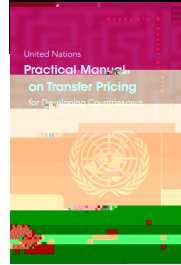UN-ATAF Workshop on Transfer Pricing
Administrative Aspects and Recent Developments
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United Nations
**Practical Manual
on Transfer Pricing**
for Developing Countries

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Company # manufactures automobiles in $apan that are ultimately to
be sold to customers in %ermany.

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(Transfer pricing is the general term for the pricing of cross**)**border* intra**)**firm transactions bet**+**een related parties& Transfer pricing **,** refers to the setting of prices for transactions bet**+**een associated enterprises involving the transfer of property or services&-

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Cross-border

Transactions

(etween ‹related= parties or ‹associated enterprises=

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Aetermine the proper prices for transactions between associated enterprises&

@ake sure that the resulting allocation of income between ta:ing ʝurisdictions reflects the underlying economic acti ity&

8each cross border agreements on proper pricing among the ta:payer and the affected countries&

oid double ta:ation&

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The Arm s Length Principle

*"

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>tated most simply' the arm's length principle re9uires the prices and other conditions of transactions between associated enterprises 0related parties2 to be the same as the prices and other conditions that would be established in comparable transactions between independent enterprises 0unrelated parties2&

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The rationale for the arm's length principle is that because markets go ern transactions between unrelated parties' determination of prices for related party transactions on the basis of the prices charged or margins earned in comparable unrelated party transactions will assure a market based allocation of income between the related parties&

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APPLYING THE ARM'S LENGTH PRINCIPLE

Transfer pricing under the arm's length principle is based on comparing controlled transactions to uncontrolled transactions.

There are three key steps in a transfer pricing analysis:

- Get the relevant facts – functional analysis;

- Identify useful comparable transactions or relationships – comparability analysis;

- Select and apply the most appropriate transfer pricing method.

FUNCTIONAL ANALYSIS

A functional analysis is the process used to assemble the economically relevant facts for a transfer pricing analysis.

Key elements of the functional analysis may include:

Understanding the overall process by which the MNE creates value and the key factors contributing to value creation in its global business.

Identifying the relevant cross border transactions between associated enterprises.

Identifying the specific terms of those transactions by reference to written contracts and the actual conduct of the parties.

Identifying specifically the functions performed, assets used, and risks assumed by each of the parties in relation to the identified transactions – Accurately Delineating the Transaction.

SOURCES OF INFORMATION ON TAXPAYER TRANSACTIONS

Written contracts, invoices, payments, etc.

Conduct of parties

What did they actually do

Was it consistent with the contracts

Are there activities undertaken or risks assumed not covered by the contracts

Are functions assigned to a party under the contract which that party lacks the capability to perform

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COMPARABLES

Application of the arm's length principle is usually based on a comparison of the conditions of a controlled transaction with the conditions of transactions between independent enterprises

The comparison is only useful if the economically relevant circumstances of the controlled and uncontrolled transactions being compared are sufficiently similar, i.e. if they are in fact comparable

To be comparable means that none of the differences between the situations being compared could materially affect the price for the transaction, or if material differences do exist, reasonably accurate adjustments can be made to eliminate the effect of such differences on prices.

COMPARABILITY FACTORS

The rele ant factors to consider in e aluating comparability include:

- characteristics of the goods or ser ices in question
- comparability of the functions performed by each of the parties
- terms of the transactions being compared
- nature and of the risks assumed by each of the parties
- economic circumstances of the parties
- business strategies followed by the parties

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COMPARABILITY ADJUSTMENTS

?n some situations comparability adjustments should be considered in order to impro e the reliability of the transfer pricing analysis

Comparability adjustments should be considered only if the adjustment will increase the reliability of the results

Aepending on the transfer pricing method being used' common comparability adjustments include adjustments for financing costs' payment terms' and specific differences in other contract terms 0e&g& deli ery' freight' etc&2

#djustments for country and market differences' currency e:change mo ements' different le els of risk' purchase olumes' and similar items can be far more difficult to calculate on a reliable basis

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TRANSFER PRICING METHODS

Transfer pricing methods are used to determine appropriate transfer prices and pro e . 659 (a) - 4 (n) - 4 (s) -6 . 66667 (f) a$. 716 t071 830 cmf/R37 DofQfe ethos tprn (t) -2 (r) -0 ( )278 . 001] To (a) - 4 (r) -0 . 659 (e) - 4 ( )

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REVIEW OF NINE STEP PROCESS FOR CONDUCTING A TRANSFER PRICING ANALYSIS

1. Determine years covered
2. Broad analysis of taxpayer's circumstances
3. Understand the controlled transactions
4. Review existing internal comparables, if any
5. Identify sources of possible external comparables
6. Select the most appropriate transfer pricing method
7. Identify potential comparables
8. Make comparability adjustments if necessary
9. Interpret relevant data and determine arm's length prices

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PRINCIPLE, REVIEWER

Transfer pricing is not a science – there may not be a single correct arm's length price for a specific transactions.

Instead, there will often be a range of reasonable arm's length

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DOMESTIC LEGISLATION

- Many countries have enacted domestic transfer pricing rules
- In most countries transfer pricing rules are based on the arm's length principle
- Domestic transfer pricing law varies
  - The transfer pricing law may be included in legislation, or
  - The legislation may express the main principles with definitions and examples included in subordinate legislation such as regulations

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"& Comparability Toolkit
-& ?ntra-group >er ices
6& Transactions ?n ol ing ?ntangibles
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;& Establishing T7 Capability in Ae eloping Countries
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