Article 9(1) of the 2011 United Nations model income tax convention adheres to the arm’s-length principle. The wording of articles 9(1) and (2) of the U.N. and OECD models are thus identical. Further, the 1999 commentary on article 9 of the U.N. model provided that:

The Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines. These conclusions represent internationally agreed principles and the Group of Experts recommend that the Guidelines should be followed for the application of the arm’s length principle which underlies the article. The views expressed by the former Group of Experts have not yet been considered fully by the Committee of Experts, as indicated in the Records of its annual sessions. Since 1999 tax authorities of developing countries have gained more experience in transfer pricing, and multinational enterprises have seen that countries such as China, India, and Brazil have adopted positions that would seem difficult to reconcile with the OECD guidelines. That there are inconsistent views on transfer pricing between developed and developing countries was made clear in the discussion of the treatment of market-specific characteristics in the 2012 OECD discussion draft on intangibles.

On October 2, 2012, the U.N. published a final draft of its first comprehensive practical transfer pricing manual for developing countries. It was approved by its Committee of Experts on International Cooperation in Tax Matters at a meeting on October 15. The U.N. manual adheres to the arm’s-length principle and addresses general transfer pricing rules and methods as

1 Article 9(3) of the U.N. model establishes that the competent authorities are not required to make a corresponding adjustment in cases of tax avoidance and evasion. A similar rule has not been adopted by the OECD.

2 Para. 3 of the commentary on article 9 of the U.N. model.

3 Id.


well as administrative and practical issues. According to the foreword, the manual seeks consistency with the OECD guidelines. The technical analysis and examples of the manual draw on both the OECD guidelines and the U.S. section 482 regulations. Separate chapters on services, intangibles, and cost contribution arrangements have not yet been drafted. However, some issues regarding intangibles and services are addressed as part of the general discussion. It is expected that the manual will later be updated with chapters on those topics. The manual includes chapters describing the practices of Brazil, China, India, and South Africa.

The U.N. manual confirms that developing countries have acquired independent views on transfer pricing, presumably to ensure that a larger share of the profits of multinational enterprises are subject to taxation in developing countries. The U.N. has thus abandoned the neutral position vis-à-vis the OECD guidelines and is now also influencing the content of the OECD guidelines.

This article will comment on the following issues of the U.N. manual:
- intangibles;
- location-specific advantages;
- risk allocation; and
- lack of comparables.

Intangibles

Background

Under general tax law, the straightforward answer to the question of which taxpayer should report the return from an intangible on its tax return is the legal owner. That is, the behavior of independent enterprises should be replicated by associated enterprises. An associated enterprise that assists the legal owner of an intangible with developing, maintaining, and enhancing the value of the intangibles would be entitled to arm’s-length compensation reflecting the functions performed, risks assumed, and assets used.

The United States has relied on various approaches to deal with the allocation of intangible returns between associated enterprises. Under the current approach, introduced in 2009, the rules for determining the ownership for an intangible, in principle, are distinct from the rules for determining the allocation of intangible profits. However, from a strict tax law perspective the new rules merely create the basis for a higher valuation of services transactions. The return from an intangible must still be attributed to the owner. An arm’s-length compensation thus must be determined for contributions that are expected to develop or enhance the value of intangible property owned by an associated enterprise. The 2009 regulations have been drafted on the basis of the IRS’s experience in GlaxoSmithKline Holdings (Americas) Inc., which involved the identification of the tax owner of marketing intangibles, joint development of intangibles, and income allocation between the owners of manufacturing and marketing intangibles. The U.S. and U.K. competent authorities were unable to resolve the dispute, and it was eventually settled by the IRS and the taxpayer.

The 2012 OECD discussion draft on intangibles proposes a three-prong approach for the allocation of intangible returns between associated enterprises. Under it, an allocation of intangible returns to the legal owner is recognized only if it is consistent with the economic substance of the arrangement, and if associated enterprises that contribute to the value of the intangible owned by another associated enterprise are compensated on an arm’s-length basis.

U.N. Manual

The U.N. manual uses legal ownership as a starting point for determining which entity should be entitled to capture intangible returns. However, it is also stated that an associated enterprise may be entitled to share in the return from the exploitation of an intangible:

For instance, where an MNE parent has legal ownership of a product trademark or trade name it may have to be determined, depending on the facts and circumstances of the case, whether the subsidiary has “economic ownership” of the associated marketing intangibles that are created based on the subsidiary’s contribution to a strategy to enhance market share. [Emphasis added.]

The concepts of economic ownership and marketing intangibles are thus endorsed by the U.N. manual. The manual provides an example concerning marketing intangibles that states:

It is assumed for the purpose of the example that B Co has established its own marketing intangibles in Country B by incurring significant expenditure on marketing and has penetrated the market for the new product in the territory of country B.

\[\text{Para. 5.3.2.13 of the U.N. manual.}\]

\[\text{See also para. 5.3.2.5.5 of the U.N. manual.}\]

These marketing intangibles are separate from the intangibles of A Co. in country A for which a technology agreement is in place with A Co.\textsuperscript{15} [Emphasis added.]

The manual elaborates on the creation of marketing intangibles:

When an MNE enters a new market with its product or expands market share of its product in an existing market through its subsidiary, questions of the creation of marketing intangibles and increases in the value of product-related intangibles such as trademarks, trade names, etc., follow closely behind. Therefore, it is quite important to examine and follow the process of creation of intangibles in a market, as well as the legal ownership of that intangible and the right to share in the return from that intangible (the notion of which some countries refer to as “economic ownership”). It is recognised that market research; designing or planning products suitable to market needs; advertising; marketing and sales promotion strategies; after-sale services and networks of dealers and sales/commission agents may contribute to the creation of marketing intangibles depending on the facts and circumstances of each case.\textsuperscript{16} [Emphasis added.]

The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}

The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18} It says that marketing intangibles are generally identified on the basis of the efforts of an Indian subsidiary concerning:

\begin{itemize}
  \item enhancing the value of foreign trademarks unknown to the Indian market by incurring large advertisement, marketing, and sales promotion costs;
  \item creation of brand and product loyalty among customers;
  \item creation of efficient supply chains;
  \item establishment of distributor networks;
  \item after-sale services support networks;
  \item customer and market research; and
  \item establishing customer lists.\textsuperscript{19}
\end{itemize}

The goal of the Indian tax authorities regarding marketing intangibles is to determine whether a taxpayer has incurred extraordinary advertisement, marketing, and sales promotion costs.\textsuperscript{20} A subsidiary must be compensated for excess expenditures on a cost-plus basis, or by entitlement to a share of the intangible returns.\textsuperscript{21} The cost-plus approach mirrors the approach of the OECD guidelines, whereas the entitlement to a share of intangible returns approach resembles the U.S. rules.\textsuperscript{22}

The U.N. manual thus recognizes and emphasizes the concept of marketing intangibles, whereas the 2012 OECD discussion draft on intangibles warns against accepting vaguely specified and undifferentiated marketing intangibles.\textsuperscript{23} The U.N. manual thus sets the scene for cross-border disputes between developed and developing countries. However, whether a taxable object (such as a marketing intangible) exists and who the owner is must be determined under domestic tax law because those issues are not addressed by the arm’s-length principle.

Location-Specific Advantages

Background

The issue of location savings was first addressed by U.S. Rev. Proc. 63-10, which provided that savings from the relocation of manufacturing activities from U.S. parent companies to subsidiaries in U.S. possessions should normally be allocated to the subsidiaries in the U.S. possessions.\textsuperscript{24}

The U.S. Tax Court considered the issue in Sundstrand Corp.\textsuperscript{25} in which a U.S. group had established a manufacturing subsidiary in Singapore (SunPac) that manufactured spare parts for the group’s products. SunPac paid a royalty for the right to use intangibles owned by the U.S. parent company, and it sold its entire output back to the U.S. parent company. The IRS determined that SunPac should be treated as a contract manufacturer and that the profits of the subsidiary should be calculated on the basis of the cost-plus method. The Tax Court held that SunPac could not be treated as a contract manufacturer. The location savings should be allocated to SunPac since the license agreement meant the subsidiary obtained a monopoly market position for the supply of the spare parts:

\begin{itemize}
  \item The manual elaborates on the creation of marketing intangibles:
  \item The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}
  \item The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18}
  \item The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}
  \item The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18}
  \item The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}
  \item The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18}
  \item The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}
  \item The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18}
  \item The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}
  \item The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18}
  \item The Chinese country report provides that marketing intangibles and location-specific advantages are often closely integrated, and due consideration is necessary to properly compensate the contribution by the subsidiary in developing countries of such resources.\textsuperscript{17}
  \item The Indian report notes that transfer pricing aspects of marketing intangibles have been a focus area for the Indian tax authorities.\textsuperscript{18}

\textsuperscript{15}Para. 5.3.2.2.14 or the U.N. manual.
\textsuperscript{16}Para. 5.3.2.5.6 of the U.N. manual.
\textsuperscript{17}Para. 10.2.4.1 of the U.N. manual.
\textsuperscript{18}Para. 10.3.8.12 of the U.N. manual.
\textsuperscript{19}Para. 10.3.8.11 of the U.N. manual.
\textsuperscript{20}Para. 10.3.8.15 of the U.N. manual.
\textsuperscript{21}Para. 10.3.8.16 of the U.N. manual.
\textsuperscript{22}Wittendorff, supra note 6, at 638 and 642.
\textsuperscript{23}Para. 11 of the 2012 OECD discussion draft.
\textsuperscript{24}Wittendorff, supra note 6, at 434.
As discussed above, petitioner advocates use of the comparable uncontrolled-price method. Petitioner further does not agree with the calculation of respondent’s adjustment under the cost-plus method. Petitioner contends that SunPac realized location savings from operating in Singapore which, since SunPac enjoyed a monopolistic position in relation to CSD spare parts, SunPac would not have passed on to its customers. Thus, petitioner argues, as an economic matter, the location savings must be allocated solely to SunPac. Petitioner argues further that the record clearly demonstrates that both the form and the substance of the relationship between petitioner and SunPac was not contractor/subcontractor, but licensor/licensee. We agree with petitioner.26

The Tax Court thus determined that the relative bargaining power between the parties was decisive for the allocation of the location savings.

The U.S. regulations from 1994 have adopted that approach and provide that adjustments should be made for significant differences in costs attributable to the geographical location of markets.27 Those adjustments must be based on the effect that the differences would have on the consideration charged or paid in the controlled transaction, given the relative competitive positions of buyers and sellers in each market — that is, on the relative bargaining powers of the parties.

The 2010 OECD guidelines have followed suit by concluding that the allocation of location savings should normally depend on the functions, assets, and risks of each party, and on their bargaining powers.28

The 2012 OECD discussion draft on intangibles states that market-specific characteristics do not qualify as intangible:

Specific characteristics of a given market may affect the arm’s length conditions of transactions in that market. For example, the high purchasing power of households in a particular market may affect the prices paid for certain luxury consumer goods. Similarly, low prevailing labor costs, proximity to markets, favourable weather conditions and the like may affect the prices paid for specific goods and services in a particular market. Such market specific characteristics may not, however, be owned, controlled and transferred by an individual enterprise. Such items are not intangibles within the meaning of section A.1., and should be taken into account in a transfer pricing analysis through the required comparability analysis. See TPG Chapter III and paragraphs 9.148-9.153.29 [Emphasis added.]

However, the discussion draft also states that residual profits should not always be allocated to the party entitled to intangible-related returns:

In matters involving the use or transfer of intangibles, caution should be exercised in adopting a transfer pricing methodology that too readily assumes that all residual profit from transactions after routine functional returns should necessarily be allocated to the party entitled to intangible related returns. The selection of the most appropriate transfer pricing method should be based on a functional analysis that provides a clear understanding of the MNE’s global business processes and how intangibles interact with other functions, assets and risks that comprise the global business. The functional analysis should identify other factors that contribute to value creation, which may include risks borne, specific market characteristics, location, business strategies, and MNE group synergies among others. The transfer pricing method selected, and any adjustments incorporated in that method based on the comparability analysis, should appropriately reflect all of the relevant factors materially contributing to the creation of value, not merely reflect intangibles and routine functions.30 [Emphasis added.]

Factors that may trigger entitlement to a share of residual profits thus include specific market characteristics, such as those mentioned above. Presumably this will require that compensation for these factors is not reflected in the routine return determined on the basis of comparable uncontrolled transactions. In any case, the 2012 OECD discussion draft has expanded the discussion of location savings to include other benefits derived from location. This position reflects the influence of developing countries, as will be shown below.

U.N. Manual

The U.N. manual contains an extensive discussion of the new concept of location-specific advantages (LSAs),31 which is supplemented by discussions in the country reports of China32 and India.33

The concept of LSAs covers both location savings (net benefit from low factor costs) and other benefits offered by a location, such as:

- highly specialized knowledge and personnel;
- proximity to growing local/regional market;

26 Id.
28 Para. 9.149 of the OECD guidelines.
29 Para. 24 of the 2012 discussion draft.
30 Para. 108 of the 2012 discussion draft.
31 Paras. 5.3.2.4.5-5.3.2.4.10 of the U.N. manual.
32 Para. 10.2.3 of the U.N. manual.
33 Para. 10.3.7 of the U.N. manual.
large customer base with increased spending capacity;
• advanced infrastructure (for example, information or communication networks, distribution systems, and so forth); or
• market premium.34

The manual applies the concept of location rent to denote the incremental profits derived from LSAs (that is, the LSAs that are not captured by customers).35 Hence, to the extent the market for the end product is highly competitive and the competitors have access to the same LSAs, most of the benefits may be passed on to consumers.36

The manual states that an arm’s-length allocation of location rents depends on competitive factors relating to the access to the LSAs, and on the alternatives available to the associated enterprises given their relative bargaining power.37 The U.N. manual and the OECD guidelines thus basically point at the same factors that are decisive for the arm’s-length allocation.

According to the U.N. manual, empirical evidence of the allocation in comparable uncontrolled transactions takes precedence over a hypothetical allocation based on relative bargaining powers. However, considering that local comparables are often unavailable in developing countries and that local tax authorities may dismiss the use of foreign comparables,38 the result may be that location rents must be assigned hypothetically using the relative bargaining powers of the contracting parties as allocation key. India’s country report states that the profit-split method may be best in the circumstances, including the risk allocation of the LSAs.41 Hence, using local comparables would mean that 100 percent of the LSAs would be allocated to India’s country report

The market conformity of a risk allocation is not specified as a factor to be considered. This is in accord with the preamble to the 2006 temporary services regulations regarding contingent-payment contractual terms, which states:

That is, whether a particular arrangement entered into by controlled parties has economic substance is not determined by reference to whether it corresponds to arrangements adopted by uncontrolled parties.46

The 1995 OECD guidelines also required the recognition of a contractual risk allocation, and they emphasized the conduct of the parties and the parties' control exercised over the risk as factors in determining the economic substance of a risk allocation.47

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34Para. 5.3.2.4.7 of the U.N. manual.
35Para. 5.3.2.4.8 of the U.N. manual.
36Para. 5.3.2.4.9 of the U.N. manual.
37Para. 5.3.2.4.10 of the U.N. manual.
38See para. 10.2.2 of the U.N. manual on China.
39Para. 10.3.7.3 of the U.N. manual.
41Para. 10.3.7.4 of the U.N. manual.
42Para. 5.3.2.4.7 of the U.N. manual
43Para. 1.64 of the OECD guidelines. See Wittendorf, supra note 6, at 323.
47Paras. 1.26 and 1.27 of the OECD guidelines (1995).
The 2010 OECD guidelines significantly expand the discussion of risks in the context of business restructurings.\(^{48}\) They state that a risk allocation must be recognized only if it is arm’s length.\(^{49}\) An evaluation of a risk allocation may be made on the basis of an empirical or a hypothetical arm’s-length test. If empirical evidence exists regarding a similar risk allocation in comparable uncontrolled transactions, the risk allocation of the controlled transaction is held to be arm’s length.\(^{50}\) In the absence of empirical evidence, a hypothetical arm’s-length test must be made based on the following factors:

- control over the risk; and
- financial capacity to bear the risk.\(^{51}\)

For the OECD, the control factor takes precedence. The concept of control is explained as follows:

In the context of paragraph 1.49, “control” should be understood as the capacity to make decisions to take on the risk (decision to put the capital at risk) and decisions on whether and how to manage the risk, internally or using an external provider. This would require the company to have people — employees or directors — who have the authority to, and effectively do, perform these functions. Thus, when one party bears a risk, the fact that it hires another party to administer and monitor the risk on a day-to-day basis is not sufficient to transfer the risk to that other party.\(^{52}\)

The concept of control resembles the concept of significant people functions developed by the OECD under article 7(2).\(^{53}\) In essence, the 2010 OECD approach means that a factual risk has replaced a contractual risk allocation in an article 9(1) context.

Compared with the U.S. rules, the OECD guidelines place more emphasis on the control factor — that is, on people functions. The purpose of the OECD rules presumably is to prevent tax planning strategies based on a separation of functions from risks/assets — for example, the transfer of risks and intangibles to a low- or no-tax country and the maintenance of people functions in high-tax countries. Note that the OECD guidelines provide examples in which contractual risk allocations to a parent company is recognized regarding contract research and development and contract manufacturing, although day-to-day research and manufacturing are performed by subsidiaries.\(^{54}\)

**U.N. Manual**

The U.N. manual recognizes the importance of risks for transfer pricing purposes.\(^{55}\) However, the country report on India states that it is unfair to give “undue” importance to risk in determining an arm’s-length price in comparison to functions performed and assets used.\(^{56}\) This is obviously correct. However, the fact remains that risk plays a key role in market transactions and consequently should be given strong deference in transfer pricing under the arm’s-length principle.

The U.N. manual has adopted the economic substance test of the 2010 OECD guidelines and requires a risk allocation to be arm’s length.\(^{57}\) The approach of relying on either an empirical or a hypothetical arm’s-length test is also accepted.\(^{58}\) In line with the OECD guidelines, control over the risk\(^ {59}\) and financial capacity to bear the risk\(^ {60}\) are the most critical factors in assessing the arm’s-length nature of a risk allocation.\(^ {61}\) Unlike the OECD guidelines, the U.N. manual recognizes the difficulty of applying the control factor:

It is pertinent to mention here that in a multinational enterprise, associated entities work together to exert control over the risks of the entire MNE group. Real and precise distribution of risk among the associated enterprises is virtually impossible to achieve, due to the lack of sufficiently detailed information in some cases.\(^ {62}\)

The U.N. manual contains several examples that urge developing countries to test claims of parent companies in developed countries that they exercise control over R&D activities and other activities subsidiaries perform in developing countries under a contract.\(^ {63}\) The Chinese and Indian country reports claim that foreign parent companies often do not control the risk and that the profit-split method may be more appropriate than the cost-plus method.\(^ {64}\) India even seems to apply a rule of presumption that foreign parent companies do not control risks over core functions being performed by Indian subsidiaries:

\[^{48}\] Part I of Chapter IX on business restructurings of the OECD guidelines (2010).
\[^{49}\] The economic substance test arguably infringes on the arm’s-length principle of article 9(1) of the OECD model tax convention because the controlled transaction is not recognized as actually structured. See Wittendorf, supra note 6, at 170.
\[^{50}\] Para. 9.18 of the OECD guidelines (2010).
\[^{51}\] Para. 9.20 of the OECD guidelines (2010).
\[^{52}\] Para. 9.23 of the OECD guidelines (2010).
\[^{53}\] Para. 9.21 of the OECD guidelines (2010).
\[^{54}\] Paras. 9.26 and 9.27 of the OECD guidelines (2010).
\[^{55}\] Paras. 5.3.2.2.15 and 5.3.2.2.16 of the U.N. manual.
\[^{56}\] Para. 10.3.4.1 of the U.N. manual.
\[^{57}\] Para. 5.3.2.2.23 of the U.N. manual.
\[^{58}\] Para. 5.3.2.2.24 of the U.N. manual.
\[^{59}\] Id.
\[^{60}\] Para. 5.3.2.2.25 of the U.N. manual.
\[^{61}\] Id.
\[^{62}\] Id.
\[^{63}\] Para. 5.3.2.2.24 (examples 1 and 2) of the U.N. manual.
\[^{64}\] Paras. 10.2.5.4 and 10.3.4 of the U.N. manual.
The Indian transfer pricing administration does not agree with the notion that risk can be controlled remotely by the parent company and that the Indian subsidiaries or related party engaged in core functions, such as carrying out research and development activities or providing services, are risk-free entities. India believes that core functions of R&D or services are located in India, which in turn requires important strategic decisions by management and employees of Indian subsidiaries or related party to design, direction of R&D activities or providing services and monitoring of R&D activities etc. Accordingly, the Indian subsidiary exercises control over the operational and other risks. In these circumstances, the ability of the parent company to exercise control over the risk — remotely and from a place where core functions of R&D and services are not located — is very limited. In these circumstances, allocation of risk to the parent MNE is not only questionable but is devoid of logical conclusion.\(^{65}\)

Indian subsidiaries are thus presumed to bear the risk over core functions performed on behalf of the group. Needless to say, that compensation on a cost-plus basis is held to infringe on the arm's-length principle.\(^{66}\) The question is whether India also will accept that losses incurred because of unsuccessful activities are borne by an Indian subsidiary if the risk is contractually assumed by a foreign parent company.

The OECD and the U.N. are applying the same economic substance test in order to evaluate the arm's-length nature of the risk allocation between associated enterprises. Whereas OECD countries adopted this test to prevent income shifting from high-tax countries to thinly staffed companies in low- or no-tax countries, developing countries are relying on the test to prevent income shifting from developing countries to fully staffed parent companies in developed countries. That contrast will undoubtedly give rise to conflicts between countries relying on the U.N. manual and those relying on the OECD guidelines.

### Lack of Comparables

#### Background

The use of databases to identify comparable uncontrolled transactions has been developed in the United States along with the application of the comparable profit method (CPM). The U.S. rules provide that comparables should normally be drawn from the geographic market where the controlled taxpayer operates.\(^{67}\) If information from the same market is unavailable, a comparable drawn from a different geographic market may be considered if adjustments are made to take into account differences between the two markets.\(^{68}\) If information is not available to enable adjustments to be made for those differences, then information drawn from comparables in the most similar market for which reliable data is available may be used, but the extent of the differences may affect the reliability of the method under the best method rule.

The OECD guidelines also say that geographic markets are an important comparability factor, but they do not present rules on the treatment of geographic market differences.

#### U.N. Manual

The U.N. manual states that in many developing countries, the availability of independent comparables, or of public information on independent comparables, is limited. Use of foreign comparables may therefore be needed, possibly adjusted to reflect geographic differences.\(^{69}\) The Chinese country report states:

> While globalization and free capital mobility are the basis for the use of foreign comparables, the existence of foreign exchange controls in many developing countries violates this pre-condition. Accordingly, significant comparability adjustments may be necessary for companies in developed countries to be used as comparables for companies in developing countries. In some cases, it may require a different methodology such as profit split as no sufficiently reliable comparability adjustments may be feasible.\(^ {70}\) [Emphasis added.]

China provides an example of an adjustment to account for geographic market differences in which a net cost-plus margin of 8 percent derived from foreign comparables of developed countries are increased 50 percent to arrive at 12 percent in order to account for the fact that factor costs in the developed countries are 50 percent above factor costs in China.\(^{71}\)

The U.N. manual gives the impression that the use of foreign comparables often will not be accepted.

### Conclusion

The U.N. practical manual on transfer pricing for developing countries endorses the arm's-length principle and draws on the OECD guidelines and the U.S. regulations. That said, the manual ends the neutral
position vis-à-vis the OECD guidelines that is expressed in the 1999 commentary on article 9 of the U.N. model. Since then, developing countries have arrived at their own perception of arm's length. The goal clearly is to exploit the flexibility of the arm's-length principle in order to ensure that a larger share of the global tax pie is captured by developing countries. However, rather than promoting the prescriptive approach of Brazil, the U.N. manual stays with the call for a concrete evaluation based on the functions performed, risks assumed, and assets used.

In line with recent OECD reports, the focus of the U.N. manual is to elevate functions at the expense of risks and assets. Functions performed may cause marketing intangibles to be developed and owned by subsidiaries in developing countries and contractual terms relieving subsidiaries from business risks to be dismissed. People functions may also cause LSAs to be allocated to subsidiaries in developing countries in the absence of clear empirical evidence for a contrary result. All in all, these factors may mean that the profit-split method is often considered to be the best method, whereby subsidiaries in developing countries more easily may share in residual returns. The U.N. manual thus makes it more difficult for multinational enterprises to get away with just leaving a routine return in developing countries.