## Background Paper

## WORKING DRAFT

## [PRELIMINARY] TABLE OF CONTENTS

Secretariat Draft May 2011

[Page]

Chapter 1	Introd	duction to Transfer Pricing – an Overview		
	1.1	Introduction - What is Transfer Pricing?		
	1.2	Basic Issues Underlying Transfer Pricing		
	1.3	Evolution of Transfer Pricing		
	1.4	Concepts in Transfer Pricing		
	1.5	Transfer Pricing Methods		
	1.6	Special Issues Related to Transfer Pricing		
	1.7	Transfer Pricing in Double Taxation Treaties		
	1.8	Transfer Pricing in Domestic Law		
	1.9	Global Transfer Pricing Regimes		
	1.10	Dispute Resolution		
	1.11	Transfer Pricing as a Current and Future Issue for Developing Countries		
Chapter 2		ness Framework: The Theory of the Firm and the on for the Existence of Multinational Enterprises		
	2.1	Introduction		
		2.1.1 Legal Structure		
		2.1.2 Companies and Branches		
	2.2	Operational Structure		
	2.3	Types of Organisational Structures		

**Functional Structure** 

Divisional structure

Matrix Structure

2.3.12.3.2

2.3.3

2.4

Financial Reporting

**Foreword** 

- 2.5 Supply Chain Analysis
- 2.6 Cost Contribution Arrangements
- 2.7 Managing the Transfer Pricing Function in an MNE

#### Chapter 3 The [General] Legal Environment

- 3.1 Introduction
- 3.1 Introduction
- 3.2 Domestic Transfer Pricing Legislation
  - 3.2.1 Structural Overview
  - 3.2.2 "Hierarchy" of Methods: vs. Best Method vs. Most Appropriate Method
  - 3.2.3 Practical Guidance for Cases without Sufficient Comparables
    - 3.2.3.1 Comparability Analysis and Administrability
    - 3.2.3.2 Presumptive taxation methods and ALP
  - 3.2.4 Advance Pricing Arrangements
  - 3.2.5 Safe Harbours
    - 3.2.5.1. Definition
    - 3.2.5.2. Possible Pros and Cons
    - 3.2.5.3. Examples
      - o Safe harbours for loan operations
      - Safe harbours for limited participation in international operations
      - Safe harbours for export operations
      - Safe harbours to avoid disputes on small deviations
      - o Safe harbours to alleviate documentation burdens
- 3.3 [Provisions of Legal and Administrative Guidance]
- 3.4 Disputes

#### **Chapter 4** Establishing Transfer Pricing Capability in a Tax

#### Administration

- 4.1. Introduction
- 4.2 Transfer Pricing Rules Justification in Developing Countries
- 4.3. The Relationship between Policy and Administration Issues
- 4.4 Setting up Policy Capability
  - 4.4.1 Co-operation [between policy and administrative arms]
- 4.5 Assessing Administrative Capacity
  - 4.5.1 Level of capacity of the Tax Administration
  - 4.5.1 Competences needed by the Tax Administration
  - 4.5.1 Training needs of the Tax Administration
- 4.6 Setting up a Transfer Pricing Unit
  - 4.6.1 Organisation
  - 4.6.2 Model for Organisation
  - 4.6.3 A "life cycle" approach
  - 4.6.4 Possible stages
  - 4.6.5 Knowledge retention
  - 4.6.6 [Managing relations with taxpayers]
  - 4.6.7 Assessing effectiveness and fine tuning
- [4.7 The use of external advisors special issues
  - 4.6.1 Assessing the need or otherwise
  - 4.6.1 Cost issues and possible support
  - 4.6.1 Designing the task and measures of success
  - 4.6.1 Choosing an expert
  - *4.6.1 Implementation and evaluation*
  - 4.6.1 Building knowledge retention into the project]

#### **Chapter 5** Transfer Pricing Methods

- 5.1 Introduction: "Traditional" and Transactional" Methods
  - 5.1.1 Use of methods
  - 5.1.2 Selection of methods (how, why and use of

#### more than one method)

		more than one method)				
	5.1.3	Choice of available methods				
5.2	"Tradit	"Traditional" Methods				
	5.2.1	Comparable Uncontrolled Prices				
	5.2.2	Comparability				
	5.2.3	Strengths and weaknesses of CUP				
	5.2.4	When to use the CUP Method				
	5.2.5	Case Examples				
5.3	Resale	Resale Price method				
	5.3.1	Mechanism of Resale Price Methods				
	5.3.2	Arm's Length Gross Profit Margin				
	5.3.3	Transactional comparison versus functional comparability				
	5.3.4	Comparability				
	5.3.5	Strengths and weaknesses				
	5.3.6	When to use the Resale Price Method				
	5.3.7	Case Examples				
5.4	Cost P	Cost Plus Method				
	5.4.1	Mechanism of the Cost Plus Method				
	5.4.2	Arm's Length Gross Profit Mark-up				
	5.4.3	Transactional comparison versus functional comparison				
	5.4.4	Comparability				
	5.4.5	Determination of Costs				
	5.4.6	Strengths and Weaknesses				
	5.4.7	When to use the Cost Plus Method				
	5.4.8	Case Examples				
5.5	Transa	ctional Methods				
5.6	Transa	Transactional Net Margin Method				
	5.6.1	Definition and choice of Tested Party				
	5.6.2	Mechanism of TNMM				
		5.6.2.1 Related party distributor				

5.6.2.2

Related party manufacturer

	5.6.3	Arm's Lo	Arm's Length Net Profit Margin		
		5.6.3.1	Definition of Net Profit Margin		
		5.6.3.2	Transactional comparison versus functional comparison		
	5.6.4	Compara	bility standard		
	5.6.5	Other Gu	idance for Application		
	5.6.6	Strength	and weaknesses		
	5.6.7	Why we	use the TNMM		
5.7	Profit Split Method		d		
	5.7.1	Definitio	n		
	5.7.2	Methods	to allocate or Split the Profits		
		5.7.2.1	Contribution analysis		
		5.7.2.2	Comparable profit split		
		5.7.2.3	Residual analysis		
	5.7.3	Strengths	s and weaknesses		
	5.7.4	When to	use the profit split methods?		

#### Possible Part of Chapter 5 or Additional Chapter 6

#### The [Possible] Use of Fixed Margins

- 6.1 Introduction Resale Price Method and Cost Plus Method with predetermined profit margins
  - 6.1.1 General explanation
  - 6.1.2 Compatibility with ALP?
  - 6.1.3 Strengths and weakness of Resale Price Method and Cost Plus Method with predetermined profit margins
  - 6.1.4 Resale Price Method With Fixed Margins 6.1.4.1 Case Examples
  - 6.1.5 Cost Plus Method With Fixed Margins 6.1.5.1 Case Examples
  - 6.1.6 Differences of the application of this methods regarding import and export operations.
    - 6.1.6.1 Imports
    - 6.1.6.2 Exports

#### **Chapter 7** Comparability

- 7.1 Introduction the Rationale for Comparability Analysis
- 7.2 Comparability Analysis Process
- 7.3 Comparability Analysis in Operation
- 7.4 Identification of Comparables
- 7.5 Adjustments to Comparables
- 7.6 Selection of Transfer Pricing Method
- 7.7 Issues with Comparability Analysis
- 7.8 Conclusion

#### **Chapter 8** Transfer Pricing Analysis and Methods – Special Issues

- 8.1 Introduction
- 8.2 Location Savings
- 8.3 Tax Holidays and Transfer Pricing
- 8.4 Business Restructuring
- 8.5 VAT/GST/ Withholding tax Issues
- 8.6 Treatment of intangibles
- 8.7 Intra-group Services and Commodities Trading
- 8.8 Cost Contribution Arrangements
- 8.9 Intra- Group Finance
- [8.10] Accounting Standards, Corporate Governance and TP]

#### **Chapter 9 Documentation**

- 9.1 Introduction
- 9.2 International Guidelines on Transfer Pricing Documentation
  - 9.2.1 OECD Transfer Pricing Guidelines (2010)
  - 9.2.2 Documentation Rules of the Pacific Association of Tax Administrators (2003)
  - 9.2.3 EU's Code of Conduct on TP Documentation (2006)
  - 9.2.4 Possible lessons from the international guidelines
- 9.3 Practical Guidance on Documentation Rules and Procedures
  - 9.3.1 Burden of Proof

- 9.3.2 Timeframes for Producing Documentation
- 9.3.3 Penalties
- 9.3.4 Special considerations for SMEs?
- 9.3.5 Language
- 9.3.6 Electronic form ability to be analysed electronically
- 9.3.7 General document handling, tracking and access issues for large TP "files"

Appendices: Country examples and sample ICC package

#### Chapter 10 Transfer Pricing Audits and Risk Assessment

- 10.1 Introduction
- 10.2 Organization and Staffing of Transfer Pricing Audits
- 10.3 Selection of Taxpayers for Transfer Pricing Audit Risk Assessment
  - 10.3.1. Types of Approach
    - 10.3.1.1 Transactional approach
    - 10.3.1.2 Jurisdictional approach
    - 10.3.1.3 Risk based approach
  - 10.3.2. Sources of Information for Risk Assessment
    - 10.3.2.1 Tax returns
    - 10.3.2.2 Publicly available data
    - 10.3.2.3 Court case judgments
    - 10.3.2.4 Financial statements
  - 10.3.3. Risk factors/risk flags
  - 10.3.4. The risk assessment process
  - 10.3.5. Risk assessment tools
  - 10.3.6. Risk assessment findings
- 10.4 Planning for a Transfer Pricing Examination
  - 10.4.1 Formation of Examination Team
  - 10.4.2 Supervision of Examination
  - 10.4.3 Issues for Examination

		10.4.4	Audit Time	table		
		10.4.5	Information already in Hand			
		10.4.6	Information to be Collected			
		10.4.7	Statutes of 1	Limitations		
		10.4.8	Approvals a	and Sign-off		
10.5		Preliminary Examination and Decision whether to continue				
		Examina	ntion			
		10.5.1	Desk Audit			
		10.5.2	Analyses			
		10.5.3	Understand	ing the taxpayers' business		
		10.5.4	Understand	ing the industry the taxpayer is in		
		10.5.5	Approval			
10.6	10.6	Examination Procedure				
		10.6.1	Audit approach			
		10.6.2	Gathering of	of information		
			10.6.2.1	How		
			10.6.2.2	From whom		
			10.6.2.3	Language		
		10.6.3	Types of in	formation to be gathered		
			10.6.3.1	General information		
			10.6.3.2	Financial information		
			10.6.3.3	Third party information		
			10.6.3.4	Approval		
		10.6.4	Contempora	aneous documentation		
		10.6.5	Information request list			
		10.6.6	Initial information requests			
		10.6.7	Supplemental information requests			
		10.6.8	Requests for interviews			
		10.6.9	Taxpayer's responses to requests for information and interviews			
		10.6.10	Requests or summons for the production of books records or other written information			
		10.6.11`	Information held by foreign related parties			
		10.6.12	Secret comparables			
		10.6.13	Unrelated third party information			
		10.6.14	Information	exchange under tax treaties		

# [10.6.14.1 The nature of the obligation 10.6.14.2 Practical issues]

## 10.6.15 Attorney Client Privilege and Work Product Doctrine

10.7.	Narrowing of issues – Development of the Tax Authority's			
	Position			
	10.7.1	Refining understanding of taxpayer's business		
	10.7.1	Refining understanding of taxpayer's industry		
	10.7.2	Refining functional and risk analysis		
	10.7.3	Choice of transfer pricing method		
	10.7.4	Interaction with taxpayer and advisors		
	10.7.5	Draft proposed adjustments (examiner's interim opinion)		
	10.7.6	Formal notification to taxpayer of proposed Adjustment		
	10.7.7	Issuance of adjustments		
	10.7.8	Settlement opportunities		
10.8	Case Closure			
	10.8.1	Audit report		
	10.8.2	Supervisor approval		
	10.8.3	Issuance of assessment or transfer pricing adjustments		
	10.8.4	Administrative appeals		
	10.8.5	Settlement procedures		
10.9	Relationship between Transfer Pricing Audits and Advance			
	Pricing Agreements			
[10.10	The possibility of joint audits]			

## **Chapter 11 Adjustments, Dispute Resolution**

- 11.1 Introduction to Dispute Resolution in a Domestic and International Context
- 11.2 Transfer Pricing Adjustments, including Corresponding Adjustments

- 11.3 Penalties
- 11.4 The Mutual Agreement Procedure (MAP) under Tax Treaties
- 11.5 Settlements
- 11.6 Alternative Dispute Resolution and Developing Countries
- 11.7 The Role of Courts and Tribunals in Transfer Pricing Dispute Resolution
- 11.8 Advance Pricing Agreements (APAs) Policy and Administrative Considerations
- 11.9 Developing an APA Program Practical Considerations
- 11.10 Arbitration of Transfer Pricing Issues
- [11.11 Practical issues in litigation cases]

#### **Chapter 12** Training, and Capacity Building Resources

- 12.1 Overview of Assistance and Capacity Building
- 12.2 CATA, CIAT, CREDAF, IOTA, SGATAR, SADC
- 12.3 UN
- 12.4 OECD
- 12.5 World Bank
- 12.6 Regional Development Banks
- 12.7 IBFD and Similar Providers
- 12.8 Other sources of Information and Data
- 12.8 Bilateral TP Assistance
- 12.9 Putting a Case for Support and Funding the Essentials
- 12.10 Ensuring Assistance meets Country Needs and Priorities

#### [Possible] Appendices

- a. Glossary of Terms
- b. Frequently Asked Questions (FAQ)
- c. Checklist [and possibly also flowchart] for transfer pricing set-up

- d. Checklist of possible transfer pricing issues- General
- e. Table of main differences and possible uses of different methods
- f. Flowchart of a typical transfer pricing scenario (with non-typical extensions)
- g. Current databases a survey of coverage, characteristics [and costs]
- h. Checklist [and possibly also flowchart] on documentation
- i. Bibliography