of the actual characteristics of a product or services being transferred in determining an arm's length price depends on the method applied in determining an arm's length price. For example, in applying the Comparable Uncontrolled Price (CUP) method, the precise characteristics of the goods or services will always be relevant. On the other hand, when the Transactional Net Margin method is applied, the functions and risks undertaken by the relevant entities are likely to be more important that the characteristics of the goods or services transferred.

II. Functions Undertaken

The compensation for the transfer of property or services between two independent persons will usually reflect the functions that each person performs, taking into account the risks assumed and the assets used. In determining whether two transactions are comparable, the functions and risks undertaken by the independent parties should be compared to those undertaken by the related persons.

It can be assumed that the operation of the market in an 'arm's length' context results in the highest profit potential being found in those person that assume economically significant risks, and those that contribute unique value-adding attributes (such as scarce capabilities) or utilize valuable assets (such as valuable intangibles).

A practical way of evaluating functional comparability is to prepare a functional analysis. A functional analysis is a method of finding and organizing facts about a business' functions, assets (including intangible property) and risks. It aims to determine how these are divided between the parties involved in the transaction under review. This identifies the nature and characteristics of the related party transactions that have to be priced.

In the open market, the assumption of increased risk will be compensated for by an increase in the expected return. The risks assumed should therefore be taken into account in the functional analysis. In applying the transfer pricing rules, the reward for risk is based on the arm's length principle, and must take into account how economically significant risk is allocated in contracts between persons, and which person in fact:

a. *Bear the financial risk (upside or downside consequences of risk outcomes)*
b. *Perform the relevant risk control functions and risk mitigation functions,*
c. *Have the financial capacity to assume the risk.*

For transfer pricing purposes, in cases where the contractual allocation of risk diverges from these factors, risk must be allocated to the person or persons that perform the relevant risk control and risk mitigation functions, and have the financial capacity to assume the risk.

III. The Contractual Terms of the Transaction

In arm's length transactions, the contractual terms of a transaction generally define explicitly or implicitly how the actual responsibilities, risks, and benefits are to be divided between the parties. This may not always be the case in contracts between related persons, and it is therefore important to examine whether the conduct of the parties conforms to the terms of the contract.

In cases where there is a divergence between the terms of an actual contract between related parties and the behavior of the parties, then the latter should be taken into used in determining arm's length conditions.

IV. Economic Circumstances

Arm's length prices and margins may vary across different markets even for transactions involving the same property, goods or services; therefore, comparability requires that the markets in which associated persons and persons conducting comparable transactions operate do not have differences that have a material effect on price or that appropriate adjustments can be made. As a first step, it is essential to identify the relevant market or markets taking account of available substitute goods or services. Economic circumstances that may be relevant to determining market comparability include the following:

a. *The geographic location;*
b. *The size of the markets;*
c. *The extent of competition in the markets and the relative competitive positions of the buyers and sellers;*
d. *The availability (risk thereof) of substitute goods and services;*
e. *The levels of supply and demand in the market as a whole and in particular regions, if relevant;*
f. *Consumer purchasing power;*
g. *The nature and extent of government regulation of the market;*
h. *Costs of production, including the costs of land, labor, and capital;*
i. *Transport costs;*
j. *The level of the market (e.g. retail or wholesale); and*
k. *The date and time of transactions.*

The facts and circumstances of the particular case will determine whether differences in economic circumstances have a material effect on price and whether reasonably accurate adjustments can be made to eliminate the effects of such differences.

a. *Business Strategies*

Business strategies must also be examined in determining comparability for transfer pricing purposes. Business strategies take into account the following:

a. *Innovation and new product development,*
b. *Degree of diversification,*
c. *Appetite for risk,*
d. *Assessment of political stability,*
e. *Input of existing and planned labor*
f. *Market penetration strategies,*
g. *Duration of arrangements, and*
h. *Other factors bearing upon the daily conduct of business.*

When evaluating whether a taxpayer was following a business strategy that temporarily decreased profits in return for higher expected longer term profits, several factors should be considered. For example, it will be important to examine the conduct of the parties to determine if it is consistent with the purported business strategy. If, for example, a manufacturer charges its associated distributor a below-market price as part of a market penetration strategy, it would be expected that the cost savings to the distributor may be reflected in the price charged to the distributor's customers or in greater market penetration expenses incurred by the distributor. If neither of these actually occur, the purported business strategy, and the associated pricing, may be challenged.

Another factor to consider is whether the nature of the relationship between the parties to the controlled transaction would be consistent with the taxpayer bearing the costs of the business strategy. For example, in arm's length transactions, a company would generally not bear the costs of a market penetration strategy if it did not have a realistic expectation of benefiting from that strategy. Where a company has undertaken market development activities at its own risk and enhances the value of a product through a trademark or trade name, this situation should be reflected in the analysis of functions for the purposes of establishing comparability.

An additional consideration is whether there is a plausible expectation that following the business strategy will produce a return sufficient to justify its costs within a period of time that would be acceptable in an arm's length arrangement. It is recognized that a business strategy such as market penetration may fail, and the failure does not of itself allow the strategy to be ignored for transfer pricing purposes. However, if such an expected outcome was implausible at the time of the transaction, or if the business strategy is unsuccessful but nonetheless is continued beyond what an independent person would accept, the arm's length nature of the business strategy may be doubtful. Ultimately, the most important consideration is whether the strategy in question could plausibly be expected to prove profitable within the foreseeable future (while recognizing that the strategy might fail), and that a party operating at arm's length would have been prepared to sacrifice profitability for a similar period under such economic circumstances and competitive conditions.

5.0 APPLICATION OF THE ARM'S LENGTH PRINCIPLE IN SPECIFIC CIRCUMSTANCES

This section illustrates the application of the arm's length principle in a number of specific circumstances.

5.1 Intangibles

1. In the transfer pricing context, an intangible refers to something which is not a physical or financial asset, and which is capable of being owned or controlled for use in commercial activities. An important attribute of an intangible is a denial or restriction on the ability of persons who do not own or control it to exploit it. For example, a patent or a copyright may not legally be exploited by anyone other than the 'owner' (usually the person in whose name it is registered) or a person to whom the right to exploit it has been granted by the owner (usually through a license agreement). An intangible will not always be enshrined in law. For example, a business may have a unique capability that results from the unique skills of particular employees. Such a capability may also not be able to be exploited by other persons, because the skills may not be replicated elsewhere.

2. An intangible will be significant for transfer pricing only if it creates value. For example, a person (including a licensee) who owns or controls an intangible may exploit it by charging a higher price for goods or services, or by selling a higher volume of goods or services. Or a manufacturer that has developed manufacturing know-how my be able to make more profit than competitors because it is able to produce goods at a lower price.

3. When considering an intangible, a fundamental issue to consider is which persons have a right to share in the value it creates. This may include more than one person. The starting point in considering this should be the contractual and legal arrangements, recognizing that, at arm's length, value in an intangible may be recognized by one or more of the persons that are involved in the development, enhancement, maintenance, protection and exploitation of the intangible. Depending on the facts and circumstances of the case, this might include:

    a. *Persons who carry out the development or enhancement of the intangible;*
    b. *Persons who assume the risks involved in such development or enhancement, in particular those that manage and control the relevant risks, and in fact bear those risks;*

c. *Persons who assume the risks involved in exploiting the intangible, in particular those that manage and control those risks, and in fact bear them;*
d. *Persons that carry out maintenance and protection functions.*

4.This analysis may inevitably be complex. For example, if a manufacturer is granted a right under a license to manufacture and sell a particular product under a valuable trademark, then consideration should be given to:

a. *The legal ownership of the trademark and the terms of the license agreement*
b. *Which persons developed the trademark*
c. *Which persons bore the financial risk of its development*
d. *Which persons in fact managed and controlled that risk*
e. *Which persons bear, and manage and control, the risks involved in the exploitation of the intangible*
f. *Which persons carry out the maintenance and protection of the trademark rights.*

5. In the arm's length situation, it might be expected that the licensor would carry out the functions described at b), c), d) and f) above, as well as have legal ownership of the intangible. The activities described at V) may be carried out by the licensee, or, perhaps, jointly with the licensor. If the factual analysis shows this to be indeed the case, then the manufacturer may be entitled to a reward in line with arm's length comparable license agreements. If the factual analysis demonstrates otherwise, then a similar licensing agreement between non-related persons may no longer provide a reliable comparable, and the right to share in the value in the intangible will depart from that resulting from a similar license agreement between non-related parties.

6. It should be noted that an entity that has legal ownership of an intangible, but carries out, or has carried out, no other functions, will not be entitled to a return in the value in the intangible. Similarly, an entity that has provided funding to develop and enhance an intangible, but which has carried out no other function (including the control and management of the related risk) will not be entitled to a return in the value in the intangible.

7. It is important that the determination of arm's length conditions for a controlled transactions involving licenses, such as that described in the example above, takes into account the perspectives of both the licensor and licensee. At arm's length, the licensor would consider the reward available if it were to grant a license to an uncontrolled party, or to directly exploit the intangible itself. The licensee would consider the benefit (in terms of increased profitability) that the license provides. A licensee at arm's length would not be willing to pay a royalty if the rights granted by the license provided no such benefit, and would not be willing to pay a royalty that exceeded that benefit. In practice, if it established that an intangible does create value to a licensee, it might be expected that the benefit derived would be shared between the licensor and a licensee.

8. Once it has been determined which persons are entitled to share in the value of an intangible, an arm's length reward to each of those persons need to be established. The transfer pricing issues raised by intangibles can be complex, and each case must be considered on the basis of its own facts and circumstances. However, a number of approaches are available.

9. In the case of a right to exploit an intangible under a license agreement, a royalty is normally payable. It may be possible to find either an internal or an external comparable for a royalty (expressed as a rate) – using a Comparable Uncontrolled Price method. The unique nature of an intangible means, of course, that it is very unlikely that an exact external comparable is available, but the use of such an approach may assist in determining a reasonable range.

10. A transactional Profit Split Method may also be used to determine an arm's length royalty rate. In such a case, the value created by the intangible needs to be determined, and the right of each person to a share in that value should be established (taking into account the factors described above). A royalty rate could then be determined which achieves an arm's length split of the value. This approach is illustrated in the example below.

11. As an example, assume that an owner of a valuable intangible (the licensor) grants a license to a manufacturer (the licensee) which gives the licensee the right to use the relevant intangible in manufacturing and selling a product in Country X. Assume, also, that, following a factual analysis, it is considered that the parties' actual conduct is in accordance with the terms of the license, and that the risks associated with creating and maintaining the intangible are properly allocated to the licensor. It should be assumed also that, other than the granting of the license, there are no further related party transactions.

12. In such a case, the value of the intangible to the manufacturer may be estimated through testing its return for carrying out the actual manufacturing and sales functions, on the assumption that it does not exploit the intangible in question. This approach essentially assumes that the manufacturer's profit is made up of two elements – the return for carrying out the pure manufacture and sales functions; and the return from exploiting the intangible. A one-sided method (i.e. cost-plus, resale price or TNMM method) may be used to estimate the first of those elements (using comparables that carry out similar functions and that do not exploit a valuable intangible). The difference between that return and the manufacturer's actual profit can be assumed to be the return that is generated by the intangible (the 'residual profit').

13. The next step is to determine how that residual profit should be allocated between the licensor and licensee. It might could reasonably be assumed that, at arm's length, the both the licensor and the licensee would expect some share of the residual profit – the former would look for a return arising from its ownership of the intangible; the latter would look

for a return arising from the risks involved in exploiting the intangible. In the light of the factual analysis, an appropriate proportional share of the residual needs to be determined – in accordance with what might be expected at arm's length.

14. The final step would be to determine a royalty rate payable by the licensee to the licensor that provides the former with its appropriate split of the residual profit. The royalty rate might be fixed up-front, on the basis of forecasts; or it may be adjusted retrospectively (an ex-poste adjustment) in order to achieve an appropriate (arm's length) split of profit.

15. The example above illustrates the application of the transactional residual profit-split method, which is discussed in detail below. Of course, the split of profit used in such a method must reflect an analysis of the allocation of rights to share in the value of an intangible, in the light of all the facts and circumstances. For example, to take an extreme scenario, if it is established that, in fact, the manufacturer controlled and managed the development and any enhancement of the intangible, and assumed (including the management and control) the associated risks, then it might be considered that 100% of the residual profit should remain with the manufacturer.

16. With regards to royalties it should be stressed that a royalty is in point only where there has been a transfer of a right to exploit an intangible. In the example above, the manufacturer is granted a right to use the relevant manufacturing intangibles and the trademarks. A royalty should not be asserted in the case of a sale of a product that carries a trademark, or a product in which intangibles have been used in its manufacture – in such a case, there is no transfer of a right to commercially exploit an intangible. It is simply a sale of goods.

17. It should not be forgotten that a payment of a royalty frequently involves the imposition of withholding tax, either at the domestic rate or, if there is a treaty in force, at the rate specified by the treaty. The Commissioner General will consider withholding tax issues when the payment of a royalty is examined, including consideration of denial of treaty benefits where appropriate – for example, in the case of 'treaty shopping' or in the case of the payment of excessive royalties.

18. Lastly, the ownership of an intangible may be transferred between related persons. In such cases, it will be necessary to establish an arm's length price for the rights that have been transferred. This is a matter that may need the input of a valuation expert. A typical approach is to establish the value of an intangible by calculating its 'net present value' at the time of the transfer. This method estimates the current value of the stream of future income the intangible is forecast to generate.

5.2 CONTRACT MANUFACTURE

1. The second specific circumstance concerns the application of the arm's length principle to arrangements that are often referred to as a **'contract manufacturer'**. It should be noted that a comparability analysis must apply to the substance of a transaction, no matter how it has been labelled. The first step, then, would be a factual analysis to determine the substance of the actual transaction in order to identify the most appropriate method, and the most reliable comparables.

2. A 'contract manufacturer' arrangement typically involves a 'principal' entity for which the manufacturer carries out manufacturing functions. Arrangements vary, but it would be expected that the principal will engage the manufacturer to produce specified products in stated numbers and stated timescales. It would also take ownership of the manufactured product, which it will itself directly or indirectly sell to its customers. Any intangibles (such as trademarks and patented designs) embedded in the products themselves will typically be in the ownership of the principal, though this will not necessarily be the case.

3. An arrangement such as this will involve a number of business risks, which include, for example, risks arising from:
    a. Maintaining the optimal level of stocks of finished products (inventory risk)
    b. Ensuring the right products are produced at the right time and in the right quantities (production scheduling risk)
    c. Efficiency of production (production cost risk)
    d. Underutilization of the factory (factory underutilization risk)
    e. The efficient supply, and pricing, of raw materials (procurement risk)
    f. The volume and prices of the sale of finished products (sales risk).

4. In accordance with the principles for the allocation of risk described in Sub-section 3 above, these risks should be allocated in accordance with contractual terms. However, where there is a divergence between such terms and the management of the risks, and financial capacity to bear them, then the risk must be allocated, under the comparability analysis, to the entities that manage the risks and have the financial capacity to bear them.

5. It is thus necessary to look beyond the contractual arrangements to examine the actual arrangements. This might involve asking, for example, which personnel:

    a. make the key decisions regarding product scheduling, and in which entity are they located?
    b. make the key decisions on procurement, and in which entity are they located?
    c. make key decisions concerning the level of inventory, and in which entity are they located?
    d. control factory efficiency, and in which entity are they located?

e. make the key decisions regarding pricing, marketing etc., and in which entity are they located?

6. The answers to these questions will inform the selection of the most appropriate method, and choice of comparables.

7. If it is found that the key entrepreneurial decisions are taken by the principal, in accord with what would be expected at arm's length under the same contractual arrangements, it is likely that comparables can be identified for the manufacturing function, and a one-sided method may be available – typically a cost-plus method or TNMM using a profit level indicator such as Return on Total Costs or Return on Assets.

8. Depending on the facts, the factory efficiency risk is likely to be appropriately allocated to the manufacturer, and the procurement risk may be assumed by either the manufacturer or the principal. The allocation will be significant in identifying comparables for the manufacturing function, assuming the latter is to be tested.

9. If it is found that one or more of the key business risks that, at arm's length, would not be expected to be assumed by the manufacturer in a 'contract manufacturer' arrangement, (in particular sales, inventory and product scheduling risks) are in fact managed by personnel in the manufacturer, then those risks should be fully or partly allocated to the manufacturer. This may mean that it will be difficult to identify comparables for the manufacturer's functions, and a one-sided method that tests the manufacturer may not be appropriate. On the other hand, if such a method is appropriate, the comparables for the manufacturing function should reflect these risks i.e. comparables should themselves assume these key risks, or a reliable comparability adjustment should be applied to them. Alternatively, and depending on the facts, if a one-sided method is considered appropriate, the manufacturer may not be the most appropriate party to be tested. If it is found that both the principal and the manufacturer assume the key risks and both manage the key risks, and have the financial capacity to bear them another method may be appropriate – including a transactional profit split method.

10. Similarly, the selection and application of an appropriate method will also be determined by the allocation of a right to a return in a valuable intangible (in accordance with the principles above). If it is determined, for example, that significant valuable intangible rights should be allocated to the manufacturer, then a one-sided method that tests the manufacturer may not be appropriate, and the questions raised in the paragraph above become relevant.

5.3 CAPITAL RICH, LOW FUNCTION ENTITIES

1. The third circumstance concerns **capital rich, low function** companies, which are companies that are capitalized with a relatively high amount of equity (or equity-equivalent) capital, but which have limited capacity to carry out the risk-management functions relating to that capital. Within multinational groups, such companies may, for example, provide debt funding to associated person, or fund research and development programs carried out by associated person. A risk of profit shifting arises if, for example, a company located in a low tax jurisdiction is established with substantial equity capital, which it then uses to make interest bearing loans to other group companies.

2. A limited capacity to carry out the relevant risk-management functions may arise because the company may have few (or no) employees, or its employees have inadequate skills or authority to manage the risk.

3. If such a capital rich person does not in fact manage and control the financial risks associated with its funding (i.e. make the key decisions related to the funding operations), then it will not be allocated the profits associated with the financial risks and will be entitled to no more than a risk-free return. The profits or losses associated with the financial risks would be allocated to the entity (or entities) that manage those risks and have the capacity to bear them.

4. For example, if such a company funds a research and development programme conducted by an associated person, but does not have the capacity to make the key decisions that manage the risks associated with the programme, it will be considered to be conducting a funding function only, and will be allocated a return on that funding on the assumption that the funding is risk-free. The key decisions that manage the risks associated with the programme may include the decisions on which research and development projects to pursue, the authorization of financing to such projects, decisions of continuing or cancelling a project at the various investment decision points in the project.

6.0 METHODS FOR DETERMINING ARM'S LENGTH PRICE CONDITIONS

1. Consistent with the OECD Transfer Pricing guidelines, the LIBERIA Income Tax Transfer Pricing Regulation, 2016 lists the methods set out below for the purposes of ascertaining arm's length prices.

2. The most appropriate method in a given case will depend on the facts and circumstances of the case and the extent and reliability of data on which to base a comparability analysis. It should always be the intention to select the method that produces the highest degree of comparability.

3. The choice of the most appropriate method should therefore be based on a practical weighting of the evidence, having regard to:

   a. *The nature of the activities being examined,*
   b. *The availability, quality and reliability of the data,*
   c. *The nature and extent of any assumptions, and*
   d. *The degree of comparability that exists between the controlled and uncontrolled transactions where the difference would affect condition in the arm's length dealings being examined.*

4. In practice, the application of the principles outlined in the paragraph above often results in the following steps in determining the most appropriate method:

   a. *In cases where, taking into account the comparability factors described in Section 4.0, one or more reliable comparable prices are available, the comparable uncontrolled price method is used. As discussed in Section 6.1 below, it is often very difficult to identify a sufficiently reliable comparable uncontrolled price.*

   b. *In cases where a comparable uncontrolled price is unavailable, the next step is to consider whether a 'one-sided method' is available. A one sided method refers to a cost-plus, resale-minus or TNMM method applied to gross or net profit derived from functions undertaken by one of the parties to the transaction (the 'tested party'). Such a method may be available if one or more sufficiently reliable comparables are available for the function or functions undertaken by one of the parties to the transaction, taking into account the comparability factors described in Section x, and that sufficiently reliable information on the relevant financial indicator in the comparables is available.*

c. *Where a one-sided method is appropriate, the tested party should be the party for which a) one or more sufficiently reliable comparables are available, and b) sufficiently reliable information on the relevant financial indicator in the comparables is available. Generally, it is less likely that a sufficiently reliable comparable will be available to test a return to a function that involves the use of scarce valuable attributes, such as valuable unique intangibles, or which assumes significant risk.*

d. *In cases where a one-sided method is not available, then a profit split method should be considered. This will often be most appropriate in cases where both parties to the transaction assume more than normal economically significant risk, or both use valuable unique intangibles.*

e. *It should be noted, however, that a profit split method will not normally be appropriate where one of the parties to the transaction is allocated neither significant risk nor valuable intangibles. In such a case a one-sided method is likely to be more appropriate. In cases where a transfer pricing analysis indicates that a one-sided method is most appropriate, a profit split method should not be used solely because reliable comparables cannot be found to apply it.*

5. Notwithstanding the guidance in the paragraphs above, a different method may be applied, provided the use of that method is approved by the Commissioner General. Approval request should be sent to the Commissioner General in a written communication, stamp and seal by the requesting entities or persons.

6. There is no requirement for a taxable person to use more than one method when carrying out a transfer pricing analysis. However, a taxpayer may choose to employ a second (corroborative) method if it is considered that this is necessary in order to improve the reliability of the analysis. In line with this, there is no requirement that transfer pricing documentation includes a systematic analysis of why methods not used have been rejected.

7. Consistent with the OECD guidelines, the LIBERIA Income Tax Transfer Pricing regulation, 2016 recognizes the standard transfer pricing methods below.
    b. *The comparable uncontrolled price method (CUP method);*
    c. *The resale price method (RP method);*
    d. *The cost plus method (CP method);*
    e. *The transactional net margin method (TNMM); and*
    f. *The profit split method.*

8. Neither the Practice Note nor the transfer pricing regulations seek to impose a hierarchy for the transfer pricing methods. The Commissioner General acknowledges that the suitability and reliability of a method will depend on the facts and circumstances of each case.

6.1 COMPARABLE UNCONTROLLED PRICE (CUP) METHOD

1. In applying the CUP method, a direct comparison is drawn between the price charged for a specific product in a controlled transaction and the price charged for a closely comparable product in an uncontrolled transaction in comparable circumstances. It therefore primarily focuses on the goods being transferred or service being rendered, but also takes into account broader business functions and economic circumstances.

2. The two transactions being compared will only be truly comparable if there are no differences between the two transactions that will have a material effect on the price, or if reasonably accurate adjustments can be made to eliminate the effect of differences that may materially affect the price.

It is important to keep in mind that two transactions will not be comparable merely because the product or service transferred is comparable. Regard should also be given to the effect on price of broader business functions and economic circumstances other than just the product comparability. For example, a manufacturer of tinned fruit in Liberia may sell a product to its own customers in LIBERIA (such as wholesalers and larger retailers) and also to an unrelated distributor in Nigeria. Even if the product in both transactions are identical, a CUP method is unlikely to be applicable, unless reliable adjustments can be made. This is because there are likely to be differences between the two transactions that, at arm's length, would have a material effect on the price. These include different risks in point (e.g. exchange risk); different costs involved (e.g. transport); differences in the level of market (i.e. selling to a distributor rather than wholesalers/retailers); differences between the Nigeria and Liberia markets.

As another example, assume a taxpayer sells 1,000 tons of a product for $80 per ton to an associated person in its MNE group, and at the same time sells 500 tons of the same product for $100 per ton to an independent person. This case requires an evaluation of whether the different volumes should result in an adjustment of the transfer price. The relevant market should be researched by analyzing transactions in similar products to determine typical volume discounts.

6.2 RESALE PRICE METHOD (RPM)

1. The Resale Price Method begins with the price at which a product which has been purchased from an associated person is resold to an independent person. This price (the resale price) is then reduced by an appropriate gross margin on this price (the "resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an arm's length gross margin. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between the associated person. This method is probably most useful where it is applied to distribution operations.

2. The 'arm's length gross margin is determined through a comparability analysis as described above.

3. Functional comparability is very important in the application of the resale price method, and it is essential that the functions performed by the independent entity or entities are comparable to the functions performed by the member of the multinational selling to an associated person. There should be no differences which have a material effect on the price, for which reasonably accurate adjustments cannot be made.

4. In applying the resale price method, fewer adjustments are normally required for product comparability than under the CUP method. Minor product differences are less likely to have an effect on profit margins than on prices. For example, if a distributor performs the same functions (taking into account assets used and risks assumed) to sell toasters and blenders, it is likely to require the same profit margin, even though blenders are not comparable in price to toasters.

5. The resale price method is most appropriate where the reseller does not add substantial value to the product, or does not use more significantly different intangibles, than identified comparables.

6. As an examples of applications of the resale price margin assume that there are two distributors selling the same product in the same market under the same brand name. Distributor A offers a warranty; Distributor B offers none. Distributor A includes the costs associated with the warranty in its sales price, and so sells its product at a higher price resulting in a higher gross profit margin than if the costs of servicing the warranty were not taken into account. Distributor B, which does not offer the warranty, sells at a lower price.

The two margins are not comparable until a reasonably accurate adjustment is made to account for the warranty difference.

6.3 COST PLUS METHOD

1. The cost plus method requires estimation of an arm's length consideration, by adding an 'arm's length' mark-up to the costs incurred by the supplier of goods or services in a controlled transaction.

2. The level of mark-up is determined through a comparability analysis.

3. This method is often applied to manufacturers, or to service suppliers, which do not exploit valuable unique intangibles, or do not take extraordinary risk.

4. The costs included in a cost-plus analysis should be the direct and indirect costs incurred in supplying the relevant goods or services. Financial costs are not included. Care should be taken to ensure that the accounting measure of 'cost of goods sold' is consistent between the tested party and those selected as comparables. Where there is a significant discrepancy, adjustments should be made. If reliable adjustments cannot be made different comparables should be used. Care should also be taken to ensure that no significant related party costs are included in the cost-base for the method, such costs may distort the analysis.

5. As an example, a subsidiary company in Liberia specializes in the production of X product for a related foreign company under a contract manufacturing arrangement. Under the arrangement, the subsidiary company is provided by the related foreign company with the technical know-how used in the manufacturing of product X and it manufacturers to the order of the related parties. The subsidiary company is also an independent contract manufacturer of product X in Liberia. It sells the products to an independent American distributor. In this case, it is provided with technical know-how by the American distributor, and it manufactures to the order of the American distributor under the same terms and conditions that it does for the related foreign company.

   The comparability analysis shows that sales to the independent American distributor are uncontrolled transactions, which can be used as a comparable for the sales to the related party. In the former, the subsidiary charges a price which represents an average mark-up of 10 per cent of direct and indirect costs of production. Assume the subsidiary incurred direct and indirect costs of USD 100.00 in producing one unit, the arm's length cost plus markup on the same costs would be USD 10.00 (i.e., USD 100.00 x 10%).

As a second example, Company X, resident in Liberia, is a manufacturer of beverages. It sells this product to its foreign subsidiary Y. Company X earns a 10 per cent gross profit mark-up with respect to its manufacturing operation.

Companies M, N, and O are independent domestic manufacturers of beverages. Companies M, N and O perform comparable functions to Company X, and sell to independent foreign purchasers. They earn gross profit mark-ups with respect to their manufacturing operations that range from 5 to 6%, which is considered to be an arm's length range (a concept discussed below).

Company X accounts for supervisory, general and administrative costs as operating expenses, and thus those costs are not reflected in cost of goods sold. The gross profit mark-ups of Companies M, N and O, however, reflect supervisory, general and administrative costs as part of costs of goods sold. If the cost plus method is used, the gross profit mark-ups of Companies M, N and O must be adjusted to provide accounting consistency.

6.4 TRANSACTIONAL NET MARGIN METHOD (TNMM)

1. The transactional net margin method examines the net profit margin relative to an appropriate base such as sales, costs or assets that a person realizes from a controlled transaction or transactions that it is appropriate to aggregate. This is compared with the result achieved by non-related persons on a comparable transaction(s).

2. The focus is initially on examining the net margin relative to an appropriate base. The relative usefulness of the various profitability ratios depends largely on the facts of the case and the extent of reliable data being available for the person and any comparables.

   For example, in testing the return to a manufacturing operation that sells goods to related parties, a net margin ratio may be relative to total costs (including raw material costs) or to assets used in production. In other cases, for example where raw materials are purchased from related parties, the ratio may be relative to 'processing costs' only (i.e. costs other than raw materials) or, where it makes sense, to labour costs only.

   For a manufacturing operation that purchases raw materials from a related party, and sells directly to non-related parties, a net margin relative to sales may be available.

   For a distribution operation, a net margin relative to sales will often be appropriate, but, under some circumstances, a net margin relative to internal costs may make sense.

3. Under the Transactional Net Margin Method (TNMM), margins are calculated after operating expenses but before interest and taxation.

3. As an example, Distributor A, a company based in Liberia, purchases food products from a related party in Ivory Coast and distributes those goods to independent customers. Its accounts for 2015 show a net return of 0.8%.

   A comparability analysis shows that it is possible to find entities in Liberia that carry out sufficiently comparable functions to A. Reliable financial data available on those comparable entities is available only at the net profit level. Accordingly, it is decided to employ a TNMM method, with A as the tested party, and using net profit/sales as the applicable indicator. By means of a database search, 14 Liberia entities are found that conduct functions that are comparable to those conducted by A. It is decided that a statistical approach (described below) is appropriate in these circumstances, utilizing an 'interquartile range'. A financial analysis of those entities reveals a range of net margins (by reference to sale) of 0.5% to 5.5%, with an inter-quartile range of 3.5% to 4.2%. The reported profit falls outside the interquartile range, and the profit of A must be adjusted, for tax purposes, to a point that falls within the range.

4. The table below illustrates possible 'profit level indicators (PLIs)' available under the TNMM method. It is important to note, that each case must be considered according to its specific facts and circumstances, and that the illustrations in the table below may not always be the most appropriate. It should be noted also that the TNMM may is unlikely to be an appropriate method to test the net return of an entity that exploits valuable unique intangibles or assumes extraordinary risk.

Tested party	Potential PLI
Manufacturer – selling to related party	Net profit/Full costs Or Net profit/ Assets used (a)
Manufacturer – selling to unrelated parties, with related party costs	Net profit/Sales revenue
Manufacturer – raw materials purchased from related party, and sales to related parties	Net profit/Assets used Or Net profit/Process (non-raw material) costs Or Net profit/Wage cost (b)
Service provider	Net profit/Full costs
Distribution	Net profit/sales Or Net profit/operating costs (excluding cost of goods sold) (c)

Note: *In all cases above it is assumed that TNMM is the most appropriate method, and that the appropriate party/function is being tested. This will always be a matter to be determined in view of a comparability analysis.*

Notes:

I. Net profit/Assets used will most likely be appropriate in a capital-intensive business
II. Net profit/Wage cost will most likely be appropriate in a labor-intensive business
III. Referred to as the 'Berry Ratio', which may be appropriate in a business where a positive relationship between operating costs and net profit can be expected.

6.5 THE PROFIT SPLIT METHOD

1. The transactional profit split method seeks to determine the division of profits that related parties would have expected to realize from engaging in a transaction or transactions, if that transaction had been undertaken on arm's length terms.

2. The first step in the profit split method is to identify the combined profit earned by the related parties in a controlled transaction. It then splits those combined profits between the associated person on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

3. The main strength of the transactional profit split method is that it can offer a solution for highly integrated operations, or where both parties assume entrepreneurial risk or contribute unique or scare capabilities, where a one-sided method would not be appropriate.

4. Two alternative approaches to the profit split method are outlined in the OECD Guidelines:

a. Contribution Profit Split Analysis

The combined profits, which are the total profits from the controlled transactions under examination, would be divided between the associated person based upon a reasonable approximation of the division of profits that independent person would have expected to realize from engaging in comparable transactions. This division can be supported by comparables data where available. In the absence thereof, it is often based on the relative value of the functions performed by each of the associated person participating in the controlled transactions, taking account of their assets used and risks assumed.
It can be difficult to determine the relative value of the contribution that each of the associated person makes to the controlled transactions, and the approach will often depend on the facts and circumstances of each case. The determination might be made by comparing the nature and degree of each party's contribution of differing types and assigning a percentage based upon the economic analysis and external market data.

The measurement of each party's contribution may be made in a number of ways, but it is important that the measurement chosen makes sense in the context of the specific transaction. In general term the measurement chosen should reflect the respective parties' contribution to value – whether by means of ownership of unique value-adding attributes (e.g. key skilled personnel or intangibles) or by the assuming (including management) of key business risks).

b. Residual Profit Split Analysis

The residual profit split approach first provides, as a first step, both the parties to the transaction with a basic return, based on what independent firms would obtain for performing similar basic functions, in the absence of assuming any non-routine risk or exploiting any unique valuable capabilities (such as intangibles). The application of other transfer pricing methods, such as a cost plus method, resale price method or TNMM, is typically used to achieve this.

For example, a distributor may carry out basic distribution functions such as sales, warehousing and distribution for a related manufacturer. It may be that that comparable data is available for this function. The distributor may also have a right to a return from valuable intangibles such as trade marks (for which a comparable return is not available). In this case, the first step would be to determine the return to the distributor for carrying out the basic functions, by reference to third party comparables. The return (if any) from intangibles would then be determined in a second step (described below).

The residual profit remaining after the first step would be allocated among the parties, in accordance with the way in which this residual would have been divided between independent persons. In the example above, the return to the distributor would take into account its right to a return from intangibles. At the same time, the residual return to the manufacturer would take into account any extraordinary risks it assumes and any unique valuable capabilities it contributes.

Facts and circumstances that could influence the profit allocation in the second stage include the same factors relevant to a contribution profit split analysis described above.

In practice, the assessment of relative contribution may, of necessity, need to be a somewhat subjective measure, based on the facts and circumstances of each case.

The table below summarises the main features of the methods described above.

METHOD	FINANCIAL INDICATOR EMPLOYED	POSSIBLE SUITABILITY
Comparable Uncontrolled Price	Price	Financial transactions Transactions involving commodities Property rents
Resale Price Method	Resale margin (gross profit)	Distribution
Cost-Plus Method	Mark-up on direct and indirect costs of supply (a gross margin)	Manufacturing and service provision where comparable data (at gross profit level) is available for the functions conducted by one of the parties to the transaction.
Transactional Net Margin Method	Net profit ratio to: I. Full costs II. Sales III. Assets	Manufacturing, distribution or service provision where comparable data (at net profit level) is available for the functions conducted by one of the parties to the transaction
Profit Split – Contribution Method	% split of combined profit	Manufacturing, distribution, service provision where both parties perform non-routine functions for which comparable cannot be identified.
Profit Split – Residual Method	Step 1 – as for RPM, C+, TNMM Step 2 – as for contribution method	Manufacturing, distribution, service provision where both parties perform non-routine functions for which comparable cannot be identified.

6.6 RECOGNITION OF ACTUAL TRANSACTIONS

1. The transfer pricing methods described above will normally be applied to the actual transaction as conducted by the taxpayer.

2. In arrangements between related parties, it is possible that the actual transaction conducted by the taxpayer departs from the contractual terms between the related parties. In such cases, the transfer pricing method must be applied to the actual transaction. For example, the contractual terms between a manufacturer and a distributor might specify that the distributor bears risks associated with product warranties, but, in fact, that risk is borne by the manufacturer. In such a case, the transfer pricing method should be applied to the actual transaction in which the manufacturer bears the risk.

3. In arrangements between related parties, it is possible also that the substance of a transaction departs the way the transaction has been legally structured. The discussion on the allocation of risk in Section 4 makes the point that where the contractual allocation of risk diverges from the performance of the relevant risk control and risk mitigation functions or the financial capacity to assume the risk, then risk must be reallocated, and the transfer pricing method will be applied to substance of the transaction that recognizes the reallocated risk. Similarly, the discussion on intangibles above recognizes that the rights of related parties to a share in the value created by an intangible may depart from the contractual arrangements. In such cases the transfer pricing method must be applied to the substance of the transaction that recognizes the reallocated rights to share in the values created by an intangible.

4. There are some circumstances in which the actual transaction conducted by the taxpayer may be disregarded by the Commissioner General. In some cases, the arm's length position would be as if the transaction had not occurred at all. In other cases, if appropriate, the transaction might be replaced by an alternative transaction, and the transfer pricing methods applied to that transaction. This treatment will only be relevant where an actual transaction conducted between related persons, viewed in its totality, differs from that which would have been adopted by independent persons behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a price that would be acceptable to both of the parties. An example of such a transaction would be one that damages the profit potential of the two parties combined (on a pre-tax basis), or one which neither party would have been willing to enter into on a commercially rational basis.

5. It should be noted that, when a transaction is subject to examination, the Commissioner General will recognize the transaction as conducted and structured by the taxpayer, and as determined by any contracts between related persons, unless there is a divergence between contractual and actual behavior (as discussed in paragraph (2) above, or a divergence between the substance of the transaction and the contractual terms (as discussed in paragraph (3), or the provisions of paragraph (4) above apply.

7.0 ARM'S LENGTH RANGE AND STATISTICAL ANALYSES

1. A comparability analysis will not necessarily identify a single price or other financial indicator, and a range of prices or other financial indicators may result from the analysis.

2. The 'arm's length range' is applicable where the comparability analysis identifies a number of comparables (and associated financial indicators) which are all reliable, and equally reliable. In this case the full range of the relevant financial indicators is adopted. It is often the case that such a range contains relatively few comparables and the range is relatively small. Indeed, a range of results will not be considered an 'arm's length range' if the highest point in the range is more than 25% greater than the lowest point in the range.

3. Where the application of the most appropriate method results in a number of financial indicators for which the degree of comparability of each to the relevant transaction between related person, and to each other, is uncertain, or the highest point in the range exceeds 25% of the lowest point in the range, a statistical approach may be used. Such an approach is most likely to be relevant in cases where a database search has been used in order to identify potential comparables.

4. Where such an approach is used, the interquartile range will be considered to be an arm's length range.

5. The interquartile range is a range of the appropriate financial indicator derived from the various comparables employed by the application of a transfer pricing method. For example, the application of a TNMM may identify 80 comparables and, for each of these comparables, a return on sales (operating profit/sales) is identified. This thus creates a 'full range' of profit/sales 80 ratios. If this range is listed from lowest to highest, the interquartile range represents the two middle quarters (in the case, the range of figures from the 20^{th} highest to the 60^{th} highest).

6. Where the relevant financial indicator resulting from a transaction between related person falls outside the arm's length range, then the taxable profit of the taxpayer must be

computed on the basis that the relevant indicator is the median (middle point) of the arm's length range.

7. Where such adjustments are necessary, they must be made by the taxpayer in order to calculate the amount of profit subject to tax, included in the relevant tax return. If no such adjustment is made by the taxpayer, the Commissioner General will make such an adjustment.

8. For the purposes of paragraphs above, a financial indicator is a price, resale margin, cost mark-up, net profit ratio or a split of profit.

8.0 IDENTIFYING AND USING DATA ON COMPARABLES.

1. The Commissioner General recognizes that taxpayers often face difficulty in accessing reliable data for comparables searches and benchmarking. This challenge is shared by taxpayers and tax authorities alike, and, although an issue in many regions of the world, is particularly acute in regions such as ECOWAS, where publicly available data is scare or non-existent.

2. There are a number of potential sources of comparables.

   a. *Some taxpayers may be able to identify internal comparables – that is, comparable data derived from a transaction between the taxpayer (or the related party counterpart to the transaction) and an independent third party. The Commissioner General encourages taxpayers to attempt to identify internal comparables where possible.*

   b. *Comparables may also be identified through research into business and industry pricing. Taxpayer entities will often have an in-depth knowledge of the industry in which they operate, and that knowledge may be useful in determining arm's length conditions in transactions between independent parties. The Commissioner General will consider reliable and relevant data and information derived from business and industry sources, as well as data derived from other publicly available sources.*

   c. *Many taxpayers rely on commercial searchable electronic databases to identify financial data on companies that conduct potentially comparable transactions. Commercial databases are developed by private-sector providers and the* *information contained in them may be regional or global in reach. Information included in such databases is based on publically available information, including company financial data submitted to government or stock exchange registers.*

d. *In many countries, including many in ECOWAS, information from the country might be very limited or non-existent. In such cases, a database might still be a useful source for identifying comparables; but this it should be recognized that such data is likely to be drawn from other markets or other regions (i.e. 'foreign comparables').*

e. *The Commissioner General will accept for consideration comparable data derived from a commercial database provided the search method and criteria are a) clear and made available to the tax authority, and b) they are appropriate to the transaction being tested.*

f. *Where comparables are difficult to identify, a strategy to expand the breadth of a benchmarking search may be appropriate. This can be achieved by considering data:*

   i. derived from products that differ (in varying degrees) to those which are the subject of the tested transaction, or
   ii. derived from sectors other than that of the tested transaction, or
   iii. derived from countries or regions outside that of the party being tested.
   Where the scope of a benchmarking search is widened, it makes sense of course, to keep economically relevant differences between the comparables and the tested transaction or the tested party as small as possible. Also, where the scope of a benchmarking search is expanded, it may be possible to make comparability adjustments to compensate for those differences. It is recognized, however, that reliable comparability adjustments may be difficult to make.

3. It is important that taxpayers the tax administration both make efforts to identify the most reliable comparable data in each case. It must also be borne in mind, however, that perfectly reliable data is not always available, and that the use of less-than-perfect data may be inevitable. In some cases, an ideal amount of information is unavailable; in other cases, there may uncertainties about the reliability of comparables. The significance of such issues will vary from case to case, and depend both on the nature of the controlled transaction and the method adopted. These considerations mean that, while tax authorities and taxpayers should always make best efforts to identify the most reliable comparables, they need also to recognize that data will often give no more than an indication of arm's length pricing rather than an exact measure.

4. It should be remembered that comparability data does not normally require data on actual prices. In practice the use of cost-plus, resale price method, TNMM and profit split methods require information concerning the profits derived by person conducting comparable transactions (expressed, for example, as a mark-up on costs or a return on revenue or on assets).

5. As discussed in Section 7.0 above, the use of statistical techniques may be appropriate in cases where there is a relatively large number of identified comparables, and, at the same time, uncertainties about their relative reliability. This is frequently the case where databases are used to identify comparable transactions and extract financial data deriving from them.

6. Data on comparables used to justify a taxpayer's transfer pricing should be derived from time periods as close as possible to the time that the transaction under examination is conducted. It is recognized that contemporaneous data may not always be available at the time of the transaction, or even when a comparability analysis is conducted, and that data derived from time periods prior to that being tested may be appropriate.

7. Multiple year data relating to comparables may be considered where it adds value to the transfer pricing analysis, to take into account, for example, of the effects on profits of product life cycles and short term economic conditions. Similarly, a multiple year average of the relevant financial indicator may be used where it adds to the reliability of the data used for comparability purposes.

8. The Commissioner General will thus consider data derived from prior years, and also consider multi-year data, provided that such data can be considered sufficiently and reasonably reliable in the context of the related party transaction.

9. A review of a taxpayer's compliance with the transfer pricing rules, will be based primarily on information provided by the taxpayer itself. However, it should be remembered that the Commissioner General, when applying any method, may have more information available than a taxpayer has, or can through its own efforts have reasonable access to. The Commissioner General does not intend to use publicly undisclosed information in an attempt to substitute an alternative measure of the arm's length amount. There are procedural problems in using such information, such as the likelihood that such information could not be provided to taxpayers whose transfer prices are under review or as evidence in court due to the secrecy provisions of the Act. Nevertheless, the

Commissioner General does not rule out the possibility that publicly undisclosed information will be used in administering the transfer pricing rules for the purposes of risk assessment and case selection.

9.0 ADJUSTMENTS

1. In cases where the conditions of an actual transaction differ from arm's length conditions, an adjustment may be made by either the Commissioner General or by the taxpayer. Such adjustments are made either in the calculation of taxable profit or to the price paid or payable in the controlled transaction. In the first case, the adjustment is reflected in the calculation of taxable profit only. In the second case, the adjustment is reflected in the financial accounts, and thus ultimately in the calculation of taxable profit.

2. Adjustments made by the Commissioner General normally arise as a result of a tax audit. If, as a result of an audit, it is established that the conditions of a related party transaction divert from arm's length conditions, and, as a result, profit has been understated, or losses overstated, then the adjustment to the taxable profit will be made. Such adjustment will be made, of course, to the measure of taxable profit that would result if related party transactions had been conducted in accordance with the arm's length principle.

3. In some circumstance, taxpayers should make adjustments themselves. Such adjustments may be either to the price paid or payable, or to the calculation of taxable profit.

4. The first of these adjustments may take place at a time after a relevant transaction has taken place, but before the financial accounts are drawn up. This might be the result of a comparability analysis undertaken at the end of an accounting period.

5. As an example, take a distributor located in Liberia that purchases goods from a foreign related party for resale in Liberia. At the beginning of the period, the purchase price may be set at a level that was expected to provide a 3% net profit return on sales, on the basis of forecasted sales volume, sales price and internal costs. At the end of the period the taxpayer's actual return on sales turned out to be only 1.5%. At that time the taxpayer conducts a comparability analysis using the most up to date data available, which suggests that the arm's length return for its distribution activities is 3.5%. In order to comply with Liberia's transfer pricing rules, the taxpayer may make a retrospective price adjustment. This might take the form of a repayment made by the related party, or a credit note. This adjustment to the actual price will be reflected in the accounts, and thus the taxable profit.

6. As an alternative, the taxpayer may make the relevant adjustment in the calculation of taxable profit included in the annual tax return. The adjustment would be to the level of

taxable profit that would result if related party transactions had been conducted in accordance with the arm's length principle. (That is, in the example above, the level of profit if the net return on sales were 3.5%).

7. In this case, an adjustment may be made only if it results in a higher level of profit, or a lower level of losses. If the taxpayer takes this course of action, there may be a risk of double taxation, which will occur unless the tax authority of the related party agrees to make a corresponding adjustment in accordance with any tax treaty with LIBERIA.

10.0 TRANSFER PRICING DOCUMENTATION

1. Sections 55 of the Liberia Revenue Code deals comprehensively with the books and records that every person with a tax obligation in Liberia is required to maintain.
2. The records are required to be maintained in Liberia and in the English language.
3. In accordance with Section 83.1 of the Executive Law, and Section 55 of Liberia Revenue Code, the Minister(Commissioner General) is authorized to request, demand, and collect from any person, natural or legal, within the Republic of Liberia, or from the head of an agency of the Government, all information necessary to enable the Liberia Revenue Authority to effectively carry out its lawful functions (including but not limited to the records, inspections, and entry onto premises specified in Section 55 of the Code).
4. Section 55 (b) of the Liberia Revenue Code requires all books and records required to be maintained under the section to be retained for a period of 7 years after the end of the tax period to which they relate.
5. All the above provisions are also applicable to transfer pricing documentation. The purpose of this section of the Practice Note is to cover the broad issues relating to the types and extent of documentation which taxpayers are advised to keep, to be able to demonstrate how their methods and prices satisfy the arm's length principle.
6. While Regulation 6.1 of the Liberia Income Tax Transfer Pricing regulation, 2016, lists the transfer pricing documentation and records required to be maintained by taxpayers, it is not possible to specify a comprehensive pre-defined set of documentation requirements that meet the requirements of all taxpayers and therefore the list is non-exhaustive. Appropriate documentation depends on each taxpayer's specific facts and circumstances.
7. According to paragraph 5.4 of the OECD Guidelines, the taxpayer's process of considering whether transfer pricing documentation is appropriate for tax purposes should be determined in accordance with the same prudent business management principles that

would govern the process of evaluating a business decision of a similar level of complexity and importance. The Commissioner General would expect taxpayers to have created, referred to and retained documentation in accordance with this principle.

8. In determining an arm's length price, a taxpayer would generally go through a process which will include a comparability analysis and information gathering on relevant comparables. This would be expected to point to an appropriate method under which the arm's length price would be determined. Once the appropriate method has been determined, the process becomes one of applying the relevant data to determine the arm's length process.

9. As a general rule the Commissioner General considers that taxpayers should contemporaneously document the process they have followed and their analysis in determining transfer prices, in their efforts to comply with the arm's length principle. This should include setting out in detail why those transfer prices are considered to be consistent with the arm's length principle.

10. The Commissioner General will rely as much as possible on documentation that should be created in the ordinary course of business and of setting an arm's length transfer price.

11. Consistent with Section 55 (a) (3) (A) of the Liberia Revenue Code which states in effect: .... ***"Regulations may specify additional disclosure and documentation requirements for transactions between related persons that are not applicable to transactions between unrelated persons"***, the Regulation on transfer pricing documentation requires persons to provide the LRA with high-level information regarding their global business operations and transfer pricing policies in a "master file" that is to be available to all relevant tax administrations.

12. It also requires that detailed transactional transfer pricing documentation be provided in a "local file" specific to each country, identifying material related party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions.

13. Taken together, these documentations (master file, and local file) will require taxpayers to articulate consistent transfer pricing positions and will provide the LRA with useful information to assess transfer pricing risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit inquiries.

14. The information should make it easier for the LRA to identify whether companies have engaged in transfer pricing and other practices that have the effect of artificially shifting substantial amounts of income into tax-advantaged environments. The countries participating in the BEPS project agree that these new reporting provisions, and the transparency they will encourage, will contribute to the objective of understanding, controlling, and tackling BEPS behaviors.

15. The specific content of the various documents reflects an effort to balance tax administration information needs, concerns about inappropriate use of the information, and the compliance costs and burdens imposed on business. Some countries would strike that balance in a different way by requiring reporting in the Country-by-Country Report (BESP Action 13) of additional transactional data (beyond that available in the master file and local file for transactions of entities operating in their jurisdictions) regarding related party interest payments, royalty payments and especially related party service fees.

10.1 DOCUMENTATION PACKAGE FOR SMALL TAXPAYERS

1. Relevant financial accounts for the fiscal year concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied.

2. For each category of transactions in which the enterprise conducts with related parties ('controlled transactions'):

    a. *A description of the nature of each category of controlled transactions. This description should identify the buyer and seller, and include controlled transactions involving goods (specifying the types of goods involved), services (specifying the nature of each category of service involved), financing, intellectual property, leasing of assets, and any other arrangement or transaction with related enterprises).*

    b. *The amount of payments and receipts for each category of controlled transactions conducted by the enterprise (including payments and receipts for products, services, royalties, and interest).*

    c. *A description of the reasons for concluding that the relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method.*

3. Copies of all agreements concluded by the enterprise that affect the conditions (including price) of the controlled transactions.

11.0 TRANSFER PRICING RETURN SCHEDULE

1. All taxpayers that must file a 'transfer pricing return' with the annual income tax return for the year in which the transactions take place.

2. This return may be found at *[www.lra.gov.lr]* and is available from the following: *[info@lra.gov.lr, and +231-880-874-339/+231-776-874-339]*.

3. The purpose of the transfer pricing return is to provide the [tax administration] with an overview of a taxpayer's transactions with related parties. This information will be used to assess the risk of tax loss through transfer pricing - on a national and sectoral level, and also at the level of the individual taxpayer. The information will also be used in determining which taxpayers and issues are to be subject to audit.

4. The requirement to submit a transfer pricing return is in addition to the requirement to keep documentation, and to provide other information to [tax administration] on request.

5. Taxpayers that conduct transactions with a related party but fail to submit a transfer pricing return with the relevant income tax return will be subject to late filing and failure to file penalty described in Section 51 of the Liberia Revenue Code.

12.0 OTHER PRACTICAL CONSIDERATIONS

Depending on the facts applicable to each individual case, the Commissioner General intends to follow the general guidelines set out in this Practice Note. The discussion below focuses on various practical issues that have not been addressed above.

1. The Commissioner General' access to and use of information

There are various sources from which the Commissioner General can obtain information. The first is from the taxpayer, by way of enquiries into its transfer pricing practices. Alternatively, information may be sought from sources external to the taxpayer, such as:

a. *Other taxpayers within the same or similar industry;*
b. *Financial databases, publicly available industry information, the Internet, etc. This includes information on comparable foreign entities;*
c. *Other jurisdictions (through the exchange of information provisions contained in tax treaties).*

2. Information in the possession of foreign related persons

Taxpayers sometimes claimed that a non-resident parent dictates the transfer price adopted by its Liberia subsidiary, and that the latter does not reveal to the Liberia taxpayer the basis for this pricing. In other cases, the taxpayer may explain that the transfer pricing is based on a transfer method that involves the benchmarking of a foreign related party, but that the details of this analysis is not available to the Liberia taxpayer.

The Commissioner General will not accept that this type of argument for failure to provide necessary information or documentation to the Liberia Revenue Authority. If the Liberia taxpayer does not have such information it cannot be certain that it has complied with the transfer pricing rules and has thus submitted a correct tax return. At the same time, the taxpayer will not be able to demonstrate to the Commissioner General that its transfer pricing complies with the arm's length principle. The Commissioner General considers it reasonable to expect taxpayers to obtain such information where necessary. The Commissioner General will treat failure to make such information available to Liberia Tax Administration when required to do so as a failure to keep adequate documentation, and the penalties articulated in Section 14.0 below will apply.

3. Acceptability of Analyses Prepared For A Foreign Tax Administration.

It would be expected that the same transfer pricing analysis would normally be applicable for the compliance purposes of both the domestic and foreign parties to a related-party transaction.

Most analyses under the accepted pricing methods focus directly on testing the return to one party to a transaction. In such cases, the return to the tested party is established and any residual profit or loss arising from the transaction lies with the counterparty to the transaction. The Commissioner General would expect an arm's length price established through any of the methods described in this Note to result in a return for the Liberia operations, commensurate with its economic contribution and risks assumed, whether or not the analysis has been carried out also for a foreign tax jurisdiction, or tests the return to a foreign related party.

4. Transactions With Entities In Low Tax Jurisdictions

Taxpayers should be aware that the Commissioner General may pay closer attention to a transaction involving an entity resident in a low tax jurisdiction. The perception exists that transactions involving low tax jurisdictions are often motivated by tax, rather than strictly commercial, reasons.

5. General Anti-Avoidance Provisions

Taxpayers should be aware that the exercising of the discretion by the Commissioner General as described in the statute and regulations and this Practice Note will not limit or exclude the application of the general anti-avoidance sections contained in Section 15 of the LRC.

6. Corresponding adjustments

An adjustment to the measure of taxable profit as a result of the application of the transfer pricing rules has the potential to create double taxation. In order to eliminate double taxation a 'corresponding adjustment' may be made, provided that the relevant legal framework exists.

Take, as an example, Taxpayer A, in Liberia, which conducts transactions with a related party, Taxpayer B, in Country B. Assume that the combined profit of Taxpayers A and B from the associated business is $1000, with $400 recognised by Taxpayer A, and $600 recognised in Taxpayer). As a result of an audit of Taxpayer A by the Liberia tax authority, an adjustment under the transfer pricing rules of $50 is made to the taxable profit of Taxpayer A. Without a corresponding adjustment, the total profit subject to tax will be $1050 (made up of $ 450 in Taxpayer A and $600 in Taxpayer B), whereas the actual profit remains at $1000. There will this be double taxation of $50.

Where the transfer pricing rules apply to adjust the measure of profit of a taxpayer in respect of a cross-border transaction, a corresponding adjustment may be available for the counterpart to the transaction in the other country. In the example above, double taxation may be eliminated if Taxpayer B makes a request to the foreign tax administration for a 'corresponding adjustment'. If that request is accepted by the foreign tax administration, then it will reduce the taxable profit for the relevant period by $50.

Similarly, where an adjustment is made by a foreign tax administration to the conditions of transactions between a person resident in a that country and a related person in Liberia, and this adjustment results in an increase in the taxable profit of the foreign associate, then the Commissioner General will consider whether to grant a corresponding adjustment in the tax computation of the Liberia taxpayer.

It should be noted that a corresponding adjustment in respect of a cross-border transaction will be considered only if Liberia has a treaty with the relevant foreign jurisdiction that reflects an intention to provide for the relief of economic double taxation. In all such cases, the Commissioner General will grant a corresponding adjustment in a taxpayer resident in Liberia only after an examination of the consistency of that adjustment with the arm's length principle, consulting as necessary with the competent authority of the other country. If the Commissioner General takes the view that the adjustment to taxable profit made by the foreign tax administration is not in accordance with the arm's length principle, a corresponding adjustment will be denied, or only granted to the extent it accords with the arm's length principle. In such cases, the Commissioner General will discuss the issue with the competent authority of the foreign tax administration with a view to eliminating double taxation.

A request for consideration of a corresponding adjustment must include the information necessary for the Commissioner General to examine the consistency of the adjustment made by the tax administration of the other country with the arm's length principle, including

a. *The name, registered address and, where applicable, trading name(s) of the connected person;*

b. *Evidence of the tax residence of the connected person;*

c. *The year(s) in which the adjusted controlled transaction(s) took place;*

d. *The amount of the requested corresponding adjustment and the amounts of the adjustment made by the tax administration of the other country;*

e. *Evidence of the adjustment made by the tax administration of the other country and the basis for the adjustment, including details of comparability analysis relied upon and the transfer pricing method applied;*

f. *Confirmation that the related person party will not, or is unable to, pursue any further recourse under the domestic law of the other country that may result in the adjustment made by the tax administration of the other country being reduced or reversed;*

g. *Any other information that may be relevant for examining the consistency of the adjustment with the arm's length principle.*

The request must be made within the applicable time period for making a request for the case to be resolved by way of mutual agreement procedure under the applicable tax treaty. It must be made to: [Add contact details of Liberia competent authority].

Double taxation may also arise from the application of the transfer pricing rules to purely domestic transactions between two Liberia related parties, the Liberia Revenue Authority shall make an appropriate adjustment to the taxable income of the other party to the transaction.

13.0 PENALTY FOR INCORRECT DOCUMENTATION SUBMISSION

Section 55 (e) of the Liberia Revenue Code imposes a penalty on any person who fails to maintain adequate records: *"If a person fails to maintain books and records as described in subsections (a) and (b), then, in addition to any applicable penalty under Section 51 and Section 52, there also shall be imposed as a penalty for inadequate recordkeeping the amount of 150 percent of any underpayment of tax that may have resulted from the lack of adequate recordkeeping. A person subject to the penalty for inadequate recordkeeping for three or more years within a five-year period or whose total understatement of tax for any year is an amount equal to more than 50 percent of the tax due, shall, on conviction, be subject to a term of imprisonment of up to 4 years"*. This penal provision also applies to transfer pricing documentations.