

Day 5, Session 2

TP in Developing and Emerging Economies



Melinda Brown

Senior Tax Advisor, CTPA



Exploitation rights:

The right to access this presentation is limited to participants of the Advanced TP Course (General Topics) on April 15-19, 2024 only. The use of this presentation is no longer permitted after May 19, 2024.



Advanced Transfer Pricing Course (General Topics), April 15-19, 2024

Institute for Austrian and International Tax Law • www.wu.ac.at/taxlaw



Agenda

- I. Inclusive Framework on BEPS
- II. UN guidance including Practical Manual on Transfer Pricing for Developing Countries
- III. Other guidance, including Platform for Collaboration on Tax – Toolkits for developing countries
- IV. Selected TP issues
- V. The future



Section I

Inclusive Framework on BEPS

WU

WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS



Institute for Austrian and International Tax Law | www.wu.ac.at/taxlaw



Inclusive Framework on BEPS

- Inclusion on an equal footing of non-OECD, non-G20 countries and jurisdictions which commit to implement the BEPS project
- Currently 145 members
 - Half are non-OECD, non-G20 developing and emerging economies
- Focus on implementation of original BEPS measures...
 - Support for developing countries – capacity building, bespoke induction programmes
 - Review of minimum standard peer review mechanisms
- ...And the Two-Pillar Solution to address the tax challenges of digitalisation/ introduce global minimum tax



Section II

UN TP Guidance

WU

WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS



Institute for Austrian and International Tax Law | www.wu.ac.at/taxlaw



UN Practical Manual on TP for Developing Countries

- A product of the UN Committee of Experts on International Cooperation in Tax Matters
- To assist developing countries to apply the arm's length principle to TP issues
 - Broad support for the arm's length principle globally
 - Impacts on double taxation, tax certainty and investment climate
 - Associated Enterprises article of UN Model is identical to OECD Model
 - Consistent with OECD TP Guidelines
 - Focus on practical application by lower capacity countries
 - Third edition 2021 – broadly consistent with OECD TPG



- Main changes in the 3rd edition (2021) of UN Practical Manual on Transfer Pricing
 - New chapter on financial transactions (loans, guarantees)
 - New guidance on procurement, marketing hubs
 - Updates on profit split, lack of comparables
 - Consolidate and edit to improve clarity and consistency
- Transfer Pricing and Extractives
 - UN Handbook launched in May 2018, revised edition 2021
 - Extractives value chains
 - Chapter on TP

- Mandate and work programme from 2022
 - Dealing with Covid/ economic downturns - completed
 - Toolkit for TP compliance assurance (risk assessment, audit) - completed
 - Transfer pricing and CO₂ certificates - completed
 - Industry-based guidance:
 - selected primary agricultural products (coffee, soybeans)
 - pharmaceuticals
 - Dispute avoidance/ resolution

Transfer pricing during the Covid downturn

- Arm's length principle is unchanged
- Need to evaluate specific impact on the controlled transactions
- Specific issues:
 - One-sided vs two-sided methods
 - Comparables
 - Treatment of exceptional costs
 - Limited risk entities and loss-making
- Dispute prevention and resolution
 - Documentation
 - APAs



Compliance assurance toolkit

- End-to-end compliance assurance
 - Objectives
 - Options
 - Developing an end-to-end compliance assurance programme
 - From education → population screening → risk assessment → compliance enforcement → case resolution → continuous improvement
- Risk assessment
 - Example road map: the risk assessment process, evaluating risks
 - Sources of data, risk flags
- Transfer pricing audit
 - Example road map: the audit process
 - Setting up a team → information gathering and analysis → audit conclusion



Transfer pricing of carbon offsets and credits

- Regulatory frameworks
 - Emissions trading schemes
- Project value chain analysis
 - Examples of carbon offset schemes
- Transfers of carbon credits



Industry guidance: Agricultural products

- Overview of the industry
- Typical activities within the global value chains
- Common issues, e.g.
 - hedging
 - pricing dates
 - use of hub structures
 - commoditisation
 - environmental regulation
 - IP rights
- Examples
 - Coffee
 - Soybeans



Industry guidance: Pharmaceuticals

- Industry segments
- Global value chain and typical activities
 - R&D
 - Manufacturing
 - Marketing
 - Distribution
 - Regulatory affairs
- Value drivers and business models
- Examples



Bilateral APAs – FAQs

- Policy choices: advantages/ disadvantages, options
- Legal frameworks
- Organisation of an APA function
- Procedures and processes



Other TP Guidance

- World Bank Group, “Transfer pricing and developing economies: A handbook for policy makers and practitioners”
 - Drafting policies / legislation
 - Practical application of ALP
 - Compliance and administrative issues
 - Resolving disputes
 - Developing an audit programme



Section III

Other Practical Guidance – Toolkits

WU

WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS



Institute for Austrian and International Tax Law | www.wu.ac.at/taxlaw



Platform for Collaboration on Tax

- Platform for Collaboration on Tax: joint initiative of the OECD, IMF, World Bank Group, and UN
- Report to the Development Working Group of the G20 on base erosion and profit shifting
 - Identified base erosion and profit shifting priorities for developing countries
 - Series of “toolkits” to assist lower capacity countries



PCT Toolkit: Addressing difficulties in accessing comparables

- Lack of comparable data is a major complaint of tax authorities and the private sector in developing countries
 - Commonly used databases contain very limited/no data for a large number of developing countries
- Toolkit first considers how to make the most effective use of available information
 - Delineation of the transaction
 - Screening for potential comparables
 - Comparability adjustments
- Supplementary section on pricing of minerals

Extractive industry guidance

- Produced by OECD with Inter-Governmental Forum on Mining, Minerals, Metals and Sustainable Development
 - Toolkits: Determining the price of minerals: a transfer pricing framework
 - Pricing framework for bauxite
 - Pricing framework for lithium
 - Policy notes on BEPS issues
 - Limiting excessive interest deductions
 - Tax incentives
 - Monitoring the value of mineral exports



Section IV

TP in emerging economies

WU

WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS



- Recent changes to move to OECD-aligned transfer pricing rules
 - Provisional Measure 1,152/2022, converted into Law 14,596 of 14 June 2023, and regulated by Normative Instruction 2,161/2023
 - Optional adoption in 2023
 - Mandatory from 2024
 - A broad concept of related parties (where involving a low tax jurisdiction/ regime, not limited to associated enterprises) was essentially maintained from the previous TP framework.
- Former TP framework:
 - Officially based on arm's length principle
 - Fixed margins by industry
 - Very limited types of comparability adjustments allowed

- New TP framework includes:
 - a definition of the "arm's length principle"
 - rules on the application of the arm's length principle, including defining the controlled transaction, application of a comparability analysis
 - 5 OECD transfer pricing methods, other methods provided they produce an arm's length outcome
 - Note that for commodities, the CUP method is presumed to be the most appropriate, unless it can be established otherwise
 - rules for intangible assets: their definition, treatment and hard-to-value intangibles; and
 - provisions dealing with intra-group services, cost sharing, business restructuring, transactions involving debt, intra-group guarantees, centralised treasury management and insurance
 - Financial transactions: If a transaction is delineated as a capital contribution (i.e. equity), interest and other financial expenses will not be deductible for tax purposes. If delineated as a debt, the interest rate must be established based on the arm's length standard, considering risk, borrower's credit rating, and other features such as guarantees, seniority level of the debt and covenants.

- Arm's length principle
- Remuneration to the local entity should be "commensurate with its role and contribution to the value chain"
 - Risk assumption may not be considered as relevant as other contributions, e.g. assets such as a factory and related employees
- SAT Public Notice [2017] No.6
 - Location Specific Advantages: location savings
 - Eg if using Cost Plus or TNMM on full cost basis, adjust the mark-up to account for the lower cost base due to the location saving
 - Cost base of tested party in China = 100
 - Comparables Average cost base = 150; mark-up 8%
 - Applicable mark-up for tested party = $8\% \times (150/100) = 12\%$
 - Location Specific Advantages: Market premia
 - Six tests for deductibility of intra-group (low value) service fees
 - Intangibles
 - Local contributions must be carefully evaluated
 - Development, enhancement, maintenance, protection, exploitation and promotion ("DEMPEP") functions

- Arm's length principle
- Broadly aligned with OECD TP Guidelines
- Local File, Master File, CbCR, Audit report to be filed
- Arm's length range
 - ≥ 6 comparables, 35th – 65th percentile;(adjust to median)
 - < 6 comparables, use arithmetic mean
- Location rents (from LSAs) need to be appropriately remunerated at arm's length
 - Local comparables
 - Profit spit may be appropriate where there are no comparables

- Payments for intra-group services may be regarded as “base eroding” and thus a high risk area
 - Overall ceiling (% of sales or revenue of the local entity) may be used
 - LVAS (5% mark up) applies with a ceiling on maximum amount
- Safe harbour provisions introduced 2013
 - Minimum operating profit margins by category of transaction, e.g. IT services, contract R&D, manufacture and export of auto components, loans, financial guarantees
- Large number of TP cases are litigated

- Arm's length principle
- Requirement to price transactions "*ex ante*" i.e. using a price-setting approach rather than a price testing approach
- Local File and Master File must be prepared annually (submitted on request); CbCR
- Application for a tax refund triggers a tax audit
- Transfer pricing adjustments are generally deemed dividends
- Interquartile range must be used
- Recent modifications:
 - Definition of parties with a "special relationship" (i.e. related parties) now includes a wider definition of "control"
 - Improvements to APA programme, including allowing rollback



- Thin capitalisation regulations (2016) – now complemented by earnings stripping rules (2022)
 - Debt to equity ratio of 4:1
 - Interest expense not deductible if there is negative equity
 - Interest limitation may also be determined based on % of EBITDA (Details to be provided via regulations)
- Specific Anti-avoidance rule for consecutive losses
 - relating to transactions with parties with a “special relationship”
 - Where losses in 3+ years of 5
 - DGT has authority to adjust based on an industry benchmark

- Arm's length principle
- Generally aligned with OECD Guidelines
 - Practice Note: TPG should be followed in the absence of specific guidance
 - Recommendation for formal adoption of TPG through a Binding General Ruling
- Local File, Master File, CbCR to be filed; TP questions in tax return
- Safe harbours, APAs viewed with caution (but Dec 2023 saw introduction of legal basis for bilateral APAs introduced)
- Comparability
 - Lack of local comparables;
 - "holistic approach" to establishing whether the ALP has been complied with
- Services
 - Payment should be evaluated from the perspective of both parties



Section V

Selected TP Issues

WU

WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS



Location specific advantages

- Location savings / LSAs in the UN Manual:
 - [net] economic benefit arising from moving operations to a low-cost jurisdiction
 - Examples could include:
 - highly specialised skilled manpower and knowledge;
 - proximity to growing local / regional market;
 - large customer base with increased spending capacity;
 - advanced infrastructure;
 - market premium
 - LSAs may lead to location rents, depending on competitive factors
 - See also section D.6, Ch I of TPG



Interface with customs valuation

- A long-standing issue; tension between CV and TP
- Both CV and TP:
 - address valuation/pricing of imported goods
 - seek to neutralise the impact that any relationship between the parties may have on the value/price
- Developing countries often more reliant on customs revenues
 - customs duty rates may be relatively high
- Timing, objectives and “correct value” may differ
 - Problematic for taxpayers/ traders, officials
 - Creates difficult policy challenges

Interface with customs valuation

- Customs value:
 - based on strict WTO valuation rules
 - must be determined on a per consignment basis
 - Generally based on “transaction value” but Customs may instead examine whether the relationship has influenced the price
 - test values or
 - “circumstances surrounding the sale”
- Definition of “related party” vs “associated enterprise” may differ
- WCO working with OECD, WBG, ICC to encourage practical co-operation
 - WCO guide to Customs Valuation and Transfer Pricing
 - WCO Revenue package
 - Joint tax / customs officials workshops



“Sixth method”

- Applied in a number of countries to certain commodities transactions
 - Often an anti-avoidance measure
 - Transfer price for the commodity to be based on an exchange-quoted price
 - Cf CUP?
 - Pricing date and terms may be established in law
 - May be rebuttable



Some key take-aways

- Approaches and capacity in developing / emerging economies vary significantly, but:
 - Increasing number are introducing rules and building capacity: *Important to keep up to date with specifics*
 - Experiences are being shared through bilateral projects, technical assistance, TIWB, regional events and global events: *Consistency of approach is vital*
 - What is immaterial to a MNE may be very material to a particular country: *Consider reputational issues*
 - Increasing transparency and exchange of information (including CbC reporting): *Tax planning based on non-disclosure is slowly, but surely, becoming unviable*



Section VI

What does the future hold?

WU

WIRTSCHAFTS
UNIVERSITÄT
WIEN VIENNA
UNIVERSITY OF
ECONOMICS
AND BUSINESS



Institute for Austrian and International Tax Law | www.wu.ac.at/taxlaw



What does the future hold?

- Impact of Inclusive Framework on transfer pricing guidance
- Pressures on the ALP, lack of information, access to comparables...
 - Capacity constraints
 - Complexity of TP analyses
 - Challenges of addressing increasingly digitalised economy and interaction with Two-pillar package
- → Amount B
 - Streamlined approach for routine activities
 - When will it be applied? Who is a “low capacity jurisdiction”?
- Fundamental changes?
 - Amount A: acceptance of use of formula-based, top-down approaches
 - Rules which override the ALP and traditional functional analysis in determining where value is created and profits should reside?



What does the future hold?

- Incremental changes in the way the ALP is implemented?
 - Simplification measures?
 - Amount B
 - Other simplification approaches/ safe harbours/ mechanical approaches?
 - Blunt instruments ?
 - Anti-avoidance type pricing rules
 - Prescriptive rules concerning selection or adjustment of comparables
 - Deeming rules in absence of information
 - Measures that reduce reliance on ALP?
 - Approaches to interest limitation
 - Impact of Pillar 2 GloBE, QDMTT and STTR minimum taxes?
 - ...



Contact details



Melinda Brown

Senior Advisor
Centre for Tax Policy and Administration
OECD

Melinda.Brown@oecd.org

