



**Transfer Pricing Intermediate Level
Regional Workshop
Nairobi, Kenya
5-6 December 2019**

**ACCURATE DELINEATION &
VALUE CHAINS**



DESA | Department of
Economic and
Social Affairs

<http://www.un.org/esa/ffd/>



Transfer Pricing Workshop

Accurately delineating
the transaction

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Application of ALP

Art 9: Non-arm's length conditions in commercial / financial relations affecting profits

1. Identify conditions in commercial or financial relations between associated enterprises, and the economically relevant characteristics → to accurately **delineate controlled transaction**

How might the conditions have affected the profits of each enterprise?

2. Consider comparable comparable transactions between independent enterprises with the same economically relevant characteristics → to price controlled transaction / determine effect on profits

ACCURATE DELINEATION OF THE TRANSACTION



Conditions in the commercial / financial relations

- What are the commercial/ financial relations?
- Understand the context
 - Knowledge of the industry / sector
 - Knowledge of the MNE group and its strategies
 - What are the conditions made / imposed?
- What are the intra-group transactions
 - How should they be characterised?
- Internal / external sources of information

IDENTIFYING THE ECONOMICALLY RELEVANT CHARACTERISTICS



Accurately delineating the transaction

- Economically relevant characteristics (comparability factors):
 - Contractual terms
 - **Functions, assets, risks**
 - Characteristics of the property / services
 - Economic circumstances of the parties and their market(s)
 - Business strategies
- **Consider in the context of the business environment, the market, the MNE group's competitive advantages**



Contractual terms

- Transactions may be formalised in written contracts or other documents. Contracts may:
 - Reflect the intention of the parties at the time the contract was concluded
- Written contracts (where available) should be the starting point for a TP analysis
 - But unlikely to provide all the information needed
 - Must be supported by substance, e.g. through the conduct of the parties
 - If inconsistent or misaligned with substance, substance will take priority to the extent the two are misaligned

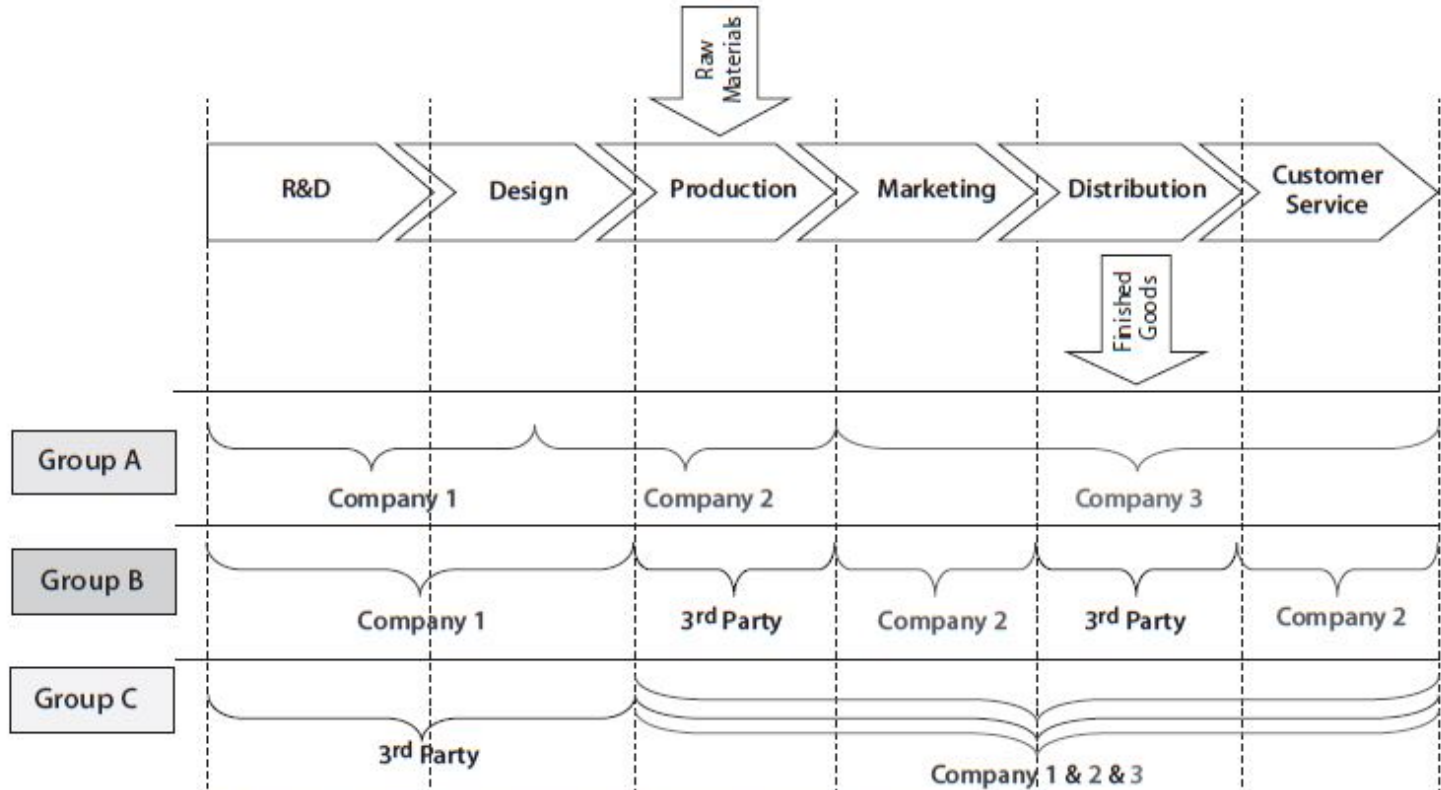


Value chain analysis

- Consider the MNE group's value chain (relative to a generic value chain for the industry)
- Where is the MNE group's competitive advantage?
- Which functions / activities (assets, risks) are most important? Which are critical to success?
- Who does what within the group (especially regarding important and critical functions/ activities (assets, risks))

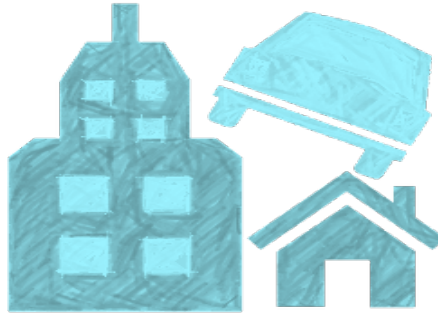


Value chain example



*Examples of how different groups could "customize" the above generic value chain

Functional analysis





Functional analysis

- Identify the **economically significant**
 - activities and responsibilities (i.e. functions) undertaken,
 - assets used or contributed (including any intangibles),
 - risks assumed...by each of the parties
- Analysis must be qualitative, not simply quantitative (more FAR vs more valuable FAR)
 - Routine → critical/strategic?
 - Fact finding via functional interviews



Functions

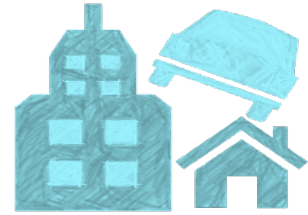
- Who does what?
- How?
- In what capacity?



- Experience?
- Qualifications?
- Job descriptions / duty statements?
- KPIs?

Assets

- ✓ physical (tangible) assets
- ✓ intangible assets
- ✓ financial assets
- ✓ Consider:
 - ❖ significance
 - ❖ market value, economic value, age
 - ❖ location
 - ❖ ownership
 - ❖ contributions to value (development, enhancement...)



Risks



- ✓ what is risk?
 - ❖ effect of uncertainty on business objectives
- ✓ risk vs. reward?
 - ❖ Higher risk → higher *expected* return
- ✓ significance of risk?
 - ❖ likelihood and size of potential impact
- ✓ assumption of risk for TP purposes?
 - ❖ ...



contracts and risk assumption

- ✓ Contracts may determine who bears a risk in the first instance...
- ✓ ...but do not determine who assumes (who *should* bear) risks for TP purposes
- ✓ Need to check contracts against conduct and substance:
 - ✓ are the contracts followed in practice?
 - ✓ how parties actually manage & control risks
 - ✓ financial capacity



Accurate delineation of the transaction

**CONTROL
OVER RISK**

Financial capacity

Capability + performance:
Decisions to take on, lay off, or decline a risk-bearing opportunity

Capability + performance:
Decisions on whether and how to respond to risks associated with the opportunity

Capability + performance **or control**:
to mitigate risk (take measures that affect risk outcomes)

Control = set objectives, hire, assess and if necessary, fire provider of risk mitigation functions



Accurate delineation of the transaction

Control over risk

FINANCIAL CAPACITY

Access to funding to take on the risk or lay off the risk, to pay for the risk mitigation functions and to bear the consequences if the risk materialises

Takes into account the available assets and the options realistically available to access additional liquidity, if needed, to cover the likely costs should the risk materialise



QUESTIONS,
COMMENTS?