Transfer Pricing in the New Global Landscape: the OECD’s Engagement beyond its Borders

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Since 1979, the OECD has taken the global lead in developing international standards on transfer pricing, the tax rules relevant to determining the appropriate pricing for transactions between associated enterprises and the resulting profit allocation between jurisdictions. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the Transfer Pricing Guidelines), originally published in 1979, and updated in 1995 and 2010, provide detailed guidance to tax authorities and multinational enterprises on the application of the arm’s length principle, which is the principle that forms the core of the internationally accepted standard on transfer pricing.

Simply put, this standard requires that the conditions of transactions between associated enterprises not differ from those that would apply to transactions between independent enterprises in comparable circumstances. The arm’s length principle has almost universal application. It is cited in the Commentary to both the OECD and United Nations Model Tax Conventions, and has been adopted by very nearly every country that has adopted transfer pricing rules into its domestic tax legislation (of which there are over 100). It has been a notable achievement to have created a broad international consensus on a principle that serves as a tool, when adopted into countries’ transfer pricing legislation, to counter artificial cross-border shifting of profit and, at the same time, to create an international investment climate that provides predictability of treatment and minimises the risk of double taxation.

Changing international landscape

Notwithstanding achievements to date, neither the economic nor the political landscapes in which international commerce is conducted remain static, and the demands on international tax standards, and the pressures on them, are thus ever-changing. Globalisation and open borders mean that the taxation of multinational enterprises is an increasingly prominent and important feature of tax authorities’ work – and this, of course, extends well beyond the borders of the 34 OECD countries. Emerging economies such as
China, India and South Africa have recognised the importance of transfer pricing in their globalised economies and have adopted comprehensive rules in line with the arm’s length principle and begun to build the skills and administrative structures needed to implement them. In addition, developing countries view transfer pricing rules based on the arm’s length principle as both a vital defensive measure to protect their tax bases and a critical element to create a commercial environment conducive to international trade and investment.

Transfer pricing has been identified by regional organisations such as the African Tax Administration Forum (ATAF) and the Inter-American Centre of Tax Administration (CIAT) as key to allowing countries to collect their fair share of tax revenue. Reflecting the importance ATAF attributes to transfer pricing as a tax risk to its members ATAF have formed a Transfer Pricing Working Group to assist ATAF members to build their transfer pricing capacity and the OECD are providing technical support and advice to the Working Group. Both the OECD’s Task Force on Tax and Development, discussed below, and the G-20 have recognised the role that effective transfer pricing rules can play for developing countries in raising the tax revenue they need to carry out their economic and social programmes and reduce their dependency on aid. Indeed, non-governmental organisations (NGOs) and others have raised awareness of the risks to the tax revenue of developing countries posed by transfer pricing abuse – but we must remember that effective country transfer pricing rules provide the key to countering such abuse.

OECD experience, and that of other international organisations, is that developing countries see the adoption of effective transfer pricing rules as key to protecting their tax revenues, and that they are seeking support in adopting and implementing transfer pricing rules in line with the arm’s length principle.

**Challenges**

There is no doubt that very many countries consider transfer pricing rules as vital to their interests and are seeking support and assistance in adopting them. Nevertheless, many countries have also reported that they face difficulties with the practical implementation of their transfer pricing rules. It is widely acknowledged that transfer pricing is often not straightforward – either for taxpayers or for tax administrations. For the latter, the implementation of a new transfer pricing regime requires a number of legal and administrative steps. The first is, of course, the adoption of transfer pricing rules into the tax legislation, together with supporting provisions on issues such as documentation and advance pricing arrangements. These rules generally require multinational enterprises operating in the relevant jurisdiction to use arm’s length pricing in cross-border, intra-group transactions, and they provide the tax authority with the power to adjust the measure of taxable profit where such prices are not used. Once the legislative
framework is in place, most countries form an administrative structure for the implementation of the rules, often centered on a team of specialists.

Building the legal and administrative framework for a transfer pricing regime, however, is probably little different from adopting legal and administrative structures for other types of tax rules. There are, nevertheless, two areas in which countries and others most often report more specific challenges: these are in the building of relevant skills amongst tax auditors and the obtaining of publicly available information on arm’s length conditions between independent enterprises which is needed for the comparability analysis conducted in applying the arm’s length principle. As far as skills-building is concerned, the OECD and other international organisations must and will continue to provide training and other support to countries as they start to implement their rules, and a description of various initiatives to that end is provided below.

As for access to public data for comparability, we are taking a two-pronged approach. The first is to consider how access to such information can be improved and the work of our Task Force on Tax and Development described below includes a focus on this question. The second is to reflect on the extent to which, and the form in which, such information is necessary for the purposes of carrying out reliable comparability analyses. We are looking at whether we need to develop more clarity on how the arm’s length principle can be effectively applied with limited access to information and data on comparable transactions, in particular in the form of databases, which are frequently not available in developing countries. This includes consideration of the standard of comparability that is appropriate in this context, the issues relating to the use of comparables data from other markets, the kinds of comparability adjustments that may be feasible and appropriate and the appropriateness of using simplification measures, such as safe harbours.

The OECD must take on board these issues and fully address them, and substantial work is already underway to do so. Many of these issues are not new to OECD countries, and, indeed, many, if not all; OECD counties have encountered similar challenges in the implementation of their own rules, and have built up experience in addressing them that must be shared. It is essential that all countries are able to effectively apply their transfer pricing rules and make them work in their interests. We are working with all stakeholders – OECD and non-OECD countries, regional organisations and other international organisations – to ensure this is the case. We also need to ensure that the standards and the guidance that the OECD produces are relevant to, and effective for, all countries. And we know that, if this does not remain the case, we risk losing the broad global consensus of approach that everyone desires. Indeed, we consider this to be one of the most important issues on our agenda.
What are we doing to address these issues? There are three main aspects to our approach. Ensuring that transfer pricing works in the interests of all countries means: engaging with non-OECD economies on transfer pricing; increasing the relevance and applicability of the OECD’s work to all countries; and increasing the impact of the OECD’s approach to transfer pricing.

**Engaging with non-OECD economies on transfer pricing**

It is vital that the voices of non-OECD economies are heard in the development of international standards on transfer pricing. Currently 9 non-OECD countries representing a significant portion of the world’s economy (Argentina, Brazil, China, Colombia, India, Malaysia, Singapore, Russia and South Africa) participate in the work of the OECD on transfer pricing, shaping future guidance, and bringing their views, perspectives and priorities to the table. These countries work side by side with OECD member countries in the activities of the OECD’s Working Party No. 6, the body responsible for the ongoing development of the *Transfer Pricing Guidelines*.

Our dialogue and engagement with non-OECD countries is being further enhanced by a new Global Forum on Transfer Pricing. This meeting is organised under the auspices of the long-standing Global Forum on Tax Treaties and Transfer Pricing, which for over 15 years has represented the leading forum for OECD and non-OECD countries on tax treaties and transfer pricing. The new annual meeting, dedicated exclusively to transfer pricing, will be held for the first time in March 2012. This annual event will provide a unique forum for government officials from more than 100 OECD and non-OECD countries to share their expertise and exchange their views on policy and administrative aspects of transfer pricing. The work of the new Global Forum on Transfer Pricing will be guided by a Steering Committee, including 10 to 15 non-OECD economies, including developing countries, working closely with the Bureau of Working Party No. 6. Such work may include, for example, the development of best practices in relation to transfer pricing documentation, risk assessment and the treatment of home and regional costs. The group, which first met on 2011, includes transfer pricing specialists representing Argentina, Brazil, China, Colombia, Egypt, Ghana, India, Indonesia, Kenya, Malaysia, Russia, Singapore, South Africa and Vietnam.

The OECD’s long-standing Global Relations programme remains the core of our dialogue with non-OECD countries on taxation. The programme consists of a series of bilateral and multilateral events, held at our 5 multilateral tax centres and elsewhere, covering all
aspects of the OECD’s work in the area of taxation. Last year, for example, the programme consisted of 75 events of which 21 were focused mainly on transfer pricing. These events provide a forum for both North-South and South-South dialogue that allows countries to share their approaches to transfer pricing and other taxation issues, mainly through real case study analysis. The events also provide a means for a very broad range of non-OECD countries to input their perspectives into the OECD’s work. The programme, which annually involves upwards of 2000 tax officials from 125 countries, is demand-driven, and shaped by an Advisory Group for Non-OECD Economies which plays a key role in inputting NOE views into the work of the Global Relations programme and the wider work of the OECD in the tax area. The Global Relations programme is delivered in partnership with regional organisations, such as ATAF in Africa and CIAT in Latin America.

**Increasing the relevance and applicability of the OECD’s work to all countries**

The core outcome of the OECD’s engagement with countries on a global level must be that its work on transfer pricing, and the standards and guidance it develops, is relevant to, and effective for, all countries. Many of our current initiatives are focused in that direction.

Working Party No. 6 is currently undertaking a project on the administrative aspects of transfer pricing, including a focus on simplification measures that tax administrations may take in order to balance an acceptable level of compliance with transfer pricing legislation, with an acceptable level of resource cost to the tax administration and to taxpayers. The Working Party published a multi-country survey of administrative simplification measures currently in place, has sought and obtained public comment on possible simplification measures and is using the main findings to inform its work on the administrative aspects of transfer pricing. In March 2011 the OECD announced a project to consider the administrative aspects of transfer pricing, including approaches designed to simplify the implementation of transfer pricing regimes, through measures such as safe harbours. This work is expected to be of great interest to less developed countries with scarce administrative resources and to emerging economies which, as we have seen, are increasingly active on the transfer pricing front.

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2 The Advisory Group for Non-OECD Economies is a group of representatives from non-OECD economies, OECD countries and regional organisations with an interest in the delivery of, or participation in, the CFA’s Global Relations programme.

3 See [http://www.oecd.org/document/45/0,3746,en_2649_33753_48131629_1_1_1_1,00.html](http://www.oecd.org/document/45/0,3746,en_2649_33753_48131629_1_1_1_1,00.html).

4 See [http://www.oecd.org/document/54/0,3746,en_2649_33753_48340470_1_1_1_1,00.html](http://www.oecd.org/document/54/0,3746,en_2649_33753_48340470_1_1_1_1,00.html).
As part of this project on the administrative aspects of transfer pricing, we are reviewing the existing guidance in the *Transfer Pricing Guidelines* on safe harbours. This is with a view to updating it in order to reflect the experience acquired since the original guidance was developed in 1995. Safe harbours are potentially of great interest to developing countries. They make it easier for multinational enterprises to comply with country transfer pricing rules and can provide them with some certainty of treatment. At the same time, they reduce the resource cost of compliance, both for taxpayers and tax authorities.

The OECD’s Forum on Tax Administration, a group of the Commissioners or Heads of Taxation of over 40 OECD and non-OECD jurisdictions,\(^5\) has also carried out work on countries’ approaches to the administration of their transfer pricing rules, and published a report in December 2011 entitled “Dealing Effectively with the Challenges of Transfer Pricing” on these issues\(^1\). This report is of significant relevance to non-OECD countries as it addresses many of the areas that are a priority for developing countries.

Supplementing this work, the OECD Secretariat is developing further explanatory material designed to help non-OECD countries adopt and implement their transfer pricing rules. Sample transfer pricing legislation, designed to assist countries intending to introduce transfer pricing rules for the first time, was published in 2010.\(^6\) The suggested legislation is intended to be purely illustrative, for countries to use and adapt according to their circumstances and priorities. We are expecting to design further sample legislation to cover various issues including Advanced Pricing Agreements and thin capitalisation. In addition, the Secretariat is developing explanatory notes on a number of aspects of transfer pricing. The first five of these (on transfer pricing methods, comparability, comparability adjustments, the arm’s length range and location savings) have been made available on the OECD’s website.\(^7\) The Secretariat is now working on further explanatory notes on issues of particular relevance for non-OECD economies, which are intended to address questions of transfer pricing implementation, recognising the challenges that developing countries in particular face in this area.

**Increasing the impact of the OECD’s approach to transfer pricing**

A complementary, but central, pillar of our work is to ensure that non-OECD countries, including developing countries, are able to fully benefit from the application of

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\(^5\) See [http://www.oecd.org/about/0,3347,en_2649_33749_1_1_1_1_1,00.html](http://www.oecd.org/about/0,3347,en_2649_33749_1_1_1_1_1,00.html).

\(^6\) This is available in English, French and Spanish - see [http://www.oecd.org/findDocument/0,3770,en_2649_33753_1_119669_1_1_1,00.html](http://www.oecd.org/findDocument/0,3770,en_2649_33753_1_119669_1_1_1,00.html).

\(^7\) These are available in English and French - see [http://www.oecd.org/findDocument/0,3770,en_2649_33753_1_119669_1_1_1,00.html](http://www.oecd.org/findDocument/0,3770,en_2649_33753_1_119669_1_1_1,00.html).
the arm’s length principle in their transfer pricing rules. That is, to ensure that they can use their transfer pricing rules to collect their fair share of tax revenue, and to counter tax loss caused by abusive cross-border intra-group pricing.

The OECD’s Task Force on Tax and Development, a multi-stakeholder body including representatives from OECD and non-OECD countries, the private sector and NGOs, has identified transfer pricing as one of its high-priority areas of work, and has formulated a detailed work programme on transfer pricing and developing countries. This work programme was approved by the OECD’s Committee on Fiscal Affairs and its Development Assistance Committee in June 2011 and is now being implemented. The programme currently consists of two main elements. The first consists of bilateral work with specific developing countries to improve their capacity to adopt and effectively implement transfer pricing rules. We are working with Ghana, Kenya, Colombia, Vietnam, and Rwanda. The second element is to support regional organisations (such as ATAF) in their capacity-building programmes. At ATAF’s request, the OECD is currently providing the technical input into ATAF’s technical training programme for African tax administrations and providing technical support and advice to its Transfer Pricing project and its Exchange of Information project.

The OECD is also responding to the need for developing countries to develop the capacity to deliver training on transfer pricing to their own tax officials and those of neighbouring countries. We are holding a “Train the Trainers event” in October 2012 which will provide selected transfer pricing specialists from developing countries with the skills to train tax auditors in their own and neighbouring countries on transfer pricing.

The Task Force on Tax and Development is also considering practical aspects of the implementation of transfer pricing rules, such as the availability of comparables data and, in this context, will consider how developing countries can better access the financial data sometimes needed to apply transfer pricing rules. Work is being carried out to explore the possible benefits and feasibility of wider statutory reporting of financial accounts in developing countries as a means of improving both the transparency of the operations of multinational enterprises and tax administration access to data on potential comparable transactions.

Through the Task Force on Tax and Development, the OECD is working with other international organisations including the UN, World Bank, IMF, the International Tax Compact (ITC), and regional tax organisations to help developing countries adopt and implement transfer pricing rules. A framework for co-operation with the World Bank and

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the European Commission (EC) on transfer pricing capacity-building for developing countries has been agreed and this forms the basis for working together on the bi-lateral work with specific developing countries. The OECD Secretariat and representatives of a number of OECD countries are also actively participating in and contributing to the work of the UN’s Sub-Committee on Transfer Pricing in the development of a Practical Transfer Pricing Manual for Developing Countries, which is focused on addressing transfer pricing implementation issues faced by developing countries in particular and how they can address those issues in the context of applying the arm’s length principle.

**Final remarks**

We are very aware of the challenges faced by many countries in implementing transfer pricing rules. Indeed, many of these challenges have been faced by OECD member countries. We are very aware also that, partly as a result of these challenges, some have advocated an alternative approach to transfer pricing, such as global formulary apportionment. We are far from convinced that such an approach represents a realistic option in the current international tax landscape – it is difficult to see, for example, how the required consensus on the computations of the profit base to be apportioned between countries, or allocation formulae to be applied to split that profit between countries, would be achieved, and it is far from demonstrated that any such approach would be advantageous to developing countries.

Clearly, the arm’s length principle should be neither rigid nor immovable, but, at the current time, we believe it is the only realistic option in the interests of developing countries. Through the initiatives described in this article, the OECD is committed to ensuring that it works to the advantage of all countries.

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1 See [www.oecd.org/...0,3746,en_2649_33749_49681354_1_1_1,00.html](http://www.oecd.org/...0,3746,en_2649_33749_49681354_1_1_1,00.html)