

# The Impact of the OECD/G20 Base Erosion and Profit Shifting Project on the Task for Developing Countries of Applying the Arm's Length Principle in Practice

**This article considers the practical implications of the OECD/G20 Base Erosion and Profit Shifting project regarding the application of the arm's length principle by developing countries.**

## 1. Introduction

The intention here is to assess the (highly practical) matter of whether the OECD's Base Erosion and Profit Shifting (BEPS) project has helped, or alternatively hindered, the task for developing countries of applying transfer pricing rules pursuant to the arm's length principle (ALP).<sup>1</sup> Such an assessment is not concerned with the justifications or merits of specific measures from the BEPS Project, nor with assessing the suitability of the ALP for developing states, or considering alternatives or modifications.<sup>2</sup> Rather, given that in the current environment developing countries rely on transfer pricing rules as one of their most important mechanisms in countering international tax avoidance, the question is simply concerned with whether the practical task of applying those rules is made easier or harder as a result of the BEPS Project.

In referring to developing states the focus is intended to be on states with limited resources and expertise with which to administer the tax system in general and the transfer pricing rules in particular.<sup>3</sup> Such states are gen-

erally considered to face a number of specific difficulties in operating transfer pricing rules, including: (1) the availability of appropriately-qualified tax officials to administer the rules effectively; (2) access to relevant comparables data; and (3) the required discretion in the operation of the rules, potentially giving rise to corruption and the perceived risk of overly-aggressive positions of the tax authorities.<sup>4</sup> These difficulties are generally seen as making developing states vulnerable to attempts by some multinational corporations (MNCs) to limit tax liabilities in especially crude ways, with common areas of dispute concerning management fees; manipulation of commodity pricing; and interest and loans.<sup>5</sup>

## 2. Pre-BEPS – The OECD and Developing Countries

In the years leading up to BEPS, there were various indications that the OECD was, in the context of its work on tax, cultivating a special focus on the position of developing states.

This may be seen in the context of the OECD's more general attempt to secure its future relevance in the light of economic research, conducted by the OECD, which underlined the expected dramatic shift in the future economic importance of non-OECD states and which had the effect of making the OECD keenly aware of the need to expand its influence (and membership base) to remain relevant.<sup>6</sup>

Since its inception, the OECD had operated a programme of out-reach to non-Member countries, but heightened concerns about maintaining its global relevance led to a renewed focus in this area of global relations. An "Enhanced Engagement" strategy was developed from 2007 and this was designed to open the OECD to new members (such as Brazil, China, India, Indonesia, South Africa and countries in South-East Asia) by involving

\* Dr Richard S. Collier recently stepped down as Partner, PwC, London; however, he continues to work on tax policy matters, including at the Centre for Business Taxation, Oxford. He is an Associate Fellow at the Saïd Business School, University of Oxford. He can be contacted at richard.collier@sbs.ox.ac.uk. A draft of this article was presented at an interdisciplinary conference "International Tax Policy in a Disruptive Environment" organized by the Max Planck Institute for Tax Law and Public Finance in Munich on 14-15 December 2017. The conference was supported by The Harvard Fund for Tax and Fiscal Research and The H. Heward Stikeman Chair in the Law of Taxation at the McGill University Faculty of Law. The author would like to express his thanks to Joseph L. Andrus for a number of very helpful comments on an earlier version of this article.

1. The definitive statement of the ALP is found in *OECD Model Tax Convention on Income and on Capital* art. 9(1) (21 Nov. 2017), Models IBFD.  
 2. It is also recognized that posing this question by reference to the BEPS Project is arguably problematic given that previous initiatives were rolled into the BEPS Project and developments post-BEPS that are attributed to the project may well have happened in any event.  
 3. For this reason, the discussion is less relevant to the BRIC (Brazil, Russia, India and China) states where there are greater resources in the tax administration. The economies of the developing countries considered here tend not to be big consumer or industrial economies but typically derive their tax revenues from natural resources, such as minerals, oil and gas, and agriculture.

4. These issues are discussed in P. Hofmann & N. Riedel, *Transfer Pricing Regimes for Developing Countries*, 72 Bull. Intl. Taxn. 4-5 (2018), Journals IBFD.  
 5. On the relative crude and more aggressive tax avoidance strategies facing developing countries, see OECD, *Two-Part Report to G20 Developing Working Group on the Impact of BEPS in Low Income Countries Part 1*, p. 12 (OECD 2014).  
 6. A summary of the position immediately prior to BEPS is available in, for example, OECD, *Looking to 2060: A Global Vision of Long-Term Growth*, OECD Economics Department Policy Notes No. 15 (OECD 2012). Relevant GDP statistics comparing OECD member countries and non-OECD countries are given on p. 8.

them in work of OECD committees, economic surveys, sector specific peer reviews, etc. The OECD also boosted cooperation with regional groupings. As reported in the 2010 Secretary-General's Report to Ministers, this programme was seen by some OECD member countries as the single biggest challenge to the future relevance of the OECD.<sup>7</sup>

In the tax sphere, the influence of this programme was seen in a number of ways. Non-OECD countries were involved in a significant way in areas of work of the OECD Committee on Fiscal Affairs (CFA), such as through The Global Forum on Transparency and Exchange of Information, The Informal Task Force on Tax and Development, The Forum on Tax Administration (FTA), etc. There were also many other developments involving non-Member developing countries, such as, from 2011, the three-year partnership between the OECD and India to strengthen ongoing cooperation on tax related issues.<sup>8</sup> The Informal Task Force on Tax and Development, created in 2010, was an important element of the OECD's general work with developing countries. That grouping brought together representatives from the OECD tax and development communities, developing countries and emerging economies, business, international organizations and NGOs and its remit included topics such as capacity building, exchange of information, and country-by-country (CbC) reporting.<sup>9</sup>

The focus on developing countries was also reflected in the OECD's work on the transfer pricing rules. The task of strengthening the implementation of standards and guidelines on transfer pricing in developing countries was from its inception one of the primary objectives of the Task Force on Tax and Development and involved a particular emphasis on easing the administrative challenge the s of applying transfer pricing rules – for example by identification of best practices.

The concern with the position of developing countries was also reflected in the general work of the OECD on transfer pricing. A good example is the project launched in 2010 on the administrative aspects of transfer pricing.<sup>10</sup> This included a review of techniques that may be implemented by countries to optimise transfer pricing resources. As part of the project, a survey was undertaken to focus specifically on simplification measures that had by then been adopted by countries as part of their transfer pricing regimes. These included not only safe harbours but also

7. OECD, *2010 Secretary-General's Report to Ministers* p. 10, OECD Publishing (OECD 2010).

8. See OECD and India to enhance tax cooperation, announcement from the OECD Centre for Tax Policy and Administration, 15 June 2011. The partnership was organized at the high-level conference, "Adapting Tax Systems and international Tax Rules to the New Global Environment", held between the OECD and India on 13-14 June 2011.

9. OECD, *Outcomes From the First Meeting of the Informal Task Force on Tax and Development*, Paris, 11 May 2010, available at [www.oecd.org/ctp/tax-global/Tax-Dev\\_1\\_Meeting\\_Outcomes.pdf](http://www.oecd.org/ctp/tax-global/Tax-Dev_1_Meeting_Outcomes.pdf) (accessed 15 Jan. 2018). The Task Force dropped the "Informal" label by 2011 and in 2016 revised its name again to be the OECD Task Force on Tax and Development on Base Erosion and Profit Shifting (BEPS) in Developing Countries.

10. See OECD, *Multi-Country Analysis of Existing Transfer Pricing Simplification Measures – 2012 Update* (OECD 2012).

measures such as less stringent documentation requirements, alleviated penalties, streamlined procedures, etc. The work ultimately led to a pre-BEPS discussion draft on safe harbours,<sup>11</sup> which was finalized contemporaneously with the commencement of the work on BEPS.<sup>12</sup>

A further example is the 2012 report, "Dealing Effectively with the Challenges of Transfer Pricing".<sup>13</sup> Although this report was not devoted exclusively to the position of developing states, it was clearly intended to be useful to them. The report, commissioned by the FTA<sup>14</sup> in the previous year, is concerned with the practical administration of transfer pricing programmes by tax administrations and seeks to identify insights for tax administrations on how to be more effective through the various practical stages of a transfer pricing enquiry. There are also comments on various issues such as the training and development of people, the framing of transfer pricing laws, and the availability of comparables data. The work drew on contributions from Nigeria and Rwanda (both states being neither OECD nor FTA members) and also includes a separate chapter on transfer pricing and developing countries.

All of the above developments had led to a climate at the OECD where the position of developing countries was being given some specific consideration. In the context of the challenges in applying the transfer pricing rules, this involved efforts at simplification, or at least clarification, of those rules in a developing country context.

The OECD was by no means the only body to be pursuing such an agenda: in the pre-BEPS period, work on the tax agenda at the United Nations had been reinvigorated (from 2009) with a large focus on the practical aspects of the transfer pricing rules.<sup>15</sup>

11. OECD, *Proposed Revision of the Section on Safe Harbours in Chapter IV of the OECD Transfer Pricing Guidelines and Draft Sample Memoranda of Understanding for Competent Authorities to Establish Bilateral Safe Harbours – Discussion Draft* (OECD 2012), International Organizations' Documentation IBFD, also available at [www.oecd.org/ctp/transfer-pricing/50514053.pdf](http://www.oecd.org/ctp/transfer-pricing/50514053.pdf) (accessed 15 Jan. 2018).
12. See OECD, *Revised Section E on Safe Harbours in Chapter IV of the Transfer Pricing Guidelines*, (OECD 2013), International Organizations' Documentation IBFD, also available at [www.oecd.org/ctp/transfer-pricing/Revised-Section-E-Safe-Harbours-TP-Guidelines.pdf](http://www.oecd.org/ctp/transfer-pricing/Revised-Section-E-Safe-Harbours-TP-Guidelines.pdf) (accessed 4 Feb. 2018).
13. OECD, *Dealing Effectively with the Challenges of Transfer Pricing*, OECD Publishing (OECD 2012), International Organizations' Documentation IBFD. The report was commissioned by the FTA in the previous year.
14. The (FTA) was created in 2002 and is a body on tax administration for Commissioners from 50 OECD member countries and non-OECD countries. The work of the Forum is overseen by a Bureau of 13 Commissioners from the participating revenue bodies. The mission of the FTA is to identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world (see [www.oecd.org/tax/forum-on-tax-administration/about](http://www.oecd.org/tax/forum-on-tax-administration/about) (accessed 13 Jan. 2018)).
15. This led ultimately to the publication in 2013 of the 495-page *UN Practical Manual on Transfer Pricing for Developing Countries* (the "Manual"), which was produced by its Subcommittee on Transfer Pricing. The *Manual, supra* is especially concerned with the practical explanation (including illustration by examples) of issues for developing states in applying the transfer pricing rules. Substantial additions and modifications to the *Manual, supra* were approved in April 2017.

### 3. The Impact of BEPS

Against the background described in section 2., and from its inception in late 2012, the BEPS Project represented a sharp shift in the immediate priorities of the OECD, both in technical terms and politically. Fundamentally, BEPS was concerned with a series of international tax problems of more direct concern to developed countries that were members of the OECD. In very broad terms, these problems centred on targeting low-function entities in tax havens. The response of the BEPS Project came through a variety of new or amended rules (such as on interest limitation, hybrid mismatches, treaty shopping, disclosure of aggressive tax planning, etc.) designed to limit the tax-driven use of such entities by countering the ability of MNCs to enter into tax-driven profit shifting arrangements.

This is not to suggest that efforts to address the position of developing states were abandoned, since there were a number of ways in which developing countries were in fact involved in the BEPS effort.<sup>16</sup> However, there was relatively little in the BEPS Action Plan that seemed directly geared to the agendas of those states, though the Action Plan did include some rather vague comments on management fees and head office expenses,<sup>17</sup> which were interpreted as a placeholder for developing country issues and some other strands of Actions from the BEPS Action Plan were attributable to earlier work on developing country tax issues.<sup>18</sup> Not surprisingly, material tracts of the BEPS output were arguably of only distant relevance in the context of the immediate, mainstream issues facing developing states (for example the work on the digital economy, hybrid mismatch arrangements, controlled foreign company (CFC) rules, the work on risk and capital, the proposals for disclosure of aggressive tax schemes). It is true that the position of developing country issues was later specifically addressed by a two-part report on the impact of BEPS practices in developing states.<sup>19</sup> However, this was not until 2014, over a year after the initial BEPS Action Plan had been developed.<sup>20</sup> Further, the report reflected the more general point that the base erosion and profit shifting practices raising issues and challenges for such

states are (at least, in some significant measure) different to those of developed countries.

The broad technical agenda of BEPS, coupled with its very high profile and broad adoption at a political level in many states, to some degree displaced the focus on developing states that had been building at the OECD in the period before BEPS (and arguably had a similar effect on work outside the OECD – as in the UN work in this area). However, for the purposes of the discussion here, it is the specific changes to the ALP that were made in the BEPS Project that are of a much greater significance.

### 4. BEPS and the ALP

As noted, prior to BEPS there had been indications of a greater recognition at the OECD of the need for more accessible approaches (for example, in relation to the application of the ALP) to suit developing states. With BEPS, this disappeared overnight.

In relation to the ALP, BEPS represents an explosion of complexity – and this issue is clearly particularly difficult for developing countries because such countries lack the capacity and resources to manage the complexity as well as developed tax administrations.

The BEPS Project led to the single biggest rewrite (and rethink) and expansion of the Transfer Pricing Guidelines since their introduction. Prior to the BEPS Project, the Transfer Pricing Guidelines had already been materially expanded since their introduction in 1995.<sup>21</sup> However, the Final BEPS Report on the transfer pricing Actions 8-10, “Aligning Transfer Pricing Outcomes with Value Creation”,<sup>22</sup> is just short of 200 pages and there is on top of this also the Action 13 report, “Transfer Pricing Documentation and Country-by-Country Reporting”<sup>23</sup> (another 70 pages). The end result, reflected in the 2017 version of the Transfer Pricing Guidelines, is a document of over 600 pages, an increase of more than 50% of the pre-BEPS text.

Further, the new complexity in BEPS is not reserved for the more difficult or arcane areas of transfer pricing guidance or restricted to specific cases of abuse by the taxpayer. Rather, that complexity is in many respects made a staple of the basic approach to transfer pricing. This can be seen, for example, in the changes made to the way a transaction is to be “framed” or characterized for the purposes of applying the transfer pricing rules. This is referred to in the Transfer Pricing Guidelines as being how the transaction is “delineated”.

16. The BRIC states were given seats on the steering committee with full veto rights and other countries were involved in the working groups. There were also some early discussions about the scope of the work on source versus residence issues and the scope of the permanent establishment (PE) work. In addition, there were discussions on how non-OECD could fully participate and commit to BEPS outcomes without having to adopt prior OECD guidance, such as the OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), International Organizations' Documentation IBFD [hereinafter: the “*Transfer Pricing Guidelines* (2107)”].

17. See the comments in the discussion of Action 10 of the BEPS Action Plan to the effect that rules would be developed to “provide protection against common types of base eroding payments, such as management fees and head office expenses” – OECD, *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, p. 21 (OECD 2013), International Organizations' Documentation IBFD.

18. For example, there had been discussion of the country by country reporting proposal in the BEPS Action Plan (Action 13) in the earlier work of the Informal Task Force on Tax and Development. Also, as noted in *supra* n. 8, the work on safe harbours arose out of the OECD's work from 2010 on the administrative aspects of transfer pricing.

19. See OECD, *supra* n. 5, *Part 1* (OECD 2014) and *Part 2* (OECD 2014).

20. OECD, *supra* n. 17.

21. This included the insertion of a lengthy chapter on business restructurings in OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (22 July 2010), International Organizations' Documentation IBFD, which took the length of the Guidelines to almost 400 pages.

22. OECD, *Action 8-10 Final Report 2015 – Aligning Transfer Pricing Outcomes with Value Creation*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015), International Organizations' Documentation IBFD.

23. OECD, *Action 13 Final Report 2015 – Transfer Pricing Documentation and Country-by-Country Reporting*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015), International Organizations' Documentation IBFD.

The BEPS output on the required approach to the delineation of a transaction is intended to address what was perceived as an over-reliance on the description of transactions or agreements in taxpayer contracts. The particular concern was that those contractual descriptions may be materially at odds with the nature of any agreement in practice. The BEPS response to this was to soften substantially the deference to descriptions or characterizations in taxpayer contracts. The notion that transfer pricing is applied based on the reality of the functions performed (and assets used and risks assumed) by related parties was hardly novel. However, the BEPS guidance articulates much more clearly than previously the importance of getting behind the contracts to the real conduct of the parties and the importance of basing the transfer pricing analysis on that conduct.<sup>24</sup> It is expressly provided that, where there is a relevant difference between the conduct of the parties and contractual terms, it is the conduct of the parties that is the required basis for the transfer pricing.<sup>25</sup> The relevance of the actual conduct of the parties is therefore significantly magnified and this in turn means that in practice a materially more involved analysis of the conduct of the parties is part of the required process of transfer pricing as a result of the revised approach to delineation. This clearly makes the process of applying the transfer pricing rules significantly more onerous.

The new enthusiasm to substitute conduct for contracts as the basis for transfer pricing exercises is also reflected in a number of other specific areas, such as for example the new BEPS guidance on risk. BEPS introduced a new and complex six-step approach to risk and a key element in this approach is the consideration of the conduct of the parties involved. Specifically, in an attempt to limit the separation of risk from business activities, the new BEPS guidance requires that risk be allocated only to entities which both functionally control the specific risk in question and have the financial capacity to assume that risk.

The focus on conduct (and the testing of contractual arrangements by reference to conduct) significantly complicates what is required in the basic transfer pricing process. However, it also introduces other issues. For example, the BEPS output on risk has been heavily criticized for a number of reasons and one of these is that there is simply a lack of clarity – for taxpayers and tax authorities alike – in what the new guidance on risk actually requires.<sup>26</sup>

There are various other respects in which the BEPS work on the ALP represents a material hike in the complexity of operating the ALP. Other examples would include: the recommended greater use of two-sided testing (rather than one sided testing that allocates the residual profits to a non-tested party); the greater openness to the use of economic valuation techniques that go beyond the five traditional transfer pricing methods; the new emphasis on

24. OECD, *Transfer Pricing Guidelines* (2017), *supra* n. 16, at ch. 1, sec. D.1.1.

25. *Id.*, at ch. 1, para. 1.45.

26. See, for example, R.S. Collier & J.L. Andrus, *Transfer Pricing and the Arm's Length Principle After BEPS* paras. 7.09-7.21 (Oxford U. Press 2017).

the distinction between ex-ante and ex-post returns; and the emerging difficulties relating to the interaction of the transfer pricing rules and the profit attribution rules in the light of the BEPS transfer pricing changes.<sup>27</sup> The true weight of the compliance obligation required by the ALP can only be understood by properly taking account of all these changes to the fundamentals of transfer pricing as now required following BEPS. Nor is there already an end to greater complexity in the ALP. Specifically, the OECD continues to work on ALP-related topics identified in BEPS, including on profit splits and on financial transactions. Both topics, and the latter in particular, have the potential to add materially to the complexity of operating the ALP.

Clearly, there are reasons that justify this expansion in complexity or make it inevitable for the functioning of the ALP. Also, it is by no means true that *all* BEPS technical developments bring inevitable complexity for the ALP.<sup>28</sup> There are also some areas where developing states might readily accept additional complexity (and the uncertainty that comes with it) in BEPS as the price for achieving progress on wider goals (such as in relation to the highly problematic BEPS lowered permanent establishment (PE) threshold<sup>29</sup>).

Nonetheless, whatever the justification for the large number of individual measures amending the ALP, it seems impossible to deny the enormous additional complexity in the operation of the ALP introduced through the BEPS approach. The ALP is, post BEPS, clearly harder to apply and the issue is especially relevant for developing states given their capacity/specialist resource issues and also their generally greater reliance on revenues from corporate income tax.<sup>30</sup> The dangers are obvious:

The amount of required information about the parties, the tested transaction, and any potentially comparable transactions may simply overwhelm the analysis and lead to a system that has some theoretical merit but that simply cannot be applied across the hundreds of thousands of transactions requiring scrutiny.<sup>31</sup>

27. The latter point is illustrated by the inordinately complex OECD, *Public Discussion Draft of July 2016, Additional Guidance on Attribution of Profits to Permanent Establishments* (OECD 2016). That draft has now been modified but the underlying complexity has not gone away – see J.L. Andrus & R.S. Collier, *OECD Discussion Draft: additional guidance on the attribution of profits to permanent establishments*, Brit. Tax Rev. 5, p. 509 (2017).

28. The BEPS proposals for a simplified approach on Low value-adding intra group services (i.e. the revisions to Chapter VII of OECD, *Transfer Pricing Guidelines*, *supra* n. 16) represent an opportunity, were they to be taken up in a meaningful way by states, of reducing complexity in the system.

29. OECD, *Action 7 Final Report 2015 – Preventing the Artificial Avoidance of Permanent Establishment Status*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015), International Organizations' Documentation IBFD.

30. See, for example, R.S. Avi-Yonah & Y. Margalioth, *Taxation in Developing Countries: Some Recent Support and Challenges to the Conventional View*, 27 Va. Tax Rev. 1, pp. 4-5 (2007). See also, OECD, *supra* n. 5, Part I, at p. 7.

31. Collier & Andrus, *supra* n. 26, at para. 7.77.

## 5. Developments Post-BEPS<sup>32</sup>

While it may be argued that the initial phases of the BEPS Project (when the direction of the project was set) showed reduced concerns over the position of developing states, the later work of the OECD on the project and especially the global roll out of BEPS following 2015 give a quite different picture. By any measure, the OECD has sought to engage with developing states in an energetic way and a material part of this engagement is highly relevant to transfer pricing.

As the BEPS Project developed, the number of states participating increased. The OECD also developed a strategy for deepening developing countries' engagement in the BEPS Project.<sup>33</sup>

The subsequent implementation of BEPS has led to the creation of the Inclusive Framework in the early part of 2016. The Inclusive Framework allows interested countries to collaborate with OECD and G20 Members on an equal footing in relation to the implementation process. There are now more than 100 countries which are members of the Inclusive Framework.<sup>34</sup> It is likely that this widened engagement helps generally with the operation of transfer pricing rules as it provides opportunities for developing states to leverage the experience of states with greater transfer pricing resources and experience. In any event, there have been various developments post BEPS that are specifically concerned with the application of transfer pricing rules in developing countries. For example, key elements of the recent work of the OECD's Task Force on Tax and Development have been to support transfer pricing capacity building efforts in developing countries and to work on expanding the Tax Inspectors Without Borders (TIWB) initiative.<sup>35</sup> Since April 2016, there has also been a significant output, with more to come,<sup>36</sup> from the Platform for Collaboration on Tax (PCT), (a body comprising the OECD, the United Nations, the International Monetary

Fund (IMF), and the World Bank). The output of the PCT is geared to addressing the developing country challenges in the implementation of BEPS measures. A major focus has been on practical assistance in applying the transfer pricing rules, for example as reflected in the recent 200-page report on accessing comparables data for transfer pricing analyses.<sup>37</sup> There is also the recent Handbook on Effective Tax Risk Assessment,<sup>38</sup> which is an attempt to set out for developing countries how best to use the CbC reporting for risk assessment and transfer pricing purposes.

Other bodies, such as the United Nations, have also been very active in providing significant practical guidance to developing countries on the application of the transfer pricing rules.<sup>39</sup>

In the context of the task for developing countries of applying the ALP, all these developments are helpful to the position of developing countries. The BEPS Project may have, at least temporarily, led to some hiatus in the focus on the position of developing states, but there is no question that in the latter stages of the project, and subsequently, major efforts have been made by the OECD (and other bodies such as the United Nations and the IMF) to work with developing states. That work has contributed materially to the task of building transfer pricing capacity and expertise in developing countries, the goal being to build basic transfer pricing competencies (by resource upgrades, tougher rules, simplified processes, and a general focus on basic transfer pricing disciplines, etc.) and thereby counter the vulnerability of developing countries to crude transfer pricing planning of the sort frequently seen to date. In principle, the task of identifying a set of relevant core transfer pricing principles and developing competencies in people to administer such a system is by no means an impossible task and so it is no surprise that, anecdotally, some real progress is reported in some specific states.<sup>40</sup>

However, notwithstanding that these developments arising from the BEPS Project and its aftermath have contributed positively to the task for developing countries of applying the ALP, there is still a rather large "but" to be addressed. As will be evident from the earlier discussion of the changes to the ALP made by the BEPS Project, the task of applying the ALP does not involve a static set of standards and there are two factors which in combination will prove highly problematic for developing countries.

32. It is acknowledged that some of the developments discussed stem from plans developed during the initial work on the BEPS actions in the period to October 2015.

33. More than 60 countries were directly involved in the development of the measures under the BEPS Project, as were leading regional tax organizations such as the African Tax Administration Forum (ATAF) and Inter-American Center of Tax Administrations (CIAT) along with the IMF, the World Bank and the United Nations. The strategy for deepening the involvement of developing countries in the BEPS Project was based on the following three pillars, being: (1) direct participation in the work of the CFA and its subsidiary bodies; (2) regional networks of policy and administration officials; and (3) capacity building support. See further OECD, *Strategy for Deepening Developing Country Engagement* (OECD 2014), announced on 12 November 2014, available at [www.oecd.org/tax/developing-countries-and-beps.htm#capacitybuilding](http://www.oecd.org/tax/developing-countries-and-beps.htm#capacitybuilding) (accessed 13 Jan. 2018).

34. OECD, *About the Inclusive Framework on BEPS* (OECD), available at [www.oecd.org/tax/beps/beps-about.htm](http://www.oecd.org/tax/beps/beps-about.htm) (accessed 17 Jan. 2018).

35. The TIWB programme is a joint initiative of the OECD and the UN Development Programme (UNDP) and aims to support developing countries to build tax audit capacity. TIWB is intended to facilitate the sharing of expertise by the deployment of experienced tax auditors on a demand-led basis to developing countries. Under TIWB, tax audit experts work directly with local officials in developing country tax administrations on current audits, which can cover both direct and indirect tax audit issues.

36. It is intended that the PCT will produce a number of further toolkits to translate the BEPS deliverables into user friendly guidance for developing countries.

37. PCT, *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* (PCT 2017). The report deals with various matters as well as comparables, such as practical guidance on choosing the most appropriate method. The earlier PCT (PCT 2016) addressed the available mechanisms to build capacity in developing states.

38. OECD (2017), *Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment* (OECD 2017), available at [www.oecd.org/tax/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf](http://www.oecd.org/tax/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf), (accessed 5 Feb. 2018).

39. The UN Subcommittee on Transfer Pricing released a substantially expanded and updated version of its *Manual*, *supra* n. 15 in April 2017.

40. Anecdotally, countries such as Kenya and Columbia are often mentioned as examples. See PCT, *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries* pp. 18 and 36 (OECD 2016) and also OECD, *supra* n. 5, *Part 1*, at p. 64.

First, there is the inevitable escalation of sophistication in the transfer pricing techniques used by (at least some) MNCs, which will presumably then require corresponding responses by tax authorities, leading in turn to more sophisticated MNC responses, and so on. Second, there is in any event the hike in complexity (and especially the step change in complexity from BEPS) in what the ALP requires. This means that as the escalation process takes effect, and the expanded and evolving notion of the ALP is applied in practice, it is inevitable that the full conceptual and practical complexity of applying the transfer pricing rules post BEPS will ultimately affect all developing states, complete with the full range of, for example, arguments bordering on the philosophical about the nature of the ALP when applied to transactions not carried out by third parties yet assessed according to third party standards; highly complex financial modelling techniques; distinctions between ex ante and ex post results; etc. The process for applying the ALP in practice is therefore on a course

of ever-increasing complexity. Expressed in these terms, the challenges to developing countries from operating the ALP post BEPS are not susceptible to any easy fix. Rather those challenges will continue to grow and expand, just as the rules in the Transfer Pricing Guidelines have grown and expanded – and just as, in a post-BEPS world, they show every indication of continuing to do so. As things stand, therefore, the simplifying/clarifying agenda for the ALP designed for developing states does not look like a strategy that will meet the challenges of the long (or even medium) term. We are long past the time when we need to take the implications of complexity seriously and address the complexity issue in its own right – or conclude we need a better long-term system for corporate income allocation. Given their higher reliance on corporate income tax and challenges with developing resources to administer the ALP, this is a debate the developing countries have an especial interest in.



**IBFD** IBFD, Your Portal to Cross-Border Tax Expertise

[www.ibfd.org](http://www.ibfd.org)



## Global Transfer Pricing Explorer Plus

Unravelling transfer pricing intricacies

Covering over 50 countries, Global Transfer Pricing Explorer Plus is a practical guide that will assist you in making carefully considered choices for your complex transfer pricing decisions.

It provides a step-by-step approach to support your strategy and includes practical examples, cases and diagrams to assist you in applying the information in practice.

Chapters cover comparability analyses, transfer pricing methods, documentation requirements, compliance, transfer pricing audits, penalties, advance pricing agreements and litigation. Very specific issues are also included, such as intangibles, services, cost contribution arrangements, business restructuring, intra-group financing and the intricate role of transfer pricing in indirect taxes.

To see the full collection content and tools, to take a free 7-day trial or to order, please visit [www.ibfd.org](http://www.ibfd.org).

**Contact us**

**IBFD Head Office**  
Rietlandpark 301  
1019 DW Amsterdam

P.O. Box 20237  
1000 HE Amsterdam,  
The Netherlands

**Tel.:** +31-20-554 0100 (GMT+1)  
**Customer Support:** [info@ibfd.org](mailto:info@ibfd.org)  
**Sales:** [sales@ibfd.org](mailto:sales@ibfd.org)

**Online:** [www.ibfd.org](http://www.ibfd.org)  
[www.linkedin.com/company/ibfd](https://www.linkedin.com/company/ibfd)  
[@IBFD\\_on\\_Tax](https://twitter.com/IBFD_on_Tax)

18\_016\_Q1