Transfer Pricing

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Transfer Pricing

- Transfer pricing refers to the setting of prices for cross-border transactions between related parties (i.e. entities that belong to the same multinational group)
- Transfer pricing is a normal aspect of the way in which multinational groups operate, as they need to allocate values to intra-group transactions to asses which parts of the group are profitable or not
- Intra-group transactions are normally subject to a combination of market and group driven forces, which can differ from the open market conditions operating between independent entities
- Even though transfer pricing does not necessarily involve tax avoidance, there is a risk that prices declared for intra-group transactions do not reflect their real economic value (“transfer mis-pricing”)

Transfer Pricing and Financing for Development

- Domestic resource mobilization aspect
  - In case of transfer mis-pricing, less income (or more expenses) might be reported in a country, where in fact more income (or fewer expenses) should be reported
  - This would result in fewer profits taxable in that country and therefore fewer taxes paid to that government, which would otherwise be available for financing development
- Foreign direct investment aspect
  - There is a risk that if one country adjusts the pricing of an intra-group transaction so as to increase profits made and taxable in that country, another country will not decrease its calculation of the profits made and taxable in that country by making a corresponding adjustment
  - In such a case, part of the profits may be taxed twice, with a possible discouragement of investment that can in itself hinder development

- The “arm’s length principle” is the guiding principle to determine transfer prices, which is embodied in Article 9 of both the UN and the OECD Model Convention
- Under this principle, intra-group transactions have to be compared to transactions between unrelated parties under comparable circumstances to determine acceptable transfer prices
- Practical application of the arm’s length principle may be very complex, especially for developing countries, due to:

UN Practical Manual on Transfer Pricing

- The UN Practical Manual on Transfer Pricing for Developing Countries was first adopted by the UN Committee of Experts in 2012

- Response to the need, often expressed by developing countries, for clearer guidance on the policy and administrative aspects of applying transfer pricing analysis to cross-border transactions between related parties

Subcommittee on Article 9 (Associated Enterprises): Transfer Pricing

- Revision of the Commentary on Article 9 of the UN Model Convention
- Update and enhancement of the UN Practical Manual on Transfer Pricing, based on the following principles:
  - Reflect the operation and provisions of Article 9 of the UN Model Convention and relevant Commentaries
  - Reflect the realities of developing countries, at their relevant stages of capacity development
  - Pay special attention to the experience of developing countries
  - Draw upon the work being done in other fora

Update of the UN Practical Manual on Transfer Pricing

- Revised format and rearrangement of some parts of the Manual for clarity and ease of understanding
  - Part A relates to transfer pricing in a global environment
  - Part B contains guidance on design principles and policy considerations
  - Part C addresses practical implementation of a transfer pricing regime in developing countries
  - Part D contains country practices, similarly to Chapter 10 of the previous edition of the Manual

Update of the UN Practical Manual on Transfer Pricing (cont'd)

- New chapter on intra-group services
- New chapter on cost contribution arrangements
- New chapter on the treatment of intangibles
- Significant updating of other chapters, taking into account other global issues such as the relevant parts of the outputs of the G20/OECD action plan on BEPS