Tax Administration Jamaica

Practice Note
Transfer Pricing

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This practice note provides guidance with respect to the application of the transfer pricing rules in Section 17 of, and the Eighth Schedule to, the Income Tax Act of Jamaica, which were enacted on December 16, 2015.

The examples in this practice note are strictly for purposes of illustrating the application of the various transfer pricing methods. They are simplified hypothetical examples and the numerical amounts, reported as prices, mark-ups, margins, adjustments, etc., have no factual basis, and should not be taken as establishing a benchmark or standard.

All references herein are to the ITA unless otherwise indicated.

Contents

Glossary of Terms and Abbreviations

1. The following list defines various terms and abbreviations used in this practice note.

ALC	"Arm's length consideration" is the consideration that would have been obtained for property or services if the connected transaction had been a comparable independent transaction. The ALC is determined by application of a TPM or other method authorized under the Eighth Schedule to the ITA to the connected transaction and comparable independent transaction.
Arm's length principle	The "arm's length principle" requires that a transaction between connected persons be carried out after taking into account the terms and conditions that would have been used in transactions with or between independent persons. The "arm's length principle" treats a group of connected persons as if they operate as separate entities and is generally based on comparing the terms and conditions of connected transactions with those of comparable independent transactions.
APA	Advance pricing agreement (see TPA definition below).
BEPS	"Base erosion and profit shifting" is a tax avoidance strategy used by MNEs, wherein profits are shifted from jurisdictions that have high taxes to jurisdictions that have low (or no) taxes (see *Appendix 3 – Low/No Tax Jurisdictions*). BEPS relates primarily to instances where the interaction of different tax rules leads to some part of the profits of MNEs not being taxed at all. It also relates to arrangements that achieve no or low taxation by shifting profits away from jurisdictions where the activities creating those profits take place. The international nature of tax planning means that unilateral or uncoordinated actions by jurisdictions will not suffice and may in fact worsen matters. The action plan to address BEPS is a collective international effort which stands to assist both developed and developing jurisdictions to address aggressive international tax planning.
Body corporate	A person, association, or group of persons legally incorporated.
CAJ	The "Competent Authority of Jamaica" is the Minister of Finance and the Public Service as delegated to the Commissioner General of the TAJ or his authorized representative, i.e. the Deputy Commissioner General, LSD, who is responsible for negotiating bilateral and multilateral TPAs and resolving specific cases of double taxation in accordance with a DTA under the MAP.
CCA	A cost contribution arrangement is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected

	to create benefits for each of the participants.
CG	Commissioner General of the TAJ.
Comparable independent transaction	Being “comparable” means that: none of the differences (if any) between the situations being compared could materially affect the terms and conditions being examined (e.g. transfer price or financial indicator); or, reasonably accurate adjustments can be made to eliminate the effect of any such differences. Accordingly, a comparable independent transaction is one where any differences identified between it and a connected transaction: would not materially affect the terms and conditions (such as the transfer price or financial indicator) of the connected transaction; or, in the case of material differences identified, could be addressed by making reasonably accurate adjustments to eliminate the effects of such differences.
Connected person	A person who is related to another person as defined in Section 2(2) of the ITA
Connected transaction	A transaction between connected persons (sometimes referred to as a “controlled” transaction).
Consideration	Consideration comprises all of the terms and conditions applicable to a transaction, and includes, but is not limited to, the transfer price, profit margin and profit share, terms of payment, security for payment, and any other commercially significant aspects of the transaction.
CPM	The cost plus method is a recommended TPM that consists in comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a connected transaction with the mark up on such costs directly and indirectly incurred in the supply of property or services in comparable independent transactions.
CUP	The comparable uncontrolled price method is a recommended TPM that consists in comparing the price charged for property or services transferred in a connected transaction to the price charged for property or services transferred in comparable independent transactions.
Double taxation	Double taxation is a taxation principle referring to income taxes paid twice on the same source of income. It can occur when income is taxed at both the corporate level and personal level. Double taxation also occurs in international trade when the same income is taxed in two different countries.
DTA	A number of jurisdictions including Jamaica have entered into “double taxation agreements” (sometimes referred to as “tax treaties” or “tax conventions”) with one another to relieve the burden of double taxation. A DTA between two jurisdictions is referred to as a bilateral tax agreement. A tax agreement between more than two jurisdictions is referred to as a multilateral tax agreement. (See *Appendix 8 – Jamaica’s Network of Tax Agreements*)
External comparable	A comparable transaction between two independent parties, neither of which is a party to the connected transaction.
Financial indicator	A financial indicator (or profit level indicator) includes such indicators as transfer price, profit margin and profit share.

Independent person	An independent person is a person who is not treated as being connected with any other participant in a transaction.
Independent transaction	A transaction between two independent persons outside a group of connected persons, or between a connected person of a group of connected persons and an independent person outside the group (sometimes referred to as an "uncontrolled" transaction).
Intangible property	An intangible property is a property that is not a physical asset or financial asset, that is capable of being owned or controlled for use in commercial activities, and the use or transfer of which would have been the subject of compensation had it occurred in a transaction between independent persons in similar circumstances. Intangible property includes, but is not limited to, a patent, trademark or trade name, a design or model, goodwill, or intellectual property such as know-how and trade secrets.
Internal comparable	A comparable transaction between one party to the connected transaction and an independent party.
ITA	*Income Tax Act* of Jamaica
JA	Jamaica
Low / no tax jurisdictions	A jurisdiction where no tax is payable on the income, profits or gains of a person resident of that jurisdiction, or the rate of tax applicable to such income, profits or gains is less than one half of the prescribed rate of tax that would otherwise be applicable under the ITA if that person were resident in Jamaica (see *Appendix 3 – Low/No Tax Jurisdictions*).
LSD	Legal Support Division of the TAJ.
MAP	Mutual agreement procedure as set out in the relevant DTAs.
MNE	Multinational enterprise.
MoFPS	Minister of Finance and Public Service of Jamaica.
OECD	Organization for Economic Co-operation and Development.
OECD Guidelines	*2010 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.
One-sided method	A TPM such as CPM, RPM or TNMM that is applied to one of the connected persons, i.e. the tested party, when performing a comparability analysis.
PE	Permanent establishment refers to a fixed place of business of an individual or body corporate in which that person's business is carried on
Property	Includes both tangible property such as property, plant and equipment, goods and intangible property.
RPM	The "resale price method" is a recommended TPM that consists in comparing the resale margin that a purchaser of property in a connected transaction earns from reselling that property with the resale margin that is earned in comparable independent transactions involving the purchase and resale of commercially equivalent property.
Secret comparable	A term used in the context of transfer pricing. It denotes a comparable whose data is not disclosed to the public or the taxpayer, but is known only to the tax authority which is making the transfer pricing adjustment.

TAJ	Tax Administration Jamaica.
Taxpayer	A taxpayer includes any individual, person, body corporate, party, entity, participant, partnership, etc. who is subject to taxation in Jamaica.
Tested party	When applying a one-sided method, the tested party is the party to which a TPM can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the party that has the least complex functional analysis. The choice of the tested party should be consistent with the functional analysis of the transaction.
TNMM	The transactional net margin method is a recommended TPM that consists in comparing the net profit margin relative to an appropriate base (including costs, sales or assets) that a person achieves in a connected transaction with the net profit margin relative to the same base achieved in comparable independent transactions.
TPA	A TPA (which is referred to internationally as an APA) is an agreement between a taxpayer (or an industry) and TAJ. It identifies, in advance, specified connected transactions covered by the agreement. The TPA sets out an appropriate set of criteria (e.g. TPM, comparables, appropriate adjustments thereto, and critical assumptions as to future events) for the determination of an ALC in accordance with the ITA, for specified connected transactions over a fixed period of time. When appropriate, the TAJ may enter into a bilateral TPA or multilateral TPA with foreign competent authorities under the MAP article of a relevant DTA.

TPM	Transfer pricing method is a basis for establishing an ALC or allocation under Section 17 of, and the Eighth Schedule to, the ITA and, where applicable, under various DTAs between Jamaica and foreign jurisdictions.
	
	The OECD Guidelines recommend a number of TPMs (known as the “recommended TPMs") that, when applied correctly, result in an ALC. These methods are divided into two groups:
	• Traditional transaction methods:
	    o Comparable uncontrolled price (CUP) method
	    o Resale price method (RPM)
	    o Cost plus method (CPM)
	• Transactional profit methods:
	    o Transactional net margin method (TNMM).
	    o Transactional profit split method (TPSM)

TPSM	The transactional profit split method is a recommended TPM that consists in allocating to each connected person participating in a connected transaction the portion of common profit (or loss) derived from such transaction, such allocation being made in accordance with comparable allocations in the case of independent transactions. The TPSM must be applied to determine the ALC for the other functions so performed, based on the common residual profit derived from the other functions when it is possible to determine the ALC for some, but not all functions performed by connected persons participating

	in a connected transaction using the other recommended TPMs.
Transaction	A transaction includes a series of transactions, an arrangement or an event.
TPRC	Transfer Pricing Review Committee is a committee of senior TAJ officials established to provide technical oversight and strategic direction in respect of transfer pricing audit adjustments in order to achieve coherence, adherence to legislative and administrative policy, integrity, sound technical standards and effective case management.

Purpose

2. The purpose of this practice note is to provide guidance with respect to the application of amendments to Section 17 of the ITA pertaining to Jamaica's transfer pricing regime, which were enacted into law by the *Income Tax (Amendment) (No, 2) Act, 2015* (see Appendix 4 below) and have taken effect from the year of assessment 2015.

Objective

3. Jamaica's transfer pricing regime is to provide specific rules for determining the ALC for transactions between connected persons.

Scope

4. Transfer pricing is the general term for the pricing of property (including property, plant, equipment, goods and intangibles) or services in cross-border and domestic transactions between connected persons. It refers to establishing the ALC for transactions between connected persons.

5. This practice note sets out the interpretations of TAJ in respect of the income tax legislation governing Jamaica's transfer pricing regime and also provides TAJ's position with respect to the application of the OECD Guidelines. Where there are distinctions between the ITA and the OECD Guidelines, TAJ will provide specific guidance in this practice note. In all other circumstances, the OECD Guidelines should be consulted for a more detailed discussion of the principles contained in this practice note.

6. Section 17 of the ITA pertains to transactions or arrangements between a taxpayer and a connected person.

7. Section 17(1) of the ITA defines a connected transaction as a transaction between connected persons. As such, the Jamaican transfer pricing regime is not limited to cross border connected person transactions, but also incorporates domestic transactions. This includes, but is not limited to, instances where there may be a tax rate differential or difference in the treatment of income or expenses; for example, an entity regulated and operating under Jamaica's *Special Economic Zone Act* and an unregulated entity.

8. Many of the principles and methods outlined in this practice note may also provide taxpayers with general guidance on the allocation of income between a PE and other parts of the same entity.

9. The transfer prices adopted by a MNE group of connected persons directly affect the profits to be reported by each of those persons in their respective jurisdictions.

10. Jamaica's transfer pricing regime embodies the arm's length principle and requires that, for tax purposes, the terms and conditions agreed to between connected persons in their commercial or financial relations be those that would have been agreed to had the persons been dealing with each other at arm's length, i.e., by independent persons acting in similar circumstances.

11. Jamaica endorses the arm's length principle as outlined in the OECD Guidelines as the basic rule governing the tax treatment of transactions between connected persons. Whether a taxpayer has adhered to the arm's length principle is a factual determination to be reviewed on a case-by-case basis.

Background

12. Section 17 of the ITA was introduced in 1970, and provided an anti-avoidance rule by way of the application of the arm’s length principle in respect of transactions carried out between connected persons for consideration substantially different than that which would have been realized by independent persons. However, the section did not provide sufficient guidance on the application of the arm’s length principle.

13. Jamaica has negotiated DTAs with a number of jurisdictions (See *Appendix 8 – Jamaica’s Double Tax Agreements*). These DTAs all refer to the arm’s length principle in relation to “associated enterprises”; however, the need for clearly defined domestic transfer pricing rules is fundamental to Jamaica adequately protecting its tax base.

14. In light of globalization, there has been an upward trend in cross-border business activities between connected persons and a rapid increase in aggressive tax planning through transfer pricing manipulation and treaty shopping which has led to a proliferation of tax avoidance and evasion schemes.

15. TAJ views intra-group business to business or commercial transactions as posing a high risk where there is a tax advantage, such as profit shifting from one person to another. Transfer pricing manipulation seeks to leverage differences in tax rates or the differences in the treatment of income and or expenses. For example, connected persons may attempt to shift profits from a taxable business organization to a connected person that enjoys a “tax holiday” in order to minimize tax payable by the group. Therefore, by using transfer pricing to artificially shift profits, MNEs deny jurisdictions of essential tax revenues, which may undermine the integrity of the tax system, thus discouraging compliance amongst all taxpayers.

16. As a result, it was necessary to develop specific transfer pricing rules to tackle these issues. Transfer pricing rules are aimed at putting in place measures designed to protect tax bases, in order to support efforts towards a transparent and predictable investment climate through the introduction of rules that create certainty and consistency for business, establish clear guidelines for determining and applying the arm's length principle, as well as clarify and strengthen the legislative framework for the taxation of cross-border and domestic intra-group transactions.

17. The *Income Tax (Amendment) (No, 2) Act, 2015*, has effectively repealed the existing Section 17 and replaced it with a new transfer pricing regime established in accordance with the OECD Guidelines and international principles that seek to entrench the arm's length principle already established in the ITA. The introduction of a new transfer pricing regime improves certainty and transparency in domestic and international taxation issues and benchmarks Jamaica's treatment of connected person transactions with international best practices. Jamaica's transfer pricing regime will serve to minimize double taxation and discourage double non-taxation, and combat BEPS by aligning taxing rights with entities / persons in jurisdictions in which economic activities are performed.

Jamaica's Transfer Pricing Regime

18. New Section 17 of the ITA sets out Jamaica's transfer pricing regime which is effective as from the 2015 and subsequent years of assessment (see Appendix 4 below).

19. Sections 2(2) and 17(1) provide definitions of the following terms (see *Glossary of Terms and Abbreviations* in paragraph 1 above):
    - Arm's length consideration (ALC)
    - Comparable independent transaction
    - Connected person
    - Connected transaction
    - Consideration
    - Independent person
    - Independent transaction

20. Section 17(2) requires taxpayers to state the ALC in respect of any connected transaction in their tax return for a particular year of assessment and use the ALC in the calculation of taxes payable for that year.

21. Section 17(3) empowers the TAJ to reassess a taxpayer's tax return to make a transfer pricing adjustment where an ALC is not used in respect of a connected transaction.

22. Section 17(4) requires taxpayers to certify whether their accounts and tax returns include connected transactions and, if so, describe the terms and conditions thereof.

23. Section 17(5) provides that if taxpayers fail to certify as required or provide an incorrect or incomplete certificate or tax return due to negligent or

fraudulent conduct, they shall be liable to a fine not exceeding two million dollars (JA$2 million) and, in default of payment thereof, to imprisonment for a term not exceeding twelve months. Section 17(5) is effective as from year of assessment 2016 and subsequent years.

24. Section 17(6) empowers the CG to require taxpayers who participate in any transaction to confirm the ALC for that transaction.

25. Section 17(7) empowers the CG to require taxpayers to provide satisfactory information or documentation regarding the relationship of the persons who participate in any transaction, in order to determine whether or not they are connected.

26. Section 17(8) empowers the CG to determine whether persons who participate in any transaction are connected persons, whether the transaction is a connected transaction, and what the ALC should be in respect of the transaction.

27. Section 17(9) grants the CG the same powers as described in Section 17(8) in respect of persons participating in cross-border transactions where one of the persons is resident in a low / no tax jurisdiction.

28. Section 17(10) empowers the CG to identify foreign jurisdictions as low / no tax jurisdictions (see *Appendix 3 – Schedule of Low / No Tax Jurisdictions*).

29. Section 17(11) provides that taxpayers are not required to provide information or documentation on a determination of the ALC for any transaction if taxpayers provide satisfactory information to the CG that the other person participating in the transaction is not a connected person.

30. Section 17(12) puts the burden of proof on taxpayers to prove that the consideration for any connected transaction is an ALC.

31. Section 17A (1) empowers the CG to enter into TPAs with taxpayers for purposes of determining the ALC in respect of connected transactions.

32. Section 17A (2) provides that a TPA will determine the ALC in respect of connected transactions covered by the agreement unless such consideration is inconsistent with the TPA.

33. Section 17A (3) empowers the CG to issue rules regarding TPAs including eligibility criteria, form and manner of application, information requirements, terms and conditions of the TPA, and such other relevant information that may be considered necessary.

34. Section 17B (1) provides that Section 17B applies in the following situation:
    - A foreign jurisdiction has made an adjustment to the consideration in respect of a connected transaction.
    - The adjustment results in an increase in the taxable income of the foreign connected person who participates in the connected transaction with the Jamaican taxpayer.
    - Jamaica and the foreign jurisdiction have a DTA to provide relief from double taxation.

35. Section 17B (2) provides that the CG will examine and determine whether the consideration after adjustment by the foreign jurisdiction in the situation described in Section 17B (1) is consistent with ALC upon request by the Jamaican taxpayer.

36. Section 17B (3) provides that the CG will carry out the requested examination by consulting the tax administration of the foreign jurisdiction if this is considered necessary.

37. Section 17B (4) empowers the CG to make a "corresponding adjustment" in respect of a connected transaction to the taxable income of the Jamaican taxpayer, if the CG determines that the consideration after adjustment is consistent with ALC for the transaction, and the adjustment was made to the taxable income of the foreign connected person by the foreign tax administration, unless the CG considers that such adjustment was made as a result of fraud or wilful default.

38. Section 17C requires every person engaged in connected transactions to prepare and keep prescribed documentation as specified in the regulations.

39. Section 17D (1) empowers the MoFP to make transfer pricing regulations including determination of the size of enterprises and size and nature of transactions to which Jamaica's transfer pricing regime applies. Regulations in respect of transfer pricing documentation and TPAs were enacted in November 2015.

40. Section 17D (2) empowers the MoFP to make transfer pricing regulations having retroactive effect, but not to a date that is earlier than January 1, 2015, upon affirmative resolution by the House of Representatives of the Parliament of Jamaica.

Taxpayers Obligations

41. Taxpayers who carry out transactions with connected persons are required to apply an ALC in respect of all such transactions and must comply with the documentation requirements as specified in the Eighth Schedule to the ITA (see *Appendix 1 – Schedule 8, Declaration of Connected Person Transactions*). In particular, taxpayers are required to:
    - Account for all transactions with connected persons using the ALC and report their income tax payable on the same basis.
    - Complete Schedule 8 in relation to all transactions with connected persons and with business entities or persons' resident in low / no tax jurisdictions. Low / no tax jurisdictions are those jurisdictions where the applicable income tax rate is less than 12.5% (see *Appendix 3 – Schedule of Low / No Tax Jurisdictions*) unless otherwise advised by the CG in writing.
    - Submit Schedule 8 by March 15, following the year of assessment in which the transactions occurred. Schedule 8 is a part of the annual income tax return. The total value of transactions with a particular connected person or business organization must be aggregated by the type of transaction for the year of assessment. Types of transactions

would include stock-in-trade, royalties, management fees, etc.

- Taxpayers must prepare and maintain transfer pricing documentation in respect of connected transactions at the time when such transactions are entered into (i.e. "contemporaneous" documentation) in order to justify that the TPM used is in accordance with the arm's length principle. Contemporaneous documentation requirements only apply to large taxpayers with gross annual revenue equal to or exceeding five hundred million dollars (JA$500 million) – see *Appendix 9 – Income Tax (Transfer Pricing Documentation) Regulations, 2015*. No penalties will be applied for year of assessment 2015, for failure to report transactions with connected parties, or for the failure to provide a complete return or certificate; however, penalties will be imposed as from year of assessment 2016 and subsequent years.
- For any year of assessment, certify whether or not transactions were made with connected persons for the particular year of assessment.
- Submit to the CG a completed *Transfer Pricing Agreement Annual Compliance Notice* for the relevant period of a TPA, (see *Appendix 2 – Transfer Pricing Agreement Annual Compliance Notice*). This requirement only applies to persons with a negotiated and approved TPA (see paragraphs 174 and 175 below for more information on TPAs).

Penalties

42. Any taxpayer who: (i) fails to certify whether the accounts or information upon which their return is based includes the nature and particulars of connected transactions; or (ii) provides an incomplete or incorrect certificate or return due to the taxpayer's negligence or fraudulent conduct, will be liable on summary conviction in a Resident Magistrate's Court to a fine not exceeding JA$2 million [see Section 17(5) of the ITA] and imprisonment for a term not exceeding twelve months if in payment default of such fine [see Section 17(5) of the ITA]. No penalties will be imposed for year of assessment 2015; however, penalties will be applied as from year of assessment 2016 and subsequent years.

43. Additionally, penalties for breaches of the ITA will also apply (e.g. penalties in respect of late filing or non-filing of returns).

Objections and Appeals

44. Where a taxpayer disagrees with a determination by the CG of the ALC in respect of a connected transaction under Sections 17(8) and (9) of the ITA, the taxpayer may object to the determination; however, the burden of proof is on the taxpayer to prove the ALC.

45. The provisions of the ITA regarding objections and appeals apply where the taxpayer disagrees with the CG's determination of ALC under Sections 17(8) and (9) of the ITA.

Arm's Length Principle

46. For tax purposes, the arm's length principle requires that a transaction

between connected persons is to be carried out by taking into account the terms and conditions that would have been used in transactions with or between independent persons.

47. For reference purposes, the arm's length principle is stated in Article 9 of the *OECD Model Tax Convention on Income and Capital,* which has been followed by Jamaica in its existing DTAs:

> "Where…conditions are made or imposed between…two [non-arm's length] enterprises in their commercial or financial relations which differ from those which would be made between [arm's length] enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

Comparability

48. The OECD Guidelines indicate that the application of the arm's length principle is generally based on a comparison of the terms and conditions agreed to by connected persons with those used or obtained by independent persons engaged in similar transactions.

49. For such comparisons to be useful, the economically relevant characteristics of the transactions being compared must be at least sufficiently similar, so as to permit reasonably accurate adjustments to be made for any differences in such characteristics. Generally speaking, transactions between connected persons should not be used for purposes of making these comparisons, because the terms and conditions may not be arm's length. However, when acceptable “internal comparables” exist, i.e., when comparable transactions in similar circumstances are carried out with both connected and independent persons, these may be used (see paragraph 93 below). In the absence of acceptable internal comparables, external comparables are to be used.

50. The OECD Guidelines indicate that a number of factors may influence the degree of comparability of transactions. These factors include:
    - Terms and conditions of the contract - the contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the respective parties to the transactions.

    - Functions performed by the parties to the transactions - the functions performed, taking into account assets employed and the risks assumed, by the respective parties to the transaction.

    - Characteristics of the property or services being purchased or sold - the specific characteristics of the property transferred or services provided in either transaction.

    - Economic circumstances of the parties - the economic circumstances related to the transaction between connected persons, specifying the conditions prevailing in the markets in which the respective connected persons to the transactions operate, including, among other things, the geographical location and size of the markets, the laws and government orders in force, costs of labour and capital in the markets, overall economic development and level of competition and whether the markets are wholesale or retail.

- Business strategies pursued by the parties - business strategies are factors that can affect comparability because they influence the price that independent persons would charge for a product. For example, where an independent person attempts to introduce a product into a new market or increase its market share, it may be reasonable for that person to temporarily charge a price lower than it would otherwise charge in an attempt to establish that market or market share. This assumes that an independent person would have estimated the potential long-term benefits of such a strategy. However, it is unlikely that an independent person would maintain such a strategy for an extended period of time.

51. Taxpayers must exercise judgement in determining the degree of comparability of transactions. Selecting the most appropriate TPM depends largely on the assessment of the comparability of transactions. The availability of comparable information on the factors present in the connected transactions will influence this determination.

52. A “comparability analysis” plays a central role in the overall application of the arm’s length principle as it leads to the selection and application of the most appropriate TPM to arrive at an ALC (e.g. transfer price or financial indicator) or a range of ALCs (e.g. transfer prices or financial indicators).

53. The following is a description of a typical process that can be followed when performing a comparability analysis. This process is considered to be a generally accepted best practice, but it is not a compulsory one, and any other search process leading to the identification of reliable comparables may be acceptable as reliability of the outcome is more important than process (i.e. going through the process does not provide any guarantee that the outcome will be arm’s length, and not going through the process does not imply that the outcome will not be arm’s length). The steps are as follows:
    - Step 1: Determination of years to be covered.
    - Step 2: Broad-based analysis of the taxpayer’s circumstances.
    - Step 3: Understanding the connected transaction(s) under examination, based in particular on a functional analysis, in order to choose the tested party (where needed), the most appropriate TPM to the circumstances of the case and the financial indicator that will be tested (in the case of a transactional profit method), and, to identify the significant comparability factors that should be taken into account.
    - Step 4: Review of existing internal comparables, if any.
    - Step 5: Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.
    - Step 6: Selection of the most appropriate TPM and, depending on the method, determination of the relevant financial indicator (e.g. determination of the relevant net profit indicator in case of a TNMM).
    - Step 7: Identification of potential comparables by determining the key

characteristics to be met by any independent transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the comparability factors set forth in paragraph 50 above.

- Step 8: Determination of and making comparability adjustments where appropriate.
- Step 9: Interpretation and use of data collected, and determination of the ALC.

54. In practice, this process is not a linear one. Steps 5 to 7 in particular might need to be carried out repeatedly until a satisfactory conclusion is reached, i.e. the most reliable TPM is selected, especially because the examination of available sources of information may in some instances influence the selection of the TPM. For instance, in cases where it is not possible to find information on comparable transactions (step 7) and/or to make reasonably accurate adjustments (step 8), taxpayers might have to select another TPM and repeat the process starting from step 4.

55. The reliability of any TPM is affected by the availability of data and the degree of accuracy with which any necessary adjustments can be made to achieve comparability. For connected and independent transactions to be considered comparable, it is necessary to confirm either that there are no differences between the transactions which would materially affect the condition being examined (e.g. transfer price in the open market or profit margin), or, if there are material differences, that reliable adjustments can be made to eliminate the material effects of such differences.

56. In applying the recommended TPMs and taking into account the effects on profits due to product life cycles and short-term economic conditions, taxpayers should consider the comparability of multiple year data for both the taxpayer and independent person.

57. When performing a comparability analysis, it should be recognized that incidental sales (e.g. non-core business sales, sales of by-products or residual sales) of a product by a taxpayer to independent persons may not be indicative of an external comparable for the same product transferred between connected persons, unless the sales by the connected person are also incidental.

Separate vs. combined transactions

58. Section 17 of the ITA applies the arm's length principle through a review of the terms and conditions attached to transactions or series of transactions entered into between connected persons. In addition, to get to the most precise approximation of an ALC, the arm's length principle should ideally be applied on a transaction-by-transaction basis. Therefore, in establishing transfer prices, taxpayers should set prices separately for each transaction they enter into with a connected person. This separate determination usually provides the most reliable estimation of an ALC.

59. In some situations, transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. In these situations, it may be necessary to combine transactions (see Clause 11 of the Eighth Schedule to the ITA). The OECD Guidelines provide the following examples

of situations where combining transactions may be appropriate:

- Some long-term contracts for the supply of commodities or services.
- Rights to use intangible property.
- Pricing of a range of closely-linked products (e.g., in a product line) when it is impractical to determine pricing for each individual product or transaction.

60. Taxpayers should consider a number of factors when determining whether transactions should be priced separately or on some aggregate basis, including:
    - Intangibles associated with the various transactions.
    - Availability of comparable data on transactions.
    - Functional comparability of transactions.
    - Additional costs associated with valuing transactions separately.

61. The underlying nature of individual transactions will not change whether the price for combined transactions is set separately for each transaction or on an aggregate basis. TAJ does not view the combination or separation of transactions as a re-characterization of the underlying transactions for purposes of determining an ALC.

62. TAJ is of the view that evaluating transactions on a separate basis generally provides the most reliable estimation of an ALC. Furthermore, taxpayers should consider separating transactions for two additional reasons:
    - Payments on some transactions to a non-resident are subject to withholding tax, while others are not.
    - DTAs may subject different types of payments to different rates of withholding tax.

63. However, where the normal industry practice is to set one price for a combination of transactions (e.g. goods and the associated intangible property) it may not be reasonable to expect to find comparable data available to set the price for separate transactions. Therefore, the total amount may be taxed on an aggregate basis for income tax and withholding tax purposes.

Transfer Pricing Methods (TPM)

64. TPMs are used to establish ALCs for transactions between connected persons.

Recommended TPMs

65. The OECD Guidelines and the Eighth Schedule to the ITA recommend a number of TPMs (known as the “recommended TPMs") that, when applied correctly, result in an ALC. These methods are divided into two groups:
    - Traditional transaction methods:
        - Comparable uncontrolled price (CUP) method
        - Resale price method (RPM)
        - Cost plus method (CPM)
    - Transactional profit methods:
        - Transactional net margin method (TNMM).

- Profit split method (TPSM)

Selection of the most appropriate TPM

66. The selection of the most appropriate TPM should take into account the following criteria:
    - Relative strengths and weaknesses of the various methods;
    - Appropriateness of a particular TPM in view of the nature of the connected transactions;
    - Availability of reliable information; and
    - Degree of comparability between connected and independent transactions.

67. TAJ's view, shared by leading tax administrations, is that the CUP method should apply where any of the recommended TPMs can be applied with equal reliability.

68. Where any of the traditional transaction methods (CUP, RPM, CPM) can be applied with equal reliability as the transactional profit methods (TNMM, TPSM), the traditional transaction methods should apply.

69. If applicable, the CUP method provides the highest degree of comparability of the traditional transaction methods because it focuses directly on the price of a transaction, and requires both functional and product comparability.

70. Although the CUP method provides the most direct and reliable means of establishing an ALC, other traditional transaction methods may have to be used where there is not enough comparable information available with respect to independent transactions, or it is not possible to reliably quantify the differences between connected and independent transactions.

71. At some point, differences become so significant that the CUP method will no longer produce the most reliable measure of an ALC. For example, it may not be possible to make appropriate adjustments due to material market differences.

72. The primary difference between the CUP method and the CPM or RPM is that the CUP method compares prices of comparable property or services, while the CPM and RPM establish the margin that a taxpayer might expect as a reward for the functions performed, assets used and risks assumed. Because the CPM and RPM operate at the gross margin level, product differences have a less significant impact on the reliability of the results than in the CUP method; however, the closer the comparability of products, the more reliable the result will be.

73. The choice between the CPM or the RPM depends on the comparability of data available for each of the parties to the transaction. Comparable information is generally more readily available for the least complex party, i.e. the tested party. For example, the RPM may be the most appropriate choice if the least complex party is a distributor.

74. Taxpayers will have to consider the transactional profit methods if no comparable data are available to apply the CPM or RPM, or the available

data to apply the CPM or RPM have material differences that cannot reliably be adjusted.

75. The OECD Guidelines do not express a clear preference for one transactional profit method over the other. In fact, they discourage the use of both methods. However, the TPSM will generally provide a more reliable estimate of an arm's length result than the TNMM unless a high degree of comparability, including the comparability of intangible assets, can be established.

76. The most appropriate TPM in a given set of circumstances will be the one that provides the highest degree of comparability between transactions. Once a taxpayer establishes comparability at a particular level within the hierarchy of methods, the taxpayer is not required to consider or apply a lower-ranking method. On the other hand, if the taxpayer cannot establish comparability at any level, other methods should be considered in order to determine the most appropriate method.

77. In certain cases, taxpayers may have some doubts about the reliability of the results produced by a particular TPM. Because the results produced by each of the "recommended methods" should have some consistency, taxpayers may wish to confirm their results by applying another TPM.

78. TAJ will examine the application of the TPM selected by a taxpayer to ensure that the selected TPM produces the most reliable measure of an arm's length result. For example, if a taxpayer used the TNMM to establish its transfer price and TAJ obtains comparable information at the CUP level, TAJ is of the view that the CUP method should be used as it provides better evidence of an ALC. TAJ would adjust the taxpayer's accounts accordingly (see Clause 9 of the Eighth Schedule to the ITA).

79. The CUP must be applied where this method and another TPM can be applied with equal reliability, after taking into consideration:
    - The relative strengths and weaknesses of the various methods;
    - The appropriateness and availability of comparable information; and,
    - The degree of comparability between the connected and independent transactions.

80. Where any of the three traditional transaction methods (CUP, RPM, CPM) can be applied with equal reliability as any of the transactional profit methods (TPSM, TNMM) after taking into consideration the relative strengths and weaknesses of the various TPMs, the appropriateness, the availability of reliable information, and the degree of comparability between the connected and independent transactions, one of the traditional transaction methods must be applied.

Alternative methods

81. Taxpayers can select an alternative method where none of the recommended TPMs can reasonably be applied and the alternative method yields a result consistent with independent persons engaged in comparable

independent transactions under similar circumstances. For this purpose, TAJ will examine the alternative method to ensure that it is consistent with the arm’s length principle, or apply another more appropriate method as the case may be.

Arm’s length range

82. TAJ recognizes that transfer pricing is not an exact science. In some cases, it will be possible to apply the arm’s length principle to arrive at a single figure (e.g. transfer price or financial indicator) that is the most reliable to establish whether the conditions of a transaction are arm's length. However, there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable. In these cases, differences in the figures that comprise the range may be caused by the fact that in general the application of the arm’s length principle only produces an approximation of conditions that would have been established between independent persons.

83. TAJ relies on the facts and circumstances in a particular case to determine a range, or the point in a range, that is the most reliable estimate of an ALC.

84. An arm’s length range is determined by using a range of financial indicators and applying the appropriate TPM to a number of comparable independent transactions. Taxpayers should exercise care in assessing the reliability of each comparable transaction used to establish the range.

85. Where the consideration for a connected transaction is within the arm’s length range, the consideration will be treated as the ALC. Where the consideration for a connected transaction falls outside of the arm’s length range, the median of the range will be treated as the ALC.

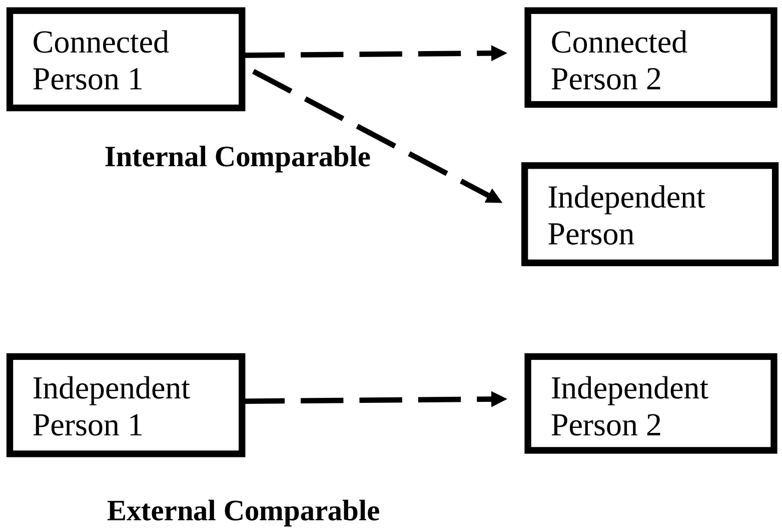
Comparable Uncontrolled Price (CUP) Method

Overview

86. The CUP method is a TPM that compares the price of property or services transferred in a connected transaction with the price charged in a comparable independent transaction under similar circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the connected persons are not at arm's length, and the price used in the connected transaction may need to be substituted for the price used in the comparable independent transaction.

87. The CUP method provides the best evidence of an ALC and may arise where:
    - The taxpayer or another connected person of the group sells the particular product, in similar quantities and under similar terms to independent persons in similar markets (an “internal comparable”).
    - An independent person sells the particular product, in similar quantities and under similar terms to another independent person in similar markets (an “external comparable”).
    - The taxpayer or another connected person of the group buys the particular product, in similar quantities and under similar terms from independent persons in similar markets (an “internal comparable”).

- An independent person buys the particular product, in similar quantities and under similar terms from another independent person in similar markets (an "external comparable").



88. The CUP method is applicable if one of two conditions is met:
    - None of the differences between the transactions being compared or between the enterprises undertaking those transactions could materially affect the transfer price in the open market; or
    - Any differences can be measured on a reasonable basis, and appropriate adjustments can be made to eliminate the effects of those differences (see example in paragraph 96 below).

When to use the CUP

89. The following are some cases of when the CUP method can be applied. The CUP method is most appropriate with internationally traded commodities such as, but not limited to, bauxite, alumina, coffee beans and sugar or where the product or service is sold to both connected and independent persons. The CUP method would also be appropriate to evaluate interest rates charged in respect of financial transactions, as well as royalties and commissions.

90. Where differences exist between connected and independent transactions, it may be difficult to determine the adjustments necessary to eliminate the effect on transfer prices. However, the difficulties that arise in making adjustments should not routinely preclude the potential application of the CUP method. Therefore, taxpayers should make reasonable efforts to adjust for differences.

91. The use of the CUP method precludes an additional allocation of related product development costs or overhead unless such charges are also made to independent persons. This prevents the double deduction of those costs, i.e. once as an element of the transfer price and once as an allocation.

Strengths and weaknesses of the CUP method

Strengths	Weaknesses
Two sided analysis	Difficult to find closely comparable uncontrolled transactions
Avoids discussions about tested parties	Challenge to apply the five comparability factors (see paragraph 50 above)
Involves direct transactional comparison	Depending on the industry, external comparables difficult to find in practice
May be more readily used in instances of commodity products and financial transactions	

Examples of CUP method

Example A

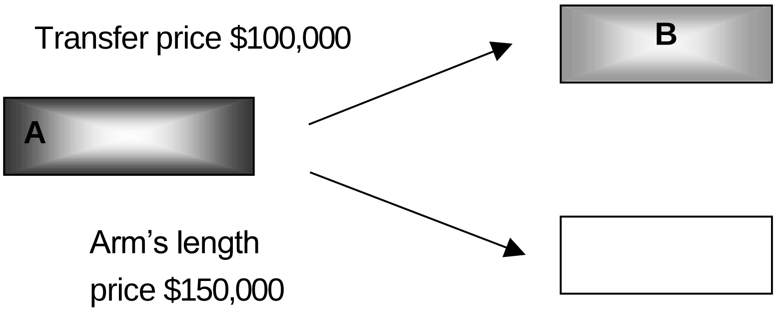
92. JAMCO, a Jamaican company, sells commodity X directly to its US subsidiary, USCO, for its own consumption. Commodity X is actively traded in the USA and an average daily US transaction price is available from a public source of information. The average daily US transaction price represents a delivered price and includes any freight and duties. On the other hand, under the agreement between JAMCO and USCO, USCO takes possession of the product at JAMCO's plant. In order to make the prices comparable, an adjustment would have to be made to reflect the differences between the contractual terms in respect of the connected transaction (i.e. the cost of freight and duties) and the publicly traded price of the commodity.

Calculation of transfer price:

Average daily US$ transaction price per ton	$576
Deduct:	
Adjustment for freight	$32
Adjustment for duties	$28
Total adjustments	$60
Transfer price per ton	$516

Example B

93. Company A sells 80% of its product to a foreign connected person, Company B, at a price of $100,000 per unit. The remaining 20% is sold to a local independent enterprise, Company I at $150,000 per unit.



94. Products sold by Company A to Company B and Company I are exact, comparable. The transaction between Company A and Company I is an internal comparable that could be used as a comparable uncontrolled transaction. However, a functional analysis of Company A, Company B and Company I must first be carried out to determine any differences that could materially affect the price of the product in the open market. If there are differences, reasonably accurate adjustments should be made to account for these differences. Assuming that there are no differences that could materially affect the price in the open market, the CUP method can be applied by using the internal comparable uncontrolled transaction determining the unit price of $150,000 as an arm's length result.

95. Therefore, the transfer price ($100,000) should be replaced by the arm's length price ($150,000). In this case, Company A's revenues should increase, acknowledging the higher arm's length price with respect to the initially applied transfer price. This increase in revenues should have an impact in the profit levels of Company A, as illustrated in the following table:

Company A

	Initial ($)	Adjustment ($)	Final ($)
Sales	100,000	50,000	150,000
Less: Cost of goods sold	70,000		70,000
Gross profit	30,000		80,000
Less: Other operating expenses	20,000		20,000
Net profit	10,000		60,000

96. In summary, after having applied the arm's length principle, Company A will have to adjust its taxable base by $50,000 ($150,000 – $100,000). The $50,000 will be subject to taxation at the applicable rate so the tax collected from this adjustment will depend on such rate. If for example, the corporate income tax is 33%, tax will be $16,500 ($50,000 x 33%).

Resale Price Method (RPM)

Overview

97. The RPM consists of comparing the resale margin that a purchaser of property in a connected transaction earns from reselling that property in an independent transaction with the resale margin that is earned in a comparable independent transaction, i.e. a purchase and resale transaction.

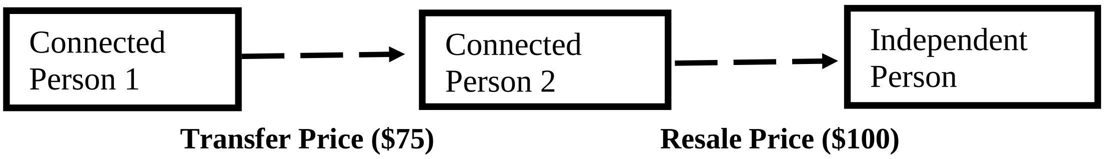
98. The RPM begins with the resale price to independent persons of a product

purchased from a connected person, reduced by a “comparable gross margin”. The comparable gross margin is determined by reference to either:

- The resale price margin earned by a connected person of the group in comparable independent transactions (i.e. an “internal comparable”); or
- The resale price margin earned by a connected person in comparable independent transactions (i.e. an “external comparable”).

For example:

Resale price	$100
Less: resale price margin @ 25% (based on external comparable)	$25
Transfer price	$75



When to use the RPM

99. The RPM is typically applied when one of the connected persons performs a sales or distribution function that does not involve the assumption of significant risks or the exploitation of unique and valuable intangibles.

100. The greater the value-added to the goods by the functions performed by the connected person, the more difficult it will be to determine an appropriate resale margin. This is especially true in a situation where the connected person contributes to the creation or maintenance of an intangible property as part of its business activities, such as in the case of a marketing intangible.

101. The more comparable the functions performed, i.e. assets employed and risks assumed, the more likely that the RPM will produce an appropriate estimate of an arm's length result. Where the functions, risks and assets are not comparable in all ways and the differences have a material effect on price, taxpayers must make adjustments to eliminate the effect of those differences to increase reliability of comparables.

Strengths and weaknesses of the RPM

Strengths	Weaknesses
Method is based on the resale price, a market price, and represents a demand driven method	One-sided method
Can be used without considering the operating expenses of the company	Data on gross margins often not available and inconsistent based on accounting difference

Examples of RPM

Example A

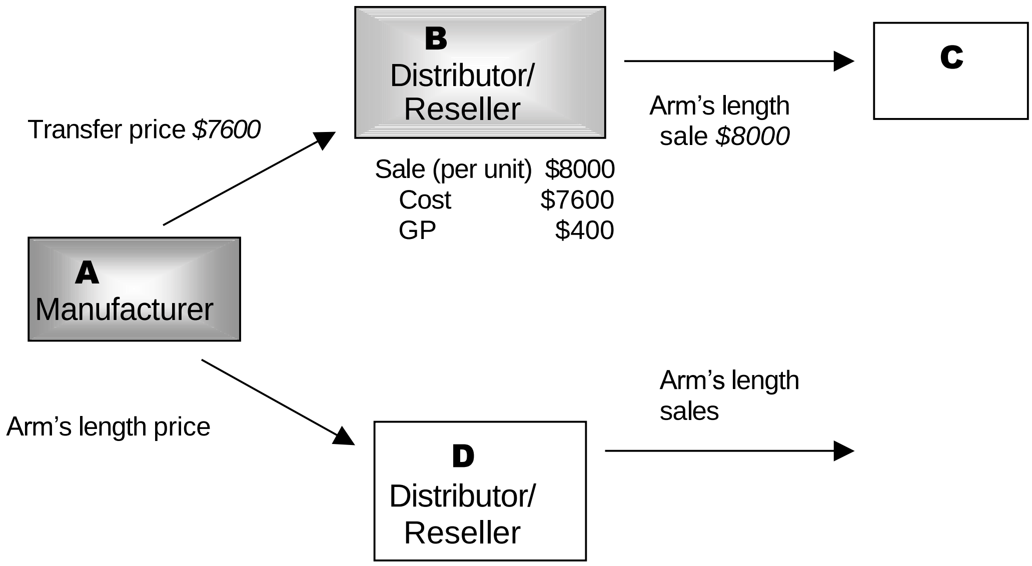
102. JAMCO distributes widgets in Jamaica for its USA parent, USCO. SALESCO, a Jamaican company operating at arm's length to USCO and JAMCO, distributes gadgets, a product similar to widgets, in Jamaica for USCO. The key functional differences, other than the minor differences in product, between the connected transactions and independent transactions are:

- USCO bears the warranty risk in the independent transaction and JAMCO bears the warranty risk in the case of the connected transaction.
- USCO provides samples and promotional materials to SALESCO free of charge while JAMCO produces its own samples and promotional materials and bears the related costs.
- The widget and gadget markets are similar in Jamaica. SALESCO earns a resale margin of 15% of gadget sales net of discounts and allowances.

Calculation of resale margin:	
JAMCO's net sales of widgets to independent persons	$4,000
Independent resale margin rate based on USCO agreement	15%
Independent resale margin based on USCO agreement	$600
Adjustments for functional and risk differences:	
Promotional costs	$10
Warranty costs	$22
Total adjustments	**$32**
Adjusted resale margin	$632
Adjusted resale margin rate	15.8%
Calculation of transfer price:	
JAMCO's net sales of widgets to independent persons	$4,000
Less: adjusted resale margin	$632
Transfer price	$3,368

Example B

103. Company B is a subsidiary of Company A, located overseas. Company B is a distributor of a high-quality product manufactured by Company A. Company A also sells a similar product to Company D, an independent distributor, which could be used as an internal comparable following the performance of a comparability analysis that confirms its reliability as a comparable. The cost of products purchased from Company A by Company B is 7600 per unit. Company B resells the products to Company C for 8000. Based on the functional analysis, it was found that functions performed by Company B are similar to those of Company D. The gross profit ratio of Company D was found to be 10%.


B
Distributor/
Reseller
C
Transfer price *$7600*
Arm's length
sale *$8000*
Sale (per unit) $8000
Cost $7600
GP $400
A
Manufacturer
Arm's length
sales
Arm's length price
D
Distributor/
Reseller

104. In this example, it is noted that there are product differences when comparing the controlled and uncontrolled transactions but they do not materially affect the methodology being applied. However, since the focus of comparison is on margins, the differences are not material, as they would have been if the basis of comparison were on prices. Furthermore, functions carried out by Company B and Company D are similar (Company D being another reseller in the same market and in the same level of the value chain). Thus, the resale price margin of 10% will be used as a basis to determine the arm's length price for the original purchase by Company B from Company A.

105. Therefore, Company B's 5% gross margin needs to be increased to a 10% gross margin. This adjustment is to be done to the transfer price of $7,600. For Company B to obtain a gross margin of 10%, the transfer price needs to be reduced to $7,200; the current transfer price of $7,600 allows Company B to obtain a 5% gross margin, compared to the 10% gross margin obtained by Company D (a comparable independent enterprise). The $7,200 will acknowledge a lower arm's length price with respect to the initially applied transfer price of $7,600. This decrease in costs should have an impact in the profit levels of Company B, as illustrated in the following table:

Company B

	Initial	**Adjustment**	**Final**
Sales	8,000		8,000
Cost of Goods	7,600	(400)	7,200
Sold Gross profit	<u>400</u>		<u>800</u>
Gross Margin	400/8000 = 5%		800/8000 = 10%

106. In case no internal comparable would have been available, Company B should have to identify independent enterprises engaged in comparable transactions under similar circumstances, for which financial information would be available to calculate their gross margins. Supposing three comparable enterprises would have been found and their gross margins calculated, the results would be the following:

Comparable Company	**Gross Margin**
Company X	8%
Company Y	10%
Company Z	12%

107. In this case, an arm's length range can be calculated. The arm's range of gross margins varies from 8% to 12% with a median of 10%. Therefore,

following the arm's length principle, Company B's 5% gross margin needs to be increased to a 10% gross margin. This adjustment is to be done to the transfer price of 7,600. For Company B to obtain a gross margin of 10%, the transfer price needs to be reduced to 7,200; the current transfer price of 7,600 allows Company B to obtain a 5% gross margin, compared to the 10% gross margin obtained by comparable independent enterprises. The 7,200 will acknowledge a lower arm's length price with respect to the initially applied transfer price of 7,600. This decrease in costs should have an impact in the profit levels of Company B, as illustrated in the following table:

Company B

	Initial	**Adjustment**	**Final**
Sales	8,000		8,000
Cost of Goods Sold	7,600	(400)	7,200
Gross profit	400		800
Gross Margin	400/8000 = 5%		800/8000 = 10%

108. In summary, after having applied the arm's length principle, Company B will have to adjust its taxable base by (7,600 – 7,200). The 400 will be subject to taxation at the applicable rate, so tax collected from this adjustment will be 400 multiplied by applicable tax rate.

Cost Plus Method (CPM)

Overview

109. The CPM evaluates the arm's length nature of an inter-company charge for tangible property or services by reference to the gross profit mark-up on costs incurred by the supplier of the property or services. The CPM consists of comparing the mark-up on those costs directly and indirectly incurred in the supply of property or services in a connected transaction with the mark-up on those costs directly and indirectly incurred in the supply of property or services in comparable independent transactions. The CPM is often used in the following circumstances:

- Cost contribution arrangements (see *Appendix 5 - Cost Contribution Arrangements*).
- Contract manufacturing.
- Intra-group services (see *Appendix 6 - Intra-Group Services*).

110. The CPM allows for a gross profit mark-up to be added to the cost of producing the property or providing the services to arrive at the ALC. The gross profit mark-up is determined by reference to the functions performed by the connected person, taking into account the assets used, risks assumed, and market conditions or by reference to the comparable independent transaction.

For example:

Cost of producing property	$5,000
Add: gross profit mark-up @ 50%	$2,500
Transfer price	$7,500

111. The CPM begins with a comparable gross mark-up being added to the costs incurred by a connected person who is a supplier of a product or service to another connected person. This comparable gross mark-up is determined in two ways, that is, by reference to: the cost-plus mark-up earned by a member of a group of connected persons in a comparable independent transaction (internal comparable); or, the cost plus mark-up earned by an independent person in a comparable independent transaction (external comparable). In either case, the returns used to determine an arm's length mark-up must be those earned by independent persons performing similar functions and preferably selling similar goods to other independent persons.

112. Where the transactions are not comparable in all ways and the differences have a material effect on the transfer price, taxpayers must make adjustments to eliminate the effect of those differences, such as differences in the relative efficiency of the connected person who is the supplier, and any advantage that the activity creates for the group of connected persons. The more comparable the functions, risks and assets, the more likely it is that the CPM will produce an appropriate estimate of an arm's length result.

113. The costs and expenses of a company normally fall into three categories:

- Direct costs such as raw materials.
- Indirect costs such as repair and maintenance which may be allocated among several products.
- Operating expenses such as selling, general, and administrative expenses.

114. The CPM is calculated by subtracting only the direct and indirect costs from the sales price in determining the gross profit margin.

115. In comparison, transactional profits methods - such as the TNMM discussed in paragraphs 138 to 152 below – calculate margins in respect of direct, indirect, and operating expenses. For purposes of calculating the cost base for the transactional net margin methods, operating expenses usually exclude interest expense and taxes.

116. Properly determining a cost base under the CPM or TNMM is important. Cost is usually calculated in accordance with generally accepted accounting principles for a particular industry in the country where the goods are produced or services provided. However, it is most important that the cost base of a person being tested in a transaction to which a mark-up is to be applied be calculated in the same manner as, the cost base of the comparable independent transactions. Where the cost base has not been accurately determined, both the mark-up (which is a percentage of cost) and the transfer price (which is the total of the cost and the mark-up) will be misstated. For example, if the “comparable” independent person includes a particular item as an operating expense, while the connected person being tested includes the item in its cost of goods sold, the cost of goods sold of the “comparable” independent person must be adjusted to include the item.

117. The OECD Guidelines provide an example where the “comparable” independent person leases its business assets while the connected person being tested owns its business assets. The example highlights that the cost base may not be comparable without the appropriate adjustment.

118. The application of the CPM also requires careful consideration of the relative efficiencies of the parties being compared. An analysis of efficiencies includes a consideration of the differences in cost structures (such as the age of the plant and equipment), business experience (such as start-up versus mature businesses), and management efficiency. Where material differences are identified, the reliability of a comparable independent person may be affected. Material differences between the capital intensity of the connected person being tested and a comparable independent person often indicate material differences in the transactions for which adjustments cannot be made.

119. For purpose of applying the CPM, items such as depreciation and other indirect charges are usually calculated in accordance with generally accepted accounting principles for a particular industry. Therefore, amounts such as depreciation for financial reporting purposes and not amounts such as capital cost allowance for calculating a taxpayer's taxable income are, in general, relevant for purposes of establishing the appropriate cost base under the CPM.

120. The CPM and RPM are applied to only one connected person, i.e. a one-sided method being applied to a tested party, of the group of connected persons participating in the transaction. Generally, the more complex the functions performed, the assets used and the risks assumed, the more difficult it is to find comparable data to apply these methods.

121. The CPM and RPM generally produce the most reliable results where the functions performed by the connected person being tested are the least complex, and the connected person being tested does not contribute valuable or unique intangible assets.

122. For example, Foreign Co. conducts research and development, and manufactures and sells, a particular technological product into its home market. JAMCO, a Jamaican subsidiary of Foreign Co., on the other hand, manufactures only one component of the technological product and sells all the components it produces to Foreign Co. This component was originally developed by Foreign Co. Because Foreign Co. develops and owns both the manufacturing and marketing intangibles, it will generally be more difficult to find comparable data to apply the CPM and RPM to Foreign Co.'s manufacturing and sales activities than it would be to find comparable data to apply the CPM to JAMCO's manufacturing activities. JAMCO should be selected as the tested party to the transaction.

When to use the CPM

123. The CPM is used if no comparable market prices exist. It is typically applied when one of the connected persons performs relatively simple manufacturing or assembly functions with the absence of valuable intangibles (e.g. contract manufacturer, custom manufacturer, toll manufacturer or assembly operations) or is a relatively simple service provider. The CPM is most useful where connected transactions involve provision of intra-group services.

Strengths and weaknesses of the CPM

Strengths	Weaknesses
Independent persons use CPM to set prices	Weak link between level of costs and market price
Based on internal costs that are readily available	Accounting inconsistencies affect comparability
	One-sided method
	Budgeted and actual cost differentials present challenges
	No incentive to control costs

Examples of CPM

Example A

124. JAMCO, a Jamaican company, manufactures specialized equipment it sells to independent persons in the manufacturing industry using designs supplied to them by the independent persons. JAMCO realizes its costs plus a mark-up of 10% on the custom manufacturing.

125. Under the arm's length agreements, costs are defined as the sum of direct costs (i.e., labour and materials) plus an additional 50% mark-up of direct costs. The additional 50% mark-up of direct costs is intended to approximate indirect costs, including overhead.

126. JAMCO also manufactures stamping machines for its USA subsidiary, USCO, using designs supplied by USCO. Under the USCO agreement, costs are defined as the sum of the direct costs plus the actual indirect costs, including overhead.

127. The objective of this example is to illustrate that the cost base of the connected person and the comparable independent transaction must be expressed in equivalent terms. Therefore, for purposes of the example, it is assumed that the transactions between JAMCO and independent persons are functionally comparable to the transactions between JAMCO and USCO - normally there would be functional differences, such as differences in marketing activities, which should be given consideration in the determination of an arm's length mark-up.

128. JAMCO has calculated its indirect costs and has allocated those costs to the custom manufacturing and manufacturing of stamping machines based on the direct labour hours charged to each project. Based on JAMCO's calculations, the actual indirect costs, including overhead, to be charged to each manufacturing project equal 45% of the direct costs. The cost base of the comparable independent transactions must be restated to determine the appropriate mark-up.

Calculation of mark-up under arm's length agreements:	
Direct costs	$1,000
Add: indirect costs (50% × $1,000)	$500
Total costs	$1,500
Add: mark-up (10% x $1,500)	$150
Price	$1,650
Calculation of mark-up under arm's length agreements using restated costs:	
Direct costs	$1,000
Add: indirect costs (45% × $1,000)	$450
Total costs	$1,450
Price established above	$1,650
Gross mark-up based on restated costs ($1,650 - $1,450)	$200
Gross mark-up % based on restated costs ($200 / $1,450)	13.8%
Calculation of arm's length transfer price:	
JAMCO's direct costs related to USCO contract	$900
Add:	
Indirect costs (45% × $900)	$405
Mark-up (13.8% × ($900 + $405))	$180
Transfer price	$1,485

Example B

129. Company C is a subsidiary of Company A. Company C manufactures electrical components, which it sells to Company A. The electrical components are specially tailored to meet the requirements of Company A. All raw materials used in the manufacture of the product are purchased from Company I, an independent enterprise, at 20 per unit. The total cost per unit of manufactured product is 80. Company C then sells the product to Company A at a price of 100 per unit.

A. Sales	100
B. Purchases	30
C. Manufacturing costs	50
D. Total costs (B+C)	80
E. Gross profits (A-D)	20

130. No internal comparables have been identified to price the electrical components by using a CUP method. Since the product is an extensively customized product, there are no reliable external comparables available. Therefore, independent enterprises engaged in comparable transactions under similar circumstances are found in commercial databases and used as reliable comparables for the analysis. Five comparable enterprises are identified, their financial information is available and their cost-plus mark-ups calculated, showing the following results:

Comparable Company	**Cost-plus Mark-up**
Company M	28%
Company N	31%
Company O	34%
Company P	37%
Company Q	40%

131. In this case, an arm's length range can be calculated. The arm's range of cost-plus mark-ups varies from 28% to 40% with a median of a 34%.

132. Company C obtained a cost-plus mark-up of 25% (20/80 = 25%). The mark-ups from the comparable companies performing the same functions, bearing similar risks and using similar assets, can be used as a basis in arriving at an ALC. Since the arm's length cost-plus mark-up is 34%, the ALC of the electrical component sold to Company A by Company C should be 80 + (80 x 34%) = 80 + 27.2 = 107.2, instead of 100. In summary, after having applied the arm's length principle, Company C will have to adjust its taxable base by 7.2 (107.2 – 100). The 7.2 will be subject to taxation at the applicable rate, so the tax collected from this adjustment will be 7.2 times the applicable rate.

Transactional Profit Methods

133. Traditional transaction methods are the most reliable means of establishing an ALC. However, the complexity of modern business situations may make it difficult to apply these methods. Where the information available on comparable transactions is not detailed enough to allow for adjustments necessary to achieve comparability in the application of a traditional transaction method, taxpayers may have to consider using a transactional profit method.

134. However, the transactional profit methods should not be applied simply because of the difficulties in obtaining or adjusting information on comparable transactions, for purposes of applying the traditional transaction methods. The same factors that led to the conclusion that it is not possible to apply a traditional transaction method must be considered when evaluating the reliability of a transactional profit method.

135. The OECD Guidelines endorse the use of two transactional profit methods, i.e. the transactional net margin method (TNMM) and the transactional profit split method (TPSM). The key difference between the TPSM and the TNMM is that the TPSM is a two-sided method (i.e. it can be applied to all members involved in a connected transaction), whereas the TNMM is a one-sided method (applicable only to the “tested party”).

136. The more uncertainty associated with the comparability analysis, the more likely it is that a “one-sided method”, such as the TNMM, will produce an inappropriate result. As with the CPM and RPM, the TNMM is less likely to produce reliable results where the tested party contributes to valuable or unique intangible assets. Where uncertainty exists with comparability, it may be appropriate to use a TPSM to confirm the results obtained. It will all depend on the particular facts and circumstances of each transaction and the particulars of the comparability analysis.

137. It is difficult to find exact comparables for good and services and particular, for valuable or unique intangible assets. Furthermore, by their nature, these intangibles are often difficult to value, making it a challenge to calculate adjustments to account for the impact of the intangible. Therefore, the TAJ's view is that the TNMM is rarely used as the recommended approach for connected transactions involving valuable or unique intangible assets.

Transactional Net Margin Method (TNMM)

Overview

138. The transactional net margin method consists of comparing the net profit margin relative to an appropriate base (e.g. sales, costs, assets, etc.) that an enterprise achieves in a connected transaction with the net profit margin relative to the same base achieved in a comparable independent transaction. This differs from the CPM and RPM that compare gross profit margins. However, the TNMM requires a level of comparability similar to that required for the application of the CPM and RPM. Where the relevant information exists at the gross margin level, taxpayers should apply the CPM or RPM.

139. The TNMM is a “one-sided” method because it is applied to the person that has the least complex functional analysis, i.e. the tested party that does not contribute to valuable or unique intangible assets. Since the TNMM

measures the relationship between net profit and an appropriate base such as sales, costs, or assets employed, it is important to choose the appropriate base taking into account the nature of the business activity. The appropriate base that profits should be measured against will depend on the facts and circumstances of each case.

140. The TNMM relies on a comparison of net margins. Therefore, a standard of comparability similar to that needed for the CPM and RPM must be met if the TNMM is to produce a reliable estimate of an arm's length result. Application of the TNMM, like the CPM and RPM, requires a careful analysis of the functional differences. Where differences between the connected person's situation and that of one or more comparable independent persons exist and can be determined, the connected person must make appropriate adjustments to ensure a high standard of comparability.

141. Some differences may not lend themselves to simple or reliable adjustments (e.g., differences in the age and productivity of plant and equipment, management abilities or philosophies, or the business experience of the respective independent persons). The failure to account for these differences or to make satisfactory adjustments may preclude the method from producing a reliable estimate of an arm's length result. Aggregated data compiled with respect to the profits within a particular industry rarely satisfy the standards of comparability required to implement the TNMM.

142. Typically, the TNMM is applied to only one of the connected persons involved in the connected transaction. However, the TNMM can be applied to more than one member of a group of connected persons. Where the TNMM is applied to only one member of a group of connected persons, it may fail to consider the relative contributions of all the members to the profits of the group. It can produce results that do not accord with the arm's length principle, where the connected person that is the tested party contributes to valuable or unique intangible assets. The result may be that a level of profit is attributed to one member of the group, leaving the other members of the group with unrealistic shares of the group's total profits.

143. Some tax jurisdictions promote the use of statistical measures (such as standard deviation, variance, interquartile range, mean, median mode, etc.) to enhance the reliability of the comparable data considered in producing a range. As previously mentioned in this practice note, TAJ does not endorse the use of statistical measures which are commonly used in the application of the TNMM. Instead, TAJ relies on the facts and circumstances of the case to determine a range, or the particular point in a range, that is the most reliable estimate of an arm's length price or allocation.

144. TAJ recommends that taxpayers follow a four-step approach in their search for external comparable transactions under the TNMM. The steps are as follows:

- Step 1: Select independent persons with similar industry classifications to the tested party, taking into consideration that closer comparability of products and functions produces more reliable results.

- Step 2: Screen the independent persons identified in a similar industry classification to determine if they have basically comparable transactions (and functions) as those of the tested party, based on the financial information available. For example, where the tested party is a manufacturer with limited intangibles, the ratio of research and development expenses to sales may highlight functional differences between the tested party and the independent persons selected.
- Step 3: Review all the detailed information (financial and textual) available on the independent persons selected in Step 1 and not screened out by the testing in Step 2. Do this to determine if the information indicates that they could be considered to have comparable transactions. Although entities are reported in a similar industry code, the narrative descriptions will often reveal that the selected entities' functions may not be comparable to those of the tested party.
- Step 4: Material differences may affect the comparability of any of the entities' transactions selected in Step 1 and not screened out by the testing in Step 2 or Step 3. In these situations, make the appropriate adjustments where possible and eliminate any entities for which necessary adjustments cannot reasonably be made.

145. Taxpayers should apply the TNMM on a transactional basis and not on a company-wide basis. However, transactions may be combined after considering the factors described in this practice note. There may be situations where a taxpayer has followed the comparability process and is unable to establish an appropriate degree of comparability based on the facts and circumstances. In such a situation, the taxpayer may have to consider using another method that will satisfy the arm's length principle. Where another method is used, it should reflect an attempt to present the particular transaction in terms of what would have transpired in an independent person relationship.

When to use the TNMM

146. The TNMM should be used where one of the connected persons makes all the unique contributions involved in the connected transaction, while the other connected person does not make any unique contribution, i.e. the party with the least complex functional analysis.

Strengths and weaknesses of the TNMM

Strengths	Weaknesses
Net margins are less affected by transactional differences than price and less affected by functional differences than gross margins	Net margins affected by factors that have less effect on price or gross margins
Can be applied to either party to the controlled transaction	Availability of information on uncontrolled transactions
Modified resale price or cost plus method	Measurement problems
May be more likely to find comparables/reliable data (public data)	One-sided method

Examples of TNMM

Example A

147. JAMCO, a Jamaican company, produces a liquid product for itself and three foreign subsidiaries of its United States parent. JAMCO and the foreign subsidiaries own the rights to the liquid product formulae for sales to their respective countries. Although JAMCO has no internal comparable transactions, it has been able to locate data relating to an independent person who performs custom formulations for “independent person” purchasers using formulae supplied to them by those purchasers. Given the absence of valuable or unique intangibles, JAMCO has been able, after the appropriate functional analysis, to verify that the independent person who is a custom formulator is comparable. However, JAMCO cannot obtain the relevant information at the gross margin level. Therefore, it is unable to apply the CPM. The independent person who is a custom formulator realizes a net mark-up of 10% on the custom formulations.

The transfer price of the liquid product is calculated as follows:

JAMCO's cost of goods sold	\$1,000
JAMCO's operating expenses	\$300
Total costs	\$1,300
Add: Net mark-up (10% × \$1,300)	\$130
Transfer price	\$1,430

Example B

148. Company X is a subsidiary of Company Y, located overseas. Company Y manufactures computers, which it sells to Company X and other connected distributors in different countries. The computers distributed by Company X bear Company Y’s trademark. Company X also provides technical support to all its customers.

Income Statement for Company X

	Initial
Sales	100,000
Cost of Goods Sold	90,000
Gross profit	10,000
Other operating expenses	15,000
Net profit	(5,000)
Net Margin	-5%

149. Assume that the CUP method is not applied as no similar comparable products are available nor reliable adjustments can be made to account for differences between those products; and the resale price method is not used as no comparable measurement of gross margin can be found due to differences in accounting practices amongst independent distributors. Therefore, the TNMM is adopted on the basis of net profit return on sales.

Independent enterprises engaged in comparable transactions under similar circumstances are found in commercial databases and used as reliable comparables for the analysis. Four comparable enterprises are identified, their financial information is available and their return on sales calculated, showing the following results:

Comparable Company	Return on Sales
Company R	6%
Company S	7%
Company T	9%
Company U	10%

150. In this case, an arm's length range can be calculated. The arm's range varies from 6% to 10% with a median of an 8% net margin.

151. Company X obtained a net operating margin of -5%. The net operating margins from the comparable companies performing the same functions, bearing similar risks and using similar assets, can be used as a basis in arriving at an arm's length price. Since the arm's length net operating margin is 8%, the arm's length price of the computers purchased by X to Y should be:

- Net profit of X = 100,000 x 8% = 8,000
- Adjusted cost of goods sold = 100,000 – 15,000 – 8,000 = 77,000

Adjusted Income Statement for Company X

	Initial	Adjustment	Final
Sales	100,000		100,000
Cost of Goods Sold	90,000	(13,000)	77,000
Gross profit	10,000		23,000
Other operating expenses	15,000		15,000
Net profit	(5,000)		8,000
Net Margin	-5%		8%

152. In summary, after having applied the arm's length principle, Company X will have to adjust its taxable base by 13,000 (90,000 – 77,000). The 13,000 will be subject to taxation at the applicable rate, so the tax collected from this adjustment will be 13,000 multiplied by the applicable rate.

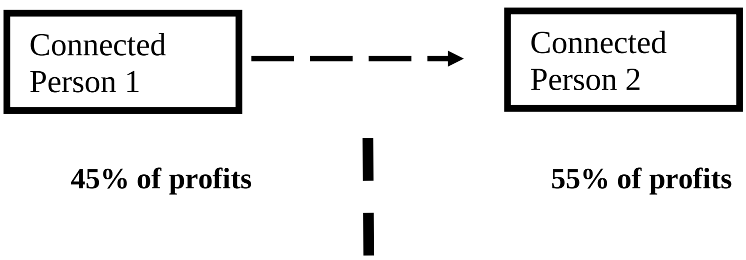
Transactional Profit Split Method (TPSM)

Overview

153. The TPSM seeks to eliminate the effect on profits of special conditions made or imposed in a connected transaction by determining the division of profits that independent persons would have expected to realize from engaging in the transaction or transactions. This method is most appropriate where both connected persons to a transaction make unique and valuable contributions (e.g. contribute significant unique intangibles). The TPSM may be applied where the operations of two or more connected persons are highly integrated, making it difficult to evaluate their transactions on an individual basis, and the existence of valuable and unique intangibles makes it impossible to establish the proper level of comparability with independent transactions to apply a "one-sided method" (i.e. CPM, RPM and TNMM).

154. Under the TPSM:

- Step 1: Determine the total profit earned by the connected persons from a connected transaction. The TPSM allocates the total integrated profits related to a connected transaction, not the total profits of the group of connected persons as a whole. The profit to be split is generally the operating profit, before the deduction of interest and taxes.
- Step 2: Split the profit between the connected persons based on the relative value of their contributions to the connected transactions, considering the functions performed, the assets used, and the risks assumed by each connected person, in relation to what independent persons would have received based on their routine functions.



155. Step 2 of the TPSM can be applied in numerous ways including splitting profits based on a residual analysis, or relying entirely on a contribution analysis. Following the determination of the total profit to be split in Step 1 of the TPSM, a residual profit split is performed in two stages. The stages can be applied in numerous ways, for example:

- Stage 1: The allocation of a return to each connected person for the readily identifiable functions (e.g., manufacturing or distribution) is based on routine returns established from comparable data. The returns to these functions will, generally, not account for the return attributable to valuable or unique intangible property used or developed by the connected persons. The calculation of these routine returns is usually calculated by applying the traditional transaction methods such as CPM or RPM, although it may also involve the application of the TNMM.

- Stage 2: The return attributable to the intangible property is established by allocating the residual profit (or loss) between the connected persons based on the relative contributions of the connected persons, after giving consideration to any information available that would indicate how independent persons divide the profit or loss in similar circumstances.

156. Where the profit is split based on the relative assets of the connected persons, merely providing each connected person with the same return on its respective assets is usually not acceptable. The methodology used should recognize that different types of assets have different expected rates of return, based on their liquidity and risk. For example, working capital would usually expect to earn a short-term financing rate of return. However, fixed assets such as property, plant and equipment would usually expect to earn a long-term rate commensurate with the risks assumed.

157. Due to the complexity of MNE operations, one member of the MNE group is seldom entitled to the total return attributable to the valuable or unique assets, such as intangibles. For example, although one member of a MNE group often develops a product intangible, another member of the group may expend considerable effort in developing a marketing intangible in a specific geographic location. Also, independent persons would not usually incur additional costs and risks to obtain the rights to use intangible properties unless they expected to share in the potential profits. When intangibles are present and no quality comparable data are available to apply a one-sided method, taxpayers should use the TPSM.

When to use the TPSM

158. The TPSM is typically used in complex situations, where transactions are so interrelated making it impossible to identify comparable transactions, and significant intangibles are used by both connected persons.

Strengths and weaknesses of the TPSM

Strengths	Weaknesses
Suitable for highly integrated operations where one-sided method may not be appropriate	Link between external data and transaction is weak and subjective
Generally no comparable transactions required	Relies on access to data from foreign affiliates
Two-sided approach and reasonableness test	Measurement problems
With this method synergies can be addressed	Independent persons do not use profit split to determine transfer prices
	What to do with a consolidated loss

Examples of TPSM

Example A

159. JAMCO, a Jamaican company, has developed and manufactures a unique computer chip. The chip is considered to be an innovative technological advancement. USCO, a United States subsidiary of JAMCO, has developed and manufactures a computer which incorporates the new chip developed by JAMCO and technology developed by USCO itself. The success of the computer is attributable to both connected persons for the design of the computer and the computer chip. JAMCO supplies USCO with the computer chips for assembly in the computers. USCO manufactures the computers and sells the computers to an "independent person" distributor. In light of the innovative nature of the chip and computer, the JAMCO/USCO group was unable to find comparables with similar intangible assets. Because they were unable to establish a reliable degree of comparability, the JAMCO/USCO group was unable to apply the TNMM. However, reliable data are available on chip and computer manufacturers not having innovative intangible property, who earn a return of 10% on their manufacturing costs (excluding purchases).

The total profits attributable to computer and chips are calculated as follows:

Sales to the independent person distributor	\$1,000
Deduct:	
JAMCO's manufacturing costs	\$200
USCO's manufacturing costs	\$300
Subtotal	\$500
Gross margin	\$500
Deduct:	
JAMCO's development costs	\$100
USCO's development costs	\$50
JAMCO's operating costs	\$50
USCO's operating costs	\$100
Subtotal	\$300
Net profit	\$200
Deduct:	
JAMCO's return to manufacturing (200 × 10%)	\$20
USCO's return to manufacturing (300 × 10%)	\$30
Subtotal	\$50
Residual profit attributable to development	\$150

160. To simplify this example, it is assumed that the current chip and computer development costs accurately reflect each of the connected persons' relative contribution to the computer's technological advantage. The split of the residual profit should consider the benefits over the entire expected life of the technology, which would usually go beyond the current year. However, given the foregoing assumption, the residual profit in this example would be split as follows:

Based on proportionate development costs:

JAMCO's share of residual profit [100 / (100 + 50)] × 150	$100
USCO's share of residual profit [50 / (100 + 50)] × 150	$50

JAMCO's transfer price is calculated as follows:

Manufacturing costs	$200
Development costs	$100
Operating costs	$50
Routine 10% return on manufacturing costs	$20
Share of residual profit	$100
Transfer price	$470

Example B

161. Companies X, Y and Z are companies located in different countries. Company X designs and manufactures the high quality electrical products which it sells to its subsidiary, Company Y. Company Y sells to Company Z, an independent wholesaler, under YY trademark, which is owned, and was developed, by Company Y.

Income Statements for Companies X and Y:

	Company X	**Company Y**
A. Sales	100	300
B. Purchases	15	100
C. Costs	20	35
D. Cost of goods sold	35	135
E. Gross profits (A-D)	65	165
F. R&D/marketing	20	15
G. Other operating expenses	15	10
H. Net profit (E-F-G)	30	140

162. Research indicates that there are several independent companies that carry out similar functions to that of Companies X and Y, although the products manufactured by Company X are much more advanced than those produced by competitors, and the YY brand is one of the most valuable in the market. The average net returns identified in independent manufacturers and distributors, which do not own valuable intangibles, are 30% of total costs and 5% of sales respectively.

163. The TPSM is adopted using the residual approach. For the sake of simplicity, assume that there is insufficient data and information to apply the CPM for X and the RPM for Y in the first step of the residual profit analysis.

Calculation of net profit:

A. Total sales (Company Y)	300
B. Cost of goods sold (Company X)	35
C. Cost of goods sold intercompany purchases (Company Y)	35
D. Gross profit (A-B-C)	230
E. R&D/marketing (Company X)	20
F. R&D/marketing (Company Y)	15
G. Other operating expenses (Company X)	15
H. Other operating expenses (Company Y)	10
I. Net profit (D-E-F-G-H)	170

Calculation of basic returns to Companies X and Y:

J. Basic return to Company X: 30% of (B+G)	30% x (35 + 15) = 15
K. Basic return to Company Y: 5% of A	5% x 300 = 15

Calculation of residual profit (net profit less basic returns):

L. I - (J+K)	170 – (15+15) = 140

164. Assume that, in this case, R&D and marketing and promotion costs incurred by Companies X and Y, respectively, provide a reliable measure of

the relative contribution of their intangible assets.

Calculation of residual profit split rate (company R&D/marketing over total R&D/marketing):

	Company X	Company Y
R&D/marketing	E=20	F=15
Total R&D/marketing	E+F=35	E+F=35
Expenditure ratio	20/35=57%	15/35=43%

Calculation of residual return (rate of residual profit split times residual profit):

M. Company X	(57% of L) or 57% x 140 = 80
N. Company Y	(43% of l) or 43% x 140 = 60

Calculation of adjusted net profit (basic return + residual return):

O. Company X	(J+M) or 15+80 = 95
P. Company Y	(K+N) or 15+60 = 75

Calculation of transfer pricing adjustment (net profit – adjusted net profit):

Q. Company X	(O-H) or 95-30 = 65
R. Company Y	(P-H) or 75-140 = -65

Adjusted Income Statements for Companies X and Y:

	Company X	Company Y
1. Sales	100	300
2. Transfer pricing adjustment	65	
3. Adjusted sales (1+2)	165	300
4. Purchases	15	100
5. Transfer pricing adjustment		~~65~~
6. Adjusted purchases (4+5)	15	165
7. Manufacturing cost	20	35
8. Adjusted gross profit (3-6-7)	130	100
9. R&D/marketing	20	15
10. Other operating costs	15	10
11. Adjusted net profit (8-9-10)	95	75

Use of Secret Comparables

165. TAJ is precluded under Section 4 of the ITA from disclosing 3rd party information in relation to another taxpayer gathered under the ITA. Accordingly, TAJ considers itself prohibited from using third-party comparable information, i.e. so-called “secret comparables” as the basis of assessment.

Mutual Agreement Procedure (MAP)

166. Jamaica has signed a number of DTAs with other jurisdictions (see Appendix 8 below). One of the reasons for signing such agreements is to eliminate double taxation that often results from the allocation of tax revenues from international transactions.

167. Many of these DTAs contain rules concerning the allocation of income in accordance with the arm's length principle. These rules, generally found in Article IX of the relevant DTA, are often modelled after Article 9 of the *OECD Model Tax Convention on Income and on Capital*, and provide a framework in which adjustments to profits by one country's tax administration may be offset by a corresponding adjustment by the tax administration of another country.

168. Most DTAs contain specific time limitations for seeking relief. Therefore, taxpayers must consult the appropriate DTA to establish the specific time limitations. Failure to notify the appropriate competent authorities within the applicable time limitations may result in double tax.

169. The CG may not find it appropriate to exercise his discretion, under Section 17 of the ITA, to make an adjustment under Section 17 of the ITA, when a foreign tax administration has initiated or proposes a transfer pricing adjustment. In such cases, the CG expects the taxpayer, under review by the foreign tax administration, to seek assistance from the CAJ to claim corresponding adjustments or deductions.

170. Jamaican taxpayers have a responsibility to seek the assistance of the CAJ before making claims for corresponding adjustments or deductions in either their current Jamaican income tax returns, or filing amending income tax returns.

171. Where a transfer pricing adjustment results in double taxation, a Jamaican taxpayer may request CAJ's consideration as provided under the MAP article of Jamaica's DTAs. The reader should refer to *PN-XX, Requests for Competent Authority Consideration Under the Mutual Agreement Procedures in Income Tax Conventions*. This practice note gives a more detailed discussion of the procedures and acceptability of requests for competent authority consideration.

172. The CAJ will not enter into negotiations nor apply the DTA provisions to eliminate double tax in the event of fraud, wilful default, or gross negligence by a taxpayer pursuant to Section 17(4) of the ITA.

173. Under the *Income Tax (Transfer Pricing Documentation) Regulations,*

2015 (see Appendix 9 below) and the laws of Jamaica's treaty partners, taxpayers have a responsibility to appropriately document their transactions with connected persons. Without the proper documentation, competent authorities may be unable to resolve disputes expeditiously and double taxation can result, in extreme circumstances.

Transfer Pricing Agreements (TPA)

174. The TPA program assists taxpayers in determining the ALC acceptable for the ITA. A TPA is an agreement or arrangement between the taxpayer and TAJ. A TPA stipulates a mutually acceptable TPM to be used in respect of connected transactions for a specified future period, with renewal provisions. A bilateral TPA under which a treaty partner also agrees to the same TPM provides assurance that potential double taxation will be avoided in connected, cross-border transactions. For further details, the reader should refer to *PN-X Transfer Pricing Agreements.*

175. No transfer pricing adjustments under Section 17 of the ITA will arise regarding the transactions covered by a TPA as long as the TPA remains in effect, and the taxpayer complies with its terms and conditions.

Customs Valuations

176. The methods for determining value for duty under the current provisions of the *Customs Act* resemble those outlined in this practice note. However, differences do remain. TAJ is not obliged to accept the value reported for duty when considering the income tax implications of a connected person importation.

Appendix 1 – Schedule 8, Declaration of Connected Person Transactions

Schedule 8

S04/IT02/ IT03

Declaration of Connected Person Transactions.

Year of Assessment
2015

PART I – TRANSACTIONS: CORPORATE INFORMATION

Has there been any change in the ownership structure of your **business organization**?
(If submitting for the first time or where there have been changes)

Provide details

PART II – CONNECTED PERSON INFORMATION

a) Particulars of **connected person** with which the taxpayer has conducted any form of transaction or dealing during the year

Name of Connected Person	Nature of relationship	Country of incorporation	Location/Residence	Description of Transaction

b) **Connected Person Transactions**

State the amount of payment in the "Expenditure" column and the amount of receipt in the "Income" column in respect of Connected Person transactions as indicated below.

Item	Expenditure($)	Income ($)	Connected Person
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
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[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
[SELECT FROM LIST]			
Total			

c) **Loans**

Loans and Guaranteed Loans from **connected person.**

Name of Connected Person	Opening balance	Additions	Repayments	Closing balance	Interest Rate

d) **Non- monetary transactions with Connected Person**

Have you received from or provided to a Connected Person any non-monetary or nil consideration for the performance of services, transfer of property (tangible or intangible), processes, rights or obligations during the year of assessment?

☐ Yes ☐ No

If yes, provide details (attach schedule, if necessary)

....

....

....

....

....

e) **Acquisition/Disposal of Assets**
Did you have any Connected Person dealings of capital nature in which you acquired interest in or disposed of asset(s)?

☐ Yes ☐ No

If yes, give details

....

....

....

....

f) **Participation by resident person**
Did a **connect**ed resident person participate directly or indirectly in your capital, finance, management or control during the year of assessment?

☐ Yes ☐ No

If yes, provide details. (Attach schedules, if necessary).

....

....

....

....

g) **Participation by non-resident person**
Did a **connect**ed non-resident person participate directly or indirectly in your capital, finance, management or control during the year of assessment?

☐ Yes ☐ No

If yes, provide details. (Attach schedules, if necessary).

....

....

....

....

Appendix 2 - Transfer Pricing Agreement Annual Compliance Notice

PART I: TPA Summary Information

1. Taxpayer Name:

2. Taxpayer Registration Number:

3. Taxpayer Representative Name and Contact Information:

4. TPA Term (taxable years *20xx* to *20xx):*

5. This Annual Report Summary is for Taxable Year Ending:

6. Type of TPA: ☐ Unilateral ☐ Bilateral ☐ Multilateral

7. Principal foreign country/countries involved in TPA covered transaction(s):

8. ☐ Original TPA ☐ Renewal TPA

9. Has this TPA been amended or changed? ☐ Yes ☐ No
   If Yes, state Effective Date:

10. Has the person complied with all TPA terms and conditions? ☐ Yes ☐ No

11. Has the person triggered any critical assumptions detailed in the TPA?
    ☐ Yes ☐ No (If yes, attach additional statement with explanation)

12. Are there any compensating adjustments required under the terms of the TPA? ☐ Yes ☐ No (If yes, attach additional statement with explanation of compensating adjustment and where the compensating adjustment was reflected in the income tax return)

13. Are there any material differences between the person's business operations (including functions, risks assumed, markets, contractual terms, economic conditions, property, services, and assets employed) during the current TPA Year from the business operations described in the TPA request?
    ☐ Yes ☐ No (If yes, attach additional statement with explanation)

14. Are there any material changes in financial or tax accounting methods or principles employed for the TIA year in respect of the covered dealings, which differ from the financial or tax accounting methods employed and reflected in the TPA request?

    ☐ Yes ☐ No (If yes, attach additional statement with explanation)

PART II: Transfer Pricing Method

15. TPA Tested party is: ☐ Taxpayer ☐ Foreign ☐ Both

16. TPA tests on (check all that apply):

    ☐ Annual basis ☐ Multi-Year basis ☐ Term basis

17. TPA provides (check all that apply) a: ☐ Range ☐ Point

    ☐ Floor only ☐ Ceiling only ☐ Other (please specify):

18. TPA provides for adjustment (check all that apply) to

    ☐ Nearest Edge ☐ Median ☐ Other point (please specify):

Section III: Additional TPA Compliance Information

Please provide the following additional information to demonstrate compliance with the TPA referenced above:

1. A brief statement demonstrating how the Jamaican company is actively targeting the agreed transfer pricing as part of the TPA.

2. Information and computations necessary to ascertain the outcome of the TPA for the covered dealings between the person and its connected party. This includes demonstrating the extent of compliance with terms and conditions of the TPA.

3. Additional items as may be appropriate to the particular circumstances of the person as it pertains the referenced TPA.

4. The Commissioner General will review the Annual Compliance Report and, if necessary, may request further information that is reasonably needed to verify that the person referenced in this TPA Annual Report has complied with the terms and conditions of the TPA.

5. If the person fails to provide the Annual Compliance Report or supply the additional information requested within the time specified in these Rules, the Commissioner General may cancel the TPA.

*Appendix 3 – Schedule of Low / No Tax Jurisdictions**

Country	Corporate Tax Rate (%)	Individual Tax Rate (%)
1. Albania	10	
2. Alderney	0	
3. Andorra	10	10
4. Anguilla	0	
5. Antigua and Barbuda		
6. Aruba		
7. Argentina	9-35	
8. Bahamas	0	
9. Bahrain	0	
10. Barbados		
11. Belize		
12. Bermuda	0	
13. Bonaire, St. Eustatius & Saba	0	
14. Bosnia and Herzegovina	10	
15. British Virgin Islands		
16. Brunei	0	
17. Bulgaria	10	
18. Cayman Islands	0	
19. Christmas Islands		
20. Cook Islands		
21. Dominican Republic		
22. Falkland Islands		
23. Fiji		
24. Gibraltar	10	
25. Grenada		
26. Guam		
27. Guernsey	10	
28. Guyana		
29. Hong Kong		
30. Isle of Man	0	
31. Jersey	0	
32. Kyrgyzstan	10	
33. Kuwait	0	
34. Liberia		
35. Liechtenstein		
36. Macau	12	
37. Macedonia	10	
38. Maldives		
39. Marshall Islands		
40. Mauritus		
41. Moldova	12	
42. Monaco		
43. Monserrat		
44. Montenegro	9	
45. Mongolia	10	
46. Nauru		
47. Netherland Antilles		
48. Niue		
49. Norman Isles		
50. Oman	12	
51. Palau		

52. Panama		
53. Paraguay	10	
54. Qatar	10	
55. Saint Kitts and Nevis	IBC	
56. Saint Lucia	IBC	
57. Saint Vincent and the Grenadines		
58. Samao		
59. San Marino		
60. Sark	0	
61. Saudi Arabia	0	
62. Seychelles	IBC	
63. Solomon Islands		
64. Timor-Leste	10	
65. Tonga		
66. Trinidad and Tobago		
67. Turkmenistan	8	
68. Turks and Caicos Islands		
69. Tuvalu		
70. United Arab Emirates	0	
71. US Virgin Islands		
72. Uzbekistan	8	
73. Vanuatu	0	
74. Wallis and Funtuna	0	

*The list of low/no tax jurisdictions provided above is not exhaustive. Please check our Transfer Pricing hub on TAJ's website for updates.
https://www.jamaicatax.gov.jm/web/guest/transfer-pricing

Appendix 4 – Income Tax (Amendment) (No, 2) Act, 2015

17. (1) For the purposes of this section, sections 17A and 17B and the Eighth Schedule-

“arm's length consideration”, in relation to a connected transaction-

(a) means the consideration that would have been obtained if the connected transaction had been a comparable independent transaction; and

(b) shall be determined in accordance with the Eighth Schedule;

"comparable independent transaction" means an independent transaction that is determined in accordance with the Eighth Schedule to be an appropriate transaction to compare with a particular connected transaction;

"connected person", in relation to a participant in a transaction, means a person who is treated as being connected, in accordance with section 2(2), with another participant in the transaction;

"connected transaction" means a transaction between connected persons;

"consideration", in relation to a transaction, means all of the terms and conditions applicable to the transaction, and includes, but is not limited to, the price, profit margin and profit share, terms of payment, security for payment, and any other commercially significant aspects of the transaction;

"independent person", in relation to a participant in a transaction, means a person who is not treated as being connected, in accordance with section 2(2), with any other participant in the transaction;

"independent transaction” means a transaction between independent persons.

(2) In each true and correct return which shall be delivered to the Commissioner General by every person liable to pay income tax in respect of any year of assessment, the person whose income the return relates to shall-

(a) state the arm's length consideration (and no other consideration) in respect of any connected transaction in which the person participated in that year of assessment; and

(b) use the arm's length consideration (and no other consideration) in computing the tax chargeable on the person's income for that year of assessment.

(3) If-

(a) the consideration in respect of a connected transaction is not arm 's length consideration; and

(b) the taxable income that would have accrued to any connected person who participates in that transaction, if the consideration for that transaction had been arm's length consideration, has not so accrued,

then, for the purposes of determining the taxable income derived from that transaction by any of those connected persons, the consideration in respect of that transaction shall be treated as that which would have been obtained if the transaction had been arm's length consideration.

(4) Where a return of income is submitted to the Commissioner General under this Act, the person in respect of whose income it is submitted shall certify whether to his knowledge the accounts or information upon which the return is based include particulars or any transactions carried out between connected persons and if so what those particulars are.

(5) With effect from the year of assessment 2016, if any person fails to certify as required by subsection (4) or provides an incorrect or incomplete certificate or return due to the taxpayer's negligent or fraudulent conduct, he shall be liable on summary conviction in a Resident Magistrate's Court to a fine not exceeding two million dollars and, in default of payment thereof, to imprisonment for a term not exceeding twelve months.

(6) The Commissioner General may require a person who participates in a transaction to confirm to the Commissioner General what, in the person's opinion, is the arm's length consideration for the transaction.

(7) For the purposes of determining whether a person who participates in a transaction is a connected person or whether the transaction is a connected

transaction, the Commissioner General may request that person to provide information or documentation regarding-

(a) the relationship of that person to any other person who participates in the transaction; and

(b) the consideration for the transaction, including the terms and conditions of the transaction.

(8) If a person fails to provide, to the satisfaction of the Commissioner General, any information or documentation requested by the Commissioner General under subsection (7) in respect of a transaction or in respect of the relationship of the person to any other person who participates in the transaction, then the Commissioner General shall-

(a) treat the person as a connected person in relation to any other person who participates in the transaction and treat the transaction as a connected transaction; and

(b) determine the arm's length consideration for the transaction accordingly.

(9) Where a person ("person A") is a participant in a transaction with another person ("person B") who is resident in a jurisdiction other than Jamaica, as described in subsection (10), then the Commissioner General shall-

(a) treat person A as being a connected person in relation to person B and treat the transaction as a connected transaction; and

(b) require person A to determine the arm's length consideration for the transaction accordingly.

(10) Subsection (9) applies in respect of a jurisdiction other than Jamaica that, in the opinion of the Commissioner General, is one in which either-

(a) no tax is payable on the income, profits or gains of person B; or

(b) the rate of tax applicable to the income, profits or gains of person B is less than one half of the rate of tax that would be applicable under this Act to the income, profits or gains of person B if person B were resident in Jamaica.

(11) Person A referred to in subsection (9) shall not be required to provide documentation on the determination of the arm's length consideration in the transaction with person B, provided person A satisfies the Commissioner General with the relevant information and evidence that person B is not a connected person.

(12) For the purposes of any assessment, objection or appeal under this Act, the onus shall be on a person who alleges that the consideration for a transaction is arm's length consideration to prove that the consideration is arm's length consideration.

17A. (1) The Commissioner General may, upon application by any person who is liable to pay tax under this Act, enter into an agreement with that person (hereinafter referred to as a "transfer pricing agreement") regarding the manner of determining the arm's length consideration for connected transactions by that person.

(2) Where a person has entered into a transfer pricing agreement with the Commissioner General, the arm's length consideration for connected transactions by that person that are within the scope of the agreement shall be determined in accordance with the agreement, unless the consideration for any such transaction is inconsistent with the agreement.

(3) The Commissioner General may make rules regarding transfer pricing agreements, including rules in respect of any or all of the following matters-

(a) the criteria for a person to be eligible to apply for such an agreement to be entered into;

(b) the form and manner for applying for such an agreement to be entered into, and the information to be provided by an applicant;

(c) the terms and conditions that are to be included in such agreements, including provisions for their duration, suspension and termination;

(d) such other manners as the Commissioner General considers necessary or desirable for the better carrying out of the provisions of this section.

17B. (1) This section applies in circumstances where-

(a) an adjustment to the consideration in respect of a connected transaction is made by a tax authority of a country other than Jamaica;

(b) the adjustment referred to in paragraph (a) results in the tax authority in that other country making an increase to the taxable base in that country, by a connected person who is a participant in the connected transaction, on an amount of income in respect of which the connected person is liable to pay tax in Jamaica; and

(c) the country referred to in paragraph (a) has a treaty with Jamaica that provides for relief from double taxation.

(2) Where the circumstances described in subsection (1) apply, a person referred to in subsection (1)(b) may request the Commissioner General to examine and determine whether the consideration, after an adjustment referred to in subsection (1)(a), is consistent with arm's length consideration.

(3) Upon receipt of a request under subsection (2), the Commissioner General shall carry out the examination requested, in consultation with the tax authority of the other country referred to in subsection (1)(c) if necessary.

(4) If, after an examination under subsection (3), the Commissioner General determines that-

(a) the consideration in respect of a connected transaction, after an adjustment referred to in subsection (1)(a) has been made by the tax authority of another country, is consistent with arm's length consideration for that transaction; and

(b) an adjustment referred to in subsection (1)(b) has been made by the taxing authority of the other country to the taxable income in that country by the connected person,

then the Commissioner General shall make a corresponding adjustment to the amount of taxable income in Jamaica by that connected person, unless the Commissioner General considers that the adjustment of taxable income in the other country has been made as a result of fraud or wilful default.

l7C. Every person who engages in a transaction to which section 17A applies shall prepare and keep the prescribed documentation.

17D (1) The Minister may make regulations generally in relation to transfer pricing, and in particular but without prejudice to the generality of the foregoing, may make regulations-

(a) determining the size of enterprises to which the provisions of this Act relating to transfer pricing shall relate; and

(b) specifying the size and nature of transactions to which the provisions of this Act relating to transfer pricing shall relate.

(2) Regulations made under subsection (1)-

(a) may be given retroactive effect to a date not earlier than January 1, 2015; and

(b) shall be subject to affirmative resolution of the House of Representatives.

EIGHTH SCHEDULE

Transfer Pricing

1. In this Schedule-

"financial indicator" includes indicators such as price, profit margin and profit share;

"transfer pricing method" means a transfer pricing method described in paragraph 5.

2. The arm's length consideration in respect of a connected transaction shall be determined by application of a transfer pricing method, or other method authorized under this Schedule, to the connected transaction and to comparable independent transactions.

3. In determining whether a transaction is an appropriate transaction for the purposes of the definition of a comparable independent transaction, the following matters shall be considered-

(a) whether there are economically relevant characteristics of the transaction, in relation to-

(i) the characteristics of the property or services transferred by way of the transaction;

(ii) the functions performed by persons with respect to the transaction, taking into account assets used and risks assumed;

(iii) the terms and conditions, including the consideration, for the transaction;

(iv) the economic and market circumstances in which the transaction takes place; and

(v) the business strategies pursued by persons in relation to the transaction; and

(b) whether there is any significant difference between the transaction and the connected transaction with which it is to be compared that could materially affect the financial indicator being examined under a transfer pricing method or other method, and, if there is such difference, whether a reasonably accurate adjustment may be made to the relevant financial indicator being examined in order to eliminate the effect of the difference on the comparison.

4. The arm's length consideration in respect of a connected transaction shall be determined by applying the most appropriate transfer pricing method to the circumstances of the case, taking into consideration the following criteria-

(a) the relative strengths and weaknesses of the various methods;

(b) the appropriateness of a particular method in view of the nature of the connected transaction, determined in particular through an analysis of the functions undertaken by each person who participates in the connected transaction (taking into account assets used and risks assumed);

(c) the availability of reliable information necessary for the proper application of a particular method; and

(d) the degree of comparability between the connected transaction and independent transaction, including the reliability of comparability adjustments, if any, that may be required to eliminate differences in the comparison of the transactions.

5. The following are the transfer pricing methods that, subject to paragraph 10 may be applied in determining the arm's length consideration in respect of a connected transaction, as well as the manner of applying them-

(a) Comparable Uncontrolled Price Method-

the comparable uncontrolled price method consists in comparing the price charged for property or services transferred in a connected transaction to the price charged for property or services transferred in a comparable independent transaction;

(b) Resale Price Method-

the resale price method consists in comparing the resale margin that a purchaser of property in a connected transaction earns from reselling that property with the resale margin that is earned in a comparable independent transaction involving the purchase and resale of commercially equivalent property;

(c) Cost Plus Method-

the cost plus method consists in comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a connected transaction with the mark up on such costs directly and indirectly incurred in the supply of property or services in a comparable independent transaction;

(d) Transactional Net Margin Method-

the transactional net margin method consists in comparing the net profit margin relative to an appropriate base (such as costs, sales or assets) that a person achieves in a connected transaction with the net profit margin relative to the same base achieved in a comparable independent transaction;

(e) Transactional Profit Split Method-

(i) the transactional profit split method consists in allocating to each connected person participating in a connected transaction the portion of common profit (or loss) derived from such transaction, such allocation being made in accordance with comparable allocations in the case of independent transactions; and

(ii) when it is possible to determine the arm's length consideration for some, but not other, functions performed by connected persons participating in a connected transaction using the methods described in subparagraphs (a) to (d), the transactional profit split method shall be applied to determine the arm's length consideration for the other functions so performed, based on the common residual profit derived from the other functions.

6. Where, taking account of the criteria described in paragraph 4, a transfer pricing method described in paragraph 5(a) and a transfer pricing method described in paragraph 5(b) to (e) can be applied with equal reliability, the transfer pricing method described in paragraph 5(a) shall be applied.

7. Where, taking account of the criteria described in paragraph 4, a transfer pricing method described in paragraph 5(a) to (c) and a transfer pricing method described in paragraph 5(d) to (e) can be applied with equal reliability, one of the transfer pricing methods described in paragraph 5(a) to (c) shall be applied.

8. It shall not be necessary to apply more than one transfer pricing method in respect of a particular connected transaction.

9. Notwithstanding paragraph 5, another method (other than a transfer pricing method) may be applied by a person for determining arm's length consideration in respect of a connected transaction if the Commissioner General is satisfied that-

(a) none of the transfer pricing methods can reasonably be applied to determine the arm's length consideration in respect of the connected transaction; and

(b) the other method to be applied yields a result consistent with that which would be achieved by persons participating in a comparable independent transaction.

10. Notwithstanding paragraphs 5 and 9, the Commissioner General may apply a method (other than one that has been used by a connected person and whether or not it is a method provided by paragraph 5) to establish arm's length consideration in respect of a connected transaction if the Commissioner General is satisfied that the method to be applied is consistent with paragraph 4.

11. If a connected person participates, under the same or similar circumstances, in two or more connected transactions that are closely linked to one another economically, or that form a continuum such that they cannot reliably be analyzed

separately, the transactions may be combined for the purposes of-

(a) determining a comparable independent transaction in relation to those connected transactions; and

(b) applying an appropriate transfer pricing method in relation to those connected transactions.

12. (1) Where the actual consideration for a connected transaction (or for a number of such transactions that are combined under paragraph 11) is within the arm's length range, the actual consideration shall be treated as the arm's length consideration for such transaction or combined transactions.

(2) Where the actual consideration for a connected transaction (or for a number of such transactions that are combined under paragraph 11) is not within the arm's length range, the median in the arm's length range shall be treated as the arm's length consideration for such transaction or combined transactions.

(3) For the purposes of this paragraph, the arm's length range in relation to a connected transaction is a range of financial indicators produced by the application of the most appropriate transfer pricing method to a number of independent transactions that are reasonably comparable to the connected transaction.

13. (1) Subject to subparagraph (2), the charge for a service between connected persons is considered to be arm's length consideration if-

(a) it is a charge for a service that is actually rendered;

(b) the service provides, or is expected to provide, the recipient of the service with economic or commercial value; and

(c) the amount charged for the service is an amount that an independent person in comparable circumstances would have been willing to pay for the service to be performed by another independent person or for the service to be performed in-house at its own expense.

(2) A charge for a service that is paid by the recipient of a service to a person who is a connected person in relation to the recipient shall not be considered to be at arm's length consideration if it is a charge that is paid by a shareholder of the recipient solely by virtue of that person being a shareholder of the recipient, including a charge for any of the following services-

(a) a service rendered in relation to the juridical structure of the parent company of the recipient, for example meetings of shareholders of the parent company, issuing of shares in the parent company and costs of the supervisory board of the parent company;

(b) a service rendered in relation to reporting requirements of the parent company of the recipient, including the consolidation of reports; except where a reporting requirement arises from a statutory obligation relating to the business of the recipient (in which case subparagraph (1) applies);

(c) a service rendered in relation to the raising of funds for the acquisition of participation in a business; except where the participation is directly or indirectly acquired by the recipient and the acquisition benefits the recipient, or is expected to benefit the recipient (in which case subparagraph (1) applies).

14. (1) Subject to subparagraph (2), if it is possible to identify a number of specific services provided by or to a connected person, the determination whether the charge for those services is considered to be arm's length consideration shall be made in respect of each specific service.

(2) Where services are provided to more than one connected person and it is not possible to identify the specific services provided to each of those persons, the total charge for the services shall be allocated among those persons according to reasonable allocation criteria based on one or more variables that-

(a) take into account the nature of the services provided, the circumstances under which they are provided and the benefits obtained or expected to be obtained by the persons to whom the services are provided;

(b) take into account only charges in respect of independent transactions; and

(c) are capable of being measured in a reasonably reliable manner.

15. (1) The determination of arm's length consideration for a connected transaction involving a grant of licence relating to a sale or other transfer of intangible property between connected persons shall take into account-

(a) the perspective of both the transferor and the transferee of the property, including in particular the price which an independent person would be willing to pay for, or accept for, the property in a comparable independent transaction; and

(b) the value and usefulness of the property to the transferee.

(2) In applying the provisions of paragraph 3 to a transaction involving the grant of licence relating to, the sale or other transfer of, intangible property, any special factors relevant to the comparability of the connected and independent transactions shall be considered, including-

(a) the benefits expected from the transfer of the property;

(b) any geographic limitation on the exercise of rights to the property;

(c) whether the rights to the property are exclusive or non-exclusive; and

(d) whether the transferee has a right to participate in further development of the property by the transferor of the property.

Appendix 5 – Cost Contribution Arrangements (CCA)

A CCA is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create benefits for each of the participants.

CCAs can exist among connected persons. For example, a CCA may be concluded for the joint development of intangible property, with each connected person being assigned an interest in the developed property. A CCA may also be concluded for services where each participant is entitled to receive services resulting from the activity of the CCA. As such, connected persons may pool their resources to acquire various types of centralized services (e.g. accounting, computer technical support, human resources, or the development of an advertising campaign common to the connected persons' markets) without paying additional consideration.

The basis for allocating CCA contributions is the benefit that a person will derive from exploiting the results of the CCA, and not from the actual activities of the CCA. In the case of CCAs involving the development, production or obtaining of intangibles or tangible assets, each connected person is not required to be a legal owner of the property, but each connected person must enjoy all or substantially all of the rights, benefits and privileges in respect of the property as if it were the legal owner.

For a CCA to satisfy the arm's length principle, each connected person's contribution must be consistent with that which an independent person would have agreed to contribute under comparable circumstances given the benefit it would have reasonably expected to derive from the arrangement.

Therefore, only connected persons who can reasonably be expected to derive a benefit from the results of a CCA can be considered participants in that CCA. The requirement of an expected benefit does not impose a condition that the subject activity in fact be successful.

Under the arm's length principle, the value of each connected person's contribution to a CCA should be consistent with the value that independent persons would have assigned to that contribution in comparable circumstances. The application of the arm's length principle would take into account, among other things, the contractual terms and economic circumstances particular to the CCA.

Where a participant to a CCA, or a connected person to a participant to a CCA, performs all or part of the qualifying CCA activities, it would expect to be compensated on an arm's length basis. The ALC would be determined under the general principles discussed in this practice note, including consideration of functions performed, assets used, and risks assumed. The ALC can include expected benefits from the CCA.

The arm's length principle also applies to capital contributions of tangible or intangible assets to a CCA. For example, where two connected persons intend to be equal participants in a CCA, with the first person contributing property with a fair market value well in excess of its cost, and the other contributing cash, cost would not be an appropriate measure of the first person's contribution.

Under a CCA, a connected person's share of the overall contributions to the CCA must be in proportion to the share of the overall benefits it expects to derive from the arrangement. In theory, each connected person's share of the benefits may be determined by directly estimating:

- The anticipated additional income that each connected person is expected to generate as a result of its participation in the arrangement; or
- The anticipated cost savings they expect to gain as a result of its participation in the arrangement.

In practice, to indirectly estimate the additional income to be derived from the arrangement, the connected persons may use “allocation keys” such as:

- Sales.
- Units used, produced or sold.
- Gross or operating profit.
- Number of employees.
- Capital invested.

A taxpayer should choose allocation keys, taking into account the nature of the CCA and the relationship between the allocation key and the expected benefits. For example, projected sales of the end-products may not be an appropriate allocation key where a particular component is developed within a CCA, and the component is used by the connected persons in a variety of end-products that differ significantly in price.

The differences in the prices of the end-products will distort the relationship between the cost to the connected persons and their expected benefits. In this case, the number of components used by each participant may be a better measure of the expected benefits to the participants. For tax purposes, the contributions by a participant to a CCA will be treated as though they were made outside the scope of the CCA to carry on the activities that are the subject of the CCA (e.g. perform scientific research and experimental development or purchase a capital asset). The deductibility of the costs allocated to a particular taxpayer is determined in accordance with the ITA. The fact that a charge for the costs is itself justified does not automatically make the costs deductible under the ITA.

Where a participant's contribution to a CCA is not consistent with its share of the expected benefit, a balancing payment may be required between the participants to adjust their respective contributions. For tax purposes, the balancing payment should be treated as an addition to the cost of the payer and as a reimbursement of costs to the recipient. Where the balancing payment is more than the recipient's expenditures or costs, the excess will be treated as a taxable amount.

The costs subject to allocation would be net of other CCA receipts, (i.e. royalties from licenses or proceeds from the sale of research assets). Costs subject to allocation for scientific research and experimental development carried out in Jamaica under a CCA will be calculated after deducting subsidies granted by the government, unless there is evidence that independent persons would have done otherwise.

Under the arm's length principle, participants in a CCA that transfer a part or all of their interests in the results of prior CCA activities (such as intangible property, work in-progress, or the knowledge obtained from past CCA activities) to a new participant should receive an ALC from the new participant for that property (a "*buy-in*" payment). The amount of a buy-in payment should be determined, based on the price an independent person would have paid for the rights obtained by the new participant. This determination would take into account the proportionate share of the overall expected benefit to be received from the CCA. For tax purposes, a buy-in payment will be treated as if the payment was made outside the CCA for acquiring the interest in the rights being obtained (e.g. an interest in intangible property already developed by the CCA, work in progress, or the knowledge obtained from past CCA activities).

Similar issues arise when a participant to a CCA disposes of part or all of its interest in a CCA. The effective transfer of property interests should be compensated according to the arm's length principle (a "*buy-out*" payment). However, taxpayers should exercise care in the event of either a buy-in or buy-out payment because the very nature of any intangibles in a CCA may often make the buy-in or buy-out valuation difficult. This valuation is particularly difficult where the intangibles developed by a CCA are valuable or unique. For tax purposes, a buy-out payment will be treated as if the payment was made outside the CCA for the disposal of pre-existing interests (e.g. an interest in intangible property already developed by the CCA, work in progress, or the knowledge obtained from past CCA activities).

Appendix 6 - Intra-Group Services

A wide variety of services are often provided by one member of a MNE group to other members within the group. These intra-group services may include services of an administrative, technical, financial, or commercial nature.

The OECD Guidelines on providing intra-group services includes a framework to determine whether a charge for a particular service is justified, and, if so, how to determine the amount of the charge.

The charge for a service between connected persons is considered justified and at arm’s length if:

- The service is actually rendered;
- The service provides economic or commercial value; and
- The amount charged for the service is an amount that an independent person in comparable circumstance would have been willing to pay for the service (i.e. “benefits test”).

Where it would not have been reasonable to expect a connected person to either pay an independent person for the activity or to perform it itself, it is unlikely that any charge for the activity would be justified, as no benefit would have been derived therefrom.

Certain costs are incurred for the sole benefit of shareholders and, therefore, should not be charged to other members of the group. For example, an independent person would not bear the costs of a shareholders meeting of another corporation; therefore, a subsidiary would not bear any costs of a parent's shareholders’ meeting.

Costs relating to the legal structure or the general financial reporting requirements of a particular group member should not be charged to another member. Certain other costs, such as those involved in raising funds for the acquisition of an interest in a business, would generally not be attributable to another member of the group. However, as suggested in the OECD Guidelines, if the funds were raised on behalf of another member of the group that used them to acquire a new company, it may be appropriate to attribute the costs to that other group member.

In some cases, there may be a valid business reason for duplicating a service. For example, an independent person may:

- Continue to operate an existing computer system, for a brief period, concurrently with a new one to deal with unforeseen difficulties which may arise during the implementation of the new system; or,

- Obtain a second legal opinion to supplement an internal legal review and opinion in order to reduce the risk of error on a particular issue.

In either of these two cases, there is a valid business reason for duplicating the function.

Where a charge for a service is justified, the amount charged should be determined in accordance with the arm's length principle. The OECD Guidelines state that the issue must be considered from the point of view of both the supplier and the recipient of the service. The ALC is not only a function of the price at which a supplier is prepared to perform the service (or the cost of providing the service), but also a function of the value to the recipient of the service. Therefore, the determination of an ALC must take into consideration the amount that an independent person is prepared to pay for such a service in comparable circumstances.

Where a service is rendered by independent persons or the service supplier (as part of their ordinary and recurring activities) to other independent persons, the price charged in those circumstances is a good indication of the ALC. Thus, the CUP method should be used, assuming sufficient quality data for its application is available. This presumes that:

- The services are substantially the same in terms of their nature and quality as well as the quantity or extent to which these services are provided;
- The markets are similar; and
- The services are provided on comparable terms.

Where the CUP method cannot be applied, taxpayers should consider the application of the CPM. The CPM is appropriate where, after the appropriate functional analysis, the taxpayer can verify comparability (including the functions performed, the assets used, and the risks assumed) with independent transactions. Taxpayers must ensure that the mark-up on costs incurred by the service supplier are substantially the same as those incurred in the comparable transactions. If not, appropriate adjustments must be made. Additionally, care must be taken when determining the cost base to which a mark-up will be added.

Arm's length service suppliers would usually expect to recover their costs plus an element of profit. However, in determining an ALC for service, one must also take into account the economic alternatives available to the recipient of the service. Often, the price the recipient is willing to pay for the service does not exceed the cost of supply to the service supplier. For example, in many cases, the services provided through intra-group arrangements are administrative or ancillary in nature, and the participants would only have been prepared to centralize the activity if they could share in the cost savings. Cost may represent an ALC in such situations.

Determining whether a mark-up is appropriate and, where applicable, the quantum of the mark-up, requires careful consideration of factors such as:

- The nature of the activity;
- The significance of the activity to the group;
- The relative efficiency of the service supplier; and
- Any advantage that the activity creates for the group.

For example, the relative efficiency of arm's length service suppliers may not be comparable to the intra-group services where the intra-group services are offered as a convenience to the group and not as an ordinary and recurrent activity.

Pursuant to the OECD Guidelines, it is important to distinguish between the situation of:

- A taxpayer who renders services for the other members of a group; and,
- A taxpayer who acts solely as an agent on behalf of the group to acquire services from an independent person.

In the latter situation, the arm's length consideration would be limited to rewarding an agency role. In such a case, it would not be appropriate to determine an ALC by referring to a mark-up on the cost of the services acquired from an independent person. Whether a taxpayer is providing a service or merely acting as an agent on behalf of the group is a question of fact.

A charge for services can be determined by two methods:

- Direct charge method: A specific charge is established for each identifiable service.
- Indirect charge method: An allocation, to a particular entity, of the cost of a service provided to more than one entity is made by referring to a basis or “allocation key” (e.g., sales, gross or operating profits, units used/produced/sold, number of employees, or capital invested) that indicates the share of the total value of the service attributable to the particular entity.

TAJ prefers the direct charge method over the indirect charge method. The direct charge method should be used in cases where the services rendered by the taxpayer to other members of the group are the same or similar as those rendered to independent persons, or can be reasonably identified and quantified.

However, in some situations, a service has been provided to a number of connected persons and the portion of the value of the service directly attributable to each of the connected persons cannot be determined (e.g., where global market research is intended to benefit all of the connected persons). In this case, the taxpayer can use the indirect charge method. Where the indirect charge method is used, it should result in a charge that is comparable to that which independent persons would accept.

When choosing an allocation key, taxpayers should consider the nature and use made of the service. For example, if the services relate to human resource activities, such as administering a global employee benefit plan, the proportionate number of employees may be the best measure of the benefit to each group member assuming the benefit allocated to individual employees is similar.

Appendix 7 - Intangible Property

In determining the ALC for a connected transaction involving any type of intangible property, the following must be considered:

- The perspective of both the transferor and the transferee of the property, including the price for a comparable independent transaction; and
- The value and usefulness of the property to the transferee.

The factors to be considered in determining the appropriateness of a comparable independent transaction include:

- The benefits expected from the transfer of the property;
- Any geographic limitation on the exercise of rights to the property;
- Whether the rights to the property are exclusive or nonexclusive; and
- Whether the transferee has a right to participate in future development of the property.

Applying the arm's length principle to transfers of intangible property raises specific issues associated with the difficulty and uncertainty sometimes encountered with attributing an ALC to such transfers. In most cases, both the transferor and transferee share the risks and benefits associated with using an intangible. Determining the ALC for the transfer of intangible property must take into account the perspective of both the transferor of the property and the transferee. A transferor attempts to recover the costs associated with developing an intangible and to earn a reasonable return. However, to the transferee, the value of an intangible is based solely on the expected benefits (additional profits) that the intangible would generate. The overall expected benefit to the transferee is usually a key consideration in determining the ALC of an intangible to both parties. For example, in most cases, an independent exclusive distributor of a product would only agree to pay a higher royalty for the use of a highly valuable brand name if the use of such brand-name is expected to generate profits, for the distributor, which are higher than those that the distributor would have expected if it had distributed a similar product without the brand-name.

The very nature of intangible property may often make its valuation difficult. The inherent risk often associated with intangible property may produce significant fluctuations in their value. In addition, intangible property may be of significant value even though it has little or no book-value in the taxpayer's balance sheet. It may be very difficult to find intangibles which are comparable. In applying the arm's length principle to transactions involving intangibles, the most appropriate TPM will be the one that provides the highest degree of comparability between transactions. Where comparable data on an intangible exists, the most appropriate TPM is a traditional transaction method (i.e. CUP, RPM or CPM). It may be possible to use the CUP method to determine an ALC for the sale, transfer or license of an intangible property (such as a patent, a trademark, or know-how) where the same or a comparable intangible property has been sold, transferred or licensed to independent persons.

Genuine offers from independent persons for the intangible may also be taken into account. However, where such an offer does not result in an agreement between the parties, taxpayers should also consider the factors leading to the rejection of the offer. An offer made by a potential purchaser may be representative of a price that the particular purchaser was prepared to pay. However, it may not be representative of the price that a vendor is prepared to accept.

The TNMM would probably not be appropriate where an intangible property is highly valuable or unique, such as a patent resulting from risky and costly research and development because of the difficulty in finding comparable information. Furthermore, to the extent that excess profits are generated by a highly valuable or unique intangible, it would be unusual that all the excess profits would accrue to either the supplier or the user of the intangible. In such cases, the TPSM may often be the most appropriate method.

In determining an ALC in respect of connected transactions related to the sale, transfer or use of an intangible, taxpayers must consider the terms and conditions that independent persons would insist on to protect their respective positions. For example, where the value of an intangible is uncertain, it is important to consider whether an independent transferor would permit the long-term exploitation of the intangible by an independent transferee. As protection, an independent transferor may insist on an agreement that has a relatively short term, a price adjustment clause, or variable royalty rates tied to profits. If the exploitation of the intangible proves highly profitable, the independent transferor would enjoy a reasonable share of that financial success.

Similarly, an independent transferee, wishing to exploit intangible property, may not agree to pay large amounts for its exclusive use for a long period of time, if the value of the intangible is uncertain. In such circumstances, an independent transferee may negotiate a short-term contract, a price adjustment clause, or variable royalty rates tied to profits.

Where a royalty rate is being established, taxpayers should consider:

- Prevailing industry rates;
- Terms of the agreement, including geographic limitations, time limitations, and exclusivity rights;
- Singularity of the invention and the period for which it is likely to remain unique;
- Technical assistance, trademarks, and know-how provided along with

access to any patent;
- Profits anticipated by the transferee; and
- Benefits to the transferor arising from sharing information on the experience of the transferee.

Taxpayers who are not the legal owners of intangible property such as trademarks or trade names sometimes undertake marketing activities. In these instances, the issue arises as to whether they should be compensated from any return attributable to the creation of the marketing intangibles. Independent distributors who bear the costs of marketing activities would usually expect to share in the return from the marketing intangibles. As well, distributors who bear marketing costs in excess of those that an independent person distributor with similar rights to exploit the intangible would incur, would expect an additional return from the legal owner of the trademark or trade name. The actual marketing activities of the distributor over a number of years should be given significant weight in evaluating the return attributable to marketing activities.

Despite the difficulty in determining an ALC for intangibles, using hindsight to determine their value is not a recommended approach. Under the arm's length principle, an agreement that is, in substance, the same as one which independent persons would have entered into, would not usually be subject to adjustment by TAJ as a result of subsequent events. Therefore, it would be inconsistent with the arm's length principle for TAJ or any other tax administration to require, or accept, an adjustment solely on the basis that income streams or cost savings differ from those initially estimated by the connected persons. However, TAJ may consider factors that a reasonable person with some knowledge of the industry would have taken into account at the time the valuation was projected.

Appendix 8 - Jamaica's Tax Agreements

The following countries have entered into bilateral tax agreements with Jamaica:

1. Canada
2. Denmark
3. France
4. Germany
5. Israel
6. Mexico (Awaiting ratification)
7. Norway
8. Peoples' Republic of China
9. Spain
10. Sweden
11. Switzerland
12. United Kingdom
13. United States

The following countries have entered into a multilateral tax agreement with the Caribbean Community:

1. Antigua and Barbuda
2. Barbados
3. Belize
4. Dominica
5. Grenada
6. Guyana
7. Jamaica
8. St. Kitts & Nevis
9. St. Lucia
10. St. Vincent and the Grenadines
11. Trinidad and Tobago

Appendix 9 – Income Tax (Transfer Pricing Documentation) Regulations, 2015

In exercise of the power conferred upon the Minister by section 17D (1) of the Income Tax Act, and of every other power hereunto enabling, the following Regulations are hereby made:-

1. These Regulations may be cited as the Income Tax (Transfer Pricing Documentation) Regulations, 2015.
2. Every person with a gross annual revenue of five hundred million dollars in the previous year of assessment shall keep (and on the request of the Commissioner General provide to the Commissioner General in accordance with paragraph 5) transfer pricing documentation that verifies that the conditions in their connected party transactions for the relevant year of assessment are consistent with the arm's length consideration.
3. Transfer pricing documentation shall include-
    a. An overview of the person's business operations (history, recent evolution and general overview of the relevant markets of reference) and organizational chart (details of business units, departments and organizational structure);
    b. A description of the corporate organizational structure of the group that the person is a member of (including details of all group members, their legal form, and their shareholding percentages) and the group's operational structure (including a general description of the role that each of the group members carry out with respect to the group's activities, as relevant to the connected party transaction);
    c. Details of the connected party transaction, including an analysis of the comparability factors specified in paragraph 3 of the Eighth Schedule;
    d. An explanation of the selection of most appropriate transfer pricing method as specified in paragraphs 4, 5 and 9 of the Eighth Schedule and, where relevant, the selection of the tested party and the financial indicator;
    e. A comparability analysis, including-
        i. A description of the process undertaken to identify comparable independent transactions;
        ii. An explanation of the basis for the rejection of any potential internal comparable independent transactions (where applicable);
        iii. A description of the comparable independent transactions;
        iv. An analysis of comparability of the connected party transaction and the comparable independent transactions (taking into account paragraph 3 of the Eighth Schedule); and
        v. Details and explanation of any comparability adjustments made;

f. Detail of any industry analysis, economic analysis, budgets or projections relied on;
g. Details of any advance pricing agreements or similar arrangements in other countries that are applicable to the connected party transactions;
h. A conclusion as to consistency of the conditions of the connected party transactions with the arm's length consideration, including details of any adjustment made to ensure compliance;
i. All connected party transactions; and
j. Any other information that may have a material impact on the determination of the person's compliance with the arm's length consideration with respect to the connected party transactions.

4. Transfer pricing documentation shall be submitted in the English language.
5. Transfer pricing documentation for a relevant year of assessment is considered to be contemporaneous where it is in place at the statutory tax return's filing date.
6. Transfer pricing documentation shall be provided to the Commissioner General within thirty working days of the written request being duly issued by the Commissioner General.
7. The obligation of the person to provide transfer pricing documentation is imposed without prejudice to the power of the Commissioner General to request additional information in the course of audit procedures or in relation to a return on income.

Dated this 24th day of November, 2015
Minister of Finance and Planning