**TRANSFER PRICING**

**Detailed description**

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# 1. TRANSFER PRICES

## 1.1 TRANSFER PRICE DEFINITION

Transfer prices are prices charged in transactions between associated enterprises operating within multinational enterprise groups, which are currently the most important players in the globalised economy; therefore, transfer prices are one of the major international tax issues today. Furthermore, this is confirmed by a number of measures taken by the Organisation for Economic Co-operation and Development (hereinafter: the OECD) and EU Directives governing this area with a view to preventing the transfer of profits from the countries where such profits are generated. Multinational enterprises have the potential to do so by abusing transfer pricing; therefore, all conditions in transactions between associated enterprises concerning goods, financial services, intangible assets, services, etc., must be such that taxes are paid in the countries where profits are actually made.

The basic standard to be taken into account in transfer pricing is the arm’s length principle, which is set out in Article 9 of the OECD Model Convention for the Avoidance of Double Taxation (hereinafter: CADT) and serves as the basis for Slovenia entering into international treaties with the countries that are its major trading partners (the full list of international treaties is available at

<https://www.fu.gov.si/davki_in_druge_dajatve/podrocja/mednarodno_obdavcenje/>).

According to the arm's length principle, prices between associated enterprises must be such that, under the same conditions, the prices between non-associated enterprises are as determined by the market. The principle reads as follows:

*“Where and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent 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.”*

The use of the arm’s length principle is defined in great detail in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereinafter: OECD guidelines)[[1]](#footnote-1). The OECD Guidelines were partially amended in July 2017 and February 2020 as a result of OECD measures to prevent tax base erosion and profit transfer, known as BEPS (Base Erosion and Profit Shifting) measures (hereinafter: BEPS).

The Financial Administration of the Republic of Slovenia (hereinafter: FURS) pays special attention to the area of transfer pricing by regularly monitoring taxable persons who deal with non-resident associated parties. It also monitors the activity of foreign companies in the territory of the Republic of Slovenia with a view to determining whether such activity is carried out by a permanent establishment, as in such case the Republic of Slovenia has the right to tax non-residents’ profits. For more information about the tax audit of transfer pricing, see: [Davčni inšpekcijski nadzor transfernih cen (Transfer pricing inspection procedure)](https://www.fu.gov.si/fileadmin/Internet/Nadzor/Podrocja/Financni_nadzor/Opis/Davcni_inspekcijski_nadzor_transfernih_cen.docx).

## 1.2 SLOVENIAN TRANSFER PRICING LEGISLATION

The arm’s length principle is implemented in Slovenian legislation through **Article 16 of the Corporate Income Tax Act** (hereinafter: ZDDPO-2[[2]](#footnote-2)), which provides that a resident or non-resident taxable person and a foreign legal entity or foreign person without legal personality who is not a taxable person (hereinafter: foreign person) is deemed to be a associated party where:

1. a taxable person directly or indirectly holds at least 25% of the value or number of shares or equity holdings, shares in management or control or the voting rights in a foreign person, or controls the foreign person on the basis of a contract, or the transaction conditions differ from the conditions that have been or would have been reached between unassociated parties in equal or comparable circumstances; or
2. the foreign person directly or indirectly holds at least 25% of the value or number of shares or equity holdings, shares in management or control or voting rights of the taxable person, or controls the taxable person on the basis of a contract, or the transaction conditions differ from the conditions that have been or would be reached between non-associated parties in equal or comparable circumstances; or
3. the same person at the same time directly or indirectly holds at least 25% of the value or number of shares or equity holdings, shares in management or control of the taxable person and foreign person or of two taxable persons, or controls them on the basis of a contract or the transaction conditions differ from the conditions that have been or would be reached between non-associated parties in equal or comparable circumstances; or
4. the same individuals or their family members directly or indirectly hold at least 25% of the value or number of shares or equity holdings, shares in management or control of the taxable person and foreign person or of two residents, or control them on the basis of a contract, or the transaction conditions differ from the conditions that have been or would be reached between non-associated parties in equal or comparable circumstances.

In establishing a taxable person’s revenue in transactions between associated parties (both residents and non-residents), transfer prices with associated persons are taken into account for assets, including intangible assets, and services, however, revenues at least up to the amount which is established by taking into account the prices of such or comparable assets or services which, in equal or comparable circumstances, are reached or would be reached on the market among non-associated parties. In establishing a taxable person’s expenditure, transfer prices with associated parties are taken into account for assets, including intangible assets, and services, however, expenditure at least up to the amount established by taking into account comparable market prices (paragraphs one and four of Article 16 of the ZDDPO-2).

Article 17 of the ZDDPO-2 further determines the prices between resident associated parties that are also required to follow the arm’s length principle; however, paragraph six of Article 17 determines that in establishing the revenue and expenditure of a resident relating to transactions conducted between two resident associated parties under this Article, the tax base is not increased or reduced, unless one of the residents,

1. for the tax period for which revenue and expenditure are established, discloses an uncovered tax loss brought forward from previous tax periods, or
2. pays tax pursuant to this Act at a 0% rate or at a special tax rate lower than the general tax rate pursuant to Article 60 of this Act, or
3. is exempt from paying tax under this Act.

The provisions of the OECD guidelines are partly summarised in the **Transfer Pricing Rules** (hereinafter: TPR[[3]](#footnote-3)) which set out the methods for determining transfer prices, a comparability analysis, the use of a range of comparable market prices, the specificities in setting transfer prices for services, etc.

In the field of transfer pricing, Slovenian legislation defines two safe harbours: in the field of interest rates for loans between associated parties (Article 19 of the ZDDPO-2 in conjunction with the **Rules on the Recognised Interest Rate**[[4]](#footnote-4)) and in the field of thin capitalisation where the ratio between loans from associated parties and equity capital is determined **(Article 32 of the ZDDPO-2).** In the event that a taxable person proves the values outside a safe haven, such taxable person is obliged to submit documents (in the same way as in proving the transactions referred to in Articles 16 and 17 of the ZDDPO-2), which will prove that the interest rate or the ratio between loans from associated parties and equity capital is in accordance with the arm’s length principle.

A non-resident’s business unit is the place of business in or through which the non-resident’s activities or business in Slovenia are conducted in whole or in part **(Article 6 of the ZDDPO-2).** The Republic of Slovenia has the right to tax the profits of non-residents if they have a permanent establishment (hereinafter: PE) in Slovenia or carry out their transactions through one. The following, in particular, are deemed to be a permanent establishment:

* an office, branch, factory, workshop, mine, quarry or other place where natural resources are obtained or exploited;
* a construction site, a project involving construction, assembly or mounting, or the related supervision, if the duration of the activities or business concerned exceeds 12 months;
* an agent that acts on behalf of a non-resident in all the activities or business for the non-resident if the agent holds and normally exercises authorisation to conclude contracts on behalf of the non-resident, unless the agent’s activities or business are limited to those referred to in Article 7 of the ZDDPO-2 such as activities of a preparatory or ancillary nature), due to which the place of business in question would not be deemed to be the non-resident's business unit;
* an agent that, on its own behalf, acts for the non-resident as a stockbroker within the framework of its regular activities, an agent holding a general authorisation or any other independent agent where the agent in whole or in part acts on behalf of the non-resident and where the conditions and circumstances pertaining to business and financial relations between the non-resident and agent in question differ from those that would exist in relations between unassociated parties.

The conditions for the existence of a non-resident business unit are regulated in Slovenian national legislation similarly to international agreements concluded by the Republic of Slovenia and modelled on the OECD Model Convention, but there are differences in that the Model Convention additionally requires that the place of business is a permanent one. In the event that the Republic of Slovenia has signed a convention with another country, the conditions for the existence of a business unit are also assessed according to the criteria of the Convention, especially compliance with the condition of permanence. The activity of a non-resident must be carried out on a permanent basis in a certain location – it must not be of a temporary nature.

As regards the attribution of profits to permanent establishments, the transfer pricing rules of the OECD Guidelines and the OECD Report on the Attribution of Profits to Permanent Establishments, 2008 and 2010, apply. In the national legislation, **Article 11 of ZDDPO-2** defines the subject of taxation, which is a non-resident’s profit, achieved by performing activities or transactions in a business unit or through a business unit located in Slovenia. **Article 12 of the ZDDPO-2** defines the tax base of a resident and non-resident in respect of activities or business performed either in or through a business unit in Slovenia. This is the profit established in accordance with the provisions of this Act. Paragraph four of the same Article of the aforementioned Act determines that the profit of a non-resident's business unit in Slovenia is the profit that can be attributed to that business unit. The profit that can be attributed to the business unit is the profit that can be expected to be earned by that business unit if it were an independent taxable person performing the same or similar activity or business. Revenues earned by performing an activity or business in a non-resident’s business unit or through a non-resident’s business unit in Slovenia, and the actual costs which are incurred for the purposes of that business unit, including executive and general administrative costs, are attributed to that business unit whether incurred in Slovenia or elsewhere.

**Article 18 of the ZDDPO-2, in conjunction with Article 382 of the Tax Procedure Act (ZDavP-2), determines** what data taxable persons dealing with associated parties are required to provide to the tax authority in the event of a transfer pricing tax audit (see more about transfer pricing documents below). Country-by-country reporting provisions (hereinafter: CbCR) are laid down by **Article 284b of the ZDavP-2 and Chapter IIIB (Articles 255i-255.l) and by Articles 86c-86g of the Rules on the Implementation of the Tax Procedure Act** (see also Annex 21).

The transfer pricing documents must be in the Slovenian language. If the documents are not in Slovene, a person referred to in **Article 32 of the ZDavP-2** must, at the request of the competent tax authority and within the period set by the latter, submit certified translations of the documents requested at its own expense. If the person liable for tax fails to submit the translated document, the tax authority will commission a translation at the expense of the person liable for tax.

**Article 39 of ZDavP-2**, which lays down the obligation to provide data, and **Article 40 of ZDavP-2,** which lays down the obligation to provide documents of associated parties that are non-residents of Slovenia, also form a very important legal basis for obtaining additional information.

With regard to the calculation of corporate income tax and transfer pricing, it is necessary to point out the provisions relating to the taxation of income earned in Slovenia, **namely the provisions of Articles 70, 71, 72 and 74 of the ZDDPO-2 and the provisions of Articles 49, 57 to 60, Articles 74, 125, 260, 262, 375 to 378 and 383a to 383g of the ZDavP-2.**

## 1.3 REPORTING BY TAXABLE PERSONS DOING BUSINESS WITH ASSOCIATED PARTIES

At the end of the tax period, taxable persons are required to fill in the **Corporate Income Tax Return Form with annexes** (hereinafter: the CIT form), as provided by the **CIT Calculation Rules**[[5]](#footnote-5). Where taxable persons are doing business with associated parties, they must appropriately circle from among the general information on the first page of the CIT form that they are doing business with associated parties under Article 16 of the ZDDPO-2 or with resident associated parties under Article 17 of the ZDDPO-2. In the event that they have adjusted their tax base, they are required to provide information under the relevant items in Annex 1 to the corporate income tax return. Taxable persons are required to disclose whether they receive loans from or grant loans to the associated parties referred to in Articles 16 and 17 of the ZDDPO-2 and whether they had to adjust their tax base for the difference between the transfer and the comparable market price.

The table below shows CIT form items relating to transactions with associated parties:

|  |  |
| --- | --- |
| **Ref. No. in the CIT form** | **Methodology** |
| *3.1 An increase in revenue due to transfer prices between the* *associated parties referred to in Article 16 of the ZDDPO-2* | *The amount of the adjustment (increase) of revenue due to transfer pricing earned from the associated parties referred to in Article 16 of the ZDDPO-2, which is made at least up to the amount determined by taking into account comparable market prices (16/3 ZDDPO-2)* |
| *3.2 An increase in revenue due to transfer pricing between the resident associated parties referred to in Article 17 of the ZDDPO-2* | *The amount of the adjustment (increase) in revenue for prices with resident associated parties when one of the associated parties meets any of the circumstances defined in 17/8 DDPO-2 (17/4 ZDDPO-2)* |
| *3.3 An increase in interest income from loans to the associated partiesreferred to in Article 16 of the ZDDPO-2* | *The amount of the adjustment (increase) in interest income from loans granted to the associated parties referred to in Article 16 of the ZDDPO-2, which, if interest was charged at a lower rate or was not charged at all, should be equal at least up to the amount determined by taking into account the last published interest rate at the time of the loan approval or at the time of the calculation of the known recognised rate of interest, unless the taxable person can prove that in equal or comparable circumstances a loan would also be given to a loan recipient which is an unassociated party at an interest rate which is lower than the recognised rate of interest (19/1 and 3 in conjunction with Article 95 of the ZDDPO-2)* |
| *3.4 An increase in interest income from loans to the resident associated parties referred to in Article 17 of the ZDDPO-2* | *The amount of the adjustment (increase) in interest income from loans granted to the resident associated parties referred to in Article 17 of the ZDDPO-2, which, if one of the associated parties meets any of the circumstances set out in 19/6 of this Act and if interest was charged at a lower rate or was not charged at all, should be equal at least up to the amount determined by taking into account the last published interest rate at the time of the loan approval or at the time of the calculation of the known recognised rate of interest, unless the taxable person can prove that in equal or comparable circumstances a loan would also be given to a loan recipient which is an unassociated party at an interest rate which is lower than the recognised rate of interest (19/1 and 3 in conjunction with Article 95 of the ZDDPO-2)* |
| *3.5 An increase in a non-resident’s revenue by revenue attributed to a business unit* | *The amount of the increase in revenue for the amount of revenue attributable to the business unit of the non-resident, if it is not included in the revenue of this business unit under Ref. No. 1.* |
| *6.2 A decrease in expenditure due to transfer pricing between the associated parties referred to in Article 16 of the ZDDPO-2* | *The amount of the adjustment (decrease) in expenditure due to transfer pricing with the associated parties referred to in Article 16 of the ZDDPO-2, which is made at least up to the amount determined by taking into account comparable market prices (16/4 ZDDPO-2)* |
| *6.3 A decrease in expenditure due to transfer pricing between the resident associated parties referred to in Article 17 of the ZDDPO-2* | *The amount of the adjustment (decrease) in expenditure for prices with resident associated parties pursuant to 17/5 ZDDPO-2, when one of the associated parties meets any of the circumstances defined in 17/6 DDPO-2 (17/4 ZDDPO-2)* |
| *6.4 A decrease in expenditure by interest on loans received from the associated parties referred to in Article 16 of the ZDDPO-2* | *The amount of the adjustment (decrease) in interest income from loans received from the associated parties referred to in Article 16 of the ZDDPO-2, which, if interest was charged at a higher rate, should be equal at least up to the amount determined by taking into account the last published interest rate at the time of the loan approval or at the time of the calculation of the known recognised rate of interest, unless the taxable person can prove that in equal or comparable circumstances a loan would be obtained even from a lender who is an unassociated party at an interest rate which is higher than the recognised rate of interest (19/2 and 3 in conjunction with Article 95 of the ZDDPO-2)* |
| *6.5 A decrease in interest expenses by interest for loans received from the resident associated parties referred to in Article 17 of the ZDDPO-2* | *The amount of the adjustment (decrease) in interest expenses for loans received from the associated parties referred to in Article 17 of the ZDDPO-2, which, if, in accordance with 19/2 and 3 in conjunction with Article 95 of the ZDDPO-2, one of the associated parties meets any of the circumstances set out in 19/6 of this Act and if interest was charged at a higher rate, should be equal at least up to the amount determined by taking into account the last published interest rate at the time of the loan approval or at the time of the calculation of the known recognised rate of interest, unless the taxable person can prove that in equal or comparable circumstances a loan would be obtained even from a lender who is an unassociated party at an interest rate which is higher than the recognised rate of interest* |
| *6.14 Costs related to the private lives of owners and associated parties* | *The amount of costs related to the private lives of the owners of the taxable person or of the associated parties referred to in Articles 16 and 17 of the ZDDPO-2* |

The corporate income tax return also contains Annexes 15, 16 and 17, which must be filled in by taxable persons doing business with associated parties, namely:

* **Annex 15 – Data on loans between associated parties,**
* **Annex 16 – Data on transfer pricing in transactions between associated parties under Article 16 of the ZDDPO-2,**
* **Annex 17** **– Data on transfer pricing in transactions between resident associated parties under Article 17 of the ZDDPO-2**

More detailed instructions for completing the annexes are provided in the CIT Rules.

Certain taxable persons – rapporteurs (generally the parent companies of multinational enterprise groups with an annual consolidated revenue of EUR 750,000,000) are required to submit to the tax authority a **country-by-country report** (CbCR) showing key business and financial data for all companies in the group worldwide. In addition, **notification of the country-by-country reporting obligation of an MNE group (CbCR Notification)** must be completed and submitted to the tax authority by all taxable persons that are part (constituent entities) of an MNE group that includes two or more enterprises whose tax residence is in different tax jurisdictions or which includes an enterprise that is resident for tax purposes in one jurisdiction and simultaneously subject to tax with respect to the activity carried out through a permanent establishment in another jurisdiction, if the total consolidated revenue of this MNE group equals or exceeds EUR 750,000,000 in the fiscal year immediately preceding the reporting fiscal year.

The content and manner of filing a CbCR Notification are defined in Article 86e of the Rules on the implementation of the ZDavP-2. Taxable persons must file the CbCR Notification in electronic form simultaneously with the corporate income tax return. The form and methodology on how to complete the form is published on the website of the Financial Administration of the Republic of Slovenia under [Obračun davka od dohodkov pravnih oseb (Corporate income tax return forms)](https://www.fu.gov.si/poslovni_dogodki_podjetja/obracun_davka_od_dohodkov_pravnih_oseb/).

More information about CbCR Notifications is available at:

[CbCR | FINANCIAL ADMINISTRATION OF THE REPUBLIC OF SLOVENIA (gov.si)](https://www.fu.gov.si/nadzor/podrocja/mednarodna_izmenjava/cbcr/%22%20%5Cl%20%22c4669)

# 2. INFORMATION CONCERNING TRANSFER PRICES AND PRICES AMONG RESIDENT ASSOCIATED PARTIES

## 2.1 TRANSFER PRICING DOCUMENTATION

Taxable persons submit transfer pricing documents as proof that the prices they use in connected transactions are in line with the arm's length principle. Article 18 of the ZDDPO-2 determines what data and documents taxable persons dealing with associated parties are required to provide to the tax authority in the event of a transfer pricing tax audit:

* **The Master File,** which may be uniform for a group of associated parties as a whole and must contain at least a description of the taxable person, its organisational structure at the global level, and the types of association (equity-based, contractual, personal) of the taxable person's transfer pricing system, a general description of its business activities and strategies, the general economic and other factors, and the competitive environment;
* **The Local File – country specific documentation,** which must comprise at least the following:
* information about transactions with associated parties (description, nature, type, value, time limits and terms and conditions);
* data about the implementation of the comparability analysis of transactions concerning the characteristics of assets and services, the performed functional analysis (the tasks performed in relation to invested assets or services and assumed risks), contractual conditions, economic and other conditions affecting transactions, business strategies, other impacts important for the execution of transactions, the use of the method or methods for determining transfer prices and their determination in accordance with comparable market prices;
* other documents proving the conformity of transfer prices with comparable market prices.

Taxable persons are required to provide transfer pricing documents on a regular basis, but not later than before the date of the submission of the tax return for an individual transaction. Taxable persons may keep the documents in electronic form and must make them available to the tax authority at its request without delay during a tax audit procedure. If it is unable to comply with the tax authority’s request, the tax authority will set a time limit which may not be less than 30 nor more than 90 days, with due consideration of the volume and complexity of the data. Taxable persons must keep the documents for 10 years following the end of the year to which they relate. Taxable persons must have the documents translated within the period of time laid down by the tax authority, but not sooner than within 60 days.

The latest amendments to the OECD Guidelines of July 2017 brought quite a few innovations regarding transfer pricing documents, as a new three-tiered approach was introduced. Multinational enterprises have to prepare the Master File, the Local File and, if the group's annual consolidated revenue exceeds EUR 750,000,000, also a CbCR. The ZDavP-2 includes provisions on country-by-country reporting, while other amendments to the OECD Guidelines on transfer pricing documents have not yet been implemented into Slovenian law.

Although the ZDavP-2 also requires the submission of both the Master and Local Files as transfer pricing documents, the revised OECD Guidelines require more detailed information on a group's business activities, intangible assets, major profit drivers, etc., such as:

* in accordance with OECD Guidelines, the Master File must include standardised information about the group, including:
* the group’s organisational structure (the legal and ownership structure and geographical location of individual entities);
* a description of business activities:
* major profit drivers, the value-added chain for five main products or for 5% of revenues;
* a list and a rough description of major contracts for the provision of services within the group, excluding research and development, including an indication of the resources required for such services and transfer pricing policies;
* a list of principal markets (in geographical terms);
* a framework functional analysis showing the added value contributed by each entity of the group;
* a description of major economic and legal restructuring;
* the intangible assets of the group:
* a general description of the strategy for the development, ownership and efficient use of intangible assets;
* a list of significant intangible assets, including a definition of the entities that are their legal owners;
* a list of significant associated party contracts relating to intangible assets;
* a rough description of transactions in intangible assets (licence fees, transfer and use of intangible assets);
* financial transactions within the group:
* a general description of the method of financing the group, including significant independent loans;
* a general description of the intra-group financing policy and the identification of any central financial companies in the group;
* the financial and tax position of the group:
* the annual consolidated financial statements;
* a list and rough description of existing unilateral APAs and other ex ante tax regulations related to income allocation between countries.
* **The Local File** must include the following:
* a description of the taxable person:

Management structure and organisation, a detailed description of activities, a description of who and where the taxable person’s managers report to. The documents must also indicate whether the taxable person may have undergone a business transformation and whether any intangible assets have been transferred in the past as part of the business transformation, and an explanation of how this has affected the taxable person’s business.

* For each transaction between associated parties, the following must be provided:
* a detailed description of the associated parties and transactions with them, as well as the values of such transactions and payments;
* copies of all relevant intercompany agreements and contracts;
* a detailed functional and comparative analysis, including the identification of any changes compared to the previous period;
* a definition (indication) of the most appropriate method and test customers;
* a summary of the main assumptions in the implementation of the transfer pricing methodology and the reasons for the multi-annual analysis, if applicable;
* a list of comparables, descriptions, reasons, adjustments, a list of APAs (locally);
* financial information:
* the taxable person’s financial statements;
* a description of the relationship between the annual financial statements and the application of the transfer pricing methodology;
* the relevant financial data for the comparables used in the comparability analysis and the sources (databases) from which these data were obtained.

Chapter 5 of the OECD Guidelines provides for a procedure relating to the documentation of the arm’s length principle (the annex lays down a detailed list of the individual data that make up the Master File and the Local File, with the broader aim of identifying standard documents to demonstrate compliance with the arm’s length principle, thus facilitating tax control procedures.

As regards the scope of documents, taxable persons must provide at least the information listed in paragraph one of Article 382 of the ZDavP-2, but the determination of the data set must be based on the broader purpose of preparing the documents, which is to enable the tax authority and the taxable person to establish transfer pricing compliance with the arm’s length principle (i.e. to facilitate the determination of whether the transfer prices or the taxable person’s revenues and expenses reflect a comparable market value).

In this regard, it should be taken into consideration that various types of transactions require a different type or set of data, which is taken into account in the aforementioned Article. That Article determines the minimum required data set and does not exclude the preparation of other data that are relevant with regard to the facts and circumstances of a particular transaction. The tax authority emphasises that it depends on the facts and circumstances of the case what other information a taxable person will have to provide in order to demonstrate that the transfer price in a particular transaction reflects the arm’s length principle, which may include more detailed information defined in the OECD Guidelines. In this way, the tax authority will be able to request from a tax inspector data that are not exhaustively listed in paragraph one of Article 382 of the ZDavP-2, such as a DEMPE analysis (more on this can be found in Chapter 2.4SPECIAL FEATURES OF INTANGIBLE ASSETS) when this is necessary in order to determine whether or not the condition of the arm’s length principle has been met (i.e. whether the transfer price in a particular transaction is in line with the arm’s length principle).

It should be added that the general principles set out in the ZDavP-2 (for example, the principle of proportionality, the principle of material truth and the principle of legality) and other rules must be taken into account in order to ensure consistency in the assessment of the arm’s length principle and to avoid an administrative burden on taxable persons, for example by preparing documents that are not relevant from the viewpoint of assessing compliance with the arm’s length principle or that do not contribute to the clarification of compliance related to determining the arm’s length principle in a particular case.

Moreover, it should be stressed that the general principles set out in the ZDavP-2 impose on taxable persons the obligation to state all the facts giving rise to their cause of action and to adduce evidence proving these facts.

**The country-by-country report (CbCR),** which taxable persons are obliged to submit if the group's annual consolidated revenues exceed EUR 750 million, must include data relating to the global allocation of income and taxes paid by a multinational group of companies together with certain indicators of the locations of the group's economic activities. Country-by-country reporting (CbCR) represents one of the OECD’s measures aimed at targeting profits where they are generated.

The tax authority may use the information provided in the CbCR for the following purposes only:

* to analyse transfer-pricing risks related to a taxable person;
* to analyse the risks of tax base erosion and profit-shifting activities; and
* to draft economic and statistical analyses.

However, the tax authority may not make a transfer pricing adjustment based on CbCR for the purposes of Article 16 of the ZDDPO-2. Notwithstanding this, the tax authority may use the CbCR information as a basis for making further enquiries into the MNE group’s business related to transfer pricing arrangements or into other tax matters in the course of a tax audit enabling appropriate adjustments to the taxable income of the constituent entities.

Based on Slovenia's international commitments to the OECD and to the EU, FURS’s responsibility is to verify the correctness or compliance of submitted CbCRs.

In the event of established irregularities in the submission of CbCRs by rapporteurs in Slovenia, FURS informs the rapporteurs thereof and invites them to submit or correct their CbCrs. When the rapporteur fails to submit a country-by-country report or fails to submit it in the prescribed manner or by the prescribed time limit, FURS may impose an appropriate sanction for this offence.

More information about the CbCR is available at: Country-by-Country Reporting - CbCR

## 2.2 TRANSFER PRICING METHODS

One of the five recognised OECD methods or a combination of them is used to determine comparable market prices, which are also set out in Article 16 of the ZDDPO-2, and are defined in more detail in the TPR. The five different methods of transfer pricing fall into two categories:

* **traditional transaction methods**
* the comparable uncontrolled price method;
* the resale price method; and
* the cost plus method;
* **transactional profit methods**
* the transactional net margin method; and
* the profit split method.

### 2.2.1 THE COMPARABLE UNCONTROLLED PRICE METHOD

Pursuant to Article 2 of the TPR, the comparable uncontrolled price method compares the prices charged for assets, including intangible assets (hereinafter: assets) or services provided to associated parties (hereinafter: associated transaction or transactions), with the prices charged for assets or services to unassociated parties (hereinafter: arm’s length transaction or transactions) in the same or comparable circumstances.

A comparable market price is determined by comparing the price of a comparable asset or service in transactions performed in the same or comparable circumstances between unassociated parties.

The price comparison is made on the basis of:

* **internal comparable** comparing prices obtained between associated parties with those achieved by associated parties themselves or associated parties with unassociated parties (e.g. similar supplies of assets and services to both associated and unassociated parties) or,
* **external comparable** comparing prices agreed between associated parties with those prevailing on the market (e.g. on a stock exchange, in an industry) between unassociated parties.

The comparable uncontrolled price method can be used:

* when there is a comparability of assets or services according to their key characteristics and a comparability of broader business functions that affect the price, or
* if the differences between them can be eliminated by appropriate adjustments.

The OECD Guidelines provide for the use of the comparable uncontrolled price method in paragraphs 2.13-2.26 (or in paragraphs 2.13–2.20 of the 2010 OECD Guidelines).

According to paragraph 2.15 of the OECD Guidelines, the method of comparable uncontrolled prices is the most direct and reliable way to apply the arm’s length principle in cases where comparable transactions between unassociated parties can be found. In such cases, therefore, the comparable uncontrolled price method takes precedence over all other methods.

Furthermore, paragraph 2.16 of the OECD Guidelines (paragraph 2.15 of the 2010 OECD Guidelines) states that it will sometimes be difficult to find a transaction between independent companies that is sufficiently similar to a associated party transaction, so that there is no difference between them that could have a significant effect on the price. In such a case, certain adjustments would be appropriate.

Paragraph 2.19 of the OECD Guidelines introduces a new *"quoted price"* concept, which can be used to assess the arm’s length price in transactions in goods. The term “quoted price” refers to the price of goods in the relevant period on an international or domestic stock market. In this context, it also includes prices for goods derived from reliable and transparent reports or data from statistical agencies or from reports of government pricing agencies used as references for unassociated parties to determine prices in transactions between them. Quoted prices of goods usually reflect an agreement between independent buyers and sellers on the market on the price of a particular type and quantity of goods, determined under certain conditions at a given time.

***A graphical presentation of the comparable uncontrolled price method using an internal comparable transaction***

*Enterprise A established in Slovenia and Enterprise B established in country B are associated parties.* Enterprise A sells the same type of products to both the associated enterprise B and the non-associated enterprise C. The price in both transactions is EUR 100 per product unit.

*Same type product*

Price: EUR 100/unit

*Same type product*

Price: EUR 100/unit

***Is the price used in a associated-party transaction in line with the arm's length principle?***

*Although the price for the same product is in both cases the same, it is necessary to check other circumstances (contractual terms, the functions performed by the parties to the transaction, etc.) in order to determine that the price in the associated-party transaction is the same as in the arm’s length transaction and therefore in accordance with the arm’s length principle.*

### 2.2.2 THE RESALE PRICE METHOD

Pursuant to Article 3 of the TPR, the resale price method is based on the prices at which assets purchased from a associated party were resold to an unassociated party. A comparable market price is determined by deducting from the selling price charged by the seller for assets or services to unassociated parties the difference in the price achieved or to be achieved in the same or comparable circumstances on the market by unassociated resellers. The difference in the price consists of the reseller's selling and other costs and the reseller's net profit in accordance with the functions performed and the related assets invested and risks assumed.

A comparable market price is determined by comparing the difference in the price of a transaction or transactions performed in the same or comparable circumstances between unassociated parties. The price comparison is made on the basis of (TPR 3/3):

* **internal comparable** comparing prices obtained between associated parties with those achieved by associated parties themselves or parties associated with them with unassociated parties; or
* **external comparable** comparing prices obtained between associated parties with those achieved or potentially achieved or potentially achieved on the market by unassociated parties.

The OECD Guidelines provide for the use of the resale price method in points 2.27 - 2.44 (or in points 2.21 - 2.38 of the 2010 OECD Guidelines). In accordance with the OECD Guidelines, there is a tendency in a market economy to compensate for similar functions to a relatively equal extent irrespective of industry sector. Therefore, the resale price method allows for greater differences in the products that are the subject of the transaction, although the general rule is that greater comparability will lead to better results. Appropriate resale profits are easiest to determine when the reseller does not significantly increase the value of the product. In contrast, when using the resale price method, it is more difficult to determine the transfer price:

* when the goods are further processed or incorporated into a more complex product before resale so that their visibility is lost or transformed (for example, when individual parts are incorporated into finished products or semi-finished products);
* when the reseller makes a significant contribution to the creation or maintenance of intangible assets related to the product (e.g. trademarks or commercial brands).

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| ***Use of the resale price method (a distributor example)*** |
| Sale to unassociated customers |  500 |
| The cost of goods sold (transfer price)\*\* |  -300 |
| **Margin (resale profit or gross margin) 40%\*** |  200 |
| Selling and other operating expenses |  -150 |
| Operating profit |  50 |
| *\* The object of comparison is the margin (the resale profit or gross margin) in a associated-party transaction with the* *price difference in comparable unassociated party transactions.**\*\* The cost of goods sold equals the cost of goods purchased from a associated party.* |

### 2.2.3 THE COST PLUS METHOD

Pursuant to Article 4 of the TPR, the cost plus method is based on the costs of the supplier of the assets or services in a associated-party transaction. The comparable market price is determined by adding to these costs an appropriate allowance which, in the same or comparable circumstances, would be achieved on the market by unassociated parties.

This is an appropriate allowance that provides an appropriate profit according to the functions performed and the associated funds invested and assumed risks.

When determining the supplier's cost margin (cost bases), the comparability of cost bases between the compared transactions needs to be ensured. If different accounting principles and standards are applied to the persons who have made the transactions and are the object of the comparison, adjustments and reconciliation are required in order to enable a comparison of the costs or cost bases that are determined in the same or in a comparable manner.

A comparable market price is determined by comparing the cost mark-up in a transaction or transactions performed in the same or comparable circumstances between unassociated parties. A cost mark-up comparison is made on the basis of the following (TPR 4/4):

* **internal comparable** comparing cost mark-ups, using an appropriately comparable cost base, between associated parties with those achieved by associated parties themselves or associated parties with unassociated parties; or
* **external comparable** comparing cost mark-ups, using an appropriately comparable cost base, between associated parties with those achieved or potentially achieved on the market by unassociated parties.

The OECD Guidelines provide for the use of the cost plus method in paragraphs 2.45-2.61 (or in paragraphs 2.39-2.55 of the 2010 OECD Guidelines). The cost plus method is based on the costs incurred by the supplier of assets (or services) in a associated-party transaction by transferring such assets or services to a associated customer. These costs are increased by a reasonable mark-up which ensures an appropriate profit in light of the functions performed and market conditions. The price, which is the sum of this cost mark-up and the aforementioned costs, can be considered to be the comparable market price of the original associated-party transaction. This method is probably the most useful when semi-finished products are sold between associated parties, when associated parties have entered into joint production or long-term purchase and supply agreements, or when a associated-party service transaction is involved.

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| ***The use of the cost plus method (a contract manufacturer example)*** |
| The cost of raw materials and supplies |  300 |
| Other direct and indirect production costs |  150 |
| **Cost mark-up 10%\*** |  **45** |
| Selling price (transfer price)\*\* |  495 |
| Overhead and other operating expenses |  15 |
| Operating profit |  30 |
| *\* The object of comparison is the cost mark-up in a associated-party transaction with a cost mark-up in the price of*  *comparable non-associated party transactions.**\*\* The selling price equals the transfer price.* |

### 2.2.4 THE TRANSACTIONAL NET MARGIN METHOD

Pursuant to **Article 6 of the TPR**, the transactional net margin method compares the net profit obtained in a associated-party transaction or transactions with appropriate base values (e.g. costs, sales revenue, assets). A comparable market price is determined on the basis of the ratio between the net profit and the appropriate base value, taking into account the functions performed and the related funds invested and assumed risks.

A comparable market price is determined by comparing the net profit margin achieved in a transaction or transactions performed in the same or comparable circumstances between unassociated parties.

The comparison of net profit margins is made on the basis of the following (TPR 6/2):

* **internal comparable** comparing net profit margins achieved between associated parties with those achieved by associated parties themselves or parties associated to them with unassociated parties; or
* **external comparable** comparing net profit margins achieved between associated parties with those achieved or potentially achieved on the market by unassociated parties.

The OECD Guidelines provide for the use of the transactional net margin method in paragraphs 2.64-2.113 (or in paragraphs 2.58-2.107 of the 2010 OECD Guidelines). Under the transactional net margin method, the net profit that a taxable person achieves in a associated-party transaction is examined in relation to the appropriate base value (e.g. costs, sales revenue, assets).

The OECD Guidelines provide that the net-profit-to-cost ratio is applied to manufacturing and service activities, and the ratio of net profit to sales revenue to companies engaged in sales activities. The net profit to investment ratio is used when an activity requires assets of great value. The selected financial ratio must reflect the value of the functions performed by the test party (i.e. the client in a controlled transaction for which the financial indicator is compared). The assets used by this party and the risks it is exposed to must also be taken into account. The data used for calculating the financial ratio should be based on objective data (such as sales to unassociated parties) and not on those based on transactions between associated parties. It is also necessary to ensure that the selected financial ratio is reliable and can be tested for both associated and comparable unassociated party transactions.

Only those items that relate (directly or indirectly) to a associated-party transaction should be considered when determining net profit. Non-operating items, such as accrued income tax and various exceptional and extraordinary items, should also be excluded. When determining the profit from non-financial transactions, interest income and expenses related to a company’s capital structure should be excluded, and interest related to receivables and payables to customers or suppliers should be taken into account. In non-financial transactions, the transactional net margin method most often uses profit or loss determined before taking into account interest income and expenses and extraordinary items before calculating income tax (Earnings Before Interest and Taxes – EBIT).

The use of this method consists in comparing the net margin achieved in a transaction or in transactions with an appropriate value base, depending on the facts and circumstances of the case (such as the sales revenues or manufacturing costs). In accordance with the OECD Guidelines (paragraph 2.94), the denominator should be reasonably independent of the associated-party transaction.

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| **The use of the transactional net margin method** |
|  **Distributor** |  **The contract manufacturer** |
| Sale to unassociated customers | 500 | The cost of raw materials and supplies | 300 |
| The cost of the goods sold(transfer price) |  -300 | + other direct and indirect production costs | 150 |
| **Price difference** |  **200** | Total manufacturing costs | 450 |
| Other selling expenses and other operating expenses |  150 | **Cost mark-up 10%** | **45** |
| **Net profit or net operating****profit\*** |  **50** | Selling price (transfer price) | 495 |
| Financing income |  10 | Overhead and other operating expenses | -15 |
| Extraordinary expenses |  20 | **Net profit or net operating profit\***  | **30** |
| Profit before taxation |  40 | \* (Operating profit (EBIT) / manufacturing costs) x 100 = (30/450)\*100 = **6.67 %** |
| \* (Operating profit (EBIT) / sales revenues)  x100 = (50/500) x 100 = **10%** |
| \* *The transactional net margin method compares*  *net profit with regard to sales revenues given that it* *is generated from the acquisition of goods from a*  *associated company.* | \* *The transactional net margin method compares* *net profit with manufacturing costs, as it relates to* *the sale of goods to associated parties.*  |

### 2.2.5 THE PROFIT SPLIT METHOD

Pursuant to Article 5 of the TPR, the profit split method is a method used to determine the amount of consolidated profit from a associated-party transaction or related-party transactions that is distributed among the participating related parties. The distribution of consolidated profits is made in the same way as unrelated parties would be expected to share such profits in comparable unrelated-party transactions.

Consolidated profits may be distributed in one of the following manners (TPR 5/2):

* a reasonable approximation to the distribution of profits is made in the same way as unassociated parties would be expected to earn such profits in comparable unassociated-party transactions, and, in the absence of comparables, on the basis of the functions performed and taking into account the invested funds and the assumed risks of each of the associated parties involved in a associated-party transaction, or
* using one of the methods referred to in Articles 2, 3, 4 or 6 of the TPR (i.e. the comparable uncontrolled price method, the resale price method, the cost plus method and the transactional net margin method), if a comparable market price can be determined for certain functions performed by associated parties in a associated transaction, where any residual consolidated profit that cannot be distributed using one of the methods referred to in Articles 2, 3, 4 or 6 of the Rules is divided on the basis of a reasonable approximation of the distribution of profits that unassociated parties would be expected to earn by participating in comparable unassociated-party transactions.

Paragraph 2.124 of the OECD Guidelines (paragraph 2.118 of the 2010 OECD Guidelines) provides that profit distribution can be assessed in a number of ways (either on the basis of the planned/projected or actual profit, if applicable), which would be agreed upon by unassociated parties. Two such methods are contribution analysis and residual analysis, which are not the only ones possible and are not mutually exclusive.

**In accordance with a contribution analysis** (paragraph 2.125 of the OECD Guidelines or paragraph 2.119 of the 2010 OECD Guidelines), consolidated profit, which is the total profit of a associated-party transaction under scrutiny, would be distributed among associated enterprises according to the proportional value of the functions performed by each associated enterprise involved in a associated-party transaction on the basis of a reasonable approximation of the profit distribution as would be expected by independent companies by participating in comparable transactions.

**In accordance with a residual analysis,** however, paragraph 2.127 of the OECD Guidelines (paragraph 2.121of the 2010 OECD Guidelines) suggests the distribution of consolidated profits in two stages, as one of the possibilities. In the first stage, each participant in the transaction is allocated a market-oriented payment for their regular contribution (the contribution is not unique in nature) to the associated-party transaction in which they participate. This initial payment would normally be determined using one of the traditional methods or the transactional net margin method. In the second stage, the remaining consolidated profit is distributed according to the contribution of each associated party in the transaction.

Like all other transfer pricing methods, the profit distribution method has its strengths and weaknesses. One of the main strengths of this method is that it examines profit allocation holistically, as it offers a more complete picture of what is happening and shows a broader, more accurate assessment of a company's transfer pricing policies. Therefore, it is less likely that one or the other party in a associated-party transaction will be left with extremely extreme and unbelievably high profits as both parties to the transaction are subject to assessment.

On the other hand, the method can also be risky, as profit distribution is often very subjective. Even minor divisive shifts can yield significantly different results. Another weak point of this method is the fact that both associated enterprises and tax authorities are likely to find it difficult to obtain information on associated enterprises in other countries. It may also be difficult to measure the consolidated revenue and consolidated costs for all associated enterprises involved in associated-party transactions, as this would require keeping books and records on a common basis and making adjustments in accounting and foreign currency practices. In addition, when the profit distribution method is applied to operating profit, it may be difficult to determine the eligible operating expenses associated with the transaction and to allocate costs to the transactions in question and other activities of associated enterprises.

The profit distribution method may be most appropriate in cases where:

* both parties to the transaction make unique and valuable contributions (i.e. they both use significant intangible assets and contribute significant added value to a associated-party transaction);
* there is a high level of interaction between transactions in which both parties make important contributions and share many synergies and cannot be easily separated (i.e. highly integrated activities);
* both parties to a associated-party transaction share significant economic risks.

On the other hand, this method is highly unlikely to be the most appropriate one when:

* one of the parties to the transaction performs simple functions and/or
* a comparative analysis can be performed (even if a well-defined transaction is quite complex) and reliable comparables are available.

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| Diagram: Choosing the profit split methodSharing of significant risksA high level of interaction of transactionsBoth parties to the transaction make unique and valuable contributions (intangible assets)Functional analysis/Supply value analysis/Value-added chain analysis to define the transaction**YES****NO**The possibility of performing a comparative analysis/the availability of reliable comparablesThe profit split method is highly unlikely to be the most appropriate oneThe profit split method may be the most appropriate method |

### 2.2.6 CHOOSING THE MOST APPROPRIATE TRANSFER PRICING METHOD

The choice of the most appropriate transfer pricing method depends on the circumstances of the individual case. When using the cost plus method, the resale price method or the transactional net margin method, the party to the transaction for which a financial ratio is being tested (cost mark-up, gross margin or net profit margin) must be selected. The choice of the test party must be made in compliance with the functional analysis of the transaction. The general rule is that a test party is the one for which the functional analysis is less complex (i.e. it performs fewer functions and assumes fewer risks).

**The choice must be made in accordance with the following criteria:**

* the strengths and weaknesses of each method;
* the suitability of each method according to the nature of the associated transactions, which is determined on the basis of an analysis of the functions performed by each party to the associated transaction (taking into account the resources used and the risks assumed);
* the availability of reliable data (internal or external comparables) required to use the selected transfer pricing method; and
* the degree of comparability between associated-party and unassociated-party transactions and the reliability of any adjustments made to comparable unassociated-party transactions needed to eliminate the differences between them.

The price and other conditions in a associated-party transaction should be compared with the price and conditions in a comparable unassociated-party transaction. A comparable unassociated-party transaction is a transaction between two unassociated parties that is comparable to a compared associated-party transaction. This can be a comparable transaction between a taxable person and an unassociated person (an internal comparable) or a transaction between unassociated persons (an external comparable). The key element in choosing the transfer pricing method is the availability of internal or external comparables. Internal comparables are more appropriate than external ones for applying the selected transfer pricing method.

Notwithstanding the strengths and weaknesses of each transfer pricing method, the comparable uncontrolled price method, the resale price method and the cost plus method should be used wherever possible, as their use is the most direct way to determine whether the conditions in commercial and financial transactions are in line with the arm’s length principle.

In some cases, the use of the transactional net margin method and the profit split method is more appropriate. The use of these methods relates, in particular, to any associated-party transaction to which each party contributes significant added value (in such cases, the profit split method is used). It is also more appropriate to use the two methods when internal comparables are not available or when no information can be obtained or where publicly available information on the gross margins of unassociated parties is unreliable.

Under the OECD Guidelines, multinational companies also have the right to use other valuation methods that are not among the five recognised OECD methods, but only if this ensures compliance with the arm’s length principle. When using other methods, taxable persons must specify why they did not use the transfer pricing methods recognised by the OECD and submit transfer pricing documents. In this regard, it should be emphasised that Article 16 of the ZDDPO-2 does not provide for the use of other methods, but only for the use of the five recognised OECD methods.

A simplified presentation of the use of transfer pricing methods:

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| **TRANSFER PRICING METHODS** | **CRITERION** | **BASIS FOR CALCULATION**  | **APPLICATION OF THE** **METHOD** |
| **THE COMPARABLE UNCONTROLLED PRICE METHOD** | Comparable market price | Direct application of the comparable market price | To all transactions (products, goods, services, interest rates, etc.) |
| **THE RESALE PRICE METHOD** | Comparable gross margin (the test party is the customer) | The market selling price that the tested party achieves when selling to an unassociated customer | To a reseller not contributing significant added value to the goods |
| **THE COST PLUS METHOD**  | A comparable cost mark-up (the test party is a seller or a contract manufacturer or service provider) | The production costs/costs of services incurred by the test party | To a contract manufacturer or service provider not using significant intangible assets |

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| **THE TRANSACTIONAL NET MARGIN METHOD**  | Comparable net margin in terms of costs(the test party is a seller or contract manufacturer or service provider) | Production costs/the costs of services incurred by the test party | To a contract manufacturer/service provider not contributing significant added value to products/services by using intangible assets. |
| Comparable gross margin in terms of sales revenues/EBIT margin[[6]](#footnote-6)(The test party is the customer) | The market selling price that the tested party achieves when selling to an unassociated customer  | To a reseller not contributing significant added value to the goods |
| Comparable net profit ratios(ROA, ROI, ROCE, etc.)[[7]](#footnote-7)(the test party is a seller, contract manufacturer or service provider) | Operating assets/capital invested by the test party | To a manufacturer, particularly when there are no reliable comparables available in terms of cost mark-up or data on the net profit to costs ratio. |
| **THE PROFIT SPLIT METHOD** | **The distribution** **of the residual profit of a transaction**(residual profit analysis)  | 1. Compensation for the performance of routine functions (use of the cost plus method, the resale price method or the transactional net margin method).2. The reasonable distribution of residual profits based on market information or internal profit distribution criteria. | To highly integrated transactionsand in transactions with significant and unique intangible assets contributed by the partiesto the transaction. |
| **Distribution** **of the overall (total) profit of the transaction**Contribution analysis  | The distribution of profits in the same manner as would be used by independent parties |

## 2.3 COMPARABILITY ANALYSIS AND THE USE OF DATABASES

### 2.3.1 COMPARABILITY ANALYSIS

A comparability analysis examines the conditions of associated-party transactions in relation to the conditions of transactions between unassociated parties, which is the basis of the arm’s length principle.

The second chapter of the TPR deals with comparability analyses. Article 9 of the TPR provides that in determining a comparable market price, the factor being examined in associated-party transactions must be compared with the factor being examined in identical or comparable transactions between unassociated parties. It is deemed that an unassociated-party transaction can be compared to a associated-party transaction when:

* none of the differences between the transactions can significantly affect the factor being examined in accordance with the appropriate method of determining a comparable market price; or,
* in the event that such differences exist, the effects of such differences can be eliminated by reasonably precise adjustments of the factor being examined in comparable arm’s length transactions in order to eliminate the impact of these differences on comparability.

The factors considered and used in each method to determine a comparable market price are in particular the following (TPR 9/2):

* the price used in the transaction;
* the gross margin;
* the net profit;
* the distribution of the overall (total) profit;
* financial ratios.

The comparability of transactions is assessed in the same way as unassociated parties, who compare all available transactions with each other and decide on the one that is most favourable to them (TPR 9/3).

In determining the comparability of two or more transactions, it is necessary to perform a comparability analysis and take into account economically relevant factors that affect the facts and circumstances of each transaction (PTC 9/4):

* the characteristics of the transferred funds or services;
* the functions performed by associated and unassociated parties (taking into account the funds employed and the risks assumed);
* the contract terms;
* the economic circumstances in which the transactions take place; and
* the business strategies.

The above-listed comparability factors are described in more detail in paragraphs 1.36-1118 in the first chapter of the OECD Guidelines (or in paragraphs 1.36-1.63 in the 2010 OECD Guidelines). In addition, they are also discussed in Chapter II of the OECD Guidelines (Transfer Pricing Methods), which outlines the importance of these factors for the application of each transfer pricing method. The TPR sets out these factors in greater detail in Article 11 (Functions Analysis), Article 12 (Funds Employed), Article 13 (Assumed Risks), Article 14 (Contract Terms), Article 15 (Economic Circumstances), and Article 16 (Business Strategies).

Other influencing factors in determining comparable market prices include the impact of government policy (Article 18 of the PTC) and paragraphs 1.132-1.136 of the OECD Guidelines (paragraphs 1.73-1.77 of the 2010 OECD Guidelines) and losses (Article 20 of the PTC) and paragraphs 1.129-1.131 of the OECD Guidelines (paragraphs 1.70-1.72 of the 2010 OECD Guidelines).

Chapter III of the OECD Guidelines bears the title “Comparative Analysis”). Paragraph 3.4 describes a typical benchmarking procedure, which is considered good practice but not mandatory. The essence of the procedure is to identify reliable comparables, where the reliability of the results of the procedure is more important than the procedure itself (this means that the implementation of the steps of the procedure does not provide any guarantee that the result will be in line with the arm’s length principle or that the non-performance of the procedure does not mean that the result will not be market-oriented).

The steps of the procedure are the following:

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| ***Step 1:*** | *determining the time period, i.e. the years covered by the analysis* |
| ***Step 2:*** | *a broad-based analysis of the circumstances in which the taxable person operates* |
| ***Step 3:*** | *understanding the associated-party transaction(s) under scrutiny, based in particular on a functional analysis, allowing the test party to choose (where necessary), the most appropriate transfer pricing methods according to the circumstances of the case, the financial indicators to be analysed (in the case of the transactional profit method) and the identification of the important comparability factors to be taken into account in the analysis* |
| ***Step 4:*** | *examining possible existing internal comparables* |
| ***Step 5:*** | *identifying the available sources of information about external comparables when such external comparables are necessary, taking into account their relative reliability* |
| ***Step 6:*** | *selecting the most appropriate transfer pricing method and, in accordance with the method selected, determining the relevant financial indicators (e.g. determining the appropriate net profit margin indicator in the case of using the transactional net margin method)* |
| ***Step 7:*** | *identifying potential comparables: identifying the key characteristics that any transaction between unassociated parties should meet in order to be considered to be potentially comparable on the basis of the relevant factors identified in Step 3 and in accordance with the comparability factors set forth in Section D1 of Chapter I of the OECD Guidelines* |
| ***Step 8:*** | *determining and making adjustments to comparables where necessary* |
| ***Step 9:*** | *interpreting and using the collected data, determining payment in line with the arm’s length principle.* |

The comparability analysis needs to be approached in a consistent manner in order to ensure the coherence of the analytical process from the preliminary analysis of the terms of the associated-party transaction, through the choice of the transfer pricing method, to the identification of potential comparables.

### 2.3.2 DATABASES

An important part of a transfer pricing analysis is finding potential comparables. This can be a comparable transaction between a taxable person and an unassociated person (an internal comparable) or a transaction between unassociated persons (an external comparable). When there are reliable internal comparables, finding external comparables may not even be necessary. There are various sources of information to identify potential external comparables, the most common ones being commercial databases containing company accounts (such as Amadeus, Orbis, GVIN, etc.).

The OECD Guidelines address the databases in paragraphs 3.30-3.34, and state that the use of commercial databases can be a practical and sometimes cost-effective way of identifying external comparables that can provide the most reliable source of information, depending on the facts and circumstances of the case.

There are also some limitations to using commercial databases. Since these commercial databases rely on publicly available information, they are not available in all countries, as not all countries have the same amount of publicly available information about their companies. Moreover, when available, they do not include the same information for all companies operating in a given country, as disclosure and submission requirements may differ depending on the legal form of a company and whether a company is listed on a stock exchange or not. Furthermore, paragraph 3.33 of the OECD Guidelines warns that the use of commercial databases should not promote quantity over quality. Experience has shown that five to thirty comparables that meet the comparability standards are sufficient, in exceptional cases even less than five.

The process of obtaining comparables must be transparent and documented, therefore it is recommended that the search for information through databases be supplemented by other publicly available information (such as data from the Internet).

## 2.4. SPECIAL FEATURES OF INTANGIBLE ASSETS

The OECD Guidelines define intangible assets in **Chapter VI,** which was almost completely amended in 2017 and is much more extensive than in the 2010 Guidelines.

The definition of intangible assets according to paragraph 6.6 of the OECD Guidelines focuses on setting out the conditions in transactions that are intended to include the intangible assets to be agreed upon by unassociated parties in comparable transactions. Intangible assets are defined as something that:

* is not a tangible or financial asset;
* can be owned or otherwise controlled and used in a gainful activity; and
* could form the basis for unassociated parties’ claim for compensation when such assets are used in a transaction in comparable circumstances.

Although without intending to categorise intangible assets in a way that would define their treatment, the OECD Guidelines classify them into marketing intangibles, which are usually derived from marketing activities, trade intangibles, which are usually derived from research and development and other business activities, routine, non-routine, unique, soft (difficult to define), hard (easier to define) intangibles, etc. From a commercial point of view, intangible assets are intellectual property such as patents, know-how, trade secrets, trademarks, names and logos, contract rights and state concessions, licences and similar rights that are the subject of transactions between both non-associated and associated enterprises.

Intangible assets do not include the synergies of a multinational group of companies, or local market characteristics such as the level of disposable income of households in that market or the size and competitiveness (development) of the market, as this cannot be owned or controlled. While these conditions may in some circumstances affect the setting of arm's length prices for individual transactions and should be taken into account in the comparability analysis, they are not intangible assets for transfer pricing purposes.

The general rules for the application of the arm’s length principle also apply to the transfer pricing of intangible assets. Thus, a transaction should not be judged solely on the basis of contractual provisions or how the parties have named it, but the key is to determine the actual transactions and their economic consequences. It is particularly important to determine the way in which a multinational group of companies operates globally, in particular how the intangible assets are used in its operations and add or create added value throughout the supply chain, and whether independent companies would agree to such terms in comparable transactions.

An individual item is considered to be an intangible asset if it is evident from its accounting recognition, but the existence of an intangible asset is not assessed on this basis alone. Intangible assets to be included in transfer pricing are not always recognised as intangible assets for accounting purposes. For example, costs related to the development of intangible assets that are disclosed only internally as R&D and advertising costs and are disclosed only as costs, and such intangible assets are not always disclosed as such in the balance sheet. Nevertheless, they can be used to create significant economic value and may therefore need to be taken into account in the transfer pricing process.

Furthermore, the identification of the legal and economic owner of an intangible asset is crucial, as legal ownership does not in itself ensure that all returns from the intangible asset are attributed to its legal owner. The purpose of these provisions is to prevent the rewarding of companies in countries with a more favourable tax environment (especially in so-called offshore centres) that were only the legal owner of the intangible assets and did not perform any important functions, but received the bulk of the income.

Legal ownership and contractual relationships are used in the analysis as a starting point for identifying and analysing associated-party transactions and for determining appropriate compensation for members of a multinational group of companies. The identification of legal ownership, functions performed, funds employed and risks assumed provides an analytical framework for pricing in accordance with the arm's-length principle. As with any type of associated party transaction, the analysis must take into account all of the relevant facts and circumstances of the individual case.

The OECD Guidelines (paragraph 6.34) set out the steps that multinational groups of companies may use to analyse transactions between associated enterprises involving intangible assets and to collect the data needed to determine the price of those transactions in accordance with the arm’s length principle. In order to determine which company in a group performs certain functions, holds assets and assumes the risks related to the development, enhancement, maintenance, protection and exploitation (use) of an intangible asset, a **DEMPE analysis** (D - development, E - enhancement, M - maintenance, P - protection, E - exploitation) must be carried out.

|  |  |
| --- | --- |
|  | ***The steps to perform a comparability analysis – a DEMPE analysis*** |
| *1.* | *Identifying the intangible asset used or transferred in the transaction and indicating the economically significant risks associated with the development, enhancement maintenance, protection and use of the intangible asset.* |
| *2.* | *Defining all contractual arrangements, with a particular emphasis on determining the legal ownership of an intangible asset, including relevant registrations, licensing and other agreements and other indications of legal ownership, indications of contractual rights and obligations, including contractual risks between associated enterprises.*  |
| *3.* | *Indicating the parties performing individual functions, including the planning and supervision of research and marketing programmes, directing and deciding on priorities, including determining the course of research without immediately apparent results; overseeing strategic decisions regarding programme development; managing and controlling the research and development budget; furthermore, making important decisions regarding the protection of intangible assets, those carrying out permanent control of the functions performed by independent or associated enterprises having a decisive influence on the value of the intangible asset (these functions are described in more detail in paragraph 6.56 of the OECD Guidelines); indicating the assets used by each party and indicating the parties in charge of managing the risks associated with the development, enhancement, maintenance, protection and exploitation of intangible assets (DEMPE analysis), and indicating the parties controlling all external contractors and economically significant risks.* |
| *4.* | *Confirming compliance between the terms agreed in writing and how the risks are actually shared between the parties, i.e. whether the parties actually follow the contractual arrangements and whether the parties assume and control economically significant risks and have the financial capacity to assume the risks associated with the development risks, enhancement, maintenance, protection and exploitation of the intangible asset.* |
| *5.* | *Identifying the actual transactions related to the development, enhancement, maintenance, protection and exploitation of an intangible asset in conjunction with legal ownership and other relevant contractual relationships and identifying the manner of acting of individual parties to the transaction, including their respective contributions in terms of functions, assets and risks.*  |
| *6.* | *Where possible, the sixth step should include setting the price by applying the arm’s length principle in accordance with each party's contributions to the transaction, based on the functions performed by each party, the funds employed and the risks assumed, except where the guidelines on compliance with the form of the transaction are applied (OECD Guidelines, paragraphs 1.119-1.127), providing that the tax authorities should, as a general rule, disregard transactions accepted by a taxable person when special circumstances arise and when transactions are commercially irrational.*  |

Some intangible assets may be identified separately and transferred on a separate basis, while others may be transferred only in combination with other business assets. Paragraph 6.8 of the OECD Guidelines provides that separate transferability is not a necessary condition for defining an item as an intangible asset for transfer pricing purposes.

Article 22a of the TPR (Special features of intangible assets) provides that in determining a comparable market price in associated transactions, which includes, for example, the right to use, sell or otherwise dispose of intangible assets between associated parties, account must be taken of both the transferor and the transferee, and in particular the price at which unassociated persons would be willing to transfer a comparable intangible asset or the right to use the intangible asset to the transferee.

When performing a comparability analysis in accordance with the provisions of Article 9 of the TPR in relation to transactions involving intangible assets, it is necessary to consider, for example, the criteria that are important for the comparability of associated and arm’s length transactions, including:

* the expected economic benefits;
* geographical restrictions on the exercise of the rights to use an intangible asset;
* the nature of the rights to use an intangible asset (e.g. the exclusive or non-exclusive right to use the rights being transferred); and
* whether the transferee has the right to participate in the further development of the intangible asset.

It is essential that the transactions involving intangible assets have **economic content** and that the sole purpose of these transactions is not to transfer profits from the country to a more tax-friendly environment.

### 2.4.1. HARD-TO-VALUE INTANGIBLE ASSETS

Paragraphs 6.186 and 6.195 of the OECD Guidelines address a specific approach to the treatment of hard-to-value intangibles (HTVI).

The term hard-to-value intangibles refers to intangible assets or to the rights to use intangible assets for which

* there are no reliable comparables between associated enterprises at the time of their transfer;
* at the time of the transaction it is very difficult to predict how successful their use will be, as the projections of future cash flows (or income expected to be derived from a transferred intangible asset) are highly uncertain, as are the assumptions used in the valuation of the intangible assets.

Where the actual results relating to the development or acquisition of intangible assets are known only after some time and cannot be predicted with certainty, a distinction must be made between:

* ex ante income from ex ante returns; and
* ex post payment relating to income actually earned by a company that is a member of the group by exploiting the intangible assets.

For example, a taxable person may transfer an intangible asset to a associated company at a very early stage of development, and such compensation (e.g. royalties) received may not be appropriate given the value of the asset at the time of the transaction. The taxable person later argues that at the time of the transaction it was not possible to predict the subsequent success of the product with absolute certainty. The difference between the value at the time of transfer (ex ante) and a subsequently determined (ex post) value based on the new approach in the OECD Guidelines will no longer be fully attributable by the taxpayer to more favourable developments or to the greater than expected success of an intangible asset.

This approach ensures that tax administrations can assess, on the basis of subsequent results, whether the taxable persons' evidence of the value of an intangible asset was relevant or appropriate at the time of the transaction and allows them to adjust the transfer price as necessary.

## 2.5. SPECIAL FEATURES OF SERVICES

Pursuant to **Article 22 of the PTR** (Special Features of Services), a associated party service shall be deemed to have been provided if an unassociated party was willing to order and pay for that service from another unassociated party or if the associated party was willing to provide it itself. For instance, these conditions are met if an unassociated party was willing to order and pay for that service from another unassociated party or if the associated party was willing to provide it itself, taking into account the circumstances where

* the service provides economic or commercial value in terms of improving the economic situation of the recipient of the service, or
* such a service would be provided by an unassociated party for its own needs with its own resources.

Associated party services for which comparable market prices are determined include, for example, the following:

* administrative services (management services, planning, accounting, auditing, legal services and the like),
* financial services (loan agreements, cash flow control, etc.),
* technical and commercial services provided in the form of aid in the fields of production, purchasing, distribution and marketing,
* human resources services (employment and staffing, education and the like).

The costs of activities charged by a associated party to others for their equity holding, management, control or voting rights and which, in the same or comparable circumstances, an unassociated party would not be willing to pay for are not justified to be charged in the form of services. The following are examples of the costs of such activities (22/4 PTR):

* the costs of activities related to the legal regulation of the parent company itself (costs related to the parent company’s general meeting of shareholders, the issuance of shares by the parent company, and costs related to the supervisory board),
* costs related to the reporting requirements of the parent company, including the consolidation of reports,
* the cost of raising funds for the acquisition of holdings.

Where certain specific services provided by a party to an associated enterprise can be identified, whether a service charged is in line with a comparable market price must be determined for each specific service as set out in Article 17 of the PTR.

When setting a comparable market price for services, the comparable uncontrolled price method is used when services comparable to the services that are the subject of a associated-party transaction are also provided between unassociated parties or where such services are also provided to unassociated parties in the same or comparable circumstances as provided to associated parties.

If a comparable market price is set by using the cost plus method, it is set by means of (22/7 PTR):

* direct determination, when the services provided and the bases for payment are clearly identifiable and the costs of individual services can be identified, or
* indirect determination if the direct determination method cannot be used due to impracticality or if the transactions of services between associated parties are not identifiable (for example, if the costs of these services are included in the cost or price of a larger transaction or if the costs are not distributed among associated parties).

If the services provided to associated parties are the main or regular and not occasional business activity of the service provider and are provided to both associated and unassociated parties, the comparable market price is determined directly, using the cost plus method in accordance with the first indent, paragraph seven of Article 22 of the PTR.

If the costs attributable to an individual service are not directly identifiable, the indirect pricing approach in accordance with the second indent of paragraph seven of this Article is used to determine a comparable market price using the cost plus method, in particular by using (22/9 PTR):

* a suitable cost distribution key based on the facts and circumstances of each service provision case,
* the realistic cost distribution,

taking into account the economic value of the services to the recipient and the extent to which comparable services are provided between unassociated parties.

**The OECD Guidelines** set out the specifics of the services in Chapter VII. In accordance with paragraph 7.5 of the OECD Guidelines, two questions arise in connection with the analysis of transfer pricing for intra-group services. The first question is whether intra-group services have actually been provided and the second is what the price for such intra-group services would be for tax purposes in accordance with the arm’s length principle.

In determining whether services in a group have indeed been provided (paragraph 7.6 of the OECD Guidelines), it is crucial to assess whether this activity provides a member of the group an economic or market value that improves its financial position. This can be determined by examining whether an independent enterprise would be willing to pay for such an activity in comparable circumstances if it were carried out by an independent enterprise or whether it would carry out such an activity on its own. If an activity is not one of the activities for which an independent enterprise would be willing to pay or willing to carry out on its own, it should not normally be considered to be an intra-group service provided in line with the arm’s length principle.

In general, an intra-group service should not take into account an activity that a group member performs for another group member and which only duplicates a service that another group member already performs on its own or has it performed for its own needs by another party (paragraph 7.11 of the OECD Guidelines).

### 2.5.1 LOW VALUE-ADDED SERVICES

With the amendments to the OECD Guidelines of July 2017, the Guidelines defined the treatment of low value-added services (paragraphs 7.43 to 7.65). These services should be considered from the point of view of both the recipient and the associated enterprise providing these services. They are characterised by the fact that they have a supporting function, that no unique and valuable knowledge or intangible asset is used in their performance, and that their use does not lead to the creation of an intangible asset. The provision of these services is also not related to the acceptance or creation of significant risks. Moreover, services are not charged to independent customers.

However, low value-added services do not include, for example, the main activity of a multinational enterprise group, research and development, production, sales, marketing, distribution, financial transactions, insurance and reinsurance transactions, company management services, extraction and research, or the processing of natural resources.

Paragraph 7.49 of the OECD Guidelines provide examples of services that could suit the definition of low value-added services:

* **accounting and auditing,** such as collecting and reviewing the information to be used in financial statements, keeping financial records, preparing financial statements, preparing or assisting with operational and financial audits, verifying the authenticity and reliability of accounting records, and assisting in drafting a plan by processing data and collecting information;
* **processing and managing accounts receivable and accounts payable**, such as collecting customer data and processing and verifying their credit rating;
* **human resource activities,** such as staffing and recruitment (e.g. recruitment procedures, assistance in assessing and selecting candidates, staff appointment, recruitment, performance appraisal and career guidance, assistance with redundancy programmes); the training and development of employees (e.g. the assessment of training needs, the shaping of internal training and programme development, the creation of management skills and career development programmes); wage policy services (e.g. consulting and devising wage policies and bonuses for employees, such as healthcare and life insurance, share option plans and pension schemes; attendance and working hour checks, payroll services, including processing and tax consulting); the development and monitoring of data related to health, safety, environmental and other standards concerning employees and the working environment;
* **monitoring and collecting data relating to health, safety, environmental and other standards governing business;**
* **information technology services,** if not part of the core business of the group, such as the installation, maintenance and updating of information systems used in the enterprise; information support (which may include an information system used in connection with accounting, production, customer relations, human resources, payment systems, e-mail); training on the use of information systems and related equipment used for the collection, processing and presentation of information; the development of guidelines for information technology, the provision of telecommunications services, the organisation of information services to help users, the implementation and maintenance of information technology security systems; network support, maintenance and control (the local area network, broadband network, and the Internet);
* **internal and external communication and public relations support** (but without specific advertising or marketing activities, such as the development of basic strategies);
* **legal services,** such as general legal services provided by international legal advisers employed by a multinational company group, including the drafting and reviewing of contracts, various agreements and other legal documents, legal advice and opinions, representing companies in litigation, arbitration and administrative proceedings, and legal and administrative work involving the registration and protection of intangible assets;
* **activities related to tax liabilities,** such as collecting information and preparing tax returns (personal income tax, income tax, sales tax, VAT, property tax, customs and excise duties), paying taxes, cooperating in auditing tax administrations and advising on tax matters;
* **general administrative or clerical services.**

The OECD Transfer Pricing Guidelines provide for a simplified pricing approach in line with the arm’s length principle for the aforementioned services. When setting a price for low value-added services in accordance with the arm’s length principle, the service provider must charge a mark-up on all costs (excluding the costs that a company merely re-invoices and are defined in paragraph 2.99 and 7.34 of the OECD Guidelines). The same surcharge on costs should apply to all low value-added services regardless of the service category. According to the OECD Guidelines, the surcharge should be **5% on an appropriate cost basis** and, as provided for in the simplified approach, the taxable person does not have to prove it through a comparability analysis procedure. However, the taxable person must provide sufficient evidence in the transfer pricing documents that the utility test has shown that the services in question actually have the characteristics of low value-added services.

# 3. PROCEDURES FOR ELIMINATING DOUBLE TAXATION

## 3.1 THE MUTUAL AGREEMENT PROCEDURE FOR ELIMINATING DOUBLE TAXATION (MAP)

In the event that a taxable person does not agree with the adjustment of the tax base due to the transfer prices in the tax audit procedure, a taxable person may, notwithstanding the legal remedies provided by national law, initiate a mutual agreement procedure pursuant to an international treaty that is binding on Slovenia. Thus, a taxable person who is considered a resident of the Republic of Slovenia and who considers that the decisions or actions of a tax authority or tax authority of another state have caused taxation that is not in accordance with an international treaty may submit a written request to FURS to initiate a mutual agreement procedure with the competent authority of another country (hereinafter: a request), within no later than three years (in the event that taxable persons file a request on the basis of an international treaty, they must verify the deadline for submitting the request in the international treaty concluded between the Republic of Slovenia and the country with which the transactions take place) from the date of:

* the submission of a tax return, or
* the submission of a tax return during the tax audit procedure, or
* the service of the notice of assessment.

For more information on the mutual agreement procedure for eliminating double taxation, see: [The mutual agreement procedure under international treaties for the avoidance of double taxation.](https://www.gov.si/assets/ministrstva/MF/Davcni-direktorat/DOKUMENTI/Postopek-skupnega-dogovarjanja-po-mednarodnih-pogodbah-o-izogibanju-dvojnega-obdavcevanja.pdf)

## 3.2 ADVANCE PRICING ARRANGEMENTS (APA)

The Financial Administration Act also determines the conclusion of an APA as one of FURS’s tasks. FURS has been able to enter into such arrangements since 2017, i.e. after the adoption of the legal basis for it as set out in Articles 14a to 14g of the Tax Procedure Act (ZDavP-2).

An APA is an agreement with which the methodology, critical assumptions and other appropriate criteria for determining the transfer pricing for these transactions and the period for which these criteria apply are defined before the execution of transactions between associated parties.

A taxable person may request the conclusion of a unilateral, bilateral or multilateral agreement. A unilateral agreement is concluded between the taxable person and the tax authority, and a bilateral or multilateral agreement is an agreement between the competent authorities of two or more countries concluded in a mutual agreement procedure.

For more information on the APA, see: [APA agreement](https://www.fu.gov.si/davki_in_druge_dajatve/poslovanje_z_nami/apa_sporazum/)

1. *The translated OECD guidelines 2010 are available at: https://www.fu.gov.si/fileadmin/Internet/Davki\_in\_druge\_dajatve/Podrocja/Mednarodno\_obdavcenje/Opis/Smernice\_OECD\_za\_dolocanje\_transfernih\_cen\_za\_mednarodna\_podjetja\_in\_davcne\_uprave\_julij\_2010.pdf* [↑](#footnote-ref-1)
2. *The ZDDPO-2 is available at: http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO4687* [↑](#footnote-ref-2)
3. *The TPC is available at: http://www.pisrs.si/Pis.web/pregledPredpisa?id=PRAV7545* [↑](#footnote-ref-3)
4. *The Rules on the Recognised Interest Rate are available at:* *http://www.pisrs.si/Pis.web/pregledPredpisa?id=PRAV7544* [↑](#footnote-ref-4)
5. *The CIT Calculation Rules with annexes are available at: http://www.pisrs.si/Pis.web/pregledPredpisa?id=PRAV11756* [↑](#footnote-ref-5)
6. ***EBIT*** *– Earnings Before Interest and Tax – operating profit or loss determined before taking into account interest income and expenses and extraordinary items before calculating income tax.* [↑](#footnote-ref-6)
7. ***ROA*** *– Return (net profit margin) on Assets – the ratio of the profitability of assets*

***ROI*** *– Return (net profit margin) on Investment*

 ***ROCE*** *– Return on Capital Employed* [↑](#footnote-ref-7)