



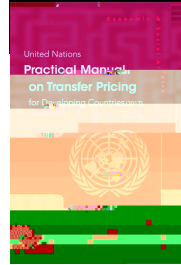
UN-ATAF Workshop on Transfer Pricing
Administrative Aspects and Recent Developments

Ez II ini#! aziland
\$-% Decem&er ' ()*



+NTR, DU-T+, NT,
TRAN#FER PR+~+N.

/ onda0" \$ Decem&er ' ()*
123(am 4.)2(am



A #+ / P5E E9A / P5E

Company # manufactures automobiles in Japan that are ultimately to be sold to customers in Germany

W; AT # TRANSFER PRIN.

US Practical Annual Para 1411

(Transfer pricing is the general term for the pricing of cross-border* intra)firm transactions between related parties. Transfer pricing, refers to the setting of prices for transactions between associated enterprises involving the transfer of property or services.

5

<E= TER / # NT; E DEF+NT+, N

Cross-border
Transactions
(between related parties or associated enterprises)

6

>ales of tangible goods including finished in ert 50237 c . 40048 T6g1 0 Tdf [28 ([(f) -4 . 04225 (l) -3 . 3527 (r) Td3852 . 2 . 93 2'uo516 . 70355 (d)6 . 70355 (g)6 . 70e55 (d)6 .

THE ARM'S LENGTH PRINCIPLE

Determine the proper prices for transactions between associated enterprises

Make sure that the resulting allocation of income between taxing jurisdictions reflects the underlying economic activity

Reach cross border agreements on proper pricing among the taxpayer and the affected countries

Avoid double taxation

1

The Arm's Length Principle

2

THE ARM'S LENGTH PRINCIPLE

Stated most simply, the arm's length principle requires the prices and other conditions of transactions between associated enterprises (related parties) to be the same as the prices and other conditions that would be established in comparable transactions between independent enterprises (unrelated parties)

3

THE RATIONALE FOR THE ARM'S LENGTH PRINCIPLE

The rationale for the arm's length principle is that because markets govern transactions between unrelated parties, determination of prices for related party transactions on the basis of the prices charged or margins earned in comparable unrelated party transactions will assure a market based allocation of income between the related parties

4

APPL8!\$ 4 T5E A2% 3 LE\$ 4T5 P2!\$C!PLE

Transfer pricing under the arm's length principle is based on comparing controlled transactions to uncontrolled transactions!

There are three key steps in a transfer pricing analysis:

- %et the rele ant facts 1 functional analysis!
- ?dentify useful comparable transactions or relationships 1 comparability analysis!
- >elect and apply the most appropriate transfer pricing method!

.1

7U\$CT!6\$AL A\$AL83!3

functional analysis is the process used to assemble the economically rele ant facts for a transfer pricing analysis!

Key elements of the functional analysis may include:

Understanding the o eral process by which the @CE creates alue and the key factors contributing to alue creation in its global business!

?dentifying the rele ant cross border transactions between associated enterprises!

?dentifying the specific terms of those transactions by reference to written contracts and the actual conduct of the parties!

?dentifying specifically the functions performed' assets used' and risks assumed by each of the parties in relation to the identified transactions 1 Accurately : elineating the Transaction!

.1

36U2CE3 67!\$762%AT!6\$ 6\$ TA>PA8E23 T2A\$3ACT!6\$3

Written contracts' in oices' payments' etc!

Conduct of parties

What did they actually do

Was it consistent with the contracts

#re there acti ities undertaken or risks assumed not co ered by the contracts

#re functions assigned to a party under the contract which that party lacks the capability to perform

.1

C6%PA2A?LE3

#pplication of the arm's length principle is usually based on a comparison of the conditions of a controlled transaction with the conditions of transactions between independent enterprises

The comparison is only useful if the economically rele ant circumstances of the controlled and uncontrolled transactions being compared are sufficiently similar' iie! if they are in fact comparable

To be comparable means that none of the differences bet+een the situations being compared could materially affect the price for the transaction* or if material differences do e0ist* reasonably accurate ad!ustments can be made to eliminate the effect of such differences on prices!

.1

FACTORS TO CONSIDER IN EVALUATING COMPARABILITY

The relevant factors to consider in evaluating comparability include:

- characteristics of the goods or services in question
- comparability of the functions performed by each of the parties
- terms of the transactions being compared
- nature and of the risks assumed by each of the parties
- economic circumstances of the parties
- business strategies followed by the parties

17

ADJUSTMENTS TO COMPARABILITY

In some situations comparability adjustments should be considered in order to improve the reliability of the transfer pricing analysis

Comparability adjustments should be considered only if the adjustment will increase the reliability of the results. Depending on the transfer pricing method being used, common comparability adjustments include adjustments for financing costs, payment terms, and specific differences in other contract terms (e.g., delivery, freight, etc.).

Adjustments for country and market differences, currency exchange movements, different levels of risk, purchase volumes, and similar items can be far more difficult to calculate on a reliable basis.

16

TRANSFER PRICING METHODS

Transfer pricing methods are used to determine appropriate transfer prices and provide a reasonable basis for the determination of the arm's length price.

2EDIEW E A \$!\$E 3TEP P26CE33 762
C6\$: UCT!\$ 4 A T2A\$37E2 P2!C!\$ 4 A\$AL83!3

- *& Aetermine years co ered
- ,& (road analysis of ta :payer's circumstances
- !& Dnderstand the controlled transactions
- "& 8e iew e :isting internal comparables' if any
- & ?dentify sources of possible e :ternal comparables
- 6& >elect the most appropriate transfer pricing method
- /& ?dentify potential comparables
- ;& @ake comparability ad!ustments if necessary
- 5& ?nterpret rele ant data and determine arm's length prices

.5

PR+N-+P5E# T, RE/E/6ER

Transfer pricing is not a science 1 there may not be a single correct arm's length price for a specific transactions!

?instead' there will often be a range of reasonable arm's length

D, /E#T+- 5E. #5AT+, N

U\$ Practical %annual Paras: #i"i"i E #i"i"i

@any countries ha e enacted domestic transfer pricing rules

?n most countries transfer pricing rules are based on the arm's length principle

Domestic transfer pricing law varies

The transfer pricing law may be included in legislation' or

The legislation may e:press the main principles with definitions and e:amples included in subordinate legislation such as regulations

!!

#AFE ; AR6, UR RU5E#

U\$ Practical %annual Para #i1i E #iCi

AD8AN-E PR+-+N. A. REE/ENT#

Course Overview

6

-, UR#E , 8ER8+EW

- *& Introduction
- ,& Transfer Pricing Documentation
- !& Audits and Risk Assessment
- "& Comparability Toolkit
- & Intra-group Services
- 6& Transactions Involving Intangibles
- /& Cost Contribution Arrangements
- ;& Establishing T7 Capability in Developing Countries
- 5& Dispute Avoidance and Resolution

6