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INSIGHT: Head to Head—OECD and UN Transfer Pricing Standards

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A number of Middle East and North Africa (MENA) tax administrations are at present working on the design and implementation of new transfer pricing regimes. In looking at a new transfer pricing regime, it is important that one takes into account all international standards with respect to transfer pricing.

This article compares the Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines (OECD Guidelines) (that most readers will be well versed in) to the United Nations Practical Manual on Transfer Pricing (UN Manual) (draft updates were published in April 2019 and so it is a good time to revisit this body of transfer pricing analysis).

By way of background and reminder, 129 OECD Inclusive Framework (IF) states have a commitment to adopt the four minimum standards:

- Action 5 (Transparency and Substance);
- Action 6 (Preventing Treaty Shopping);
- Action 13 Transfer Pricing Documentation;
- Action 14 Making Dispute Resolution More Effective.

Notable countries in MENA that have not signed the base erosion and profit shifting (BEPS) Inclusive Framework to date include Algeria, Kuwait, Lebanon, Libya, Syria.

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The 194 UN member states have a commitment for cooperation to solve economic problems (in addition to other key elements) and transfer pricing is one of these ''problems'' to ensure (according to the UN Manual) that:

- the tax base (national tax yield) is protected;
- double taxation is eliminated; and
- cross-border trade is enhanced.

Countries not included in UN member states (recognized by at least one other country) are Vatican City, Palestine, Taiwan, Western Sahara, Kosovo, South Ossetia, Abkhazia and Northern Cyprus.

The remainder of this article compares and contrasts the two international transfer pricing standards.

Divergences Between the Two Standards Before highlighting some of the key differences it is important to point out that there is a significant amount of consistency, with both standards setting out consistent analysis in the following core areas:

- business restructurings;
- intangibles;
- cost contribution agreements; and
- financial transactions.

In addition, both advocate the same five factors of comparability, five core transfer pricing methods (see sixth

United Nations Practical Manual method below), and six-step risk control framework.

General Tone and Attitude Towards Transfer Pricing Design and Planning The tone of the UN Manual is more supportive of transfer pricing advisory, design and planning, whereas the OECD BEPS Project approaches regulations as a response to aggressive tax planning. The UN Manual has the following comments in this regard:

- Successful multinational enterprises (MNEs) use location and internationalization advantages to maximize the share of global markets and growth. They are able to minimize costs through integration economies that are not available to domestic firms.

- In order to optimize the value chain, MNEs may establish new business operations in a developing country (establishment of infrastructure, improvement of the education of individuals and provision of economic benefits to the country).

- Tax authorities should not start from the assumption that MNEs are manipulating their results in order to obtain tax benefits. Many MNEs have published codes of conduct and a set of transfer pricing principles requiring the MNE to comply with the tax legislation.

- In many cases, MNEs have an incentive to set an arm's length price so as to judge performance on an equitable basis. The UN Manual reiterates that it should not be an implicit assumption that there is profit manipulation.

Recommendations for Governance for MNEs and Tax Administrations The UN Manual contains detailed recommendations for an MNE setting up an in-house transfer pricing department and for a tax administration establishing a new transfer pricing regime.

Sixth Transfer Pricing Method The sixth method advocated in the UN Manual is applied in practice in many Central and Southern America regimes and considers quoted prices of the commodities market that may be comparable uncontrolled prices (CUPs) for transactions with related parties (under similar circumstances).

Whilst this may prove difficult to prove in absolute terms (especially in developing countries) the method has had some success in transfer pricing regulations by looking at:

- bringing together the CUP and safe harbor principles (e.g. a cap/ceiling);

- providing distinct treatment for import and export prices; and

- mandatory usage if a price is regulatory.

Intangibles Market features and group synergies are considered in the UN Manual to be intangibles (whilst the OECD holds these out as comparability factors and not intangibles in their own right). Workforce in place (qualified and skilled) is also listed as an intangible (a concept that was recently adopted by the Internal Revenue Service (IRS)).

The UN Manual adds an all-important ''A'' to the OECD DEMPE functions:

- Development
- **Acquisition (of Intangibles)**
- Enhancement
- Maintenance
- Protection
- Exploitation of intangibles

In addition, and another major departure from the OECD Guidelines, is the contention (shared by the author) that legal rights/ownership provide the starting point for the analysis of intangibles.

Recommendations for Governance for MNEs and Tax Administrations The UN Manual contains detailed recommendations for an MNE setting up an in-house transfer pricing department and for a tax administration establishing a new transfer pricing regime.

Other Important Elements The UN Manual sets out strong economic analysis on comparables and certain measures that can be considered when there is a lack of comparables.

The economic analysis contained in the UN Manual will be useful in all transfer pricing situations in all countries in the same way that economic precedents discussed in international transfer pricing case law in Canada or Australia, for example, can be useful in resolving disputes in other jurisdictions. While legislation may vary from state to state, economic disciplines cut across all geographies.

The UN Manual sets out the following important comments:

- Finding a satisfactory comparable in developing countries is possibly the biggest practical problem faced by MNEs and tax administrations. Reference is made to the IMF/OECD/UN/WBG Toolkit.

- Lack of comparables ''does not mean that such transaction is not at arm's length.'' Consider the use of foreign comparables (adjusted) or the use of local comparables from another industry (i.e. benchmark the transaction).

The UN Manual also sets out a comprehensive summary of potential CUP adjustments:

- accounting adjustments (sales rebates, research and development reflected in CoS or operating expenses, direct v. indirect cost adjustments, intangibles not recognized on the balance sheet);

- balance sheet/working capital adjustments (stock to turnover rations, working capital adjustments, interest rate/parity adjustments). A simple formula to make working capital (WC) adjustments by way of example: Tested Party WC/Tested Party Profit Level Indicator (PLI) – Comparable WC/Comparable PLI x interest rate (on net working capital)

Country Specific Examples The UN Manual includes examples of major regimes that depart from the OECD standard. The U.S. could be added as another major regime that enacts and implements unilateral measures that are at odds with other regimes.

Planning Points Unilateral actions/regulations from tax authorities that do not conform to an international transfer pricing standard can cause economic double taxation or non-taxation.

The UN Manual has considered this and updated the UN Manual in April 2019 to try to manage consistency with the OECD Guidelines but the UN also cautions against transfer pricing documentation overburdening the taxpayer with disproportionately high costs.

Note that the use of de minimis limits and exemptions presents an opportunity for businesses to manage compliance burdens in a more equitable manner.

It is conceded by the UN Manual that documentation requirements should (as far as possible) be consistent between the OECD and UN models; however, ''it cannot be automatically assumed that these international guidelines should be adopted wholesale in every developing country.''

Many new transfer pricing regimes in MENA are in line with the OECD Guidelines due to the IF commitment and whilst consistency from regime to regime will help businesses, ignoring the UN practical analysis does not do justice to the economic, commercial and practical analysis contained therein which should be taken into consideration by advisers, MNEs and tax administrations.

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Timeline OECD Guidelines

First edition—1979

Second edition—1995

The most recent edition of the Guidelines (2017) incorporated the outcomes of Actions 8, 9 and 10 as well as Action 13 of the OECD BEPS project.

In July 2018 draft guidance was published addressing issues relating to the pricing of financial transactions made within MNEs.

UN Manual

First edition—2013

Second edition—2017

Draft updates to financial transactions and profit splits—2019