



TASK FORCE ON TAX AND DEVELOPMENT

SUB-GROUP ON TRANSFER PRICING

**UPDATE ON TRANSFER PRICING PROGRAMME
PAPER FOR DISCUSSION**

**Friday 8 March 2013
OECD Conference Centre
Paris, France**

MEETING OF THE SUB-GROUP ON TRANSFER PRICING
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Introduction

This paper is provided for discussion by delegates to the meeting of the Task Force on Tax and Development Sub-Group on Transfer Pricing, to be held in Paris, Friday 8th March 2013. The paper:

- Describes the transfer pricing capacity development initiatives carried out under the auspices of the Task Force;
- Discusses the initial impact of these activities and the lessons learned.

Background

1. In 2011 the Task Force on Tax and Development began a programme of support for developing countries seeking to strengthen their transfer pricing rules, or the implementation of them. Such rules are critical for the protection of the tax base of many developing countries.
2. The programme helps developing countries to protect their tax bases through effective enforcement of rules designed to combat cross-border profit shifting. The work also supports efforts towards a transparent investment climate through introducing rules that create certainty and consistency for business. With these issues in mind, the demand-led programme aims to assist developing countries assess the extent of their risk from transfer pricing abuse and support those seeking to introduce and effectively enforce transfer pricing rules in line with internationally accepted principles. In doing so, it aims to gain an understanding of the challenges faced by developing countries on implementing transfer pricing rules, and to feed lessons learned into the development of international standards and guidance on transfer pricing.
3. Assistance programmes, delivered in partnership between OECD, World Bank/IFC and EU, together with other agencies, are currently in place in Colombia, Honduras, Ghana, Kenya, Rwanda and Vietnam. Other country and regional projects are in the formative stages. The WB/IFC is also conducting transfer pricing technical assistance projects in a range of additional countries including Albania, Armenia, Azerbaijan, Bangladesh, Bosnia and Herzegovina, Georgia, Serbia, Solomon Islands and a pipeline of potential project countries that includes the EAC region, ECOWAS, Ethiopia and Thailand. These additional WB/IFC projects also benefit, as required, from technical input by the OECD's Tax and Development Programme, particularly by the development of tools, guidance and training materials to assist countries in the practical application of their transfer pricing rules.

Key features of the programme

4. The Programme has the following key features:

- Adoption of a risk and needs assessment approach to diagnose country capacity-building needs. This is supported by a “Transfer Pricing Needs Assessment Tool” designed to assist countries assess the level and significance of their transfer pricing risk and their capacity to adopt an effective transfer pricing regime. It also aims to help countries appreciate the regulatory and administrative implications of implementing such a regime. The tool is included as **Annex I** to this document.
- Medium and longer term in-depth and comprehensive country support on transfer pricing, tailored to the specific needs and priorities of partner countries, and agreed with partner countries.
- Shorter-term engagements with other developing countries, on a demand-led basis. This work includes assistance and advice on drafting transfer pricing legislation and guidance, and ad hoc assistance in support of transfer pricing capacity building. For example the WB/IFC and the OECD provided significant assistance to Bangladesh in drafting its new transfer pricing legislation which came into force in July 2012. Much of this work can be done remotely.
- Initiatives are delivered in partnership between international organisations and donors working on the ground, and facilitated by serving, or seconded, government tax officials with relevant practical experience.
- The Programme builds in the transfer of knowledge about the broader business sector involved in each case. This broader understanding, for example of supply chains, underpins transfer pricing. The Business and Industry Advisory Committee (BIAC) provide business experts to assist in building industry knowledge. For example, BIAC provided an expert from the mining sector to facilitate a workshop with the Colombian tax administration. BIAC has agreed to provide appropriate experts for further programme events.
- The use of a framework for measuring the impact of country capacity- building initiatives, aligned to country priorities and measurement approaches. A copy of a draft “Transfer Pricing Results Measurements Framework”, developed jointly by the OECD, WB/IFC and EU is included in **Annex II** to this document
- A broad and balanced approach encompassing policy, regulatory and administrative issues, as well as a full spectrum of international taxation compliance and enforcement tools - transfer pricing, thin capitalisation, taxation of non-residents; treaty provisions, international exchange of information and co-operation and anti-avoidance rules.
- The development of tools and training materials to support capacity development on transfer pricing. Extensive training material has been developed, based on practical case-studies on issues of particular relevance to developing countries, for use in country and regional programmes. Country capacity to conduct in-house training has been strengthened by a “Train the Trainer” programme delivered in 2012, with participation by all main partner countries.
- Support to countries wishing to introduce transfer pricing simplification measures (such as safe harbours for low value transactions) and measures designed to assist taxpayers comply with transfer pricing rules (such as Advance Pricing Arrangements). Such measure may assist developing countries to address their transfer pricing capacity issues.
- Close alignment with other initiatives (e.g. capacity building initiatives of the Global Forum on Transparency and Exchange of Information for Tax Purposes, the proposed Tax Inspectors Without Borders, and links with Customs Valuation).

Impact

5. The **programme** has already had significant impact:

- Following transfer pricing adjustments made as a result of audits of multinational enterprises, the Colombian tax administration has increased revenues from US\$3.3m in 2011 to US\$5.83m in 2012 (a 76% increase). The Colombian administration claim this has only been possible because of the practical advice provided by the Tax and Development Programme.
- In December 2012 Congress in Colombia passed revised and improved transfer pricing legislation which is aligned with international standards. The Tax and Development Programme has provided significant input and advice to Colombia on the drafting of the new legislation.
- New transfer pricing regulations, aligned with international standards, were introduced in Ghana in September 2012. The Tax and Development Programme has worked closely with Ghana from July 2011, which saw the beginning of Ghana's current initiative to build an effective transfer pricing regime. The Programme has provided significant input and advice on the drafting of the new legislation, as well as supporting guidance. It has also undertaken a comprehensive skills-building programme with the newly established team of specialist auditors.
- Supported by input from the Tax and Development Programme since November 2011, Vietnam's tax administration has significantly increased its capacity to enforce its transfer pricing rules. A recent audit of a large Multinational Enterprise resulted in increased tax paid in Vietnam of US\$3.9m
- In July 2012, the Kenyan tax administration embarked on a significant training programme for its staff on advanced transfer pricing issues. This is expected to assist the tax administration increase its revenue from transfer pricing audits. This initiative followed advice from the Tax and Development Programme, which is providing support in developing and delivering the training programme.

Lessons learned and the future

6. The initial 18 months of implementation of the transfer pricing pillar of the Task Force's programme has revealed:

- i) evidence of a significant impact on tax revenue from the strengthening of the transfer pricing regimes in some countries;
- ii) that co-operation between agencies working on the ground in this area can be highly effective;
- iii) huge demand from developing countries for assistance in this area. With increasing globalization, greater focus on countering artificial cross-border profit shifting and growing evidence of the success of the Task Force programme, demand is only expected to increase;
- iv) that, despite some success stories, many developing countries experience difficulties in effectively implementing their transfer pricing rules. Access to reliable data on transactions between independent parties, for example, is a particular issue for many developing countries.

7. This leaves the Task Force with the challenge of how to build on the initial successes of this work pillar, satisfy demand for assistance, and ensure that transfer pricing regimes are effective for all countries that need them. Initial proposals for taking the programme forward are discussed below.
- Co-operation between agencies working on the ground in this area has been effective. There are opportunities to expand the number of inter-agency country projects, and encourage alignment of, and cooperation between, country and regional initiatives conducted by different agencies.
 - The effectiveness of regional capacity-building programmes needs to be further explored. Currently, the Task Force Secretariat provides technical advice to ATAF's Transfer Pricing Working Group. Regional programmes in the East African Community and ECOWAS are being explored by the OECD, World Bank/IFC and EU partnership. Regional co-operation can strengthen the enforcement of transfer pricing rules, for example through joint audits and exchange of information between countries. It can also build a strengthened business investment climate, for example through the use of common documentation requirements or dispute-resolution mechanisms.
 - Many developing countries express demand for assistance on the practical implementation of transfer pricing rules, including in particular on building the capacity to effectively audit, and if appropriate challenge, transfer pricing issues. There is evidence that some of the assistance provided to developing countries in the past has been over-theoretical and not aligned with the most pressing needs. Demand led country projects have identified and started to address this issue.
 - As mentioned above, there is evidence of significant impact on tax revenue from the strengthening of the transfer pricing regimes in some countries, but further work on the measurement of impact needs to be carried out. It is important that agencies working in this field adopt measurement criteria that are aligned with the policies of the partner countries.
 - It is also evident that many developing countries experience difficulties in effectively implementing transfer pricing rules, and that, for many, the challenges stretch beyond capacity limitations. For example, financial data on transactions between independent parties (needed to carry out comparability analyses) is often inadequate. Developing countries also experience problems in obtaining the information from Multinational Enterprises needed to conduct an adequate risk assessment and effective audit. It is important that the lessons learned from the programme continue to feed into the development of standards and guidance on transfer pricing (e.g. on simplification initiatives) and other initiatives designed to improve the accessibility of data (e.g. exchange of information and transparency in financial reporting).
 - Innovative means for delivering support in this area – including, for example, Tax Inspectors Without Borders – need to be explored, and governments of experienced countries encouraged to input relevant expertise into initiatives such as this. “Whole of government” approaches can be very effective in this area - for example, with development agencies supporting revenue authorities to share specialist expertise with their counterparts in developing countries.

ANNEX I



A COUNTRY TRANSFER PRICING NEEDS ASSESSMENT AND IMPLEMENTATION TOOL (Pilot version)

Please note that this is a draft pilot version of a tool designed to assist countries:

- **Assess the extent of their risk of tax revenue loss due to transfer pricing**
- **Assess whether they possess the administrative capacity to effectively implement transfer pricing regulations**
- **Plan the steps and processes required to adopt and then implement transfer pricing regulations.**

Introduction

This is a pilot version of a tool designed to assist countries:

- Assess the extent of their risk of tax revenue loss due to transfer pricing
- Assess whether they possess the administrative capacity to effectively implement transfer pricing regulations
- Appreciate and plan the steps and processes required to adopt and then implement transfer pricing regulations.

Comments on this pilot tool are invited. They should be sent to Colin Clavey (colin.clavey@oecd.org) or Lee Corrick (lee.corrick@oecd.org).

This tool is designed to be used by countries considering adopting transfer pricing legislation. The tool aims to:

- Assist countries assess the extent of their need for adopting transfer pricing rules
- Assist countries identify pre-conditions required for adopting transfer pricing rules
- Assist countries identify the steps (including “next steps”) required for successful implementation, in cases where countries take the view that the adoption of transfer pricing rules is justified, and the necessary pre-conditions are in place.

Background

Recent years have seen taxation's role in promoting sustainable development become a major item on the development agenda, with the spotlight on international taxes and transfer pricing in particular. As many developing countries reduce their levels of customs duties and rely more heavily on direct taxes for revenue their focus on identifying and effectively addressing risks to their direct tax base is increasing. Many such countries have identified transfer pricing as a key issue as they open their borders to the increasingly globalised economy. It is therefore not surprising that international and regional organizations, as well as NGOs and donors, are increasingly focusing their attention in this direction.

Countries generally look for two outcomes from their transfer pricing rules. The first is to promote a predictable business climate that provides business with some certainty of treatment of their international transactions. The second is to protect the domestic tax base, by requiring taxpayers to report a measure of profit in line with the arm's length principle, and by using the rules to counter artificial cross-border shifting of profit.

Many countries have found transfer pricing rules to be very effective in protecting the tax base, with considerable tax yield resulting from their application. For some countries, however, the adoption of transfer pricing rules has had little impact. Such countries have found that rules alone are not sufficient and that successful implementation of such rules requires tax authorities to invest in the capacity to administer them. This typically requires the formation of a specialist team and specific administrative structure, as well as the building of requisite skills amongst risk assessment staff and auditors.

The tool is intended to assist countries assess the extent to which they face a loss of tax revenue from transfer pricing. It is also intended to assist countries consider whether they have the requisite capacity to implement such rules, and to understand the steps typically required in order to build an effective transfer pricing regime.

Structure of the tool

The tool is structured as follows.

Step 1. Is there a need for adopting transfer pricing rules?

This step consists of a series of questions designed to assist countries consider whether there is a need for adopting transfer pricing rules.

Step 2. Are the preconditions for successfully implementing transfer pricing rules in place?

This step consists of a series of questions designed to assist countries consider whether the preconditions for adopting transfer pricing rules are in place.

Step 3. In cases where a) it is considered that there is a case for adopting country transfer pricing rules and b) the preconditions are considered to be in place, the tool assists in identifying the steps that need to be taken to successfully implement such rules.

Step 1. To what extent is there a need for adopting transfer pricing rules?

Introduction

This section consists of a series of questions designed to assist countries consider whether there is a need for adopting transfer pricing rules. It is designed to assist in assessing the extent to which there is a significant tax revenue risk arising from transfer pricing. Inevitably, any such assessment will be relatively subjective and countries will take different views on what constitutes a significant tax revenue risk.

Key questions

Largest 20 corporate taxpayers

| QUESTION | COMMENTS |
|---|--|
| <p>Analyse the tax return and accounts of the largest 25 corporate taxpayers.</p> <ul style="list-style-type: none"> • How many are members of a multinational group of companies? • What percentage of the total tax revenue of the country is paid by these 25 corporate taxpayers | <p>Multinational groups consist of related companies which are located in more than one country. If there are a relatively small number of large multinational companies operating in the jurisdiction, the risk of general tax loss arising from transfer pricing may be small. On the other hand, if all, or nearly all, of the largest 25 corporate taxpayers are multinational enterprises, transfer pricing is more likely to be a significant issue.</p> <p>When conducting this analysis, all the group affiliates in the country should be treated as one taxpayer. (e.g. if there are 5 affiliated companies located in the country they should together be treated as a single multinational enterprise).</p> |
| <p>For those large taxpayers that are members of multinational groups, to what extent do they:</p> <ul style="list-style-type: none"> • Import goods for sale or processing? • Manufacture goods for export? • Pay royalties? • Pay management fees? • Pay service charges? | <p>All these factors are indicators of intra-group transactions i.e. transactions between the domestic taxpayer and affiliates in other countries. The higher the value of such transactions, the greater the tax risk of tax loss arising from transfer pricing.</p> <p>Indicators of higher risk:</p> <ul style="list-style-type: none"> • Royalty charges greater than 5% of turnover or 30% of pre-royalty operating profit • Management fees in excess of 5% of turnover or 10% of operating profit • Service fees in excess of 5% of turnover or 10 % of operating profit <p>[It should be noted that these figures are intended to provide indicators of transfer pricing risk. Further analysis would be required before a view can be taken on whether the any such payment accords with arm's length pricing. Depending on the facts and circumstances of each case, payments in excess of the indicators above may found to be arm's length, and payment less than the indicators above may be found to be in excess of an arm's length amount.]</p> |

| | |
|---|--|
| <p>For those same taxpayers:</p> <ul style="list-style-type: none"> • Is there a pattern of loss making? • Is there any indication that they engage in transactions with low tax jurisdictions? | <p>A history of loss-making is not conclusive that a company’s transfer pricing is wrong – but may be an indicator.</p> <p>Transactions involving a low tax jurisdiction may indicate tax planning with significant transfer pricing implications.</p> |
| <p>For those same taxpayers: Are there significant interest payments?</p> | <p>Interest may be significant if:</p> <ul style="list-style-type: none"> • The profit and loss account shows interest payment of greater than 1/3 of operating profit • If the balance sheet shows the ratio of interest bearing debt to equity in the company is greater than 2:1 |
| <p>For those same taxpayers:</p> <ul style="list-style-type: none"> • Is there a pattern of decreasing profits over the previous 5 years? • Have there been any sudden and unexplained decrease in profitability during the previous 5 years? | <p>A consistent reduction in profitability of a company cannot be taken as conclusive of transfer pricing issues - there are many reasons for such a decline. On the other hand, for a multinational enterprise with significant cross-border transactions, such a reduction may be an indicator of transfer pricing issues.</p> <p>A sudden and significant decrease in profitability may be an indicator of transfer pricing planning.</p> <p>If the information is available it may be useful to compare any changes in the profitability of the taxpayer company against changes in the profitability of the group. If, for example, the group increases its consolidated profit over a period of time, but the taxpayer company is making reduced profits over the same period, this may indicate a transfer pricing issue.</p> |
| <p>For those same taxpayers:</p> <ul style="list-style-type: none"> • Is there evidence of a substantial presence in the country, involving senior decision-making employees? • Is there evidence that the local presence in the country includes ownership of valuable intellectual property? • Is there evidence that ownership of valuable intellectual property has been transferred out of the local jurisdiction? | <p>If the taxpayer houses senior decision-making employees, or owns valuable intellectual property, or takes significant risk, this might mean that it carries out a more “entrepreneurial” activity. Is this reflected in its profits? (Such companies will often not be expected to make stable, relatively modest profits)</p> <p>The cross-border transfer (e.g. sale) of valuable intellectual property may be an indicator of tax planning with transfer pricing implications.</p> |

FDI Companies

| QUESTION | COMMENTS |
|---|---|
| <p>Analyse the tax return and accounts of a sample of 25 FDI companies.</p> | |
| <p>To what extent do they:</p> <ul style="list-style-type: none"> • Import goods for sale or processing? • Manufacture goods for export? • Pay royalties? • Pay management fees? • Pay service charges? | <p>All these factors are indicators of intra-group transactions i.e. transactions between the domestic taxpayer and affiliates in other countries.</p> <p>The higher the value of such transactions, the greater the tax risk of tax loss arising from transfer pricing.</p> <p>Indicators of higher risk:</p> <ul style="list-style-type: none"> • Royalty charges greater than 5% of turnover or 30% of pre-royalty operating profit • Management fees in excess of 5% of turnover or 10% of operating profit • Service fees in excess of 5% of turnover or 10 % of operating profit <p>[It should be noted that these figures are intended to provide indicators of transfer pricing risk. Further analysis would be required before a view can be taken on whether the any such payment accords with arm's length pricing. Depending on the facts and circumstances of each case, payments in excess of the indicators above may found to be arm's length, and payment less than the indicators above may be found to be in excess of an arm's length amount.]</p> |
| <p>For the same companies:</p> <ul style="list-style-type: none"> • Is there a history of loss making? • Is there any indication that they engage in transactions with low tax jurisdictions? | <p>A history of loss-making is not conclusive that transfer pricing in a company is wrong – but may be an indicator.</p> |
| <p>For those same taxpayers: Are there significant interest payments?</p> | <p>Interest may be significant if:</p> <ul style="list-style-type: none"> • The profit and loss account shows interest payment of greater than 1/3 of operating profit • If the balance sheet shows the ratio of debt to equity in the company greater than 2:1 |
| <p>Are members of a multinational group concentrated in a specific sector or small number of sectors?</p> | <p>If the largest multinational enterprises or FDI companies are concentrated in a specific sector or sectors, and transfer pricing is seen as a significant risk, then the application of transfer pricing rules might be restricted to that sector (or sectors). (See below).</p> |

Cross-border trade

| QUESTION | COMMENTS |
|---|--|
| What is: <ul style="list-style-type: none"> • Share of imports as a proportion of GDP. • Share of exports as a proportion on GDP | [Can we develop parameters for assessing the significance of import/export share of FDI?] |
| <ul style="list-style-type: none"> • To what extent do the main trading partners have transfer pricing rules in place? • Are there treaties with trading partners which have transfer pricing rules in place? | <p>If main trading partners have transfer pricing rules in place, there may be an incentive for taxpayers to “over-comply” in those jurisdictions.</p> <p>If there are treaties in place with major trading partners, then transfer capacity within the tax administration will be necessary in order to carry out treaty-related activities. (e.g. to consider and implement a “corresponding adjustment” claim following a primary transfer pricing adjustment by the treaty partner).</p> |

Additional analyses

Countries may want to supplement the analysis above by **conducting interviews** with the largest multinational enterprises. In such cases the following information might be sought:

- The extent, nature and value of transactions with foreign related parties (including goods, services, royalty payments, leases and rents, financial transactions).
- The work carried out to establish that the pricing of such transactions is at arm's length.
- The documentation in place to establish and demonstrate arm's length pricing.

The tax administration might hold meetings with their largest taxpayers where there is a general discussion of the taxpayers business and this discussion can incorporate obtaining the above information.

The analysis might also be supplemented with **further information** derived from internet searches. In such cases, the following information might be appropriate:

- The nature of the business and worldwide operations – does the nature of the business suggest that there will be significant cross-border transactions?
- Is there evidence of tax planning involving low tax jurisdictions?

Assessment

- The questions above should assist in determining the extent to which there is a significant tax risk arising from transfer pricing. There is no one method for determining the extent of the risk, and criteria for assessment will vary between countries. Inevitably, there will be an element of judgement.
- If it is established that significant transaction risk is confined to taxpayer companies in a specific sector, or a small number of sectors, it may be appropriate to initially restrict the application of transfer rules to those sectors, rather than apply the rules more generally to all taxpayers. Approaches to this will depend on country policies. Some countries may wish to restrict the scope of their rules, initially at least, to specific sectors. Others may wish to inform taxpayers that the rules (which potentially apply to all sectors) will in practice be applied only in specific sectors. Both of these approaches have the advantage of providing some certainty to taxpayers, although there may be issues concerning inequitable treatment of taxpayers. An alternative approach may be to potentially apply the rules to all sectors, but in practice apply them only to the high risk sectors - this might be achieved, for example, through the application of risk assessment procedures.
- If it is established that the significant tax risk is restricted to interest payments, it may be appropriate, as an initial step, to introduce or strengthen thin capitalisation rules, or strengthen the implementation of such rules if they are already in place. (Cross-reference to model thin capitalisation legislation).

Issue 2 Are the preconditions for successfully implementing transfer pricing rules in place?

This section consists of a series of questions designed to assist countries consider whether they have the necessary administrative capacity for adopting transfer pricing rules.

| QUESTION | COMMENTS |
|---|---|
| Are companies required to maintain financial accounts? | |
| Are companies subject to company income tax on their profits? | Transfer pricing rules apply to the calculation of profit for tax purposes. If there is no taxation of company profits, such rules will be ineffective. |
| Is there experience in the country of auditing the returned profits of multinational enterprises? | The enforcement of transfer pricing rules is an aspect of the auditing of multinational enterprises - that is, checking (and investigating as necessary) taxpayers' compliance with tax rules. It is unlikely that this can be carried out effectively if there is no experience in the country of auditing the accounts of multinational enterprises. |
| Are there effective tax collection procedures in place? | |
| Is there resource availability and willingness for a number of auditors to specialise in transfer pricing? | Most countries find that enforcement of transfer pricing rules requires some specialist knowledge and skills. In order to effectively apply such rules, it is highly recommended that a number of auditors undergo training (and acquire relevant experience) to adopt such skills. |
| Is there resource and willingness for a group of auditors to undergo specialist training? | |
| Are there effective dispute resolution mechanisms (courts and appeal processes) in place? | Transfer pricing is "not an exact science" and disputes between tax authorities and taxpayers are not unusual. An effective dispute resolution mechanism, including the ability to engage a judicial process, is thus essential. |

If the answers to any of the questions above are negative, then it is likely that there is insufficient administrative capacity to implement transfer pricing rules. The introduction of any such rules might be delayed until adequate capacity is in place.

STEP 3

Introducing Transfer Pricing Rules

The steps in this stage apply only if the analyses carried out in Stages 1 and 2 above demonstrate a need for the introduction of transfer pricing rules, and that sufficient administrative capacity is in place.

This section outlines the steps needed to introduce TP rules.

1. Policy, legislation and guidance

| STEP | COMMENTS |
|---|--|
| Identify current tax or financial governance reform programmes in place. | It will be important that any programme to introduce transfer pricing rules is aligned with existing relevant reform programmes, In this context, dialogue with relevant donors, aid agencies and international organisations will be essential. |
| Define policy objectives of introducing transfer pricing rules, and political commitment and buy-in | It will be necessary to define the policy objectives of introducing transfer pricing rules, in terms of both tax revenue and investment climate objectives and impacts. This will ideally specify what transfer pricing rules can achieve, and issues that are out of scope of transfer pricing rules. There will then be a process for achieving political buy-in. |
| Put in place a process for taxpayer and other stakeholder consultations and taxpayer education | Consultations with business allow a) taxpayers to input their views and perspectives into the introduction of a transfer pricing regime, and b) taxpayers to be aware of their compliance responsibilities. |
| Introduce primary transfer pricing legislation | See OECD's "Transfer Pricing Legislation: a Suggested Approach". Legislation should a) require taxpayers to apply the arm's length principle when computing the measure of taxable profit and b) provide the tax administration with the power to adjust that measure of taxable profit where taxpayers do not apply the arm's length principle. |
| Consider "secondary legislation" | It will be necessary to consider whether to enforce transfer pricing rules through "secondary legislation" such as administrative regulations or circulars |

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| <p>Introduce ancillary provisions:</p> <ul style="list-style-type: none"> • documentation requirements; • penalty provisions; • information requirements; • filing requirements; • secondary or corollary adjustments • advance pricing arrangements (if required) | <p>It will be necessary to consider introducing rules that:</p> <ul style="list-style-type: none"> • require taxpayers to maintain documentation of their transfer pricing, which must be provided to the tax authority on request • impose penalties where a) inadequate documentation is maintained and/or b) taxpayers get their transfer pricing wrong • require taxpayers to provide information on request in the context of an audit • require taxpayers to provide information on cross-border transactions with related parties with their tax return • require taxpayers to make a secondary adjustment to make the allocation of income consistent with the primary adjustment. |
| <p>Consider any administrative simplification measures (e.g. safe harbours or simplified or streamlined procedures for smaller taxpayers or transactions)</p> | <p>The implementation of transfer pricing rules can be resource intensive for both tax payers and tax authorities. Simplification measures aim to reduce these burdens, and are frequently applied to smaller taxpayers and transactions. Countries have developed some experience of simplification measures, which are summarised in a training module.</p> |
| <p>Consider interactions with tax treaties</p> | <p>In the context of transfer pricing, treaties a) provide a mechanism for reducing the risk of double taxation; b) provide a mechanism for obtaining information under “exchange of information” provisions c) provide a platform for bilateral APAs and other forms of co-operation, such as simultaneous audit.</p> |
| <p>Consider interaction with other legislation and government regulations (e.g. exchange controls)</p> | |
| <p>Develop guidance for auditors and taxpayers</p> | <p>Most tax authorities find it helpful to draft guidance for taxpayers and tax auditors on how transfer pricing rules will be administered</p> |

2. Administration of transfer pricing rules

| STEP | COMMENTS |
|--|--|
| Consider mechanisms for governance and oversight of transfer pricing audits | Many countries put in place administrative provisions to ensure that the implementation of transfer pricing rules is undertaken efficiently, fairly and consistently. |
| Forming a team of transfer pricing specialists – role, relevant skills Consider where such a team should be located in the tax administration | Country experience is that TP audit is most efficiently conducted by trained and experienced specialists. It will be necessary to consider where such specialists are located and their exact role in the audit process. Some countries, for example, concentrate transfer pricing audits in the hands of a specialist group. Others establish a specialist group to support and assist general auditors as they conduct transfer pricing audits. |
| Consider whether to establishing a Large Taxpayers Unit or similar | Transfer pricing is normally of most significance to larger taxpayers, and there is a need to build auditor experience and skills in auditing the tax returns or filings of large multinational enterprises. For these reasons, many countries find it very useful to concentrate the auditing of larger taxpayers, for which transfer pricing is likely to be most significant, in specific locations and offices. |
| Consider staff retention issues re transfer pricing specialists | Countries that have established transfer pricing rules sometimes find that their specialists are recruited by private sector advisors. Countries may wish to consider how best to manage this. |
| Decide where competent authority function will be located | |
| Consider links between transfer pricing team and exchange of information function | |
| Consider links between transfer pricing team and legal function | |
| Ensure that dispute resolution procedures are in place and understood | |
| Put in place a process for risk assessment and case selection | |

3. Building auditing skills

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| <p>Put in place a process for building auditor skills:</p> <p>A programme of training should include:</p> <ul style="list-style-type: none">• The arm's length principle• Comparability and comparability analyses (including functional analysis)• Obtaining information required• Transfer pricing methods• Selection of an appropriate method• Specific types of transactions: services, intangibles, financial transactions• Business restructuring• Practical auditing skills – including negotiating skills• Making adjustments to profit; secondary adjustments | |
| <p>Consider who should take part in the training programme:</p> <ul style="list-style-type: none">• Specialist auditors• Competent authority• Specialist lawyers• Exchange of information specialists | |
| <p>Consider the components of a training programme:</p> <ul style="list-style-type: none">• Dedicated country training• Inwards and outwards secondments• Inward placements of consultants• International tax programmes• Academic and similar programmes• “Training by doing” | |

ANNEX II

Transfer Pricing Results Measurement Framework World Bank Group – OECD - EU

| Outputs | Outcomes | Positive Criteria | Impact |
|---|---|---|--|
| New laws/regulations/amendments/codes/ government policies drafted or contributed to the drafting | Effective transfer pricing legislation/regulations enacted (<i>see note 1</i>) | Adoption of new legislation including the following key features: <ul style="list-style-type: none"> • arm’s length principle • clearly defined taxpayer’s compliance criteria, and tax administration powers • clarity of penalty rules • effective documentation criteria that does not create a disproportionate or unreasonable compliance burden | Improved taxpayer service and perceptions, measured by business survey score (IC) Increased audit revenue (DRM) |
| Recommendations provided for an adoption of a risk assessment process | Effective case selection in place Reduced number of audits taken up without eventual adjustment to taxable profit (<i>see note 2</i>) | | Increased audit revenue (DRM) |
| Recommendations provided on establishment of TP administrative framework | Effective TP admin and governance framework implemented (<i>see note 3</i>) Reduced number of audits taken up without eventual adjustment to profit Reduced duration of audit | A governance process in use that includes: <ul style="list-style-type: none"> • A process for governing the opening of TP audits • A process for regular reviews of the audit • A process for ensuring audits are closed at the appropriate time and in the most appropriate way. | Increased audit revenue (DRM) |

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|--|---|--|---|
| <ul style="list-style-type: none"> • Number of skills-building workshops conducted for specialist team • Number of participants attending all skills building workshops • Number of TP specialists attending “train the trainer” events • Number of internal/regional workshops conducted by the specialists for their colleagues (and number of participants) | <p>Effective team of specialists equipped with skills and knowledge suitable for conducting audits, applying internationally accepted principles.</p> <p><i>(see note 4)</i></p> <p>Reduced duration of audit</p> <p>Reduced number of audits taken up without eventual adjustment to taxable profit</p> <p>Reduced instances of international economic double taxation</p> | | <p>Improved taxpayer service and perceptions, measured by business survey score (IC)</p> |
| <p>Number of recommendations provided/reports submitted</p> <p>Number of workshops with judiciary</p> | <p>Effective domestic dispute resolution in place</p> <p><i>(see note 5)</i></p> <p>Reduced audit duration</p> <p>Adoption and use of a negotiation process, and/or ADR.</p> <p><i>(Numbers to track by the TA: Number of audits settled without recourse to formal judicial processes.)</i></p> | | <p>Increased audit revenue (DRM)</p> <p>Improved taxpayer service and perceptions, measured by business survey score (IC)</p> |
| <p>Effective international dispute resolution through the application of double taxation treaties</p> <p>Number of recommendations provided/reports submitted</p> <p>Number of workshops conducted to build relevant skills amongst the team</p> | <p>Reduced instances of international economic double taxation</p> <p>Establishment of competent authority function with capacity to enter into MAP process on transfer pricing issues.</p> <p><i>(Numbers to track by TA: Number of MAP discussions involving transfer pricing)</i></p> | | <p>Increased audit revenue (DRM)</p> <p>Improved taxpayer service and perceptions, measured by business survey score (IC)</p> |

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|---|---|---|--|
| <p>Number of meetings/consultations/seminars with taxpayers</p> <p>Number of KM tools: guidance notes, information circulars and other reference materials produced by TA</p> <p>Number of KM tools available online</p> <p>A central contact point in centralized team for taxpayers</p> | <p>Effective Taxpayer education and assistance strategy implemented</p> | | <p>Improved taxpayer service and perceptions, measured by business survey score (IC)</p> |
| <p><i>APAs</i></p> <p>Number of laws drafted or contributed to the drafting</p> <p>Number of workshops conducted to build relevant skills amongst the APA team</p> <p>Number of APA specialists trained</p> | <p><i>APAs</i></p> <p>Effective APA legislation in place (if in line with Country policy) (<i>see note 6</i>)</p> <p>APA team established that is capable of negotiating terms of agreements with taxpayers and foreign competent authorities</p> <p>(Numbers to track by TA: <i>i. Number of APAs agreed in the year</i> <i>ii. Time taken to agree</i></p> <ul style="list-style-type: none"> • <i>Unilateral APAs</i> • <i>Bilateral APAs</i> • <i>Multilateral APAs</i>) | <p><i>APAs</i></p> <p>Effective APA legislation enacted or amended with following features:</p> <ol style="list-style-type: none"> i. Covers transfer pricing and attribution of profits to a PE ii. Clear size and/or complexity thresholds iii. Clear time periods for APAs iv. Clear documentation requirements v. Clear revocation rules | <p>Improved taxpayer service and perceptions, measured by business survey score (IC)</p> |

NOTES

1. A legal and regulatory TP framework provides tax administrations with a) the powers to ensure that MNEs operating in their jurisdiction pay the right amount of tax, and b) the requisite tools to counter profit shifting. If the rules are in line with internationally accepted principles, the investment climate will also be enhanced - the risk of double taxation will be mitigated and there will be increased certainty and predictability of tax treatment for domestic and foreign investors.
2. Risk-based audits are critical to the strategic targeting of significant transfer pricing abuse. An effective risk assessment and case selection process also reduces the compliance costs of taxpayers by ensuring low risk transactions are not taken up for audit by the tax administration.
3. An administrative framework for the governance and oversight over TP audits ensures a) efficient use of tax administration resources b) taxpayers do not face unnecessary compliance costs c) fair and consistent treatment, in line with international approaches. The framework may adopt either a centralised or a decentralised structure.
4. Establishment of a TP Unit or team of TP specialists within the tax administration ensures a) proper enforcement of legislation through effective audit, b) proper evaluation and management of TP audits, and c) high quality, professional services and guidance to the taxpayers. If auditors apply the legislation in line with internationally accepted principles, the investment climate will also be enhanced - the risk of double taxation will be mitigated and there will be increased certainty and predictability of tax treatment for domestic and foreign investors.
5. A robust dispute resolution mechanism helps to resolve transfer pricing disputes between the taxpayer and tax administration, thus lowering compliance costs for business and ensuring the most effective use of tax administration resources. Setting up a system that can deal with disputes in a transparent, consistent and timely manner provides taxpayers with greater certainty and has a beneficial impact on the country's overall investment climate.
6. A sound APA regime provides taxpayers with certainty of the tax treatment of their cross-border activities. In addition, bilateral and multilateral programs resolve the issue of potential double taxation. For many countries, putting APA legislation in place and the establishment of an APA team capable of negotiating terms of agreements with taxpayers and foreign competent authorities is a vital component of a comprehensive TP regime.