



Article 9 of the UN Model Tax Convention

Rome, 30 January 2013

Michael Lennard

Chief, International Tax Cooperation Section

What is Transfer Pricing?

Associated
Enterprise

Unrelated
Enterprise

Transactions:
-Goods
-Services
-Intangibles
-Loans

Resident

Resident

**Transfer
Price**

**Arm's Length
Price**

What is Transfer Pricing?



What is Transfer Pricing?

- The Wind Group is the **parent company** in a wind turbine manufacturing group. The company has **two subsidiaries**:
 - **X-Parts**, which manufactures circuit boards for the turbines in State X, and
 - **Y-Turbines**, which produces and assembles the turbines in State Y.

Y-Turbines purchases the circuit boards from X-Parts at a transfer price set by the parent company.

(Based on example published in Gideon Benari, Tricky Tax: Two tax avoidance schemes explained, 2009.)

What is Transfer Pricing?

Wind Group

Tax-40%

Y-Turbines (Sub)

Payments

Tax-20%

X-Parts (Sub)

Circuit boards

Risks of Transfer Pricing?

- Profits may be “allocated” away from higher-tax countries to low

Looks to Arm's Length Pricing.

- Commentary explains the term as meaning a price based upon the “normal open market commercial basis”.
- Not always clear comparables – creates difficulties in application.
- Where do the costs of complexity fall?

What does Article 9 Say?

1. Where

a) an enterprise of a Contracting State **participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or**

b) **the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,**

What does Article 9 say about it?

... 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.**

Article 9(2)

- Provides for a **corresponding (downwards) adjustment** to profits made in a country where an upwards adjustment has been made under Article 9(1) by the other country.
- Seeks to eliminate the [economic] **double taxation** that would otherwise arise.
- Not always found in treaties.

Article 9(3)

- Says Article 9(2) does not apply if **judicial, administrative or other** - 31.98

The Commentary

- "3. With regard to transfer pricing of goods, technology, trademarks and services between associated enterprises and the methodologies which may be applied for determining correct prices where transfers have been made on other than arm's length terms, the Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines. These conclusions represent internationally agreed principles and the Group of Experts recommend that the Guidelines should be followed for the application of the arm's length principle which underlies the article."

Paragraph 3 of the UN Model Commentary

- **Now it:**
 - Puts that **statement in context** as one made by the **former** UN Group of Experts;
 - Notes that the issue has **not been fully considered by the current Committee;**
 - Refers to the public **records of Committee's Annual Sessions** for the debate so far; and

Paragraph 3 of the UN Model Commentary

- The records of the 2011 Annual Session of the Committee noted that the **recommendation may need to note that the Guidelines are for guidance only and some reservations expressed.**
- **Clear agreement on Arm's Length Standard.**
- **Made clear no change to direction of Practical UN Transfer Pricing Manual.**
- **Debate likely to begin again this year.**