



BEPS TRANSFER PRICING WORKSHOP
TRANSFER PRICING DOCUMENTATION –
RISK ASSESSMENT AND SAFE HARBOURS

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26 – 30 OCTOBER 2015

15. Developing Bilateral Safe Harbours – Memorandum of Understanding (MoU)



Sample Memoranda of Understanding to Establish Bilateral Safe Harbours

- Provided in Annex to the OECD Transfer Pricing Guidelines
- Three sample MoU
 - Low risk Manufacturing services
 - Low risk Distribution services
 - Low risk Research and Development services
- So far few bilateral safe harbours developed for these transactions



Sample MoU to Establish Bilateral Safe Harbours

- A tool to address cases that take up time when processed on a case by case basis
- Under authority of Article 25(3) of the OECD Model Tax Convention
- Concluded between the competent authorities of the countries involved
- Content may change depending upon agreement between the competent authorities



Advantages of such MoU

- Prevent safe harbours from causing double taxation or double non-taxation
- Compatible with the arm's length principle
- Minimise opportunities for manipulation



Advantages of such MoU

- Limit exposures to tax revenue
- Could be reviewed and modified when necessary
- Protect tax base in common transfer pricing cases with less enforcement effort



Content of MoU

- Preamble
- Description of the qualifying enterprise
- Description of the qualifying transaction
- Determination of the taxable income of the qualifying enterprise
- Permanent establishment
- Election and reporting requirements
- Termination of the agreement



Preamble

- Aim of the MoU: provide legal certainty by establishing specific procedures to comply with the TP rules in both states and to eliminate double taxation
- Applicable Treaty provisions: generally articles 9 and 25
- Mention of the taxable years to which the MoU is applicable



Qualifying Enterprise (QE)

- Description of the QE under the MoU
 - Resident of one State conducting predominantly business in such state (for associated enterprise in the other state)
 - Principal activity: depends on MoU
 - Manufacturing services or production of manufactured products for sale
 - Marketing and distribution services or purchase of products for resale to unrelated customers
 - Research and Development services



Qualifying enterprise (QE)

- Existence of a written agreement between the associated enterprises stating to compensate the QE at levels consistent with the MoU
- Limitation of other activities of the QE
 - Depend upon activity



Common Qualifying Criteria to all three activities

- No managerial, legal, accounting or personnel management functions other than directly related to the performance of the function under the MoU.
- Limitations with regard to
 - Industry sector (for example extraction industry)
 - Annual net sales
 - Total assets
 - Revenues derived from ‘other’ transactions
 - Past transfer pricing adjustments and experience



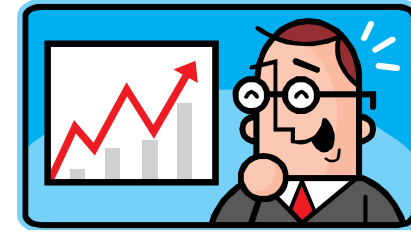
Qualifying criteria – Low Risk Manufacturing



- R&D activities shall not exceed a certain threshold
- Disallowed activities: advertising, marketing, distribution, credit collection or warranty administration functions, ...
- No title to finished products after they leave the factory
- No transport cost or other risk bearing with regard to finished products in transit
- Threshold criteria with regard to production or manufacturing assets



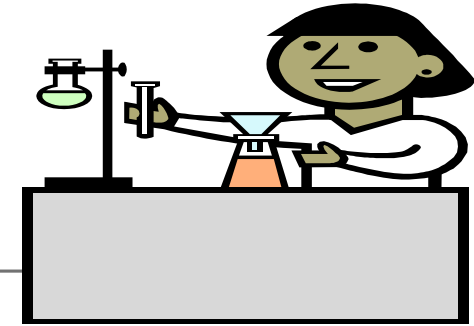
Qualifying Criteria – Low Risk Distribution



- R&D activities shall not exceed a certain threshold
- Disallowed activities: manufacturing or assembly functions, ...
- Maximum threshold with regard to marketing and advertising expense
- Maximum threshold with regard to finished good inventory



Qualifying Criteria – Low Risk R&D



- **Disallowed activities:** manufacturing and assembly, advertising, marketing and distribution functions, ...
- No use of proprietary patents, know-how, trade secrets or other intangibles other than those made available by the associated enterprise for which it performs R&D functions
- R&D programme shall be designed, directed and controlled by the associated enterprise for which it performs R&D functions



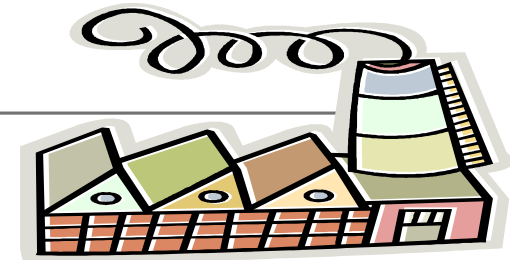
Qualifying transactions

- Rendering of
 - Manufacturing services or production of manufactured products for sale or
 - Marketing and distribution services or purchase of products for resale to unrelated customers or
 - Research and Development services

to an associated enterprise resident in the other State without the interposition of other transactions or parties



Determination of the Taxable Income of the QE



- **Low Risk Manufacturing**

- Method based on Net Cost Basis Profit Level Indicator (PLI) (EBIT)
- Range of PLI or fixed PLI - to be determined between competent authorities
- Different PLI depending on whether the qualifying enterprise takes title or does not take title to raw materials and work in process

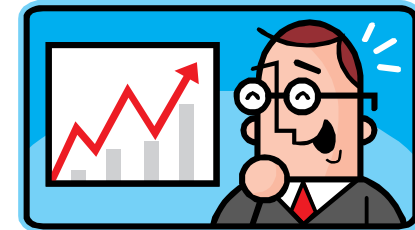


Determination of the Taxable Income of the QE

- **Low Risk Distribution**

- Method based on sales based PLI

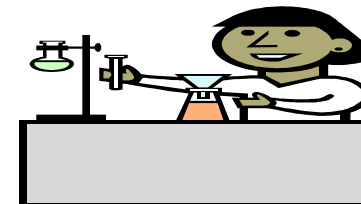
- Range of PLI or fixed PLI - to be determined between competent authorities



- **Low Risk R&D**

- Method based on costs incurred in performing R&D (EBIT)

- Range of PLI or fixed PLI - to be determined between competent authorities





Determination of the Taxable Income of the QE

Both states agree that such compensation is an arm's length compensation under the transfer pricing provisions of the states and of article 9 of the treaty.





Documentation and reporting

- Filing criteria (when, how, ...)
- Statement to apply and be bound by MoU and the period;
- Statement that income and expense will be reported on a consistent basis in both states in accordance with the MoU;
- Narrative description of the Qualifying Transactions;
- Identification of each of the parties to the Qualifying Transactions;
- Audited financial statements accounting information to demonstrate the status of the QE as a QE;
- Detailed calculation of the income of the QE from Qualifying Transactions applying the methods described in the MoU;
- Statement to respond within 60 days to any request of the tax authority.



Other Issues

- Permanent Establishments: for purposes of the MoU the enterprises are not deemed a permanent establishment
- Dispute resolution: through Mutual Agreement Procedure (MAP)
- Exchange of Information under Article 26 of the Treaty
- Termination clauses of the MoU



**THE USE OF THE SAMPLE
MEMORANDA OF UNDERSTANDING
IS NOT COMPULSORY**



Q & A

