United Nations launches Practical Manual on Transfer Pricing for Developing Countries

The United Nations Committee of Experts on International Cooperation in Tax Matters (the Committee) began its work on the Practical Manual on Transfer Pricing for Developing Countries (the Manual) in 2009. The Subcommittee was to develop a Practical Manual on Transfer Pricing for Developing Countries, which would:

- follow the “arm’s length principle" adopted in Article 9 of the UN Model Double Taxation Convention between Developed and Developing Countries (the UN Model), which is consistent with the OECD Model Tax Convention on Income and on Capital (the OECD Model);
- reflect the realities of developing countries, at their relevant stages of capacity development;
- pay special attention to the practical experience of developing countries; and
- draw upon the work being done in other fora, in particular the OECD.

The Subcommittee fulfilled its mandate and the Manual was adopted by the Committee during its annual session in October 2012. It was launched in e-version during a special meeting of ECOSOC (United Nations Economic and Social Council) on "International cooperation in tax matters" in New York on 29 May 2013. The Manual will be issued in print shortly.

The Manual is designed to be in accordance with the “arm’s length principle,” an approximation of the market based pricing provided for in both the UN Model and the OECD Model Conventions. Such an approach seeks to minimize potential double taxation disputes among countries,
while combating potential mispricing of internal transactions within a multinational enterprise (MNE) for profit shifting between jurisdictions.

The Manual addresses the difficulties faced, especially by developing countries, in applying the OECD Transfer Pricing Guidelines and the need for clear and practical guidance for those countries on the policy and administrative aspects of applying transfer pricing analyses to transactions of MNEs. While consistent with the OECD Transfer Pricing Guidelines, the Manual in effect provides a novel and needs-based approach to explain what those guidelines mean for developing countries, and how they can be applied in practice in a way that responds to their priorities and realities.

Manual contents

The Manual is not intended to be prescriptive as it is left up to each country to choose a tax policy most appropriate to its stage of economic development. It rather intends to offer developing countries a basis for an informed debate at a practical level about transfer pricing. On a more technical level the Manual is organized around several chapters. They are briefly described below.

Chapter 1: introduces the Manual as a whole and represents a broad survey of transfer pricing issues for developing countries, starting with an overview of the transfer pricing concept and the arm’s length principle. It describes the difficulties faced by developing countries when designing tax policies that take into account the rapid evolution of global trade and the increasing share of MNEs in that trade.

Chapter 2: describes the factors that gave rise to MNEs and shows how an MNE is able to exploit integration opportunities in the cross-border production of goods and provision of services through a “value chain.” It outlines the legal structures that are used by MNEs, and considers the differences between them.

Chapter 3: gives a structural overview to domestic transfer pricing legislation and describes the key concepts including, the definition of associated enterprises, transactions covered and methods used, treatment of cases without sufficient comparables, the burden of proof, and the “arm’s length principle.”

Chapter 4: addresses the need for transfer pricing capabilities in developing countries. It takes into account factors widely recognized to be key features of modern tax administrations. These include:
  • relationships between tax policy and tax administration;
  • the need to evaluate current capabilities and gaps to be filled;
  • the need for a clear vision, mission and culture that reflects them;
  • organizational structure;
  • approaches taken to building team capability;
  • the need for effective and efficient business processes;
  • the advantages of staged approaches to reaching long term goals; and
  • the need for monitoring to assess effectiveness and allow fine tuning.

Chapter 5: deals with comparability analysis under the “arm’s length principle” and addresses in particular the main hurdles faced by many countries, especially developing countries, in finding appropriate comparables.

Chapter 6: reviews the different transfer pricing methods used to determine an “arm’s length price” and how these methods are applied in practice. Several methods are reviewed without expressing any preference and with ample examples.

Chapter 7: deals with the importance of documentation. It introduces some existing international guidelines on transfer pricing documentation, which will be helpful to tax administrations. An Appendix to the Manual sets out some countries’ legislation examples on transfer pricing documentation and provides a sample transfer pricing study.

Chapter 8: surveys audit issues related to transfer pricing and stresses the need for risk assessment. It describes difficulties in conducting audits and advises on preparation of cases and the necessary risk assessment that needs to be done before starting such a process.
**Chapter 9:** deals with dispute avoidance and dispute resolution. It examines processes and procedures of dispute avoidance and dispute resolution and advises on effective ways to prevent disputes. It also reviews the possible role of Advance Pricing Agreements (APAs) and arbitration and outlines the advantages and disadvantages in each case without taking position, as it takes a view that what suits some countries will not suit others.

**Chapter 10:** is devoted to country practices. The chapter compiles four papers on country practices from China, India, Brazil, and South Africa. The papers were prepared by country officials and each case seeks to inform the readers/users of specific country experience in dealing with transfer pricing issues in its specific country conditions. The Manual does not take any position on whether or not the described cases follow the “arm’s length” approach. It is explicitly noted that this is not a chapter agreed by consensus, however. Because of its focus on practicality, the launch of the Manual is much welcomed by many developing countries trying to implement or apply transfer pricing rules. The Manual is anticipated to be updated on a “rolling” basis. The next version is likely to address transfer pricing of intangibles and to deal in greater detail with the provision of services by one group entity (such as Head Office) to another.
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About Transfer Pricing/TESCM
We bring you a global perspective on transfer pricing and tax effective supply chain management (TESCM), based on our long-standing experience of what really works. We help you configure your supply chain effectively and design and implement sustainable transfer pricing policies. Our multi-skilled teams support you in implementing proactive, pragmatic and integrated strategies that address tax risks and help your business achieve its potential. It’s how Ernst & Young makes a difference.

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