

EASTERN AFRICA TRANSFER PRICING LEGAL FRAMEWORK

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Presentation agenda



- ☐ Global International tax trends
- ☐ Regional legal framework around transfer pricing
 - ☐ Tanzania
 - ☐ Rwanda
 - ☐ Kenya

Global international tax trends



OECD: Three Pillars BEPS Action Plan



Coherence

- Hybrid Mismatch arrangements (2)
- Interest Deductions (4)
- Controlled Foreign Corporation (CFC) Rules (3)
- Methodologies and Data Analysis (11)

Substance

- Harmful Tax Practices (5)
- Preventing Tax Treaty Abuse (6)
- Avoidance of PE Status (7)
- **TP Aspects of Intangibles (8)**
- **TP /Risk and Capital (9)**
- **TP / High Risk Transactions (10)**

Transparency

- Harmful Tax Practices (5)
- Disclosure Rules (12)
- **TP Documentation (13)**
- Dispute Resolution (14)

Digital Economy (1)

Multilateral Instrument (15)

BEPS Final Report - Hierarchy



Minimum standards

- Action 5: Harmful tax practices
- Action 6: Prevent treaty abuse
- Action 13: Country by Country (CbC) reporting only
- Action 14: Dispute resolution

Strengthening existing International standards

- Action 7: Permanent Establishment (PE)
- Actions 8 - 10: Transfer Pricing
- Action 13: Master file and local file

Common approach and best practices

- Action 1: Digital economy
- Action 2: Hybrid mismatch arrangements
- Action 3: CFC
- Action 4: Interest deductions
- Action 11: Measuring and Monitoring BEPS
- Action 12: Disclosure of Aggressive Tax Planning

Action 15: Multilateral Instrument

The OECD Transfer Pricing Guidelines, July 2017: *Impact of BEPS*



2010 Transfer pricing Guidelines **as modified by BEPS**



- The Arm's Length Principle (Amended by Action 9)
- 2. Transfer Pricing Methods (Amended by Action 10)
- 3. Comparability Analysis
- 4. Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes [updated 2009]
- 5. Documentation (Amended by Action 13)
- 6. Special Considerations for Intangible Property [S - 1996] (Amended by Action 8)
- 7. Special Considerations for Intra - Group Services [S - 1996] (Amended by Action 10)
- 8. Cost Contribution Arrangements [S -1997] (Amended by Action 8)
- 9. Transfer Pricing Aspects of Business Restructurings (Amended by Action 8)

BEPS impact on Transfer pricing



- ❑ The increasing participation by non-OECD/non-G20 countries in the technical work of the OECD/G20 BEPS project and by their tax administrations in international forums is likely to result in a changing transfer pricing landscape in the region.
- ❑ Increased compliance requirements, including increased transparency with countries adopting BEPS Action 13
- ❑ Applying new OECD concepts - different views on what constitutes an arm's length transfer price
- ❑ Dynamic (retroactive) interpretation of the OECD TPG?
- ❑ Transfer Pricing and reputation.

BEPS Action 8: TP for Intangibles



Concern

- Difficulties in determining the transfer price for intangibles

Intention

- Provide broad and clear definition of intangibles
- Ensure that profits associated with transfer / use of intangibles are aligned with value creation
- Provide special measures for transfer of hard-to-value intangibles (HTVI)

What does this mean for taxpayers

- Legal ownership of intangibles does not guarantee entitlement to returns but a parting undertaking of the DEMPE functions can expect appropriate remuneration
- Entity assuming risks to exercise control over risk and have financial capacity

BEPS Action 9: TP for risk and Capital rich and low function persons



Engages in Funding activities in controlled transaction(s)

Does not control financial risks associated with its funding activities

Capital rich and low function person

Entitled to no more than a risk free return as remuneration for the activities

Should not be allocated profits associated with those financial risks

BEPS Action 10: TP for other high-risk transactions



Concern

- BEPS through engaging in transactions that would not occur / very rarely occur between third parties

Intention

- Adopt transfer pricing rules / special measures to clarify circumstances in which transactions can be re-characterized
- Clarify application of TP methods in particular profit splits in the context of global chain
- Provide protection against common types of base eroding payments (management fees and head office expenses)

Impact to taxpayers

- Contractual arrangements to reflect economic reality
- Contractual allocation of risks to be supported by actual decision making

BEPS Action 13: TP documentation and CbCR



Coverage

- Increase transparency for tax authorities
- For MNEs with annual revenue above 750 million Euros

Master File

- High-level information on MNC available to all tax authorities
- **Local File**
- Detailed information about the local business

CbCR

- High level information on:
- Allocation of profits
- Revenues
- Employees
- Assets

Regional legal framework



Kenya

Income Tax Act, Cap 470



- ☐ Income Tax (Transfer Pricing) Rules, 2006
 - ☐ TP first legislated in Kenya in 2006
 - ☐ Case law: Unilever Kenya Limited
- ☐ Definition of related parties:
 - ☐ Direct / Indirect participation by an enterprise in management / control / capital of the other
 - ☐ Direct/Indirect participation by a third person in management / control / capital of both
 - ☐ Association by marriage, consanguinity or affinity by individuals in the management, control or capital of two businesses
- ☐ Transactions subject to transfer pricing rules
 - ☐ Sale/purchase of goods / tangible assets
 - ☐ Provision or receipt of services
 - ☐ Lease of tangible assets
 - ☐ Lending / borrowing of money
 - ☐ Transfer / purchase / use of intangible assets

Income Tax Act, Cap 470



☐ Transfer pricing methods

☐ Traditional transactional method

☐ Comparable uncontrolled price method

☐ Resale price method

☐ Cost plus method

☐ Transactional Profit methods

☐ Transactional net margin method

☐ Profit split method

No hierarchy under Kenya's TP Rules, unlike under the OECD TP Guidelines

Income Tax Bill (ITB) 2018



- ☐ Proposal to expand the list of transactions subject to TP adjustments to include:
 - ☐ Insurance and re-insurance transactions
 - ☐ Business Restructuring or re-organization between associated persons
 - ☐ Cost Contribution arrangements
 - ☐ Guarantee, purchase or sale of marketable securities or any type of advance payments or deferred payments or receivable or any other debt arising during the course of business

Income Tax Bill (ITB) 2018

8th Schedule: Extends scope of transactions covered



- ❑ Transactions required to comply with the arm's length principle include (para 4):
 - ❑ A resident person operating in a **beneficial tax regime carries** on business with an associated resident person not operating in a beneficial tax regime
 - ❑ A person resident in Kenya engages in one or more transactions with a non-resident person located in a **preferential tax regime whether or not such a person is associated person; or**
 - ❑ A PE of a non-resident in Kenya with the non-resident or other associated person including other branches of the non-resident person in a preferential tax regime whether or not the person is an associated person
 - ❑ A resident person or PE of a non-resident person in Kenya with the non-resident person where or non-resident **lacks economic substance**

Income Tax Bill (ITB) 2018

8th Schedule: TP documentation and CbCR



- ☐ A person engaged in controlled transactions to prepare contemporaneous documentation to indicate consistency with the arm's length principle:
 - ☐ Penalty of 2% of the value of the controlled transactions chargeable in case of failure
 - ☐ Additional taxes assessed through TP adjustments
- ☐ Requirement to file Country by Country Reports:
 - ☐ By Ultimate parent entity or constituent entity of a MNE group not resident in Kenya for tax purposes
 - ☐ Not later than 12 months after the last day of the reporting financial year of the MNE

Income Tax Bill (ITB) 2018

8th Schedule: Other changes



- ☐ Interquartile range recognized as the arm's length range and the **median shall be used as the reference point**
- ☐ Transfer Pricing adjustments deemed to be as dividend distribution and is subject to withholding tax

Regional legal framework



Tanzania

Introduction



- ❑ The growth of international business has resulted in the rise of cross border transactions between entities in various jurisdictions.
- ❑ Many jurisdictions have become sensitive to the potential shifting of profits through transfer pricing, and have adopted rules regulating the setting or testing of prices or allowance of deductions or inclusion of income for related party transactions.
- ❑ Many jurisdictions (including Tanzania) have adopted broadly similar TP rules so as to counter aggressive tax planning techniques used by MNEs to shift profits to other jurisdictions.
- ❑ The Tanzania Revenue Authority (TRA) established an International Taxation Unit (ITU) in the year 2011 under the Large Taxpayers' Department, a specialized unit dedicated to handle all International Taxation issues.

History of Transfer Pricing Rules in Tanzania



- ❑ Prior to 2014 the TP issues were dealt with under S.33 of ITA 2004 (Section 33), Regulation 6 of the Income Tax Regulations and S.27 of the ITA 1973.
 - ❑ Transactions be undertaken at arms' length
 - ❑ Commissioner given power to undertake adjustments, re-characterize the transactions and re-allocate costs, revenues, losses etc
- ❑ In the year 2014, the Income Tax (Transfer Pricing) Regulations 2014 and Transfer Pricing Guidelines were introduced as a guide in the application of Section 33 and replace Regulation 6 of the Income Tax Regulations.
- ❑ In the year 2018, the Income Tax (Transfer Pricing) Regulations 2014 was amended and replaced by the Tax Administration (Transfer Pricing) Regulations 2018 published in April, 2018.

Tax Administration (Transfer Pricing) Regulations 2018



- ☐ Regulations to be construed and applied in line with:
 - ☐ The *arm's length principle* as set out under UN and OECD Conventions:
 - ☐ OECD Transfer Pricing Guidelines
 - ☐ UN Practical Manual on TP for Developing Countries
- When there is inconsistency between the Regulations and OECD/UN documents, the Regulations takes precedence
- ☐ Some similarities:
 - ☐ Associate definition – 50% rights to income or capital
 - ☐ Use of the Arm's length principle
 - ☐ TP Methods to be used are the same as those under the OECD / UN Guidelines
 - ☐ In adopting the TP methods, hierarchy to be observed – traditional transaction methods first – but the overriding factor: use of the most appropriate method
 - ☐ Comparability analysis is as required under the OECD / UN Guidelines
 - ☐ The TP documentation process – what should a document contain?

Tax Administration (Transfer Pricing) Regulations 2018



- ☐ Some similarities:
 - ☐ Special focus on Intra-group services: analysis to the effect that:
 - ☐ Services have been rendered
 - ☐ Conferred economic benefits
 - ☐ Charge is justifiable and at arm's length
 - ☐ Disregard: Custodial /shareholder activities, duplicative services
 - ☐ Allocation keys for jointly rendered services – no. of users for IT Services, no. of employees for HR functions
 - ☐ Intangible property section - Undertake Comparability analysis, functional analysis in regard to:
 - ☐ DEMPE of the IP
 - ☐ Recognition and pricing of marketing intangible

Tax Administration (Transfer Pricing) Regulations 2018



- ❑ Departure from generally accepted TP norms:
 - ❑ The arm's length range:
 - ❑ To be applied on more than 4 comparable data shall be the data point between 35th percentile and 65th percentile. Under OECD is between the 25th and 75th percentile IQR
 - ❑ For 4 or less comparable data is used, the average of the data shall be the arm's length result.
 - ❑ Where result from comparability analysis fall outside the arm's length range the results shall be adjusted to the median point of the range.
 - ❑ Commodity transactions
 - ❑ Specific provision for commodity transactions and use of Comparable Uncontrolled Prices (CUP) as an appropriate TP method.
 - ❑ The 'quoted spot price' may be used as a reference to determine the arm's length price

Tax Administration (Transfer Pricing) Regulations 2018



- ❑ The recently introduced TP Regulations are more comprehensive aimed at achieving certain objectives which include;
 - ❑ Enhancing the level of transfer pricing compliance for taxpayers - penalties for non compliance with the arm's length principle, penalty for failure to file TP documentation
 - ❑ Making amendments to some provisions - arm's length range, powers of the commissioners, TP report filing
 - ❑ Introducing specific provisions for specific transactions – commodity transactions, intra-group services (cost of performing services or use of allocation keys for joint services)
 - ❑ Providing clarity on some contentious issues - arm's length point, matters not covered under the Regulations but covered under OECD / UN documents

Tax Administration (Transfer Pricing) Regulations 2018



S/N	Amended / Introduced provision	Issue	TP Regulations 2014	TP Regulations 2018
1	Consistency with the ALP	Penalty for failure to comply with the ALP	Penalty equal to 100% of the underpayment of tax	Penalty equal to 100% of the adjusted amount
2	Comparability Factors and Analysis	Powers of the Commissioner to reject a TP analysis	n/a	Commissioner may reject wholly or partly a TP analysis
		Arm's Length Range (more than 4 comparable data)	Between 25 and 75 percentile	Between 35 and 65 percentile
		Arm's Length Range (less than 4 comparable data)	not specified	Average of data
		Arm's Length Point	not specified	Median Point of the Range
3	TP Doc.	Actual Computational Workings	n/a	Required to be included in the TP document
		Functional Analysis	not specified	Detailed double sided analysis of functions, assets and risks is required
		Financial statements of foreign entities selected as tested party	not specified	Financial statements of the foreign entities selected as a tested party should form part of TP documentation
		Penalty/Fine for not filing TP documentation	not less than 50m or imprisonment or both	not less than 3,500 currency points

Tax Administration (Transfer Pricing) Regulations 2018



S/N	Amended / Introduced provision	Issue	TP Regulations 2014	TP Regulations 2018
4	Application of OECD/ UN Documents	Matters under OECD/UN documents but not covered under Regulations	not specified	Regard is given to the Commissioner to provide the most appropriate interpretation based on facts and circumstances of the case
5	Intra Group Services	Basis for determination of the arm's length price	not specified	Cost of performing the services
		Basis for determination of the arm's length price (joint/centralized services)	not specified	Allocation criteria that is measurable and relevant to the type of services
6	Intangible Property	Arm's length price for the transfer or licence of intangible	not specified	DEMPE Analysis
		Factors to consider in determining arm's length prices for intangibles	not specified	Consider comparability factors such as expected benefits, commercial alternatives etc.
		Charge of Royalty for locally developed intangibles	not specified	no charge shall be allowed for locally developed intangibles when licensed back for use in URT
7	Commodity Transactions	Arm's Length TP method	not specified	Comparable Uncontrolled Prices (CUP)
		Arm's length price for commodities	n/a	Quoted Prices

Regional legal framework



Rwanda

Ministerial order establishing general rules on TP - *Draft*



- ☐ Significantly similar to the OECD TP guidelines – though no mention of either OECD or UN models
- ☐ Conformity with the arm's length principle
- ☐ Use of the OECD TP methods
- ☐ Controlled (or deemed) transactions within the scope of TP Rules include transactions between:
 - ☐ Rwanda resident entity and non-resident entity
 - ☐ Non-resident entity and PE of either that non-resident entity or its other related entities
 - ☐ Rwanda resident entity and an entity located in a **beneficial tax jurisdiction**, whether or not the two are related
 - ☐ A PE in Rwanda and an entity located in a **beneficial tax jurisdiction**, whether or not the two are related

Ministerial order establishing general rules on TP - *Draft*



- ☐ Transactions subject to adjustment / TP
 - ☐ sale, purchase or transfer for free of goods;
 - ☐ sale, purchase, transfer for free or lease of tangible assets;
 - ☐ sale, purchase, transfer for free, giving or receiving the right to use intangible assets;
 - ☐ supply of services;
 - ☐ lending or borrowing of money;
 - ☐ any other transaction which may affect the profit or loss of the person involved.

Ministerial order establishing general rules on TP - *Draft*



- ☐ Critical definitions have been provided, pointing to the nature of information to be included in the TP documentation:
 - ☐ Overview of the taxpayer's business operations
 - ☐ Organizational chart of the business – Departments
 - ☐ Corporate organizational structure of the group – group members, their legal status and shareholding
 - ☐ Group's operational structure
 - ☐ Financial indicator – mark up on costs, gross margin, net profit
 - ☐ Country by country report
 - ☐ Tested party – least complex, a TP method can be most reliably applied

Ministerial order establishing general rules on TP - *Draft*



- ☐ Comparability of commercial transactions:
 - ☐ No differences that materially affect the factors being examined
 - ☐ Such differences, if they exist, can be eliminated through adjustments
- ☐ List of comparability factors
 - ☐ Characteristics of the property, goods or services transferred or supplied;
 - ☐ the functions undertaken by each person involved in the transaction taking into account assets used and risks assumed;
 - ☐ the contractual terms of the transaction;
 - ☐ the economic circumstances in which the transaction took place;
 - ☐ the business strategies pursued by the related persons in relation to the controlled transaction.

Ministerial order establishing general rules on TP - *Draft*



- ❑ Risk Analysis and Control - in determining whether two transactions are comparable, the allocation of risk between related persons must take into account how economically significant risk is allocated in contracts between those persons; and
 - ❑ the person who assumes the financial risk;
 - ❑ the person who performs the relevant risk control and risk mitigation functions; and
 - ❑ the person who has the financial capacity to assume the risk.
- ❑ The risk must be allocated to the person who:
 - ❑ Controls the risk; and
 - ❑ has the financial capacity to assume the risk

Ministerial order establishing general rules on TP - *Draft*



- ☐ Reference to intra-group services
 - ☐ Meet the benefit test
 - ☐ Services rendered
 - ☐ There was commercial /economic benefit
 - ☐ Charge is at arm's length
 - ☐ No charge for shareholder costs
 - ☐ Allocation keys
- ☐ Transactions involving intangible property
 - ☐ Contractual terms
 - ☐ Functional / DEMPE analysis

Questions



THANK YOU

