

What's New

News Flash



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United Nations releases final version of its "Practical Manual on Transfer Pricing for Developing Countries"

The United Nations (UN) recently released the final version of its “Practical Manual on Transfer Pricing for Developing Countries” (the Manual). As compared to the draft manual which was released in October 2012, the final version, from a content standpoint, is largely similar to the draft.

The foreword to the Manual clearly states that owing to the widespread reliance on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010 (OECD TP Guidelines), by both developing and developed countries, consistency with these Guidelines has been sought.

The Manual has ten chapters. In this regard, the Foreword to the Manual and the Preamble to Chapter 10, clarify that this Chapter is different as it contains country-specific perspectives on transfer pricing administrative practices prevalent in four countries, *viz.* , Brazil, China, India (referred to as India chapter), and South Africa, as described by representatives of those countries. Accordingly, as further stated in the Foreword and the Preamble, no consensus on Chapter 10 has been sought, and thus this chapter does not reflect the official view of the UN.

The India chapter, which is a part of Chapter 10, primarily discusses some of the emerging transfer pricing issues in India as described by the Indian tax administration. Some of the India issues have been discussed in the Manual, while others have not yet been addressed at all in the Manual. A detailed analysis thereof was provided in our news alert released last year, dated 11 October, 2012 (when the draft manual was published). The link to the news alert is provided below, for your reference.

http://www.pwc.in/services/tax/news_alert/2012/pdf/pwc_transfer_pricing_news_alert_11_october_2012_india_chapter_of_un_manual.pdf

As regards the first nine chapters – they broadly cover the following:

Chapter 1 – An Introduction to Transfer Pricing

Apart from providing an introduction to transfer pricing, transfer pricing methods, and determination of arm’s length price, Chapter 1 briefly touches upon some transfer issues, *viz.* , intangibles, intra-group services, cost contribution arrangements, and use of secret comparables. In particular:

- The Manual (in Chapter 1 and also later in Chapter 3) cautions against the use of secret comparables, unless tax authorities disclose the data to taxpayers, so that taxpayers can defend themselves. Notably, this is more or less in line with OECD’s views and also the judiciary’s view in India.

- As for intangibles, apart from a brief overview in Chapter 1, there is no detailed discussion on the subject elsewhere in the Manual. Moreover, intangibles have been categorised as ‘trade intangibles’ and ‘marketing intangibles’, a categorisation which is out of line with OECD’s discussion draft on intangibles, wherein the proposed definition of intangibles has witnessed a significant change. Further, this categorisation seems dated as compared to the definition of intangibles introduced in the Indian transfer pricing legislation.
- Chapter 1 also recognises certain specific challenges that many developing countries face in dealing with transfer pricing issues. These challenges have been discussed in more detail in subsequent chapters, and include lack of reliable comparables, scarce tax administration resources having requisite knowledge and skill sets, and location savings.

Chapter 2 – Business Framework

This chapter essentially examines the business framework (both operational and legal) under which Multinational Enterprises (MNEs) are organised, and in this regard, acknowledges the relevance and importance of a ‘value chain’ analysis.

Chapter 3 – The General Legal Environment

This chapter provides an overview of the various legal aspects surrounding transfer pricing legislations of different countries. These include (i) the legislative approach (which as per the Manual could be self assessment driven or driven by tax administration); (ii) definition of associated enterprises (which as per the Manual would be defined by the degree of control); (iii) coverage of transactions (which as per the Manual would generally be all transactions); (iv) availability/ priority of transfer pricing methods (the Manual emphasises that the UN does not provide any hierarchy of methods); (v) burden of proof (the Manual provides examples of countries where burden of proof lies with the taxpayer, *viz.* , India, US, Canada, Australia, and South Africa, and examples of countries where burden of proof lies with the tax administration, *viz.* , France, Germany, Netherlands, and Japan); (vi) dispute resolution mechanisms (the Manual highlights the importance of MAP and bilateral APAs).

Chapter 4 – Establishing Transfer Pricing Capability in Developing Countries

Chapter 4 discusses the importance of establishing transfer pricing capability within the tax administration in developing countries. As part of this, the Manual emphasises the need to (i) identify current capabilities and fill the gaps; (ii) improve co-operation and cross-working between policy making (which typically resides with the Ministry of Finance) and tax administration; (iii) ensure professional and effective relationships with taxpayers; (iv) put in place a risk-based approach to compliance; (v) put in place a team with diverse competencies and skill sets (economists, lawyers, accountants, database experts, business process experts, etc.).

Chapter 5 - Comparability Analysis

This chapter propagates a practical approach in ascertaining the degree of comparability. The comparability factors listed in this chapter are similar to those outlined by OECD. However, the practical guidance provided herein is greater as compared to that provided in the OECD TP Guidelines. Some noteworthy aspects covered in this chapter are as follows:

- It is stated that lack of comparables does not imply that the transaction is not at arm’s length – it is possible to use ‘imperfect comparables’. At the same time, ‘cherry picking’ of comparables has been discouraged, and in this context outright rejection of loss-making comparables has also been discouraged.
- As for losses incurred by taxpayers, the guidance highlights the need to understand the reasons for losses. For this, it is emphasised that an analysis of functions performed and risks assumed by the taxpayer *vis-à-vis* its associated enterprises, is undertaken.
- Furthermore, of note, are: (i) the examples provided in relation to control over risk and the consequent allocation of risk (and returns) (the examples are in the context of R&D activities); (ii) the discussion on location savings and location specific advantages; (iii) the discussion on business strategies. All these have been discussed in detail along with an analysis of their relevance in the Indian context, in our previous alert (referred to above) dated 11 October, 2012.

Chapter 6 – Transfer Pricing Methods

This chapter outlines the transfer pricing methods and describes the approach to select a particular method. It also provides the strengths and weaknesses of the methods, and situations under which they can be used. There is

greater practical guidance provided in this chapter of the Manual on application of transfer pricing methods, as compared to that provided in the OECD TP Guidelines.

Chapter 7 – Documentation

Chapter 7 outlines some existing international guidelines on transfer pricing documentation, and offers practical guidance on transfer pricing documentation rules and procedures, including examples of special considerations (such as exemptions) for small and medium sized enterprises (SMEs) – in this context, the exemption offered by India from transfer pricing documentation in case transaction value is less than INR 10 million, has been quoted as one of the examples.

Chapter 8 – Audits and Risk Assessment

This chapter highlights the need for tax administrations to appropriately organise and staff transfer pricing audits. It emphasises the need for risk-based assessment, and in this regard also provides guidance on commonly agreed risk indicators.

Chapter 9 – Dispute Avoidance and Resolution

Chapter 9 describes different means to avoid transfer pricing disputes – through domestic and cross-border dispute avoidance mechanisms, including unilateral APAs, bilateral APAs, MAP, and developing co-operative relationships between tax administration and taxpayers, and their advisors.

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