Practical Manual on Transfer Pricing for Developing Countries

Foreword

The United Nations Practical Manual on Transfer Pricing for Developing Countries is a response to the need, often expressed by developing countries, for clearer guidance on the policy and administrative aspects of applying transfer pricing analysis to some of the transactions of multinational enterprises (MNEs) in particular. Such guidance should not only assist policy makers and administrators in dealing with complex transfer pricing issues, but should also assist taxpayers in their dealings with tax administrations.

The United Nations Model Double Taxation Convention between Developed and Developing Countries considers (in Article 9 – “Associated Enterprises”) whether conditions in commercial and financial relations between related enterprises, such as two parts of a multinational group, “differ from those which would be made between independent enterprises”. The same applies for Article 9 of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital. In this respect both Models, which between them are the basis for nearly all bilateral treaties for avoiding double taxation, endorse the “arm’s length standard” (essentially an approximation of market-based pricing) for pricing of transactions within MNEs.

While it is for each country to choose its tax system, this Manual is addressed at countries seeking to apply the “arm’s length standard” to transfer pricing issues, as the approach which nearly every country seeking to address such issues will decide to take. Such an approach minimises double taxation disputes with other countries, with their potential impact on how a country’s investment “climate” is viewed, while combating potential profit-shifting between jurisdictions where a MNE operates.

In recognising the practical reality of the widespread support for, and reliance on, the arm’s length standard among both developing and developed countries, the drafters of the Manual have not found it necessary, or helpful, for it to take a position on wider debates about other possible standards. The Manual will, at most help inform such debates at the practical level, and encourage developing country inputs into debates of great importance to all countries and taxpayers.

Without an effective response to transfer pricing issues, there is a risk, for example, that profits might appear to be earned in low or no-tax jurisdictions (thereby serving to reduce tax rates on taxable profits/incomes and associated tax obligations), and losses might appear to be incurred in high-tax jurisdictions (thereby increasing allowable deductions for tax purposes). This may have the net effect of minimizing taxes and, in so doing, may impact on the legitimate tax revenues of countries where economic activity of the MNE takes place, and therefore the ability to financco6

There are as yet no figures which clearly indicate the amount of revenue lost to transfer mispricing that might otherwise be directed to development, but with intra-firm trade generally regarded as comprising more than 30% of global trade[1], there is reason to believe that the figures are large. While more research needs to be done on the size of the potential losses for developing countries, and the situation will no doubt vary greatly from country to country, there is clearly great scope for pricing decisions about intra-group transactions to detrimentally impact on domestic revenues for development.

Conversely, in this complex area there is a risk that taxpayers, especially multinational enterprises, will be faced with a multiplicity of approaches to applying the arm's length standard in practice that can lead to compliance burdens and the risk of unrelieved double taxation. This can be the case even where there is no issue of tax avoidance or evasion, because of the scope for differences of view about what the arm's length price would be in a particular case. Helping achieve common understandings on transfer pricing issues can also improve trust between taxpayers and tax authorities, both avoiding some differences between them and helping resolve others more quickly.

In offering practical guidance to policy makers and administrators on the application of the arm's length principle, the Manual does not seek to be prescriptive. In particular it recognises that the needs of countries, along with their capabilities, will evolve over time. A "phased" or "life cycle" approach, with a transfer pricing capabilit

- the drafting should be as simple and clear as the subject matter permits;
- the Manual will be prepared initially in English, but with a recognition that this will not be the first language of most users; it should be translated at least into the other official UN languages;
- a key “value added” of the Manual is to be its practicality - addressing real issues for developing countries (and of course those dealing with the administrations of such countries) in a practical and problem-solving way. It therefore seeks to address the theory of transfer pricing, but in a way that reflects developing country realities in this area;
- the Manual, as a product of the United Nations Committee of Experts on International Cooperation in Tax Matters, has a special role in reflecting the diversity of the United Nations Membership and placing transfer pricing in its developmental perspective. This recognises both the importance to development of fair and effective tax systems, but also the fact that foreign investment, on appropriate terms, is seen as an important path to development by most countries;
- helpful guidance in this complex area must, in particular, be geared to the inevitable limitations in some countries’ administrations, and deficits in information and skills that many countries are affected by in this area. Issues of building and retaining capability, focus and efficiency in dealing with limited resources, in particular, bear strongly on the approach taken in the Manual;
- practical examples relevant to developing countries have been especially relied upon, because the experiences of other developing countries in addressing the challenges of transfer pricing are an important way of finding effective solutions that work in their context, and of doing so in the most cost and time effective ways; and
- consistency with the OECD Transfer Guidelines[2] has been sought, as provided for in the Subcommittee’s mandate and in accordance with the widespread reliance on those Guidelines by developing as well as developed countries.

Just as building an effective and efficient transfer pricing capability is a journey, so too is the preparation of a Manual seeking to give guidance for that journey. This Manual has been the work of many authors, and particular thanks are due to the current Members of the Subcommittee on Transfer Pricing - Practical Matters[3]: Stig Sollund (Norway - Coordinator) Julius Bamidele (Nigeria) Giammarco Cottani (Italy) Nishana Gosai (South Africa) Mansor Hassan (Malaysia) Michael McDonald (USA) Sanjay Mishra (India) Harry Roodbeen (Netherlands) Marcos Valadao (Brazil) Shanwu Yuan (China) Joseph Andrus (OECD) Keiji Aoyama (University of Waseda, Japan) Carol Dunahoo (Baker & McKenzie, US) Michael Kobetsky (Australian National University & Melbourne University) Kyung Geun Lee (Yulchon Lawyers, Korea) Toshio Miyatake (Adachi, Henderson, Miyatake & Fujita, Japan) T.P. Ostwal (Ostwal and Associates, India) Jolanda Schenk (Shell, Netherlands) Caroline Silberztein (Baker & McKenzie, France) and Monique van Herksen (Ernst and Young,, Netherlands).

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[2] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2010 Paris.

[3] Members as of October 2012, when the Manual was presented to the Committee for consideration. Members of the Subcommittee serve purely in their personal capacity. Accordingly, the references to countries (in the case of Members in government service) or employers (in other cases) are for information only.

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While consensus has been sought as far as possible, it was considered most in accord with a practical manual to include some elements where consensus could not be reached, and it follows that specific views expressed in this Manual should not be ascribed to any particular persons involved in its drafting. Chapter 10 is different from other chapters in its conception, however. It represents an outline of particular country administrative practices as described in some detail by representatives of those countries, and it was not considered feasible or appropriate to seek a consensus on how such country practices were described. Chapter 10 should be read with that difference in mind."

Finally, it should be noted that this Manual is conceived as a living work that should be regularly revised and improved, including by the addition of new chapters and additional material of special relevance to developing countries. This will only improve its relevance to users and its significance as a work that can be relied upon in the capacity building efforts of the United Nations and others that are so needed in this field.