



ORGANISATION FOR ECONOMIC
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Transfer pricing and developing economies

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What is transfer pricing?

- FDI; an MNE group sets up a subsidiary; will transact with other parts of the MNE group => needs to price transactions
- TP should not be confused with abuse. Need clear rules for compliant international taxpayers
- Problem arises if prices are artificially lowered or increased => may artificially shift profit out of the country
- In fact, the tension is more between high tax and low tax jurisdictions than between developed and developing countries.

What is the arm's length principle (“ALP”)?

- A simple, common sense principle: the conditions of transactions between enterprises that belong to the same MNE group should not be different from what they would be if the parties were independent
- i.e. transfer prices should not be manipulated to artificially shift profits out of the country
- (A similar principle exists for customs valuation purposes)

What will the ALP NOT achieve?

- The ALP cannot resolve all the international tax issues that a country may face.
- Countries may need anti abuse rules to fight tax fraud and tax evasion; thin capitalisation rules to specifically address the cases where profits are stripped out of the country by locating heavy indebtedness in a subsidiary; rules to specifically tackle transactions with tax havens; etc.
- The ALP serves one purpose, quite well, but it does not serve all purposes.

How does it work in practice?

- An analysis of the activities carried out e.g. by the subsidiary when it transacts with other members of the same MNE group (“functional analysis”).
- Objective: to ensure that the subsidiary gets a similar return for these activities performed for other group members as it would get if it was dealing with independent parties.
- This will be assessed through comparisons with open market transactions.

What are the policy objectives of implementing TP legislation?

- Protect tax revenues against the artificial shifting of profits out of the country through mispricing of transactions by MNEs.
- Protect MNEs against risk of double taxation, i.e. try to avoid that the same amount of profits be taxed in two countries.

The ALP serves these two objectives.

These objectives are not specific to developing countries.

What are the main strengths of the ALP?

- International consensus: all OECD countries as well as an increasing number of non member countries such as China, India, South Africa, Argentina, etc.
- Therefore, level playing field among countries,
- Can limit risks of double taxation,
- And benefit from considerable expertise that has been developed in many countries in the past two decades.

What is the main difficulty in implementing the ALP?

- While the principle is simple, its application can be complex.
- This means that countries willing to implement TP legislation and enforce the ALP need to develop a strategic plan over a few years, focusing in priority on the main types of cross-border transactions and industry sectors, and deploy administrative capacities over time.
- (This is also what OECD countries have done and continue to do.)

What are the challenges for developing countries?

Many !

- Assess the needs of the country:
 - Type of cross-border trade, number of international taxpayers, variety of transactions, industry sectors, etc.
- Develop effective TP legislation:
 - Tailored to the needs of the country and its legal environment
 - Consistent (to the extent possible!) with internationally agreed principles

What are the challenges for developing countries?

- Develop administrative capacity:
 - Resources are usually scarce
 - Need to build (and retain) expertise over time
 - Prioritise the use of existing resources
- Encourage taxpayer compliance:
 - Audit activities
 - Clear rules, certainty for compliant taxpayers
 - Elimination of double taxation

The OECD dialogue on TP

- Being aware of the concerns of developing countries helps us increase the relevance of our work
- Produce practical guidance (the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations; www.oecd.org/ctp/tp)
- Technical assistance; transfer pricing manual; draft legislation

Thank you for your attention.

Any questions ?

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