The United Nations Practical Manual on Transfer Pricing for Developing Countries: a brief discussion of its origins, current state and future
The 2013 United Nations Practical Manual on Transfer Pricing for Developing Countries originated from discussions at the 2010 annual meeting of the UN Committee of Experts on International Cooperation in Tax Matters. At that annual meeting, it was recognized that the Commentary to Article 9 (regarding associated enterprises) of the UN Model Double Tax Convention between Developed and Developing Countries would benefit from an update. Considering the importance of transfer pricing and the increasing awareness of and concern regarding “mis-pricing,” it was also considered relevant to provide policy makers and administrators in developing countries with guidance on transfer pricing. As a result, a subcommittee was established with the mandate to prepare a Practical Manual on Transfer Pricing for Developing Countries (the Manual), which in particular would focus on practical issues and problem-solving rather than present a legislative framework. In essence, the Manual should try to address real transfer pricing issues for developing countries taking into consideration inevitable limitations that some developing country administrations have, as well as deficits in information and skills in those countries.

The mandate given to the subcommittee in charge of preparing the Manual clearly included adherence to the arm’s length principle, which is also embraced by the OECD in its Model Tax Convention and in the OECD Transfer Pricing Guidelines. There was never any intention to deviate from the arm’s length principle and introduce alternatives, such as formulary apportionment.

Furthermore, the subcommittee was instructed to include practical examples relevant to developing countries to the extent possible. Considering the strict mandate to adhere to the arm’s length principle, the subcommittee sought consistency with the OECD Transfer Pricing Guidelines, but, as technical issues were being discussed, it became quite clear that several developing country administrations encountered practical situations where the earlier version of the OECD Transfer Pricing Guidelines could be considered to not provide for sufficient recognition of the relevant facts as present in those countries or of their tax policies. Multinational enterprises conduct business in developing countries for a myriad of reasons, such as access to a client/customer base for end products, availability of a skilled labor force at a relatively lower cost than in developed countries and creating a generally lower cost operations base because of, for example, a less complex regulatory environment in that country. Furthermore, often business is conducted in developing countries to gain access to valuable natural resources and to mine and extract these resources. One could

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consider that the OECD Transfer Pricing Guidelines did not necessarily differentiate between these reasons and the impact they may have for the way business is conducted and could be valued.

The subcommittee discussed these situations at great length. Developing countries whose positions or practices were considered by the subcommittee members to be inconsistent with the arm’s length standard were requested to include their positions and practices in the descriptions given by them in the separate Country Chapter to the Manual. That Chapter allows developing countries to share their transfer pricing regimes in general as an illustration of how different administrations handle transfer pricing issues. For example, some country practices prescribe fixed margins to be applied with certain transfer pricing methods. Although there is undoubtedly a great practicality and predictability argument in favor of such an approach, if those fixed margins are not (regularly) benchmarked against unrelated party transactions and no flexibility exists for taxpayers to provide evidence that the fixed margin is not at arm’s length to opt out of the fixed margin, this approach does not qualify as being at arm’s length. In other situations, due regard was given to the developing country–specific issues raised, such as inclusion of the concept of location-specific advantages and location rent in the Comparability Chapter.

The first version of the Manual was issued in the spring of 2013. Since then, it has been used for capacity development training purposes in several countries, and efforts are being undertaken to translate the Manual in other languages, notably Spanish and French. Considering the short time within which the Manual was put together and the challenging international tax environment and changing opinions on transfer pricing, the Manual could greatly benefit from further work. Therefore, at its annual meeting in the fall of 2013, the UN Committee of Experts on International Cooperation in Tax Matters mandated the subcommittee, now reconstituted as the earlier mandate and subcommittee had expired, to update and enhance the Manual. Again, the mandate to the subcommittee explicitly included that the arm’s length principle be adhered to. The update included addressing intra-group services and management fees and intangibles, and, to the extent necessary and appropriate, considering the OECD/G20 Action Plan on Base Erosion and Profit Shifting.

During its work, the subcommittee discussed at great length different positions and interpretations and views on how to interpret transfer pricing principles as applicable to intra-group services, intangibles and cost contribution arrangements. The subcommittee’s mandate in particular emphasized that the update ought to reflect the realities for developing countries at their relevant stages of capacity development and that special attention should be paid to the experience of developing countries. This led inter alia to the recognition of the so-called sixth method, or commodity method related to commodity transactions, in the Methods Chapter of the Manual. The new addition does not endorse the sixth method as being an arm’s length method, but it describes the approach taken by several countries (many of them Latin American countries) and touches upon issues such as the anti-abuse nature of the sixth method, the risk of double taxation that it provides and what can be done to make the commodity method consistent with the arm’s length principle. Furthermore, the Dispute Resolution Chapter was aligned with the UN Committee of Experts’ efforts to enhance access to dispute resolution and arbitration. During the 2016 annual meeting of the UN Committee of Experts on International Cooperation in Tax Matters, the updated Manual was adopted.

Because of its mandate, the Manual discusses and emphasizes other aspects than the OECD Transfer Pricing Guidelines do. For example, benchmarking efforts are described in quite some detail in the Comparability Chapter, developing country transfer pricing practices are provided, and administrative issues, such as how a government might want to structure its transfer pricing units and audits, are touched upon. The Manual’s layout has also undergone a change. It is now divided into three parts: Part A includes substantive issues as they relate to transfer pricing, Part B has guidance on administrative issues and Part C has country experiences.
Besides being a valuable practical training tool and guide for developing country administrations, the Manual offers great benefits to transfer pricing practitioners as well, in allowing them to get a sense of and anticipate developing country issues and positions. Although it remains important to note that the Manual is not equivalent to nor purports to include transfer pricing legislation. The future of the Manual will be determined largely through its de facto usage. Each capacity development training session provides an opportunity to assess whether further guidance and examples are needed. But also, as the Manual is inherently linked to Article 9 of the UN Model Double Tax Convention between Developed and Developing Countries and to the extent the Commentary to Article 9 recognizes the Manual, its role is likely to remain a relevant one for anyone working in the field of transfer pricing with developing countries.

Detailed insights on this and more in the India Tax Insights (Issue 9)