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Update of the United Nations Practical Manual on Transfer Pricing for Developing Countries

particular transaction is a part of a broader arrangement in respect of a business length consideration for that transaction requires that all ~~of~~ the circumstances relevant to the broader arrangement are taken into account in evaluating the comparability factors that might reasonably apply under an agreement between independent parties

B.7.1.9.~~11.~~ In the absence of reliable uncontrolled comparable data~~,~~ an assessment has to be made of the consistency of the conditions of the controlled transaction with those that might reasonably be expected under an agreement between independent

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B.7.1.10.~~15.~~ The above mentioned process with respect to the implementation s the need for developing countries ~~of being~~to be alert to business restructurings and their potential consequences. As already stated in other parts of this manual, while it is for each country to determine its own tax system, the desire to avoid double taxation has been an important factor in the very

~~1.3.~~ Process for setting or testing the arm's length principle in business restructuring operations

B.7.1.11.~~16.~~ This paragraph describes a typical process which may be followed when setting or reviewing transfer prices in the context of a business restructuring. This process is neither prescriptive nor exhaustive

B.7.1.12.~~16.~~ As a first step, it is important to characterize the transactions entered into by the associated enterprises, taking into account the business environment in which the MNE group ~~at stake~~ is operating. This entails carrying out the following activities:

I. identification of the scope, type (e.g. supply of goods, provision of services, licensing arrangements) and economic nature of the arrangements0 0 1Θ4etween im imot5-41(int)6(o)6( )]T into3(t5-41inv3(ri)5(zlvn)-3( )]TET5-

certain intangible property and those evidencing the terms and conditions of the pre and post-restructuring arrangements for the business activities affected by the restructuring) as well as an examination of risk assumed and functions performed by the associated enterprises;

III. Examination of the consistency of the contractual terms with the outcome of the functional analysis of the associated enterprises taking part ~~to~~in the business restructuring, in order to determine the true nature of the transactions, including ~~its~~the legal, economic and tax effects thereof. It should not be automatically assumed that the contracts, though they are the starting point of any transfer pricing analysis, accurately or comprehensively ~~always~~ capture the actual commercial or financial relations between the parties. The core part of such an examination is the performance of a thorough functional analysis, which is needed to identify the value-adding activities and functions performed, assets used and risk assumed in respect of the business activities affected by the restructuring;

B.7.1.13.~~17.~~ The selection of the most appropriate method or methodologies applicable to the transaction(s) at stake follows from the functional analysis. As discussed in more ~~in~~ detail below, a business restructuring is commonly implemented through a series of intertwined transactions. For instance, a business restructuring might involve transferring functions, assets and risks to a tax favorable location. This should not of itself warrant the conclusion that a non-
been implemented. ~~.~~

B.7.1.14. ~~18.~~ Provided the pricing of the business restructuring itself and of the post-restructuring arrangements are consistent with what would occur under an agreement between independent parties ~~-~~in comparable circumstances~~,~~
length principle and its requirements ~~thereof~~ are met.

B.7.1.15.~~19.~~ For example, an associated enterprise may transfer the ownership of an intangible asset to its foreign principal and also agree to enter into a licensing agreement with ~~the latter~~that company.~~.~~ In determining whether the transfer of ~~a~~that the
transaction ~~that~~ is part of a broader business restructuring arrangement, comparability needs to be assessed.

B.7.1.16.~~21.~~ In practical terms, in many instances relevant ~~-~~third party data are not available as the types of business restructurings commonly taking place tend to be unique to the various business models existing within MNE groups. However, the lack of reliable third party data should not lead the tax authorities to automatically conclude commercial advantages to the enterprise are expected from contracting out vis-à-vis performing the activity by itself. These expected commercial advantages ~~-~~may relate to cost reduction and/or retaining or increasing profits.

B.7.1.20.~~25.~~ When restructuring, an MNE may undertake a ~~–~~cost-benefit analysis. Should such an analysis exist and be documented~~,~~ it may be helpful (as well as any other financial and commercial data relevant to the restructuring) to determine the existence of the underlying commercial rationale triggering the restructuring.

B.7.1.21.26. An MNE Tm]d]T1.02 64.08 0.48 BT1 0 0 1 263.57 684.7 Tmf413(NE)-10( )-41

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A key question is whether a transfer of functions, assets and/or risks conveys value and would

~~2.1.2.~~ *Termination or substantial renegotiation of existing arrangements*

B.7.2.11.~~45.~~ In the case of a contract termination or substantial renegotiation, it should be determined whether an indemnity payment may be warranted under the arm's length principle. epending on the applicable commercial law of the country concerned, an indemnity payment may be warranted, for instance in the event a party withdraws from– a contract in an unjustified and unforeseeable manner. Depending on the applicable commercial law, such an indemnification may for instance encompass the loss of future expected profitability. There is a wide variety of elements that may be taken into account by commercial judges in determining whether a termination period indemnification should be applied, for instance the nature and terms of the contractual arrangements and/or the economic dependence of one party on another.

B.7.2.12.~~46.~~ Therefore, in the event a contract between associated enterprises includes a termination clause (and assuming the terms and conditions set out in it are followed upon termination), it should be determined whether such terms and conditions .

B.7.2.13.~~47.~~ From a transfer pricing standpoint, another relevant factor relates to the opportunities the terminated party will be granted to obtain alternative business opportunities. That is, there may be a commercial counterpart to the business restructuring. This appears specifically relevant in the context of a cross border business restructuring, as it is frequent in practice that in a group context the affected party having its contract terminated (or substantially renegotiated) will be entering into a different agreement with the same or another affiliate within the group. Tax administrations should examine the entirety of the commercial arrangements to

~~2.2.~~ Operational Considerations on the Transfer Pricing Aspects of a Business Restructuring: Example

B.7.2.14.~~49.~~ The following example illustrates the application of the approach to business restructurings as outlined above. The example summarises the indicative issues which might arise in addressing
any specific business restructuring arrangement.

B.7.2.15.~~50.~~ OpCo is a taxpayer resident in Country A operating a full fledged manufacturing and distribution activity of chemical components. Based on the contractual arrangements existing at the group level, OpCo has the following rights and responsibilities:

(i) OpCo owns or holds licensing rights over all the intangibles (such as patents, trademarks, and a manufacturing planning know-how) it needs to operate its manufacturing and distribution activities;

(ii) OpCo is responsible for arranging the procurement of all raw materials (including selection of suppliers and qualification of raw materials);

(iii) OpCo owns the inventories of raw materials, work-in-process and finished goods, assumes related inventory risk and actually performs the risk management control functions;

(iv) OpCo manages and controls the production planning, sets~~ting~~ the output budget and determines the milestones within the supply chain process;

(v) OpCo sells the finished goods to third party customers in its market and to associated enterprises acting as distributors in foreign markets.

(vi) ~~OpCo manages and controls the production planning, setting the output budget and determines the milestones within the supply chain process;~~

(vii) ~~OpCo sells the finished goods to third party customers in its market and to associated enterprises acting as distributors in foreign markets.~~

B.7.2.16.

B.7.2.18.~~53.~~ In particular, the implementation of the business restructuring arrangements requires the implementation of the following steps:

(i) OpCo transfers to Principal Co by means of an outright sale arrangement ~~to Principal Co~~ all the intangibles rights that it owned in relation~~respect~~ to the products. All the

B.7.2.19.~~54.~~ A suggested approach for a tax official of a developing country auditing