AFRICAN TAX ADMINISTRATION FORUM
FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

TRANSFER PRICING INTRODUCTION & METHODS

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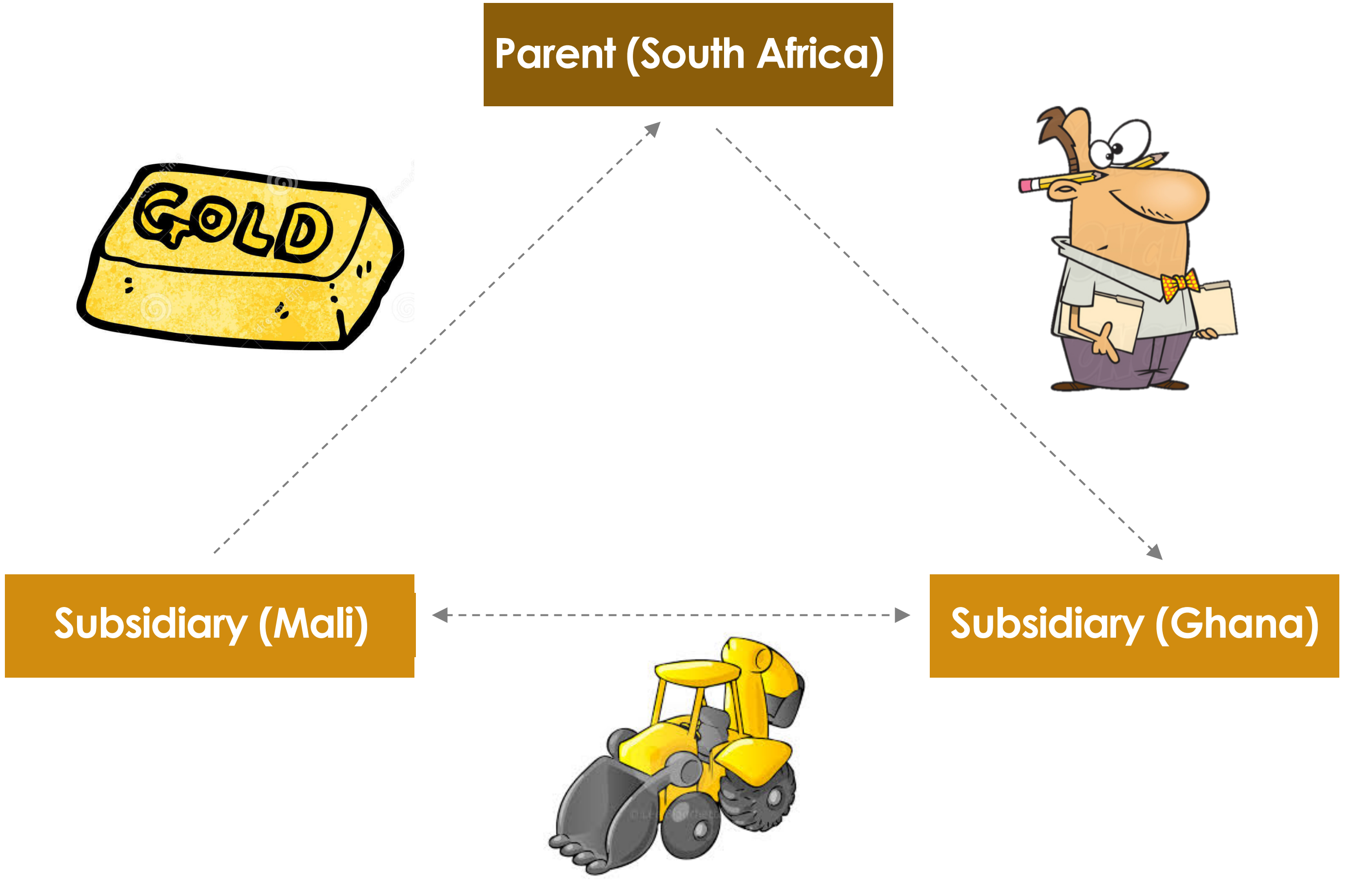
WHAT IS TRANSFER PRICING?

- Transfer pricing is a **legitimate method** used by multinational companies
- Transfer pricing is the price that multinational companies who are **related to each other**, charge one another.
- For there to be a transfer pricing, the companies have to be related → **from the same group.**
- The term ‘transfer pricing’ is usually used for **tax purposes to describe transfer prices that result in profits being shifted from one related entity to another across a ‘tax border**’ (usually an international country border) and this has tax consequences

WHAT IS TRANSFER PRICING?

- We are selling gold, mined in Africa, owned by a company also in Africa.

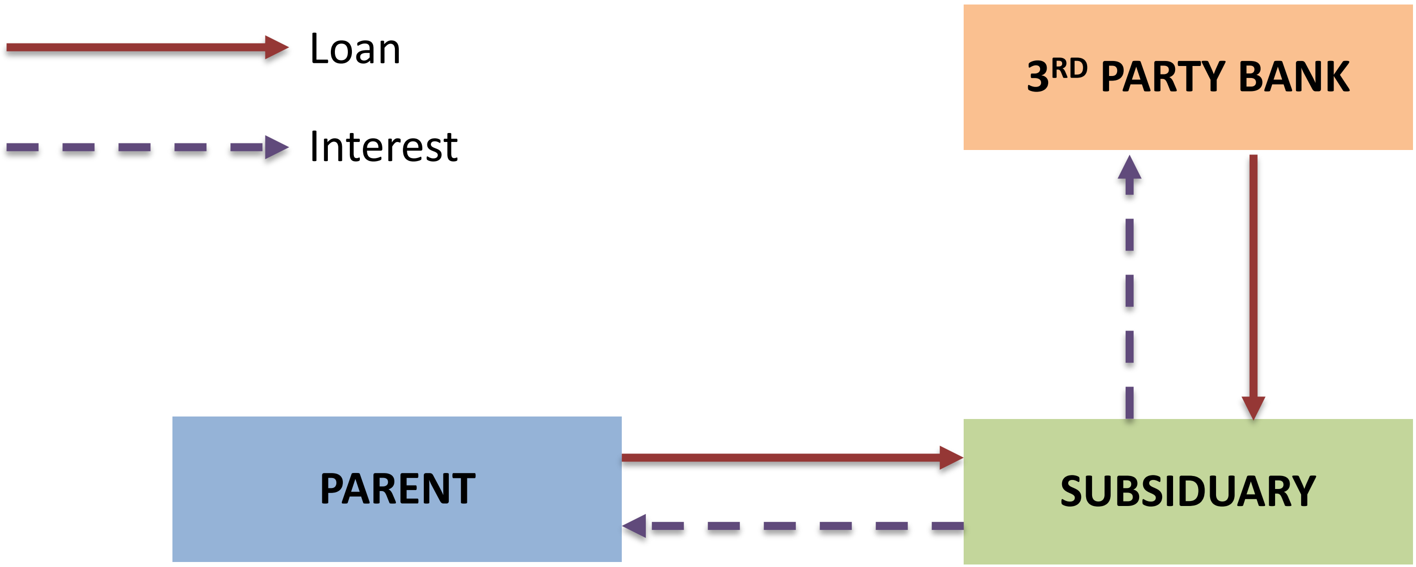


THE ARM'S LENGTH PRINCIPLE

- What would be the price paid for the gold if the companies were not related?
- This is the fundamental question and it is governed by what is called **Arm's length Principle (ALP).**
- This principle is covered in the **OECD Model Tax Convention under Article 9.**
    - *If conditions made or imposed between associated enterprises in their commercial or financial relations differ from those which would have been made between independent enterprises, then profits that, but for those conditions, would have accrued to one of the enterprises may be included in the profits of that enterprise and taxed".*

WHAT WOULD BE AN ACCEPTABLE PRICE?

- Let's look at how transfer pricing could be used by a Parent to fund a Subsidiary



CHALLENGES IN IMPLEMENTING ALP

- Lack of comparable data from **uncontrolled transactions**;
- For some transactions **comparables** may not exist (e.g. Chevron);
- Problems **accessing information** from other tax jurisdictions;
- Complexity of **transfer pricing methods**;
- Limited transfer pricing expertise;
- Can involve **significant time**, effort and expense.

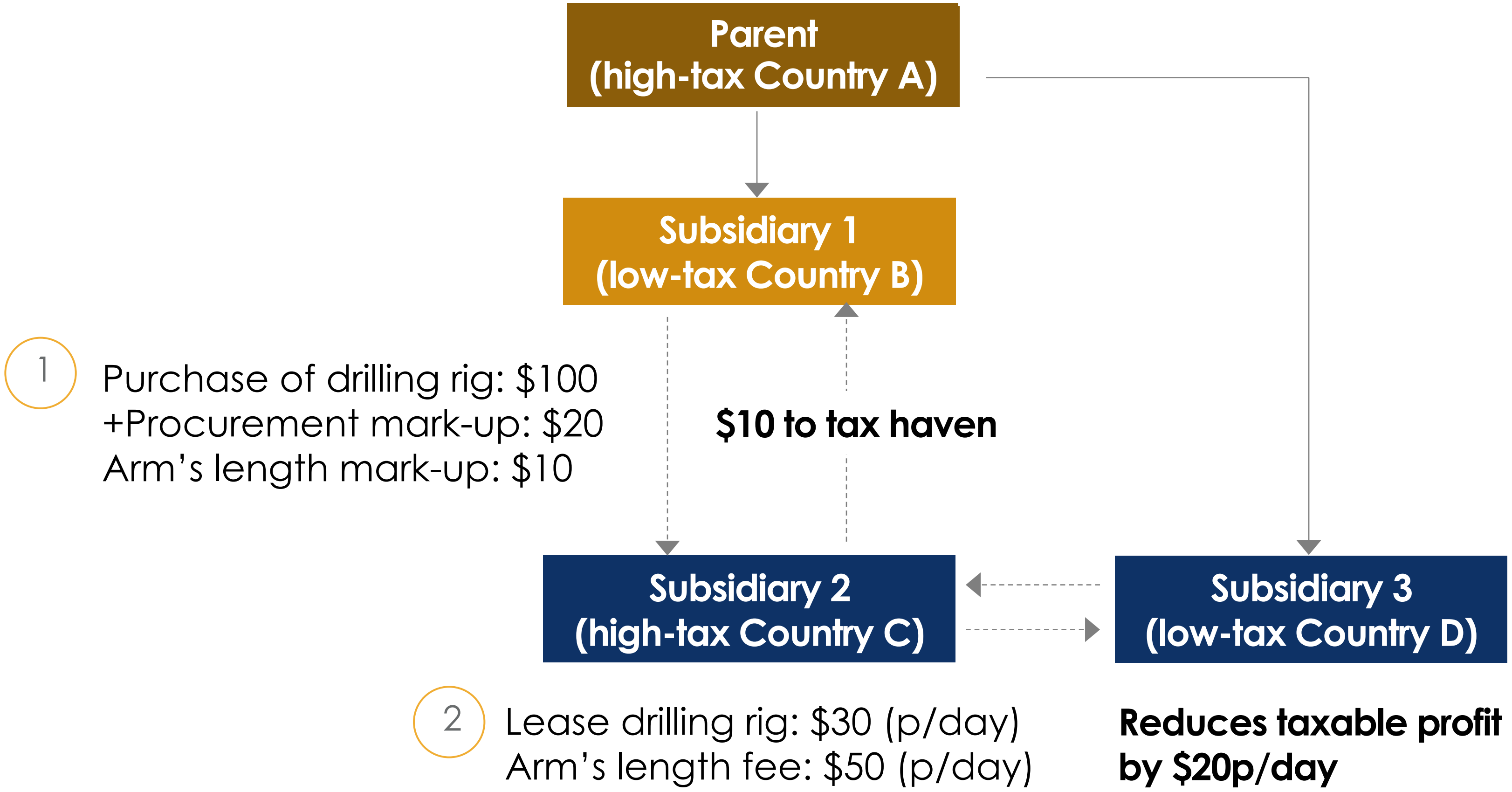
HOW DO YOU MEASURE THE PRICE?

- These methods are prescribed by the OECD and UN TP Guidelines
- Choosing the right method will determine how to cost the transaction
- This can be difficult and has to be precise

PRESCRIBED METHODS	
Transactional Methods	**Profit Methods**
Comparable Uncontrolled Price (CUP)	Transactional net margin method (TNMM)
Resale price method (RPM)	Profit Splits
Cost Plus (Cost +)	

ABUSIVE TRANSFER PRICING

- Transfer Mispricing – Used to avoid taxes



SO WHAT IS THE PROBLEM FOR AFRICA?

01

AGGRESSIVE TAX PLANNING

- The lack of strong interest deductibility legislation allows taxpayers to strip out profits through related party transactions (excessive loans & excessive interest – tax deductible)
- Due to poor legislation on documentation, taxpayers may to take their chances

02

TIME VS RETURN

- Transfer pricing audits take months to years to resolve..
- Poorly trained audit teams not supported by enabling legislation can cripple and demoralise the audit.
- This leads to revenue losses of the above does not happen

03

POOR PENALITIES

- The bulk of legislation on the continent is outdated and has low penalty regimes.
- The penalties do not scare off taxpayers and therefore there is a risk of increased non-compliance culture, e.g. $1000 fine viz Multiple $$$ profits

SO WHAT IS THE PROBLEM FOR AFRICA?

04

THE USE OF HUBS

- Many MNEs are increasingly using marketing hubs and technology hubs to sell of their products and services to end customer.
- The use of hubs “hides” the activities undertaken in that country.
- Most hubs are low tax jurisdictions / incentives

05

INCENTIVES

- Incentives used to reduce tax burden of two related companies, e.g. through capital allowances (construction and mining)
- Due to poor coordination of incentives and treaties, taxpayers can neutralise their taxes by using treaties that create erosion.

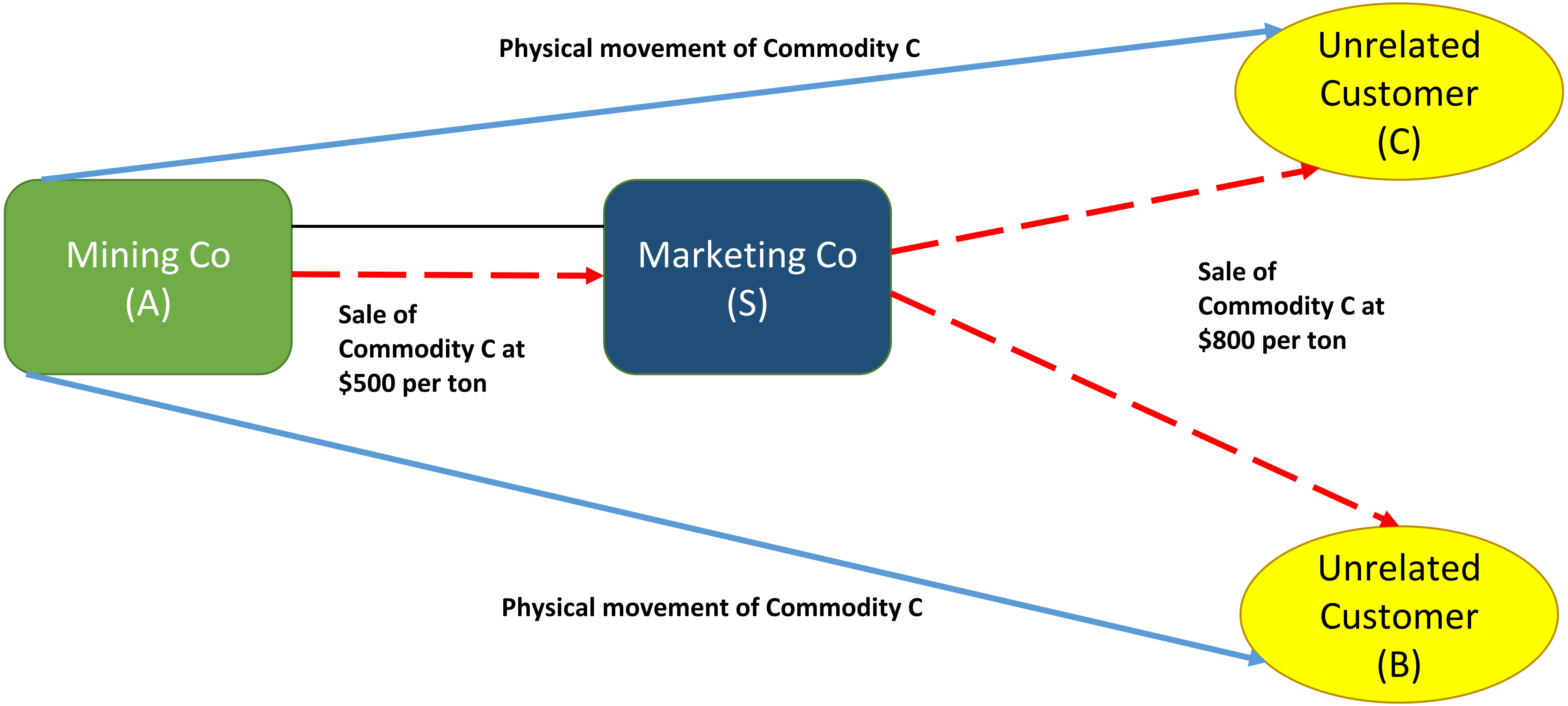
06

TREATIES

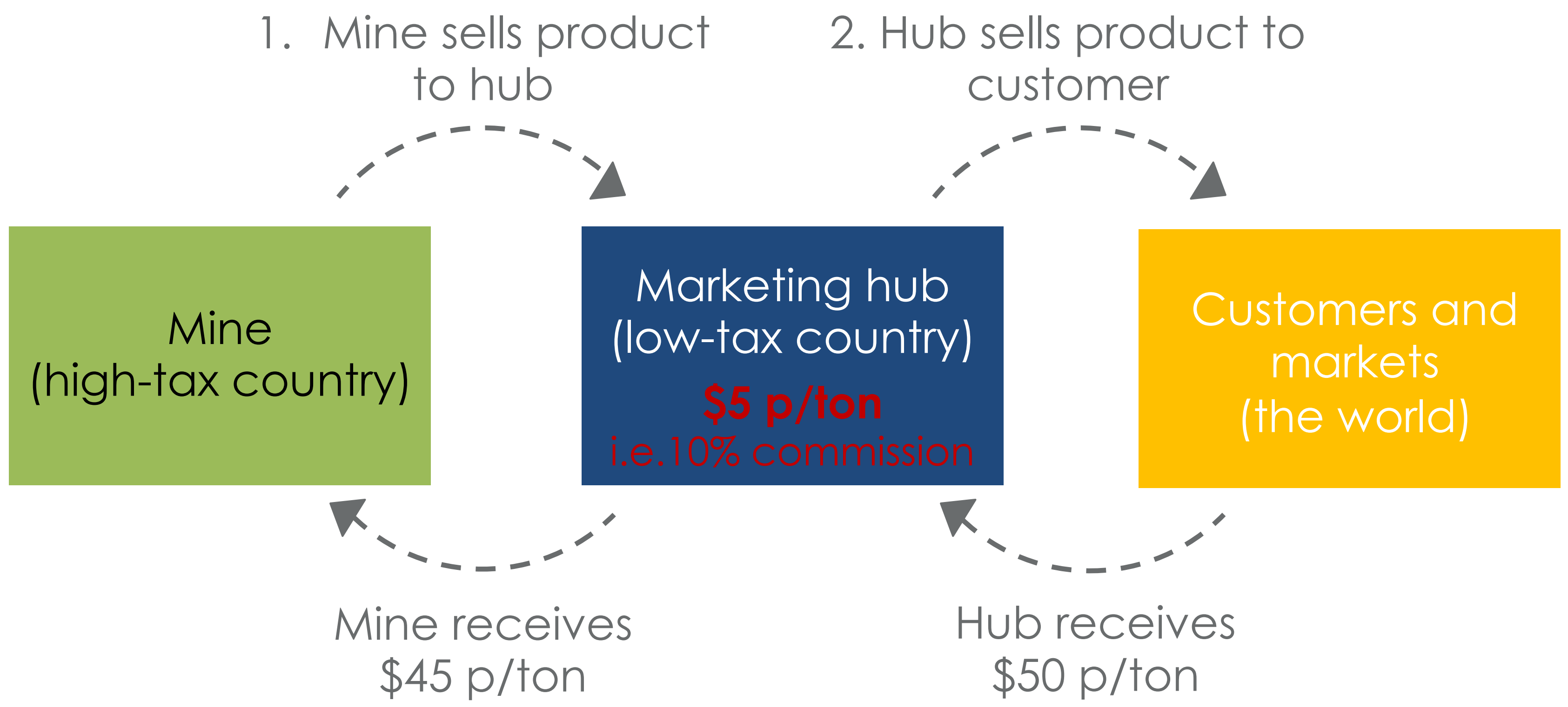
- Lack of treaties among African countries → This may be exploited by taxpayers.
- It makes it difficult to go into mutual assistance procedures (MAP) as arbitration may prove difficult for low capacity administrations.

EXAMPLES – MARKETING HUB USED IN MINING

AN EXAMPLE OF A MARKETING HUB

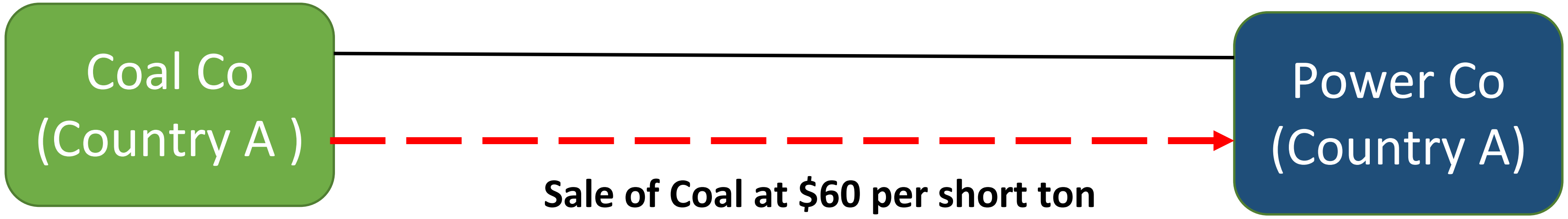


MARKETING ARRANGEMENTS AS TAX PLANNING



EXAMPLES – EXPLOITING A TAX INCENTIVE

TAX INCENTIVES & PROFIT SHIFTING



- **Prior to 2015 Power Co purchased coal from foreign unrelated supplier**

- **Coal Co set up end 2014 to mine coal to supply related party Power Co for its power plant**

- **Coal Co given a tax holiday of 10 years (CIT rate 0%) to encourage coal mining to be done in country**

	2014	2015
Sales	500m	550m
COGs	(200m)	(400m)
Gross Profit	300m	150m
Op Exps	(200m)	(200m)
Op. Profit	100m	(50m)
Tax (30%)	(30m)	Nil

ATAF WORK ON TP

ATAF PRODUCTS TO ASSIST AFRICAN COUNTRIES

Suggested Approach to Drafting Transfer Pricing Legislation

Transfer Pricing Risk Assessment

Suggested Approach to Drafting Interest Deductibility Legislation

Transfer Pricing Risk Assessment for Mining

ATAF Model Double Non Taxation Agreement

Suggested Approach to Drafting Permanent Establishment Legislation

THANK YOU FOR YOUR ATTENTION!