OECD

Tax & Development

Developing Capacity in BEPS and Transfer Pricing

TASK FORCE ON TAX & DEVELOPMENT WORK ON BEPS AND TRANSFER PRICING

KEY POINTS

- In the globalised economy, developing countries are opening their borders to trade and investment, exposing them to the risk of tax base erosion and profit shifting (BEPS).
- These countries have stated they require fully effective transfer pricing regimes in place to deal with risks arising from BEPS, which denies them essential tax revenue.
- In 2011, the OECD's Task Force on Tax and Development began a programme of support for developing countries seeking to implement or strengthen their transfer pricing rules.
- The programme has already had a significant impact in all countries of operation including the introduction of transfer pricing rules aligned with international standards, setting up of specialist units to carry out the transfer pricing work and increased revenues from transfer pricing audits.
- The Programme has shown the need and opportunities to further scale up its work in 2017 and beyond including through the work to be done under the OECD's new Inclusive Framework.

THE TASK FORCE ON TAX AND DEVELOPMENT

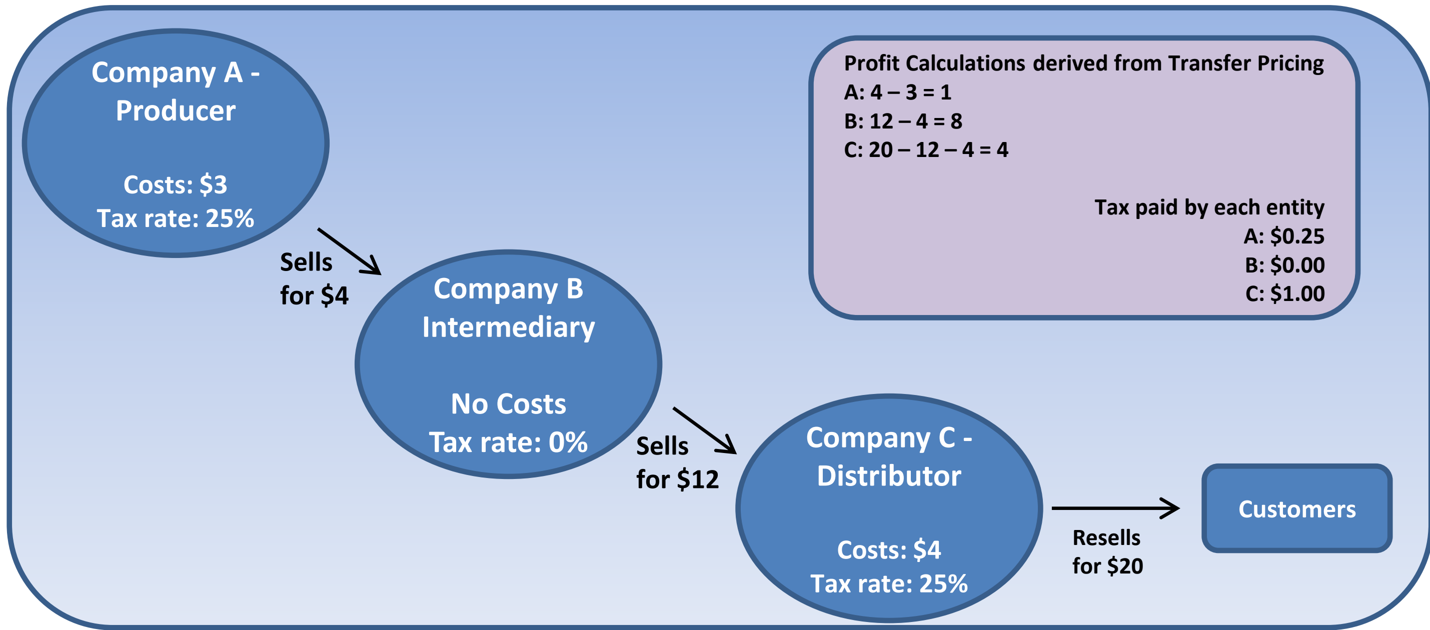
In partnership with the European Commission and World Bank Group, the Task Force on Tax and Development has developed a highly successful Transfer Pricing assistance programme in developing countries.

1. Why is transfer pricing important for developing countries?

In the globalised economy, developing countries are increasingly opening their borders to international trade and investment. Much of this trade is conducted by multinational enterprises (MNEs), and it is estimated that as much as 2/3 of all cross-border business transactions take place between companies belonging to the same group. Such cross-border trade and investment is vital to economic development. But it is essential, also, that developing countries are able to collect tax on the profits that multinational enterprises earn in their countries and do so in a way that does not discourage or distort international trade and investment.

When members of multinational groups of companies undertake transactions with each other (e.g. purchases of inputs, transfers of assets), one member of the MNE charges a price to another member (i.e. the "transfer price"), which is reflected in their accounts and forms the basis for the computation of their accounting and taxable profits. The transfer prices used by multinational enterprises influence the amount of profits that they report (and pay tax on) in each country in which they operate. An example of a transfer pricing transaction between companies belonging to the same MNE and operating in three different jurisdictions is illustrated in figure 1.

Figure 1: Transfer pricing between related parties of the same MNE



For purposes of this example, the intermediary company B (which buys goods from A for $4 and sells them to C for $12) generates significant profit despite carrying on no identifiable economic activity, nor incurring any cost. In this case, the intermediary is located in a no-tax jurisdiction and does not incur tax on this profit. Transfer pricing rules raise the question as to whether an "arm's length" price has been set between the producing, intermediary and selling companies. If not, the governments of either or both of the producing and selling companies may lose out on significant potential revenues.

It should be stressed that transfer pricing is a legitimate and necessary feature of the commercial activities of multinational enterprises, and far from all transfer pricing involves artificial profit shifting such as that illustrated in the example above. However, multinational enterprises can use their transfer pricing as a means of reducing their global tax bill by shifting profit from normal tax-rate counties to low tax-rate countries. This is an issue faced by developing and developed countries alike.

When transfer pricing is used by multinational enterprises to artificially shift profit out of a country, it, first and foremost, denies the country of essential tax revenues. But it can also have much wider implications: tax avoidance by high profile corporate taxpayers will be perceived as "unfair" by citizens, and may undermine the legitimacy and credibility of the tax system, thus discouraging compliance among all taxpayers.

Base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike and the G20 has asked the OECD to take forward work on BEPS and advice on how the international tax system can evolve so as to address the challenges. Therefore, the lessons learned through working intensively on transfer pricing and BEPS issues in developing countries are constantly being fed back into the OECD's standard-setting process, to ensure that the developing country perspective is consistently considered in the development of standards and guidance on these fields. This has provided opportunities for developing countries to have a voice in the OECD's work on BEPS.

2. Transfer pricing and BEPS rules in developing countries

Most OECD and many non-OECD countries have introduced and are introducing transfer pricing and BEPS rules into their tax legislation. They have done this in order to ensure that the profits reported by MNEs in their jurisdictions are computed in line with internationally accepted principles, to counter any inappropriate or abusive transfer pricing by MNEs, and to avoid BEPS practices done by taxpayers. In most countries that have transfer pricing rules, the benchmark adopted is the "arm's length principle". The arm's length principle requires that transfer pricing between associated enterprises should be the same as if the two companies involved in the transaction were two unrelated parties negotiating in the market, rather than part of the same corporate structure.

Relatively few developing countries have fully effective transfer pricing and BEPS regimes in place. Many developing countries that have legislation in place often lack the administrative, technical and auditing capacity to enforce the law and conduct effective and efficient audits. This is where the Tax and Development Programme provides solutions to these types of problems.

3. Transfer Pricing Programme of the Task Force on Tax and Development

In 2011, the OECD's Task Force on Tax and Development[1] began a programme of support for developing countries seeking to implement or strengthen their transfer pricing rules. The programme has in recent years broadened in scope, as it now provides assistance to implement or strengthen their regimes for addressing transfer pricing and other BEPS-related issues. The work has been done through two-to-three year-long capacity development programmes and has assisted countries putting in place measures designed to protect their tax bases, supporting efforts towards a transparent and predictable investment climate through the introduction of rules that create certainty and consistency for business. As these programmes are demand-led they provide solutions to the different needs developing country tax administrations have in the area of transfer pricing and other BEPS matters.

Support initiatives have been put in place in Botswana, Cambodia, Colombia, Ethiopia, Ghana, Jamaica, Kenya, Malawi, Morocco, Peru, Rwanda, Sri Lanka, Tunisia, Vietnam, Zambia and Zimbabwe. A regional project is underway in the Economic Community of West African States (ECOWAS) region (including Liberia, Nigeria and Senegal).

A key feature of these demand-led programmes is co-operation between the international agencies involved in their delivery. Most of the programmes are delivered by the OECD in co-operation with international agencies such as the African Tax Administration Forum, the European Commission and the World Bank Group ensuring a coherent and co-ordinated support. The programme also works closely with other partners such as GIZ, SECO and Tax Administrations/Ministries of Finance of developed countries. This ensures that work in this area supports wider financial governance reform and country-owned approaches to development.

This work is also closely aligned with existing country tax reform programmes. Additional World Bank Group projects also benefit, as required, from technical input by the OECD's Tax and Development Programme, particularly by the development of tools, guidance and training materials to assist countries in the practical application of their transfer pricing rules.

4. Main areas of support

The Tax and Development Programme provides assistance in the following areas:

- Legislation: Review and recommendations on existing and new primary and secondary legislation, taking account of the specific needs of each country
- Capacity building: Workshops addressing policy and audit issues through the use of practical case studies to provide technical knowledge to auditors, policy makers and senior management
- Risk Assessment: Design and implementation of processes and procedures to ensure the most effective use of scarce resources in international tax audit work
- Organizational changes: Review and recommendations on the appropriate structure for the international tax unit within a tax administration

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[1] The OECD's Task Force on Tax and Development brings together all major stakeholders on tax and development, including representatives from developed and developing countries, international organisations, business, NGOs. It is co-chaired by senior officials from an OECD and a non-OECD country, and is supported by a Secretariat - incorporating extensive government transfer pricing experience – managed jointly by the OECD's Centre for Tax Policy and Administration and Development Coordination Directorate, with staffing and other costs met by the OECD and donor contributions.

5. Transfer Pricing Programme's results to date

The programme has already had a significant impact in all countries of operation.

Impact	Countries
Revised and improved legislation / regulations	Colombia, Ethiopia, Ghana, Jamaica, Kenya, Peru, Vietnam and Zimbabwe Legislative changes in process: Botswana, Cambodia, Malawi, Mauritania, Nigeria, Rwanda, Senegal, Sri Lanka, Uganda, Vietnam and Zambia
Capacity building	All countries
Increased tax collection from transfer pricing and other BEPS related adjustments	Colombia: From USD3.3m (2012) to USD33m (2014) Vietnam: From UDS3.9m (2013) to USD61m (2016) African countries: USD166.5m increase between 2012 and 2016
Improved risk assessment processes	Colombia, Ghana, Nigeria, Rwanda and Vietnam In progress: Botswana, Jamaica, Sri Lanka
Tax administration organisational changes	Colombia, Ghana, Jamaica and Zambia In progress: Cambodia

6. Next steps

These results demonstrate that substantial progress is possible and there is growing demand for such programmes in 2017 and beyond.

As these capacity development programmes put the building blocks in place for effective transfer pricing/BEPS regimes, some of the countries are deploying experts under the Tax Inspectors Without Borders (TIWB) initiative to consolidate the impact of the programmes. Ghana, for example, has a TIWB deployment of transfer pricing specialists from The Netherlands tax administration who are working side-to-side with tax administration auditors increasing their knowledge, experience and abilities in this field. Albania, Jamaica, Malawi, Rwanda, Lesotho and Senegal are also benefitting from TIWB deployments working together with the United Kingdom, Italy and France. The Tax and Development Programme is working with the joint UNDP/OECD TIWB Secretariat to offer TIWB assistance to developing countries.

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