

## Chapter 4

### Establishing Transfer Pricing Capability in Developing Countries

#### 4.1. Introduction

4.1.1. This Chapter addresses issues of setting up a dedicated unit to address transfer pricing challenges on many fronts. The

design of such a unit, its vision and mission statements and the measurement of its success will have to take into account factors widely recognized to be key features of modern tax administrations. These include factors such as:

- a) Relationships between tax policy and tax administration;
- b) The need to evaluate current capabilities and gaps to be filled;
- c) The need for a clear vision, a mission and a culture that reflects them;
- d) Organisational structure;
- e) Approaches taken to building team capability;
- f) The need for effective and efficient business processes;
- g) The advantages of staged approaches to reaching long term goals; and
- h) The need for monitoring to assess effectiveness and for fine



development/capability in the tax administration should be a key factor to consider when formulating

4.3.3. Factors to consider when assessing the level of development/capability of the tax administration include:

- a) Levels of education and expertise;
- b) The legal environment (as addressed in Chapter 3) including the characteristics of the transfer pricing legislation and responsibilities for and the scope of regulations;
- c) Networks of comprehensive bilateral tax treaties including articles relating to Associated Enterprises (usually Article 9), the Mutual Agreement Procedure (usually Article 25) and Exchange of Information (usually Article 26). Also any more limited Exchange of Information agreements – especially with countries of residence of key participants in the economy and their related parties;
- d) Availability of information within the country/tax administration; and
- e) Availability of information technology systems that allow for the most effective strategies to encourage compliance, develop and support audit strategies and facilitate collection and litigation where necessary, as well as those skilled in using them.

#### **4.4. Developing the Vision, the Mission and the Culture of the Unit**

##### 4.4.1. Objectives

4.4.1.1. The goals of the team should be clear, both to team members and to others they will deal with (including others in the administration and stakeholders such as taxpayers and their advisors). This is often put in terms of developing a “mission” (what the Unit will do in its daily operations)

Many tax administrations also have “Taxpayer’s Charters” which reflect what taxpayers can expect from the administration, and what

- 4.4.2.1. A central consideration to be borne in mind is that a Transfer Pricing Unit will have key taxpayer service and education functions as well as a central enforcement function. These functions are interrelated: better education and taxpayer service reduces the cost, resource intensiveness and “pain” of compliance. This, in turn, helps increase compliance and allows the administration to focus enforcement measures on the greatest risk areas.
- 4.4.2.2. Understanding the functions and environment of Multinational Enterprises (MNEs) will most effectively and efficiently further all these service, education and enforcement activities.  
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4.4.2.7. Overall, there needs to be a sustained commitment to this part of the “set up” process, which is designed to maximise compliance and to assist in risk management (by helping differentiate non compliance due to lack of understanding from more “deliberate” and therefore systemically risky, non compliance). A fair amount of institutional patience and sustained commitment is required if the transfer pricing regime is to fully meet its medium to longer term goals. Some specific steps through which this can be achieved are recommended below.

4.4.2.8. Steps that could be taken by the tax authority include:

Knowing its stakeholders and their commercial environment

#### 4.4.3. The Enforcement Approach: Risk Based Approach to Compliance

##### 4.4.3.1. A “risk management” approach to the

A high value of related party transactions compared to the taxpayer's turnover and operating profit;

Significant transactions with major counterparts from low or no tax jurisdictions, non treaty partners and countries from which information will not readily be made available by tax authorities;

An economically unrealistic profit trend compared to the industry trend, with no obvious explanation;

Inconsistencies between inter company contracts, transfer pricing policies and detailed transactional documents such as invoices and customs documents; or

Significant royalty payments to



sharing and issues “falling between gaps”; and some taxpayers may take advantage of a lack of coordination by, for example, “picking and choosing” who they approach for rulings.

4.5.4. Whatever approach is taken, it is important to have a clear and coordinated approach to transfer pricing issues and their possible solutions, especially as MNEs will generally be far

with transfer pricing cases. National coordination is then achieved by placing team members of each region on a rotation basis to work together and discuss the latest developments in transfer pricing.

- 4.5.9. Another model is to make all corporate income tax inspectors responsible for all transfer pricing cases. In that case it is sensible to appoint some regional focal points which have to be aware of all major issues and are responsible for contacting and informing policy makers.
- 4.5.10. As noted above, some countries also have a separate office dealing with MNEs (such as a Large Taxpayer Office) because of their specific characteristics, their relevance in terms of investment and tax revenue they may generate and the related tax issues that are of special importance. This MNE unit can be organised on a national level or within the regions, depending on the number of MNEs that are active in the country. As noted above, this unit should as far as possible act as a central contact point (or “one stop shop”) for responses on MNE issues and it will therefore need to contain transfer pricing expertise or at the very least work especially closely with the Transfer Pricing Unit.

#### 4.6. Building Team Capability

##### 4.6.1. General Human Resource Management Issues

- 4.6.1.1. A new transfer pricing regime is probably itself related to major changes within a tax administration, such as a recognition of the impact of globalisation and international value chains on the particular country. As with most changes there are potential pros and cons. While the human resources management strategy for the Unit needs to be integrated with the organisation’s wider human resources strategy, there are aspects that are likely to be of particular relevance in this area, including:

The importance of the Unit’s “culture”, focusing on achieving the organizational vision, mission, and objectives, motivating and providing incentives for performance, measurable goal setting and mutually agreed and annually updated performance objectives and standards. In a new team, possibly with some reluctant but very capable members, the importance of this work and of good team leaders should not be underestimated;

Recognising the importance of broadly developed officers who understand the importance of investment for country development (including the importance of avoiding double taxation) and understand the drivers and environment of business, but believe also in the crucial importance of collecting the country’s appropriate tax take and also of public confidence, the integrity of

A strategy for the identification and development of managers who are respected, have

and may accordingly propose unjustified or disproportionate tax adjustments leading to time consuming litigation and MAP. It is often stated that transfer pricing is not an exact science, and there is a broad range of possibilities to discuss and adjust tax returns. That inexact quality can be abused by authorities as well as by taxpayers. It is thus important to manage this process, and ensure that any proposed transfer pricing adjustment is justified on purely transfer pricing grounds; it is also important to show that the discretion implicit in such an inexact situation is properly exercised.

#### 4.6.2. Competences/Skill Sets needed by the Unit – Putting Together the Best Team

4.6.2.1. Recognising the many aspects of transfer pricing and that the Unit will have educative and taxpayer service functions as well as an enforcement role, a transfer pricing Unit should ideally include, or have ready access to, the following skillsets:

Team and Project Managers – people

later stage expertise from outside may be encouraged to join the tax administration by higher than usual salaries (although that can create resentments among other staff), the ability to work on the governmental side, perhaps with policy

- 4.6.2.9. A system of review of important cases by a formal panel or informal reviews by a senior group is suggested as a way towards achieving coherence, adherence to administration rulings, integrity, sound technical standards and effective case management. This can also help to some extent, on the job training. This group should ideally comprise not just officers from the Unit, but also from other relevant areas. The group could include officers dealing with the type of business or industry (such as officers from the Large Taxpayer Office if it is separate), intelligence officers, officers from the Economists Unit (if that is not part of the TPU) tax treaty experts and those dealing with potentially related areas, such as thin capitalisation.
- 4.6.2.10. Transfer pricing knowledge and experience require both legal and economic expertise. It is not purely one or the other. Transfer pricing knowledge is about pricing, economic rationale, market knowledge and business and industry knowledge. But it is also important to understand international taxation and to understand the tax rationale underlying certain transactions.
- 4.6.2.11. There are sometimes questions as to whether a group with a specific professional specialism, such as economists, should be distributed within other teams or should comprise, at least in start up mode, a separate unit. Some of the same issues arise as in structuring the Transfer Pricing Unit as a whole. The advantages of distributing the economic expertise more broadly are that economic issues are most clearly treated as just one aspect of transfer pricing issues, economic approaches are spread more broadly within the administration and economic perspectives are more easily integrated into the work of multidisciplinary teams.
- 4.6.2.12. The advantage of a separate economist unit (for example) is that greater “quality control” can be exerted, especially in the start up phase, over the consistency of economic analyses and that the economists in a new area can discuss issues and learn from each other more easily. As with any specialist skill, having economists working in groups at the start up phase may also be seen as promoting integrity. Here too, whichever approach is adopted, efforts will need to be put in place to ensure sufficient linkages between economists and their fellow economists as well as other officials that will be part of multi disciplinary transfer pricing teams.

#### 4.6.3. Training

- 4.6.3.1. In some countries the educational system provides a good supply of accountants, auditors, economists and lawyers from which the tax administration can draw. In other countries the situation is more difficult because of educational issues or more competition from the private sector. This will affect the type of training required and it is of the utmost importance to assess the existing knowledge, capabilities and competences in these areas.
- 4.6.3.2. In developing what might be called a “learning curve” for the Unit and its individual officers, it is recommended multi t s 3(g)]TJ /TT3 1 Tf v 0 TD 0 Tc <0003>Tj (assess)T0035 Tc>Tto

4.6.3.3. This assessment will be followed by setting up a training programme. For a start it is good to first have a group of experts with accountancy and legal backgrounds, The pioneer group to be trained should consist of senior tax

#### 4.6.4. Research Materials/ Databases

4.6.4.1. The Unit should have access to basic transfer pricing books and, if financing allows, a subscription to a dedicated transfer pricing journal dealing with current issues of interest to countries. As noted



4.6.5.3. Some countries require material to be provided in electronic form, and others require or encourage an index system for the documents provided and a description of the record keeping system used. If such information is electronically searchable then, subject to the availability of the necessary software and skills, there are potentially great resource savings in dealing with potentially very large files. The cost to taxpayers of providing material in certain forms should always be considered in deciding

4.8.1. Initial Phase and Evolution over Time. Drawing upon the factors discussed above, the start up phase of transfer pricing operations requires:

4.8.1.1. A critical look at the availability of human resources within the tax administration. Prioritisation is essential and choices have to be made concerning the attention to be given to different kinds of taxes. Policy on transfer pricing without sufficient resources in the tax administration will not achieve its objective;

4.8.1.2. Definition of the country's industrial characteristics. It will be useful to look for statistics on trading volumes and other indicators for cross border transactions. In a start up phase many countries focus on their main industries (such as mining, pharmaceuticals, telecommunications, breweries, autos), and usually on the



- c) Ability to respond quickly to emerging issues – including measurable deterrent effects on taxpayer behaviour;
- c) The number of mutual agreement procedures;

