Introduction

At the conclusion of discussions on the United Nations Practical Transfer Pricing Manual for Developing Countries at its eighth session in 2012, the Committee noted:[1]

> 20. The Subcommittee was thanked for its impressive efforts and, with its mandate met, it was dissolved. The Committee requested Mr. Sollund to work with the Secretariat in preparing the Manual for publication, including non-substantial editing and ensuring consistent terminology. It was agreed that comments addressing inconsistencies and errors would be received until 15 November 2012 but that matters of a substantial nature would not be considered for the first version of the Manual. Issues that could not be addressed at the present stage would be collected by Mr. Sollund until 30 June 2013 and included in a catalogue of items to be handed over to the new membership of the Committee for future discussion and possible inclusion in later editions.

2. As it happened, no suggestions for changes or additions of a substantial nature were proposed in correspondence to Mr. Sollund or the secretariat. There have at times been suggestions about the need to address issues such as intangibles and intra-group services, but these were issues that had already been considered by the Subcommittee on Transfer Pricing – Practical Aspects, and will be subject to decisions by any new subcommittee and the Committee. Paper E/C.18/2013/4 addresses such issues.

3. In view of the interest shown in the Manual since its publication, however, the attachment to this paper gives excerpts of the publicly available responses to the Manual. They are generally favourable, with particular interest shown in the Chapter 10 country positions. Sometimes concerns have been expressed about the possibility of a divergence of rules between the UN and OECD approaches, but the balanced approach taken by the Manual has generally been commented on favourably. The views are intended to be broadly representative of views since the time of the last Annual Session, but not comprehensive.

4. Of course the views reflected in the attachment should not be taken as necessarily reflecting Secretariat, Committee or Subcommittee views as to their accuracy or otherwise.

[1] E/2012/45 at paragraph 20.

ATTACHMENT: A SELECTION OF PUBLIC COMMENTS ON THE UN TRANSFER PRICING MANUAL

Examples of References to the Manual

US Council for International Business Letter on the Manual of 9 October 2012

Comments on the Transfer Pricing Manual[2]

Recognition of actual transactions undertaken. Taxpayer's transactions should be respected, absent exceptional circumstances. Restructuring legitimate business transactions is arbitrary and significantly increases the risk of double taxation. Paragraphs 5.3.1.2.1, 5.4.10.1, and 5.4.10.2 of the draft manual deal with this issue. These paragraphs are very similar to the OECD language on disregarding the transaction, with one extremely important difference. The OECD TPGs4 provide "there are two particular circumstances in which it may, exceptionally, be both appropriate and legitimate for a tax administration to consider disregarding the structure adopted by the taxpayer in entering into a controlled transaction." This language is generally seen as a limitation, that is, if neither of these circumstances existed it would not be appropriate to disregard the controlled transaction. Elimination of this language could be interpreted as a broadening of the ability to disregard the transaction as structured and therefore the language quoted above ought to be added to paragraphs 5.3.1.2.1 and 5.4.10.1 of the manual.

Intangibles. The Subcommittee concluded that they did not have time to adequately address issues relating to intangibles and therefore deferred work on that topic to the next revision of the manual.5 Nevertheless, the manual seems to reach conclusions on a number of key intangible transfer pricing issues; this is premature. In USCIB's view, paragraph 5.3.2.2.13 should be deleted. The issue of ownership of marketing intangibles is one that requires careful analysis and should be dealt with in the context of the overall review of intangibles. Similarly, paragraph 6.1.2.7 concludes that the party that "developed the intangibles should be able to obtain benefits from those intangibles". Identifying the developer of an intangible is not necessarily straightforward. Is the developer the person who funds the development, the person actually performing the functions, a participant in a cost contribution arrangement? This is a complex issue that ought to be considered in depth when the topic of intangibles is taken up. Therefore, the final sentence of section 6.1.2.7 ought to be deleted. Paragraph 6.3.17.3 provides that "this allocation is based on relative R&D expenses which are assumed to be a reliable key to measure the relative value of each company's intangible property." Again, valuation issues are complex and this conclusion ought not to be reached without a thorough analysis of the issues relating to intangible valuation. Thus, this sentence ought to be deleted.

Information requests. Chapter 8 covering Audits generally provides guidance that USCIB believes will be helpful to developing countries initiating transfer pricing audits. In the section on

[2] Note that, while these comments were before the Committee at the eighth annual session (e.g. E/2012/45 at para 17) they remain useful in giving one perspective of possible approaches for the second edition

information requests, however, the manual recommends requesting one item that we believe many taxpayers may not be able to provide. Paragraph 8.6.9, item 12 provides: "Group global consolidated basis (sic) profit and loss statement and ratio of taxpayer's sales towards group global sales for five years." It is not clear precisely what this requires. If global consolidated profit is determined based on the company's financial statements, then this information should be available for publicly traded companies. However, this number is unlikely to be useful for transfer pricing purposes since it does not bear any relationship to any particular transaction. As the manual points out in paragraph 8.6.6.2 the accurate review and assessment of financial results would be impossible without segmented profit and loss statements. This item needs to be either clarified or deleted.

Dispute resolution. USCIB believes that Chapter 9 contains a balanced discussion of dispute prevention, administrative remedies including APAs and MAP, arbitration and litigation. We have two concerns with the chapter. First, we believe that section 9.4.2 (Multilateral Agreements) ought to be deleted in its entirety. In our view, the only purpose of this section is to undercut the value of the OECD TPGs as the global standard in the area of transfer pricing. This is inconsistent with the mandate of the Subcommittee. The preface to the manual provides: "consistency with the OECD Transfer Guidelines 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." As the manual recognizes in a number of places, global consistency of transfer pricing rules and interpretations promotes cross border trade and investment. Global consistency therefore promotes foreign direct investment, which benefits developing countries. This section of the manual potentially undercuts consistency, serves no other useful purpose and thus ought to be deleted.

The manual contains a number of statements concerning the global transfer pricing policies of MNEs. Generally, the statements concerning global transfer pricing policies recognize the usefulness of such policies. However, two paragraphs (9.3.1.6. and 2.4.9) seem to misconstrue the role of global transfer pricing policies. Paragraph 9.3.1.6 provides: "Many multinational enterprises apply transfer pricing policies to their intercompany transactions on a consistent basis globally, so the absence of national legislation may not encourage compliance by an MNE." If the national legislation contains no rule, then it would neither encourage nor discourage compliance. However, since the MNE will apply its consistent global policy in any event, the absence of legislation does not, in this case, change the transfer pricing result. It would therefore be more accurate to say that the absence of legislation does not "discourage" compliance with the global transfer pricing policy.

Paragraph 2.4.9 provides:

> In principle, designing, implementing and documenting an appropriate transfer pricing policy should not be viewed solely as a compliance issue for MNEs. The main goal should be to develop a consistent global policy which cannot be altered to exploit tax laws. A well developed and consistently applied transfer pricing policy should reduce an MNE's risk of transfer pricing adjustments and the potential for double taxation, thereby increasing profitability by minimizing transfer pricing costs. Moreover, a global transfer pricing policy may be used as evidence in negotiations with tax authorities when transfer pricing disputes occur.

The main goal of MNEs in “designing, implementing and documenting an **appropriate** transfer pricing policy” probably is compliance. The main goal of governments in encouraging the adoption of such policies may be the development of a policy that “cannot be altered to exploit the tax laws”. MNEs want governments to respect their global policies. If governments want them to be unalterable, so that they cannot be used to exploit tax laws, then governments should have to respect global policies absent some clear abuse (in which case the policies would likely not be appropriate). Governments cannot require taxpayers to comply with their global policies, but feel free to reject prices computed under such policies merely to bring more revenue into their jurisdiction.

China Formally Announces its Transfer Pricing Policy

PricewaterhouseCoopers

October 2012

The State Administration of Taxation ("SAT") has announced its position on transfer pricing practices in China with the release of its paper, China Country Practices ("the paper"). The paper forms part of Chapter 10 on Country Practices in the United Nations’ Practical Manual on Transfer Pricing for Developing Countries ("UN Transfer Pricing Manual").

The paper marks a significant development as it represents the SAT’s views and practices on a number of transfer pricing challenges faced by China, as a developing country, which are not addressed by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Transfer Pricing Guidelines").

China’s Chapter of U.N. Manual Advocates Reimbursement for Location Savings, Added Profit for Local Intangibles

Bloomberg BNA Tax Management Transfer Pricing Report

(Kevin A Bell)

15 November 2012

U.N. Manual

[Sébastien Gonnet of NERA Economic Consulting in Beijing] said many foreign companies are setting up R&D centers in China—not for the purposes of providing services to the U.S. or German parent, ‘‘but to get closer to the market to develop products that will be more acceptable in the region.’’

Previously, the concept of location savings related only to the issue of cost, Gonnett said, but taxpayers now must address the issue of location-specific advantages, because the SAT believes that taxpayers benefit not only from China’s cost advantage but also from its large market.

United Nations approves Manual addressing transfer pricing in developing countries

DLA Piper

(Ray H. Brown
Oscar Burakoff
Tim Carreon)

28 November 2012

Compliance with transfer pricing rules, while difficult in many countries, has proven to be especially challenging in certain developing countries, such as Brazil, China and India. Historically, some developing countries have (i) issued unique rules that are often inconsistent with global standards, (ii) instituted burdensome compliance requirements (e.g., central bank registration) and (iii) applied their own rules inconsistently.

As a result, taxpayers have found it extremely difficult and costly to implement, document and defend transfer pricing policies in these countries. For example, such policies mean taxpayers face more extensive audits and more frequent litigation. In addition, dramatic variations across jurisdictions mean taxpayers have often

Audits and risk assessment

Dispute avoidance and resolution and

Country practices

Insights on Transfer Pricing Issues with "Unique Chinese Characteristics"

Grant Thornton

China Transfer Pricing Alert, 8 December 2012

…In recent years, the SAT has obtained an important position on the global stage of international anti-tax avoidance. The announcement of the "China Country Practices" as part of "Practical Manual on Transfer Pricing for Developing Countries" (draft version) by the UN indicates a great leap in the TP administration of the SAT. Meanwhile, this initiative broadcasts the TP issues with Chinese characteristics to a wider audience. …

United Nations Practical Manual on Transfer Pricing

ITAT Online (India)

3 June 2013

The United Nations has released a publication titled "

formulas when applying arm's length pricing profit methods….[Monique van Herksen of Ernst & Young] explained the potential benefit to developing country tax administrations in making use of presumptive margins and safe harbours in relevant circumstances. Additionally, she mentioned as an idea to be considered that the United Nations, in an appropriate form, might issue temporary industry margins based on research and statistics to be

and even fought by other large developing countries, who didn't see why Brazil should get a chapter all of its own. Certainly it seems inconsistent with the way the subgroup interpreted its mandate (see 2 above).

Whoever opposed the Brazilian chapter may instead have created a monster in chapter 10. It's probably the only detailed descrip

[*UN Transfer Pricing Manual: what Brazil, India and China do Differently*]

Martin Hearson (blog)

6 June 2013

‘Country Practices’. The title of Chapter 10 of the new United Nations Practical Manual on Transfer Pricing [pdf] doesn’t exactly set the pulse racing. But

Brazil's Resale Price Method is similar, except that rather than looking for a comparable, you apply a fixed margin of (usually) 20% to the actual price at which the minerals were sold on to third parties. In other words, the transfer price from Brazil to Bermuda would be 80% of the resale price from Bermuda to a third party. Last year Brazil made its method a bit more fine-grained, by setting out different margins for different sectors, based on data about each sector.

The Brazilian section of Chapter 10 argues that this method is easier to apply and provides more certainty than the OECD approach. It acknowledges that the approach may create double taxation because it's not compatible with other countries that use the OECD methods, and that, "it is unavoidable that some Brazilian enterprises will be taxed at (higher or lower) profit margins not compatible with their profitability."

China, India and South Africa

"As a developing country, China faces a number of difficult challenges, to many of which ready answers have not been found from the OECD guidelines," notes the Chinese section of Chapter 10, written by two senior tax officials. South Africa's submission concurs:

Whilst the OECD Guidelines have been particularly useful in providing a conceptual understanding of what is the nature of the arm's length principle, there are instances when the Guidelines fail to address the more practical aspects of how to apply the principle

According to all three of these countries, the difficulty is with how to implement the arm's length principle. And their sections of the manual set out many practical problems with implementation. But I think that there's something more than that at stake here. These countries (or at least India and China) want to claw back a larger share of the tax base, which is about changing the apportionment between themselves and other countries. They may argue that their position is a more accurate implementation of the arm's length principle, but to do so is to understate what they're trying to achieve. Below are three examples.

Location specific advantages

The premise of the Location Specific Advantage (LSA) approach is that investments by multinational companies in these countries are more profitable than those in other countries, as a result of LSAs such as a cheap, comparatively skilled labour force, a large, relatively untapped consumer market, and more lax environmental legislation. This needs to be take into account when identifying and using comparables that do not have these same advantages.

To determine the transfer price by reference to a comparable transaction or company in another country, "China takes the view that there may be instances where the differences in geographical markets are so material that it warrants comparability adjustments to bridge the differences." In other words, China revises up the profit made by Chinese subsidiaries, and hence the tax charge, when comparing them to other countries, because it thinks the LSAs it offers make investments in China more profitable than those in other countries.

South Africa says it shares this concern:

> There are many instances where unique dynamics exist within the South African market enabling South African subsidiaries to realise higher profits than their related party

> counterparts in other parts of the world, or than are evidenced by comparable data obtained from foreign databases…Building on the practice followed in India and China, the SARS is currently considering its approach to location savings, location specific advantages and market premiums etc. within certain industries and such factors will be addressed when conducting audits.

The Indian section also discusses location specific advantages. Its argument, however, relates to whether local comparables, as well as foreign ones, are valid. Although the chapter doesn't say this, I think India's argument is also that the arm's length principle doesn't work here, because there is no arm's length scenario that captures the location specific advantages:

Hypothetically, if an unrelated third party had to compensate another party to the transaction in a low-cost jurisdiction by an amount that was equal to the cost savings and location rents attributable to the location, there would be no incentive for the unrelated third party to relocate business to a low-cost jurisdiction.

What makes the LSA concept interesting is not merely that these countries are laying claim to a larger share of MNCs' tax base than the OECD guidelines attribute to it. They are saying, quite explicitly in China's case, that under free market ("arm's length") conditions, they don't receive a fair share of the profits from inward investment, because the LSAs aren't fairly priced by the market. China is using the tax system to correct for what it sees as unfair conditions in the global economy.

Below is a presentation by another Chinese official at a Tax Justice Network conference last year. Scroll through to slide 20 for the part on LSAs.

Intangibles

Transfer pricing is supposed to start from a 'functional analysis' that takes into account functions, assets and risks to determine how profit should be allocated. But intangible assets (and risks, see below) can be more easily moved than functions and tangible assets. China and India are concerned that multinationals tend to characterise subsidiaries in their economies as exploiting foreign-owned intellectual property, on which they must pay royalties, in order to deflate the profits made there.

For example, China takes the view that the value of a marketing intangible (such as a brand name) is inextricably linked to the market in which it is sold. In a memorable example, Head & Shoulders is a popular shampoo in China, and a foreign brand. But when it first arrived on the Chinese market, most consumers didn't know what the words "Head and Shoulders" meant. "Over time," says the manual, "the local Chinese affiliates acquire the skill and experience from operations in China, and may even contribute to the improvement of the MNE's original intangibles. The issue in this scenario is whether the local Chinese affiliates should be entitled to additional profit, and if so, what is the appropriate method to calculate the additional profit?"

The Indian approach is similar:

> Indian subsidiaries/related parties (which are claimed as no risk and limited risk bearing distributors by the parent MNE in order to justify low cost plus return) have

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[*The Impact of Nigeria's New Transfer Pricing Rules on Multinational Enterprises*]

PWC Nigeria

(Taiwo Oyedele, Anthony Curtis, Elizabeth Sweigart and Robert Smallwood)

March 2013

"… Over the last several years, Nigeria has worked to develop its own transfer pricing rules based on the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) and the commentary surrounding the creation of the UN Transfer Pricing Manual (UN Manual) which was formally approved in October 2012. The FIRS released the draft transfer pricing rules in May 2012, and the final rules in September 2012, as The Income Tax (Transfer Pricing) Regulations No. 1, 2012 (The Regulations)."

R&D centres and Transfer pricing – The latest controversy

Rajendra Nayak Ernst and Young, India

Undated

...The administrative position of the Indian tax authorities is also asserted in the India chapter of the United Nations Practice Manual on transfer pricing issues for developing countries (UN TP Manual). The India chapter states that during transfer pricing audits the Indian revenue officers often find that the India-based R&D centers perform sophisticated and value-added activities which not only require significant investment in the physical infrastructure but also require the Indian entity to attract, train and retain highly skilled personnel. In cases where the India-based R&D centre was found to be engaged in the creation of unique intangibles, the India transfer pricing administration has allocated additional compensation for transfer of intangibles in addition to the arm's length compensation for the R&D activities, as it believes that risk lies with the Indian entity.

The Indian transfer pricing administration explicitly does not agree with the notion that risk can be controlled remotely by (employees operating out of) the parent company and that the Indian entity engaged in core functions, such as carrying R&D activities or providing services can be risk free entities. According to the India Country specific chapter, the Indian revenue administration believes that core R&D functions which are located in India require important strategic decisions by management and employees of the Indian subsidiary and accordingly the Indian subsidiary exercises control over operational and other risks. In this context, allocation of routine cost plus return will not reflect a true arm's length price (ALP) for the services rendered.

Other Coverage

The Manual has also received wide coverage in specialist journals. In an editorial to the Indian Journal International Tax Review, it was noted, inter alia that:

> UN Manual provides no detailed guidance on cost contribution agreements, business restructuring and dispute resolution tools like APA on which OECD TPG contains detailed chapters. I hope those may be covered in later updates.
>
> The searching of relevant topic in the Manual is slightly difficult as no detailed contents are given in the beginning.

While the published version has an index at the front, it is hoped by the secretariat that a more detailed index of particular concepts can be included at the back of the next version.

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