

TRANSFER PRICING FOR DEVELOPING COUNTRIES



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Outline

- Developing countries' need for transfer pricing rules
- What should be considered when developing countries adopt transfer pricing rules?
- Difficulties in implementing transfer pricing rules
- Workable system of transfer pricing for developing countries
- How to assist developing countries' capacity building

Developing Countries' Need for Transfer Pricing Rules

Integration with the global economy

=> more capital flows to developing countries (DCs)

=> more intra-group transactions

=> Increase risk of losing revenue owing to multinational enterprises (MNEs)' transfer pricing (TP) and other schemes + internal TP with an entity enjoying tax holidays

 Many DCs adopted TP rules

What Should be Considered when Developing Countries Adopt Transfer Pricing Rules (1)

- Need to avoid economic double taxation
⇒ TP rules should be in line with internationally agreed principles,
i.e., Arms' Length Principle (ALP)?
- OECD Transfer Pricing Guidelines (TPG)
(1979, 1995, and 2010)
- OECD Model Tax Convention
- UN Model Tax Convention
- UN Transfer Pricing Manual (Draft)

Arm's Length Principle

where “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”.

- Art. 9 of the OECD Model Tax Convention

What Should be Considered when Developing Countries Adopt Transfer Pricing Rules (2)

- Need to review the whole tax regime

⇒ Streamline tax incentives

Otherwise, no revenue increase owing to “domestic TP”

- Need to establish workable dispute resolution mechanism

Difficulties in Implementing Transfer Pricing Rules

- Cannot make a TP adjustment
 - Little/no expertise on transfer pricing
 - Scarce public data on comparables
- Making too aggressive an assessment
 - lack of proper internal review mechanism
 - lack of workable dispute resolution mechanism

Beer Brewery Company Case

An NGO accuses a multinational beer brewery company (B Co) of not paying their fair share of tax to African countries by:

- Registering trademarks for its African brand in Europe (B Co's African subsidiaries pay royalties to B Co's European affiliate.);
- Charging management fees to its African subsidiary which had been in business for many years before acquired by B Co;
- Not sharing the benefits obtained by a centralized procurement center for the group with its African subsidiaries;
- Thinly capitalizing its African subsidiary

The real problem is capacity constraints in tax administration to detect the schemes and apply TP rules.

(based on information published by Action Aid)

Workable System of Transfer Pricing for Developing Countries (1)

Application of ALP

- Need for special guidance tailored to DCs
 - How to complement scarce public data
 - need for changing disclosure (financial reporting) rule ?
 - Geographical adjustment
 - Location savings
 - Non competitive business arrangement
 - Risk stripping
 - e.g. Contract manufacturer, Commissionaire
 - Safe harbor rules
 - Documentation

=> Could be provided by OECD or UN or

Workable System of Transfer Pricing for Developing Countries (2)

■ Tax administration

- TP section in Large Taxpayer Office (LTO)
 - LTOs need experience in auditing international transactions
- TP audit team consisting of lawyers, economists, accountants, and engineers
- TP section should have information for analyzing TP risk, e.g., tax returns' attachments
- HQ control of all TP cases
- Stepwise enforcement

Workable System of Transfer Pricing for Developing Countries (3)

■ Dispute resolution

- Why economic double taxation should be avoided (of course, non-taxation should be avoided, too)
 - What aggressive TP enforcement brings to DCs
 - Does domestic dispute resolution system fit TP?
 - Mutual agreement procedure (MAP)
 - =most reliable and practical measure to solve economic double taxation
 - but need to have DTAs and “competent” competent authority staff
 - If no agreement in MAP=> arbitration
- How to solve a TP case involving non-treaty partners

Workable System of Transfer Pricing for Developing Countries (4)

- **Advance Pricing Agreement (APA)**
- APA is more reliable, less adversarial way to avoid (prevent) economic double taxation
- But time-consuming and expensive
- Risk of crowding out limited resource of TP experts?
- Unilateral APA= a viable option?
- Role of tax practitioners (they may disseminate TP rules, but may increase tax compliance costs)

How to Assist Developing Countries' Capacity Building for Transfer Pricing

- Workshops/Conferences (need to reflect DC's need and views to “internationally agreed principles”)
- Technical assistance
 - Training courses (medium term, sustainable)
 - Tailored country advice (preferable if provided in conjunction with the whole tax system or tax administration)

References

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THANK YOU