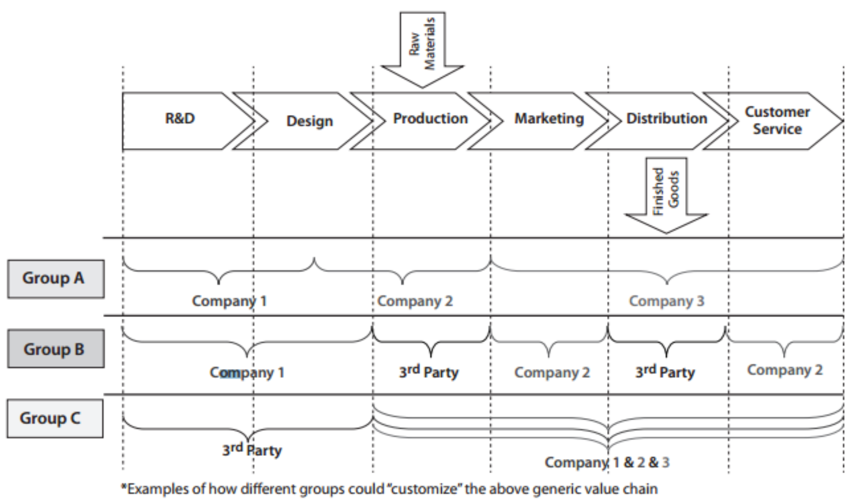
United Nations Issues 2017 Transfer Pricing Manual

On April 7, 2017, the United Nations issued a revised version of transfer pricing manual that improves the alignment of the UN's standards for transfer pricing with those offered by the OECD. Key updates related to value chain analysis and pricing controlled transactions involving services or intangible property. The manual also offers important insights regarding country-specific practices in Brazil, China and India.

Value Chain Analysis

The updates to the manual address the OECD's current emphasis on value chain analyses by establishing a seven step process for analyzing a value chain. Moreover, the updated manual provides examples on how operational structures can imply different transfer pricing methods and strategies despite a similar value chain. Third, the manual provides a template of a diagram to use to illustrate a value chain in disclosures and/or transfer pricing documentation.

Figure 1: Value Chain Diagram Example



Intra-Group Services and Intangible Property

The manual also includes new chapters on intra-group services and intangibles that adopt key concepts from corresponding sections of the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines"). One point of interest related to these new chapters is the additional examples that focus squarely on challenges developing countries face in such transactions. For example, the Manual provides examples of how developing countries' tax authorities place emphasis on intangibles developed by an MNE's entity that is performing contract services for the MNE. For example, tax authorities in China and India take the stance that intangibles are developed in the course of providing services (i.e., know-how) and that such intangibles become increasingly valuable the longer the services are rendered.

Country-Specific Commentary for Brazil, China and India

Brazilian transfer pricing legislation establishes fixed margins for specific economic sectors. Pricing transactions by reference to fixed margins has certain advantages relative to the use of conventional methods to determine pricing based on arm's length principles, including increased simplicity, avoiding the need for specific comparables and stabilizing the expectation of the taxpayer with respect to Brazilian tax liability associated with inter-company transactions. However, there are weaknesses to using the fixed margins such as double taxation, requiring the clear classifications and accounting conformity between COGS and operating expenses and that some enterprises will be taxed higher than if the margins were determined based on the arm's length standard.

China

State Administration of Taxation ("SAT") prefers that transfer pricing studies reference the profits of domestic comparable companies (i.e., Chinese companies) instead of foreign-based companies. That said, one of the key challenges for evaluating transactions involving entities in China, and other developing countries, is the lack of reliable, public information on comparables. Due to these data limitations, foreign companies (i.e., South Korean, Japanese, South East Asian companies) are often included as comparables in a transfer pricing study. SAT is notorious for making adjustments to the comparables that underpin a transfer pricing study to the detriment of the multinational taxpayer. As such, it is stressed that MNE's pay close attention to their transfer pricing policies and the use of comparables in China.

India

India has introduced safe harbor provisions in its legislation with the intent to reduce the compliance burden. The safe harbor rules cover the following sectors/transactions:

- Software development;
- IT enabled services;
- Knowledge process outsourcing services;
- Outbound intra-group loans;
- Corporate guarantees;
- Contract R&D services in software;
- Contract R&D services in pharmaceuticals;

- Manufacture and export of core auto components; and,
- Manufacture and export of non-core auto components.

For more information on the United Nations Transfer Pricing Manual or for any other questions regarding transfer pricing, please contact Ben Miller by calling 770.396.2200.