



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



## TRANSFER PRICING LEGISLATION – A SUGGESTED APPROACH JUNE 2011

**Disclaimer:** This paper, which has been prepared by the OECD Secretariat, contains a suggested approach to the drafting of transfer pricing legislation. It is intended to provide countries that are developing transfer pricing rules with a suggested structure and content for their legislation. It is purely illustrative; countries will want to adapt their approach to suit their own circumstances and priorities, as well as their legislative language and conventions. This paper bears no legal status and the views expressed therein do not necessarily represent the views of the OECD member states. For a more comprehensive description of the views of the OECD and its member states in relation to the arm's length principle and transfer pricing, readers are invited to refer to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations which were approved by the Committee on Fiscal Affairs on 27 June 1995 and by the Council of the OECD for publication on 13 July 1995 [C(95)126/FINAL] and were supplemented and updated since (the most recent update of the Transfer Pricing Guidelines was approved by the Council on 22 July 2010, see [www.oecd.org/ctp/tp](http://www.oecd.org/ctp/tp).)

Also available: *Législation sur les prix de transfert – Proposition d'approche (juin 2011)*  
*Legislación en materia de precios de transferencia – Propuesta de enfoque (junio 2011)*



CENTRE FOR TAX POLICY AND ADMINISTRATION

## INTRODUCTION

This paper, which has been prepared by the OECD Secretariat, contains a suggested approach to the drafting of transfer pricing legislation. It is intended to provide countries that are developing transfer pricing rules with a suggested structure and content for their legislation. It is purely illustrative; countries will want to adapt their approach to suit their own circumstances and priorities, as well as their legislative language and conventions.

### **Why should a country implement the arm's length principle in its domestic legislation?**

At the theoretical level, the challenge for developing and transitioning countries in the development of transfer pricing legislation is in essence the same as for OECD countries: protecting their tax base while not creating double taxation or uncertainties that could hamper foreign direct investment and cross-border trade. The adoption of transfer pricing legislation embodying the arm's length principle can be instrumental in achieving this dual objective.

The suggested approach in this paper is based on the arm's length principle underlying Article 9 of both the OECD Model Tax Convention on Income and on Capital ("the OECD Model") and the United Nations Model Double Taxation Convention between Developed and Developing Countries ("the UN Model"), as that principle is elaborated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("the OECD Transfer Pricing Guidelines"). Dozens of countries around the world have implemented transfer pricing laws, and virtually all of them are based on the arm's length principle. Paragraph 3 of the Commentary on Article 9 of the United Nations Model Convention states that:

With regard to transfer pricing of goods, technology, trademarks and services between associated enterprises and the methodologies which may be applied for determining correct prices where transfers have been on other than arm's length terms, the Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines. These conclusions represent internationally agreed principles and the Group of Experts recommends that the Guidelines should be followed for the application of the arm's length principle which underlies the article.

Alignment of domestic transfer pricing rules with the internationally accepted principles set forth in the OECD Transfer Pricing Guidelines can:

- Provide countries with the tools they need to fight artificial shifting of profits out of their jurisdiction by multinational enterprises ("MNEs");
- Provide MNEs with some certainty of treatment in the country concerned;
- Reduce the risk of economic double taxation;
- Provide a level playing field between countries, which is less likely to distort the pattern of international trade and investment; and
- Provide a level playing field between MNEs and independent enterprises doing business within a country.

Whenever two countries have a treaty in place that contains an Associated Enterprises (or equivalent) Article worded in a manner similar to Article 9 of the OECD and UN Models, that article will be interpreted in line with internationally accepted transfer pricing principles. Those principles will set the boundaries for the application of the transfer pricing rules in the domestic legislation of the Contracting States in relation to transactions that are covered by the provisions of that treaty article. It

is, therefore, desirable for countries that have or intend to develop a network of bilateral treaties containing Article 9-type provisions to align their domestic transfer pricing legislation with the relevant internationally agreed principles in order to avoid mismatches that would lead to a greater number of more complex and more lengthy disputes and Competent Authority procedures.

Furthermore, even where no treaty is in place, domestic courts may fall back on internationally accepted principles to interpret domestic legislation, especially where countries do not provide detailed guidance on the application and interpretation of their domestic legislation.

For all the reasons listed above, it is desirable to avoid any significant discrepancy between domestic transfer pricing legislation and internationally agreed principles. However, should a country wish to incorporate in its domestic legislation a significant departure from internationally agreed principles, it is advisable for it to do so in an informed and transparent manner.

The suggested language contained in this paper is intended to facilitate the drafting of legislation that is in line with internationally agreed transfer pricing principles and, to the extent needed, the identification of any departure from those principles.

### **Is the arm's length principle more favourable to developed economies than to developing and transitioning ones?**

The arm's length principle simply states that transactions between associated enterprises should not be distorted by the special relationship that exists between the parties. As such, the arm's length principle is neutral. A similar principle is used for customs valuation purposes.

In fact, transfer pricing is not as much about a tension between developed and developing countries, as about a tension between high tax and low tax jurisdictions. Many OECD and non-OECD countries suffer in the same way from the artificial shifting of profits to low tax jurisdictions. The arm's length principle and the Transfer Pricing Guidelines were developed to establish a principled way to resolve disputes that arise among OECD countries related to the allocation of taxing rights over MNE profits. Developing and transitioning economies that are faced with the challenge of measuring the profits from MNEs that should be taxable in their jurisdiction can benefit from the arm's length principle and Transfer Pricing Guidelines in the same way as OECD countries have.

The dual objective of the arm's length principle (protecting a country's tax base while limiting risks of double taxation) is shared by OECD and non-OECD countries. For the latter as well as for the former, being part of the international consensus is the most efficient method of achieving these objectives.

Of course, transfer pricing legislation is not sufficient to resolve all the international tax issues that may arise for a country. In particular, while transfer pricing legislation is part of the measures needed to tackle international tax avoidance, it does not replace anti-abuse rules and/or controlled foreign companies legislation that may be needed to fight abusive transactions.

### **Is the arm's length principle too complex to administer for developing and transitioning economies?**

The question is often raised whether the arm's length principle is too complex to administer for those countries that have limited administrative resources and in particular for developing and transitioning economies. It is true that the application of the arm's length principle can be complex and resource-intensive. In fact, most OECD countries started modestly and built their transfer pricing legislation and practices progressively over a decade or two and are still in the process of improving them.

One key to success may be to tailor legislative measures and the deployment of administrative capacities to the strategic needs and administrative resources of each particular country. This typically means prioritising transfer pricing enforcement activities in accordance with the circumstances of each particular economy and in particular the type of cross-border trade, its complexity and the number of large taxpayers concerned; setting enforcement objectives that are realistic given the administration's capacities; and designing compliance requirements that are reasonable for taxpayers given the size of the cross-border trade.

The OECD has developed a seminar on "Implementing Transfer Pricing Legislation" that is designed to address these issues with participants from non-OECD economies. Further information about that seminar may be obtained from the contact persons listed below.

### **The OECD's dialogue with non-OECD economies**

A significant part of the OECD's activities in the transfer pricing area consists in developing a strong policy dialogue with non-OECD economies to share experience on the development of legislative measures that fit each country's particular needs in accordance with the most recent international standards and the deployment over time of administrative capacities. The suggested approach contained in this paper is intended to add to, and further inform, that dialogue.

### **Drafting Approach**

Countries that have adopted transfer pricing legislation based on the arm's length principle follow different legislative drafting approaches. Some countries have adopted very brief language setting out basic principles in "primary legislation" (*i.e.* mainly in the law), often elaborating on those principles in "secondary legislation" (including regulations, circulars, decrees or similar administrative pronouncements). Other countries have adopted more elaborate and extensive language in primary legislation. The choice of a particular drafting approach will depend on the legal system of the country concerned, and in particular on whether it is a civil law or common law system.

The draft language set out in the attached is intended to be flexible. The entire draft would be suitable for primary legislation if that approach is consistent with the country's normal legislative practices. Alternatively, primary legislation might be limited to the material in Section 1, Section 9 and Section 12, with the language of other sections reserved for secondary legislation. The intention, however, is that the subject matter contained in each of the sections of the draft be considered by countries as they implement a transfer pricing regime based on the arm's length principle. The explanatory notes at the end of the document describe in greater detail some of the reasoning underlying the draft legislation. For further elaboration, reference should be had to the OECD Transfer Pricing Guidelines.

### **Contact persons**

Should you have questions or comments on the attached, please feel free to contact one of the following persons at the OECD Centre for Tax Policy and Administration:

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## DRAFT LEGISLATION

### PART 1. TRANSACTIONS BETWEEN ASSOCIATED ENTERPRISES

#### *SECTION 1. The Arm's Length Principle*

1. For purposes of [relevant provisions of Country's tax law], where an enterprise engages in one or more commercial or financial transactions with an associated enterprise that is not an enterprise of [Country], each such enterprise shall determine the amount of its taxable profits in a manner that is consistent with the arm's length principle. The amount of taxable profits derived by an enterprise that engages in one or more commercial or financial transactions with an associated enterprise shall be consistent with the arm's length principle if the conditions of those transactions do not differ from the conditions that would have applied between independent enterprises in comparable transactions carried out under comparable circumstances.

2. Where the conditions made or imposed in commercial or financial transactions between associated enterprises to which paragraph 1 applies are not consistent with the arm's length principle, then any amount of profits that would have accrued to either one of the enterprises and been taxable to that enterprise in [Country] if the conditions of the transactions had been consistent with the arm's length principle, but have not accrued to that enterprise due to the non-arm's length conditions, may be included in the taxable profits of that enterprise and taxed accordingly.

3. The determination of whether the conditions of a controlled transaction are consistent with the arm's length principle of paragraph 1, and of the quantum of any adjustment made under paragraph 2, shall be made in accordance with the provisions of Sections 2 to 8.

[optional] 4. To the extent specifically required [in secondary legislation] in order to prevent the avoidance of tax, the provisions of paragraph 1 shall also apply where an enterprise of [Country] engages in one or more commercial or financial transactions with an associated enterprise that is also an enterprise of [Country].

[optional] 5. The provisions of paragraph 1 shall also apply where an enterprise of [Country] engages in one or more commercial or financial transactions with an enterprise located in [include here a definition or list of tax haven countries], whether or not such enterprise is an associated enterprise.

#### *SECTION 2. Definitions*

1. Two enterprises are considered to be associated where:

- (a) One enterprise participates directly or indirectly in the management, control or capital of the other, or
- (b) The same person or persons participate(s) directly or indirectly in the management, control or capital of both enterprises.

2. A person or enterprise participates directly or indirectly in the management, control or capital of an enterprise where:

- (a) It owns, directly or indirectly, more than [50%] of the share capital of the enterprise, or
  - (b) It has the practical ability to control the business decisions of the enterprise.
3. Independent enterprises are enterprises that are not associated with one another.
  4. A controlled transaction is any transaction between associated enterprises.
  5. An uncontrolled transaction is any transaction between independent enterprises.
  6. The conditions of a transaction include, but are not limited to, the financial indicator measured in applying the appropriate transfer pricing method (*e.g.* the price of the transaction, the gross margin or net profit earned by one of the parties to the transaction, or the division of profit between the parties to the transaction).
  7. An enterprise of [Country] is an enterprise carried on by a person resident in [Country].
- [*optional*] 8. An advance pricing arrangement is a procedural arrangement between one or more taxpayers and one or more tax administrations intended to resolve potential transfer pricing disputes in advance by determining, in advance of controlled transactions, an appropriate set of criteria for the determination of the arm's length conditions for those transactions over a fixed period of time.
- [*optional*] 9. A competent authority is a person identified as such in a double taxation convention and who thereby is given the authority to carry out certain functions under that convention.

### ***SECTION 3. Comparability***

1. An uncontrolled transaction is comparable to a controlled transaction within the meaning of Section 1:
  - (a) When there are no significant differences between them that could materially affect the financial indicator being examined under the appropriate transfer pricing method, or
  - (b) When such differences exist, if a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison.
2. To determine whether two or more transactions are comparable, the following factors shall be considered to the extent that they are economically relevant to the facts and circumstances of the transactions:
  - (a) The characteristics of the property or services transferred;
  - (b) The functions undertaken by each enterprise with respect to the transactions (taking into account assets used and risks assumed);
  - (c) The contractual terms of the transactions;
  - (d) The economic circumstances in which the transactions take place; and
  - (e) The business strategies pursued by the associated enterprises in relation to the transactions.

#### **SECTION 4. Transfer Pricing Methods**

1. The arm's length remuneration of a controlled transaction shall be determined by applying the most appropriate transfer pricing method to the circumstances of the case. Except to the extent provided in paragraph 5, the most appropriate transfer pricing method shall be selected from among the approved transfer pricing methods set out in paragraph 2, taking into consideration the following criteria:

- (a) The respective strengths and weaknesses of the approved methods;
- (b) The appropriateness of an approved method in view of the nature of the controlled transaction, determined in particular through an analysis of the functions undertaken by each enterprise in the controlled transaction (taking into account assets used and risks assumed);
- (c) The availability of reliable information needed to apply the selected transfer pricing method and/or other methods; and
- (d) The degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.

2. The following are approved transfer pricing methods for purposes of paragraph 1:

- (a) **Comparable Uncontrolled Price Method.** The comparable uncontrolled price method consists of comparing the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction.
- (b) **Resale Price Method.** The resale price method consists of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions.
- (c) **Cost Plus Method.** The cost plus method consists of comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction.
- (d) **Transactional Net Margin Method.** The transactional net margin method consists of comparing the net profit margin relative to an appropriate base (*e.g.* costs, sales, assets) that an enterprise achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions.
- (e) **Transactional Profit Split Method.** The transactional profit split method consists of allocating to each associated enterprise participating in a controlled transaction the portion of common profit (or loss) derived from such transaction that an independent enterprise would expect to earn from engaging in a comparable uncontrolled transaction. When it is possible to determine an arm's length remuneration for some of the functions performed by the associated enterprises in connection with the transaction using one of the approved methods described in subparagraphs 2 (a) to (d), the transactional profit split method shall be applied based on the common residual profit that results once such functions are so remunerated.

3. Where, taking account of the criteria described in paragraph 1, a comparable uncontrolled price method described in subparagraph 2 (a) and an approved method described in subparagraphs 2 (b) to 2 (e) can be applied with equal reliability, the determination of arm's length conditions shall be made using the comparable uncontrolled price method. Where, taking account of the criteria described in paragraph 1, an approved method described in subparagraphs 2 (a) to 2 (c) and an approved method described in subparagraphs 2 (d) to 2 (e) can be applied with equal reliability, the determination of arm's length conditions shall be made using the method described in subparagraphs 2 (a) to 2 (c).

4. It is not necessary to apply more than one method to determine the arm's length remuneration for a given controlled transaction.

5. The taxpayer may apply a transfer pricing method other than the approved methods contained in paragraph 2 where it can be demonstrated that (i) none of the approved methods can be reasonably applied to determine arm's length conditions for the controlled transaction, and (ii) such other method yields a result consistent with that which would be achieved by independent enterprises engaging in comparable uncontrolled transactions under comparable circumstances. The taxpayer asserting the use of a method other than the approved methods contained in paragraph 2 shall bear the burden of demonstrating that the requirements of this paragraph 5 have been satisfied.

6. Where a taxpayer has used a transfer pricing method to establish the remuneration of its controlled transactions and that transfer pricing method is consistent with the provisions of this Section 4, then the tax administration's examination of whether the conditions of the taxpayer's controlled transactions are consistent with the arm's length principle shall be based on the transfer pricing method applied by the taxpayer.

#### ***SECTION 5. Evaluation of a Taxpayer's Combined Controlled Transactions***

If a taxpayer carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to (i) perform the comparability analysis set out in Section 3 and (ii) apply the transfer pricing methods set out in Section 4.

#### ***SECTION 6. Arm's Length Range***

1. An arm's length range is a range of relevant financial indicator figures (*e.g.* prices, margins or profit shares) produced by the application of the most appropriate transfer pricing method as set out in Section 4 to a number of uncontrolled transactions, each of which is relatively equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with Section 3.

2. A controlled transaction, or a set of transactions that are combined according to Section 5, shall not be subject to an adjustment under Section 1, paragraph 2 where the relevant financial indicator derived from the controlled transaction or set of transactions and being tested under the appropriate transfer pricing method is within the arm's length range.

3. Where the relevant financial indicator derived from a controlled transaction, or from a set of transactions that are combined according to Section 5, falls outside the arm's length range, the tax administration may adjust it pursuant to Section 1, paragraph 2, and any such adjustment shall be to a point in the arm's length range that best reflects the circumstances of the case.

## PART 2: APPLICATION TO SPECIFIC TRANSACTIONS

### *SECTION 7. Services between Associated Enterprises*

1. A service charge between associated enterprises shall be considered consistent with the arm's length principle where:

- (a) It is charged for a service that is actually rendered,
- (b) The service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position,
- (c) It is charged for a service that an independent enterprise in comparable circumstances would have been willing to pay for if performed for it by an independent enterprise, or would have performed in-house for itself, and
- (d) Its amount corresponds to that which would have been agreed between independent enterprises for comparable services in comparable circumstances.

2. A service charge made to an enterprise shall not be consistent with the arm's length principle where it is made by an associated enterprise solely because of the shareholder's ownership interest in one or more other group members, including for any of the following costs incurred or activities undertaken by such associated enterprise:

- (a) Costs or activities relating to the juridical structure of the parent company of the first-mentioned enterprise, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the parent company's supervisory board;
- (b) Costs or activities relating to reporting requirements of the parent company of the first-mentioned enterprise, including the consolidation of reports; and
- (c) Costs or activities related to raising funds for the acquisition of participations in members of the group of associated enterprises, unless those members are directly or indirectly acquired by the first-mentioned enterprise and the acquisition benefits or is expected to benefit that first-mentioned enterprise.

3. Where it is possible to identify specific services provided by an enterprise to an associated enterprise, the determination whether the service charge is consistent with the arm's length principle shall be made for each specific service, subject to the provisions of Section 5.

4. Where services are rendered by an enterprise jointly to various associated enterprises and it is not possible to identify specific services provided to each of them, the total service charge shall be allocated among the associated enterprises that benefit or expect to benefit from the services according to reasonable allocation criteria. For the purpose of this provision, allocation criteria shall be viewed as reasonable where they are based on a variable or variables that:

- (a) Take into account the nature of the services, the circumstances under which they are provided and the benefits obtained or that were expected to be obtained by the parties for which the services are intended,
- (b) Relate exclusively to uncontrolled, rather than controlled, transactions, and
- (c) Are capable of being measured in a reasonably reliable manner.

## ***SECTION 8. Transactions Involving Intangible Property***

1. The determination of arm's length conditions for controlled transactions involving licenses, sales or other transfers of intangible property between associated enterprises shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including in particular the pricing at which a comparable independent enterprise would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.
2. In applying the provisions of Section 3 to a transaction involving the license, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including:
  - (a) The expected benefits from the intangible property,
  - (b) Any geographic limitations on the exercise of rights to the intangible property,
  - (c) The exclusive or non-exclusive character of the rights transferred, and
  - (d) Whether the transferee has the right to participate in further developments of the intangible property by the transferor.

## **PART 3. INFORMATION AND DOCUMENTATION**

### ***SECTION 9. Transfer Pricing Documentation***

1. A taxpayer must have in place sufficient information and analysis to verify that the conditions of its transactions with associated enterprises are in accordance with the provisions of Section 1, paragraph 1. This information and analysis shall be provided to the tax administration [at its request] [within xxx days of receiving the tax administration's request]. The obligation of the taxpayer to provide this information and analysis is established without prejudice to the authority of the tax administration to request additional information that in the course of audit procedures it deems necessary to carry out its functions.

[*optional*] 2. The taxpayer shall have the documentation described in paragraph 1 in place at the time of filing its return.

3. The documentation referred to in this Section must be prepared taking into account the complexity and volume of transactions.

4. The tax administration shall have the authority, by regulation, to specify the items of documentation required to be [optional: prepared at the time of submitting the tax return and] provided to the tax authorities upon request.

[*optional*] 5. If:

- (a) A taxpayer fails to satisfy the provisions of paragraph[s] 1 [and 2] relating to transfer pricing documentation on a timely basis; and
- (b) An adjustment under Section 1, paragraph 2 [in excess of \_\_\_\_\_] is ultimately sustained with respect to the taxpayer;

Then a penalty in the amount of [\_\_\_\_\_] percent of [the additional tax resulting from such adjustment] [the amount of the adjustment to income] may be imposed in addition to the tax otherwise due.



## PART 4. ADMINISTRATIVE PROCEDURES

### *[Optional] SECTION 10. Advance Pricing Arrangements*

1. A taxpayer may request that the tax administration enter into an advance pricing arrangement to determine an appropriate set of criteria for the determination of the arm's length conditions for certain future controlled transactions over a fixed period of time.
2. The taxpayer's request for an advance pricing arrangement shall be accompanied by:
  - (a) A description of the taxpayer's activity, of its controlled transactions, and of the proposed scope and duration of the determination;
  - (b) A proposal by the taxpayer, based on the arm's length principle of Section 1, paragraph 1, describing the comparability factors that are regarded as significant to the circumstances of the case in accordance with Section 3, the selection of the most appropriate transfer pricing method to the circumstances of the case in accordance with Section 4, and critical assumptions as to future events under which the determination is proposed;
  - (c) An identification of any other country or countries the taxpayer wishes to participate in the arrangement; and
  - (d) Any other information the tax administration may prescribe by regulation.
3. The tax administration will consider the request of the taxpayer and make a decision whether or not to proceed with it taking account of the taxpayer's compliance with this Section 10[, of whether the proposed scope for the determination is economically coherent, of the complexity of the case] and of the expected benefits from an advance pricing arrangement in the circumstances of the case. The tax administration may reject the taxpayer's request to enter into an advance pricing arrangement. Should the tax administration agree to enter into an advance pricing arrangement with the taxpayer, the arrangement may ultimately adopt the taxpayer's proposal, reject it or change it with the taxpayer's consent.
4. The tax administration may agree to enter into such an arrangement alone or in consultation with the competent authorities of the country(ies) of the associated enterprise(s) identified by the taxpayer.
5. Where the tax administration approves the taxpayer's proposal or changes it with the taxpayer's consent, it shall formalise the determination in an advance pricing arrangement that will provide confirmation to the taxpayer that no transfer pricing adjustment will be made under Section 1, paragraph 2 to controlled transactions that are within the scope of the arrangement as long as the taxpayer follows the terms of the arrangement.
6. An advance pricing arrangement shall have effect with respect to the controlled transactions specified therein that are carried out subsequent to the date [on which it is approved] [on which the request is presented], and shall be valid during the tax periods indicated in the arrangement itself, which may not extend beyond [xx] tax periods beginning after the date on which the arrangement is approved. In addition, the parties to the arrangement may determine that the effects of the agreement will apply to transactions during the tax period in progress at the time the request is presented, or to tax periods prior to the tax period in progress at the time the request is presented.
7. Revocation or cancellation of an advance pricing arrangement may be made as follows:

- (a) The tax administration may revoke an advance pricing arrangement with retroactive effect if it is established that there was a misrepresentation, mistake or omission that was attributable to the neglect or wilful default of the taxpayer, or that the taxpayer failed to materially comply with a fundamental term or condition of the arrangement.
- (b) The tax administration may cancel an advance pricing arrangement for the remaining duration of the arrangement if it is established that there was a misrepresentation, mistake or omission that was not attributable to the neglect or wilful default of the taxpayer, or that the taxpayer failed to materially comply with a fundamental term or condition of the arrangement, or that there was a material breach of one or more of the critical assumptions, or that there was a change in tax law materially relevant to the arrangement.

8. The tax administration shall ensure the confidentiality of trade secrets and other sensitive information and documentation submitted to it in the course of an advance pricing arrangement proceeding.

### ***SECTION 11. Corresponding Adjustments***

Where:

- (a) An adjustment to the conditions of transactions between an enterprise taxable in [Country] and an associated enterprise is made by a tax administration in another country,
- (b) This adjustment results in the taxation in that other country of an amount of profits on which the enterprise taxable in [Country] has already been charged to tax in [Country], and
- (c) The country proposing the adjustment has a treaty with [Country] that reflects an intention to provide for the relief of economic double taxation,

Then, the tax administration of [Country], after a request is made by the enterprise taxable in [Country], shall examine the consistency of that adjustment with the arm's length principle of Section 1, paragraph 1. If the tax administration concludes that the adjustment is consistent with the arm's length principle both in principle and as regards the amount, it shall make an appropriate adjustment to the amount of the tax charged to that enterprise on those profits.

## **PART 5. FINAL PROVISIONS**

### ***SECTION 12: Regulations***

The tax administration is empowered to develop the provisions of this law through regulations.

## ANNEX - EXPLANATORY NOTES

### ***SECTION 1. The Arm's Length Principle***

#### *Scope of legislation*

Section 1, paragraph 1 of this draft legislation allows a country to identify the portions of its domestic tax law to which the transfer pricing rules will apply. Depending on the structure of individual countries' tax laws, the arm's length principle may be relevant for purposes of applying income tax, corporation tax, withholding tax, profits tax, etc.; the choice is left to each country to define.

#### *Transactions between associated enterprises*

The arm's length principle is mostly applied in the international tax context to cross-border transactions between a resident taxpayer and a non-resident taxpayer. Typically, this will cover transactions between, for example, a resident parent company and a non-resident subsidiary (or *vice versa*), or between two subsidiaries of the same group, one of which is resident and one of which is non-resident.

This legislation is drafted so as not to apply to purely domestic transactions (*i.e.* transactions between two resident taxpayers). (See Section 1, paragraph 1.) Many countries consider that it would not be an efficient use of tax administration and taxpayer resources to enforce transfer pricing legislation for domestic transactions. Some countries have, however, chosen to apply transfer pricing principles to purely domestic transactions. One approach to applying transfer pricing principles to purely domestic transactions is illustrated by optional paragraph 4 of Section 1, which allows a tax administration to extend the transfer pricing provisions to such transactions by regulation to the extent necessary to prevent tax avoidance.

This draft legislation can in some circumstances apply to transactions between two non-resident associated enterprises. It would apply, for example, where a non-resident enterprise has a permanent establishment in the country, and that permanent establishment enters into transactions with another non-resident associated enterprise. Some countries also find it relevant to apply their transfer pricing rules to transactions between two foreign affiliates, neither of which is directly taxable in the country. An example would be a transaction between two enterprises subject to the controlled foreign companies ("CFC") rules where a controlled foreign company may not be directly taxable but its income may be included in the income of the shareholder.

This draft legislation does not apply for purposes of attributing profits to different parts of a single juridical person. For a discussion of how to attribute profits to a permanent establishment that a resident company has in another country, or that a non-resident company has in the host country, please see the OECD Report on the Attribution of Profits to Permanent Establishments dated July 2008.

Some countries apply transfer pricing legislation to transactions with "tax havens" irrespective of whether the parties are associated or not. Countries willing to do so sometimes define tax havens as

low tax jurisdictions with which they do not have a double taxation agreement or a Tax Information Exchange agreement, or provide a list.

#### *Adjustments made by tax authorities and taxpayers*

Section 1 (2) provides tax authorities with the ability to make adjustments to a taxpayer's computation of taxable income where that taxpayer has entered into transactions that are within the scope of the transfer pricing legislation and the conditions of those transactions are not consistent with the arm's length principle. Section 1(2) specifies that a tax authority may make an adjustment required in order to tax those profits that would have accrued to the enterprise had arm's length conditions been in place, but have not so accrued, *i.e.* where there has been a "shortfall" of profit in the enterprise. As such, it does not give the tax authority the ability to make a negative adjustment in order to reduce taxable profit in circumstances where non-arm's length conditions result in "excess" profit being accrued in the enterprise. Of course, such a provision in the domestic legislation should not prevent a tax administration from granting a corresponding downward adjustment under the terms of a double taxation treaty. This reflects the position taken in the transfer pricing legislation of many countries.

Section 1(1) imposes on taxpayers the requirement to compute their taxable profit in accordance with the arm's length principle. This means that they may need to make adjustments to their profits where the conditions of their transactions are not consistent with the arm's length principle. Depending on each country's legislation, such adjustments may be made in the tax return only, or may have to be reflected also in the legal accounts. In cases where adjustments are permitted in the tax return only, some countries restrict such adjustments to making positive adjustments consistent with the position described above with regards to Section 1 (2).

## **SECTION 2. Definitions**

### *Participation in Management, Control, or Capital*

The OECD does not define the phrase used in Article 9 of its Model Tax Convention: "participates directly or indirectly in the management control or capital" of an enterprise. In particular, Article 9 of the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines do not specify a minimum level of shareholding or capital ownership for the "control" criterion in transfer pricing legislation to be satisfied. In practice, countries take different approaches.

Almost all countries use a definition based on formal control through shareholding or voting rights, such as that contained in Section 2, paragraph 2(a). This is sometimes referred to as a "*de jure*" approach. In considering paragraph 2(a), countries should weigh the "*de jure*" circumstances in which they will automatically deem one enterprise to participate directly or indirectly in the management, control or capital of an enterprise, for the reasons outlined below.

Some countries include within their definition a more general approach, concentrating on an actual ability to control the business decisions of another enterprise. Section 2, paragraph 2(b) provides an example of such an approach. This may be instead of, or in addition to, a "*de jure*" definition. This is sometimes referred to as a "*de facto*" approach.

It should be borne in mind that as the definition of control becomes broader, the number of taxpayers within the scope of the rules increases. If a very broad definition is used, there is a risk that the rules can encompass transactions between two parties where, in reality, neither party can effectively control the pricing of transactions between them and where the risk of loss of tax revenue through non-arm's

length transfer pricing is low. In such cases the tax administration may incur unnecessary enforcement costs, and taxpayers may incur unjustified compliance costs. In addition, as the definition of control becomes broader, the pool of uncontrolled transactions from which potential uncontrolled comparable data can be drawn will reduce, thus making the application of the arm's length principle more complex and uncertain.

Finally, a very broad definition of associated enterprises may lead to cases where an adjustment made by the Country would not be considered by the treaty partner as falling under the scope of Article 9 of the relevant double taxation treaty, if the treaty partner does not see the parties to the transaction as being associated. This can lead to unresolved double taxation.

### *Conditions*

The OECD Transfer Pricing Guidelines do not define the term “conditions”. In this draft legislation, the term “conditions” should be understood, depending on the transfer pricing method used (see Section 4), to include either the price, the resale margin, the mark up on costs, the net profit margin or the allocation of profits between the parties. In the draft legislation, these types of conditions are sometimes referred to as “financial indicators”. Depending on the context, and as used in the OECD Transfer Pricing Guidelines, the term “conditions” may also include features of controlled and uncontrolled transactions going beyond the financial indicators relevant in applying transfer pricing methods.

### *Enterprise of [Country]*

Article 3(1)(c) of the OECD Model Tax Convention provides that the term “enterprise” “applies to the carrying on of any business”. In light of the common use of the term in international tax usage, this draft legislation also uses it, and Section 2, paragraph 7 clarifies that “an enterprise of [Country] is an enterprise carried on by a person resident in [Country]”, which can refer to either the domestic or foreign business activities of a resident taxpayer.

### *Individuals*

Individual shareholders are taken into account in the definition of control. For instance, if two enterprises are controlled by the same individual, they qualify as associated enterprises. On the other hand, transactions with individuals who do not carry on an enterprise are excluded from the scope of the draft legislation as the latter applies to transactions between associated “enterprises”.

### *Advance pricing arrangement and competent authority*

Paragraphs 8 and 9 of Section 2 contain optional definitions of the terms “advance pricing arrangement” and “competent authority” which would be useful to include if a country decides to include a provision such as Section 10 (Advance pricing arrangement) in its transfer pricing legislation.

### *Other definitions*

Countries intending to provide more detailed guidance in either their primary or secondary legislation than is found in this draft legislation may wish to refer to the Glossary in the OECD Transfer Pricing Guidelines for additional definitions of commonly used terms.

### **SECTION 3. Comparability analysis**

Guidance on how to conduct a comparability analysis can be found in Chapter I of the OECD Transfer Pricing Guidelines. More detailed guidance will be available in the revised Chapters I and III of the OECD Transfer Pricing Guidelines which are expected to be finalised mid-2010 and will be released on the Internet (see [www.oecd.org/ctp/tp/cpm](http://www.oecd.org/ctp/tp/cpm)).

Identifying appropriate comparables is challenging for a number of reasons. There are in many countries important limitations with respect to publicly available information, *e.g.* where there is no requirement for companies to file detailed reporting with administrative bodies, or where the domestic market is too small to find comparable independent parties. Furthermore, the development of global supply chains and the increased importance of intangibles in today's economy mean that MNEs' transactions are often unique. A critical question to keep the arm's length principle workable in practice is therefore what to do in the absence of "perfect" comparables, and how to determine whether a given comparable is sufficiently reliable.

The OECD view is that, as part of the process of selecting and applying the most appropriate transfer pricing method, the comparability analysis always aims at finding the most reliable comparables. This does not mean that there is a requirement for an exhaustive search of all possible sources of comparables as it is acknowledged that there are limitations in availability of information and that the compliance burden created for taxpayers should be proportionate with the complexity and size of the transaction. While the availability of information on comparables and the reliability of comparables data are factors that are taken into account in the selection of the most appropriate transfer pricing method, that method should in all cases be appropriate to the nature of the transaction, as determined through the functional analysis.

In other words, the risk of error is probably less in the case where the correct transfer pricing method is applied with imperfect comparables than in the case where an incorrect transfer pricing method is selected due to defects in available comparables. For instance, where the controlled transaction consists in low value added contract manufacturing and no "perfect" comparables are found, it seems better to use *e.g.* a cost plus with imperfect comparables than a profit split with no comparables. A pragmatic approach is often needed, based on a costs/benefits analysis.

### **SECTION 4. Transfer Pricing Methods**

Guidance on the selection and application of transfer pricing methods can be found in Chapters II and III of the OECD Transfer Pricing Guidelines. More detailed guidance will be available in the revised Chapters I and II of the OECD Transfer Pricing Guidelines which are expected to be finalised mid-2010 and will be released on the Internet (see [www.oecd.org/ctp/tp/cpm](http://www.oecd.org/ctp/tp/cpm)).

#### *The CUP Method*

The comparable uncontrolled price method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction. The comparable uncontrolled price method can be applied on the basis of the taxpayer's transactions with independent enterprises (internal comparables), or on the basis of transactions between other independent enterprises (external comparables).

Although this method is potentially available for all types of transactions, the product comparability requirement to be able to apply it in a reasonably reliable manner is especially high, because any product difference may materially affect the price of the transaction while it is often not practicable to determine reasonably accurate comparability adjustments for such product differences. In the absence of internal comparables, the CUP method is therefore most helpful for establishing an arm's length price for a) sales of commodities traded on a market, subject to the controlled transaction and comparable uncontrolled transaction(s) taking place in comparable circumstances, including at the same level of the commercial chain (*e.g.* sale to a secondary manufacturer, to a distributor, to a retailer, etc.), and b) some common financial transactions, such as the lending of money. Market prices (such as commodity prices or rates of interest) may be publicly available for these types of transactions.

#### *The Resale Price Method*

The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price (the "resale price") is then reduced by an appropriate gross margin (the "resale price margin"), determined by reference to gross margins in comparable uncontrolled transactions, representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (*e.g.* customs duties), as an arm's length price for the original transfer of property between the associated enterprises.

This method is probably most useful where it is applied to sales and marketing operations such as those typically carried out by a distributor. In some circumstances, the resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions (an internal comparable). In other circumstances the resale price margin may be determined by reference to the resale price margin earned by independent enterprises in comparable uncontrolled transactions (external comparables).

#### *The Cost Plus Method*

The cost plus method begins with the costs incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to an associated enterprise. An appropriate mark up, determined by reference to the mark up earned by suppliers in comparable uncontrolled transactions, is then added to these costs, to make an appropriate profit in light of the functions performed and the market conditions. Such arm's length mark up may be determined by reference to the mark up that the same supplier earns in comparable uncontrolled transactions (an internal comparable), or by reference to the mark up that would have been earned in comparable transactions by an independent enterprise (external comparable). In general, the cost plus method will use margins computed after direct and indirect costs of production or supply, but before the operating expenses of the enterprise (*e.g.* overhead expenses).

This method probably is most useful where a) goods are sold by a manufacturer that does not contribute valuable unique intangible assets or assume unusual risks in the controlled transaction, such as may be the case under a contract or toll manufacturing arrangement; or b) where the controlled transaction is the provision of services for which the provider does not contribute any valuable unique intangible assets or assume unusual risks.

### *The Transactional Net Margin Method*

The transactional net margin method seeks to equate the net profit margin relative to an appropriate base (*e.g.* costs, sales, assets) that a taxpayer realises from a controlled transaction (or from transactions that are appropriate to aggregate and consider together) with the net profit margin earned in comparable uncontrolled transactions. The arm's length net margin of the taxpayer from the controlled transaction(s) may be determined by reference to the net margin that the same taxpayer earns in comparable uncontrolled transactions (internal comparables), or by reference to the net margin earned in comparable transactions by an independent enterprise (external comparables).

In cases where the net profit margin is weighed against costs or sales, the transactional net margin method operates in a manner similar to the cost plus and resale price methods respectively, except that it compares the net profit margins arising from controlled and uncontrolled transactions (after relevant operating expenses have been deducted) instead of comparing a gross margin on resale or gross mark up on costs.

In general, it is observed that cost-based net profit margin indicators are used for manufacturing and service activities; sales-based indicators are used for sales activities; and asset-based indicators are used for asset-intensive activities. The selected financial indicator should be one that:

- (i) Reflects the value of the functions performed by the tested party (*i.e.* the party to the controlled transaction for which a financial indicator is tested), taking account of its assets and risks;
- (ii) Is reasonably independent from transfer pricing formulation, *i.e.* it should be based on objective data (such as sales to unrelated parties), not on data relating to the remuneration of controlled transactions (such as sales to associated enterprises); and
- (iii) Is capable of being measured in a reasonably reliable and consistent manner at the level of the controlled transaction and of the comparable uncontrolled transaction(s).

Functional comparability is generally of greater importance than product comparability in applying the transactional net margin method.

### *The Transactional Profit Split Method*

The transactional profit split method first identifies the profit to be split for the associated enterprises from the controlled transactions in which the associated enterprises are engaged. The combined profit may be the total profit from the transactions, or a residual profit intended to represent the profit that cannot readily be assigned to one of the parties from the application of another transfer pricing method described under Section 4, paragraphs a) to d), such as the profit arising from high-value, unique intangibles. Note that the combined profit may be a loss in some circumstances.

The transactional profit split method then splits that profit between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated between independent enterprises. This economically valid basis may be supported by independent market data (*e.g.* uncontrolled joint-venture agreements) or by internal data. The types of such internal data that are relevant will depend on the facts and circumstances of the case and may include, for example, allocation keys relating to the respective sales, research and development expenses, operating expenses, assets or headcounts of the associated enterprises. The splitting factor should reflect the respective contributions of the parties to the creation of income from the controlled transaction and be reasonably independent from transfer pricing formulation (*i.e.* it should be based on

objective data (such as sales to unrelated parties), not on data relating to the remuneration of controlled transactions (such as sales to associated enterprises).

### ***SECTION 5. Evaluation of a Taxpayer's Combined Controlled Transactions***

This Section aims at taking account of the fact that in practice, depending on the circumstances of the case, transfer pricing may need to be dealt with at the level of a product line or business unit rather than at the level of each particular product or transaction, for instance where a taxpayer deals with a very large number of different products which are managed as a few product lines.

On the other hand, there are cases where a taxpayer engages in a variety of different controlled transactions that cannot be appropriately compared on an aggregate basis with those of an independent enterprise because they would materially affect the reliability of the comparison. This would be the case for instance where the taxpayer engages in a mix of transactions that are materially different from each other, and where independent enterprises do not engage in a comparable mix of transactions. In such cases, Section 5 should not be misread as allowing company-wide comparisons irrespective of the existence of materially different transactions.

### ***SECTION 6. Arm's Length Range***

In practice, the application of a transfer pricing method rarely gives a single outcome (price or margin). Most often, several comparable uncontrolled transactions are identified, giving rise to a range of figures. Some countries use statistical tools such as the interquartile range, in order to refine the arm's length range. Obviously, such statistical tools only make sense where the range includes a sizeable number of observations.

When the result of the controlled transaction falls within the arm's length range, the tax administration should not make a transfer pricing adjustment to another point in the range. Where the result of the controlled transaction falls outside the arm's length range, the draft legislation provides that any adjustment should be to a point in the range that best reflects the facts and circumstances of the case. In such cases, some countries adjust the result of the taxpayer's controlled transaction to the closest point of the arm's length range, while some others use a point of central tendency (*e.g.* the median).

### ***SECTION 7. Services Between Associated Enterprises***

Guidance on the application of the arm's length principle to intra-group services can be found in Chapters VII and VIII of the OECD Transfer Pricing Guidelines. Section 7 of the draft legislation is designed to highlight some key considerations relevant to applying the arm's length principle to controlled transactions in services.

### ***SECTION 8. Transactions Involving Intangible Property***

Guidance on the application of the arm's length principle to intra-group transactions involving intangible property can be found in Chapters VI and VIII of the OECD Transfer Pricing Guidelines. Section 8 of the draft legislation is designed to highlight some key considerations relevant to applying the arm's length principle to controlled transactions in intangibles.

### ***SECTION 9. Transfer Pricing Documentation***

The provisions contained in Section 9 with regard to transfer pricing documentation and related penalties are merely illustrative and they leave various aspects to be decided upon by the particular country that is considering their inclusion in its legislation (*e.g.* whether to specify when a taxpayer must create or produce its documentation, whether to impose a penalty for failure to satisfy the

documentation requirements and, if so, how to determine that penalty). Practice among countries on these points varies widely. Depending on the country's rules on burden of proof and the general information powers available to it, specific transfer pricing documentation requirements may need to be included in the legislation. Such requirements may be particularly important if the burden of proof is on the tax administration. To make documentation requirements effective, they may need to be accompanied by documentation-related penalties and/or provisions to reverse the burden of proof in cases where inadequate documentation is provided. Further guidance on transfer pricing documentation and on related penalties may be found in Chapter V of the OECD Transfer Pricing Guidelines.

The OECD Transfer Pricing Guidelines do not contain a prescriptive list of the types of documentation that countries may require taxpayers to provide. Countries have elected to require some or all of the following types of documentation:

- (a) A general description of the organisational, legal, and operational structure of the group of associated enterprises of which the taxpayer is a member, as well as any relevant change therein during the taxable period.
- (b) The group financial report or equivalent annual report for the most recent accounting period.
- (c) A description of the group's policy in the area of transfer prices, if any.
- (d) A list of advanced pricing agreements entered into by members of the group with respect to transactions to which the taxpayer is a party.
- (e) A general description of the nature and value of the controlled transactions in which the taxpayer is involved or which have an effect on the income of the taxpayer.
- (f) A description of the functions, assets and risks of group companies to the extent that they affect or are affected by the controlled transactions carried out by the taxpayer, including any change compared to the preceding period.
- (g) With respect to each material controlled transaction carried out by the taxpayer, a description of the transfer pricing method utilised by the taxpayer to demonstrate that the prices and other financial indicators associated with the transaction satisfy the requirements of the arm's length principle and a description of why such methods are the most appropriate transfer pricing methods within the meaning of Section 4, paragraph 1.
- (h) A comparability analysis supporting the taxpayer's application of the most appropriate transfer pricing method prepared in accordance with the provisions of Section 3.
- (i) Financial data showing the results of controlled transactions sufficient to demonstrate the taxpayer's compliance with Section 1 applying the most appropriate transfer pricing method within the meaning of Section 4, paragraph 1.

### ***SECTION 10. Advance Pricing Arrangements***

An advance pricing arrangement ("APA") is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (*e.g.* method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations. APAs are intended to supplement the traditional administrative, judicial and treaty

mechanisms for resolving transfer pricing issues. They may be most useful when traditional mechanisms fail or are difficult to apply.

In 2010, approximately 30 countries (OECD and non-OECD) have formal APA programmes. Some countries have a preference for bilateral or multilateral APAs in which two or more countries concur, conducted under the mutual agreement procedure (Article 25 of the OECD and UN Model Tax Conventions), while some others have developed extensive unilateral APA programmes whereby the tax administration and the taxpayer in its jurisdiction establish an arrangement without the involvement of other interested tax administrations. See Section 4.4 and Best Practice No. 19 of the OECD Manual on Effective Mutual Agreement Procedures (<http://www.oecd.org/ctp/memap>) for a discussion of the difficulties unilateral APAs may pose to the elimination of double taxation in certain circumstances.

Please see Chapter IV, Section F of the OECD Transfer Pricing Guidelines for a discussion of the advantages and risks associated with APAs. Detailed guidelines for conducting bilateral advance pricing arrangements under the mutual agreement procedure are found in the Annex to Chapter IV of the Transfer Pricing Guidelines (see <http://www.oecd.org/dataoecd/10/10/38008392.pdf>).

### ***SECTION 11. Corresponding adjustments***

Section 11 of the suggested approach to transfer pricing legislation is intended to provide suggested wording to allow countries to give effect to a corresponding adjustment under the terms of a relevantly-worded tax treaty. Although it is essential that countries implement a provision to enable them to make such adjustments, such provision does not necessarily need to be included in the specific transfer pricing legislation. Many countries include a provision in their domestic legislation which deals with the implementation of treaty provisions; for other countries, the existence of a bilateral treaty provision based on Article 9(2) of the OECD Model Tax Convention or of the United Nations Model Convention may be sufficient, without further domestic legislation.

The provisions of this section (or its equivalent elsewhere) are applicable only where:

- A tax treaty is in place that reflects an intention to provide relief from economic double taxation,
- The other Contracting State to the tax treaty makes an adjustment to the taxable profit of an enterprise in its own jurisdiction in respect of a transaction with an associated enterprise in [Country], and
- [Country] agrees that the adjustment made by the other Contracting State accords with the arm's length principle and is justified both in principle and as regards the amount.

It should be noted that a corresponding adjustment to relieve economic double taxation may be made under the terms of a treaty even if that treaty does not contain paragraph 2 of Article 9 (or an equivalent article). Most OECD member countries consider that economic double taxation resulting from adjustments made to profit by reason of transfer pricing falls within the scope of the Mutual Agreement Procedure of Article 25 of the OECD Model Tax Convention.

### ***SECTION 12. Regulations***

Legislation such as that illustrated in this document provides tax authorities with the ability to enforce the arm's length principle within their respective jurisdictions. At the same time, these rules will normally also create compliance obligations for taxpayers. Most countries find it useful to supplement these basic statutory provisions with further guidance and regulations to:

- Provide further interpretation and clarification of the provisions contained in the legislation, and
- Provide guidance for both taxpayers and tax officers on the practical application of those provisions.

Countries take different approaches to supplementary guidance and regulations. Some include this in their primary legislation. Others include it in secondary legislation and guidance.