

NEW TRANSFER PRICING REGULATIONS 2018

Background

With the evolution of international tax regimes and the increasing globalization of multinational corporations has left numerous gaps in local country tax laws around the world. This has given multinational enterprises (“MNE”) the ability to artificially reduce, and even eliminate, their corporate tax burden through “artificially” shifting profits to low or no-tax jurisdictions where there is little or no economic activity through transfer pricing.

Introduction in Tanzania

On 27 April 2018 the Government of Tanzania published The Tax Administration (Transfer Pricing) Regulations 2018 (“The Regulations”) under the Income Tax Act through Government Notice No. 166 in an attempt to reduce tax avoidance. These Regulations expand on the rules found in Section 33 of the Income Tax Act that deal with transactions between related persons. Although the new regulations were made in April 2018, they were released on 21st November. NB: The Regulations of 2014 have been revoked.

These regulations govern the procedures for applying the arm’s length principle and specify the appropriate transfer pricing methods, comparability analysis, intra-group services & financing, intangible property, commodity transactions, advance pricing agreements, documentation and penalties.

In view of The Regulations, companies that transact with related entities both in and outside Tanzania will be required to put in place a contemporaneous transfer pricing documentation that supports their transactions using one the accepted transfer pricing methods provided for by the regulations.

Transfer pricing in practice

To justify that the transaction with the related party is in accordance with the arm’s length principle, a transfer pricing study is usually conducted. In conducting a transfer pricing study, one looks at the following:

- i) Industry analysis
- ii) Functional analysis
- iii) Selection of method
- iv) Economic analysis

DEFINITION

Transfer pricing refers to how related entities price goods, intangible assets, services, and loans among each other.

The transfer pricing rules reduce tax avoidance by requiring related parties to use prices that they would have charged unrelated parties in comparable transactions and circumstances.

This is an application of what is commonly called the ‘arm’s length’ standard; a term on art that treats related parties as unrelated, or non-market transaction as if made subject to market discipline.

Characterisation

The conclusions from the above are used to characterise an entity into a certain functionality

Why do we characterise entities for transfer pricing purposes?

- To utilize a common taxonomy
- To select and apply the appropriate transfer pricing methodology to the appropriate tested party

Selection of methods

After characterising a company, the most appropriate transfer pricing method needs to be selected such as:

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| a) Traditional transaction methods: | b) Profit methods: |
| • Comparable Uncontrolled Price Method (CUP); | • Profit Split Method (PSM); and |
| • Cost Plus (CP); and | • Transactional Net Margin Method/ Comparable Profits Method (TNMM) |
| • Resale Price Method (RPM) | |

Documentation requirements:

According to the Income Tax (Transfer Pricing) Regulations, 2018, Section 7;

- Any person participating in a controlled transaction shall prepare contemporaneous transfer price documentation.
** Controlled transaction means a transaction between associates.*
- The contemporaneous documentation shall include records and documents that provide description of the following:
 - a) Organizational structure, including group and operational structure that role and shareholding percentages;
 - b) Nature of the business or industry and market conditions;
 - c) Description of the controlled transactions including volumes and values involved;
 - d) Strategies and assumptions workings factors that influenced the setting of any pricing policies;
 - e) The actual computational workings carried out in determining transfer prices;
 - f) Details of the functions performed, assets employed, and risks assumed by each person in relation to the controlled transactions;
 - g) Comparability analysis,
 - h) Selection and application of the transfer pricing method tested party and the financial indicator; financial statements for the parties to the controlled transaction including where the tested party has been selected outside the country;
 - i) Documents that provide the foundation for or otherwise support or were referred to in developing the transfer pricing analysis;
 - j) Index to document; and
 - k) Any other information, data or document considered relevant by the person submitting the documents.
- The documentation referred to above, for a year of income shall be prepared and filed with the income tax return for that year of income by a person whose total transactions with associates amounts to or is above ten billion Tanzanian shillings.

- The documentation for a year of income shall be in place prior to the due date for filing the income tax return for that year.
- The documentation shall, upon request by the Commissioner be submitted within thirty days from the date of request.
- A person who contravenes the above-mentioned requirements shall be liable to penalty not less than three thousand five hundred currency points and prescribed time to time by the Commissioner
- Where a person fails to comply with the sub-regulations, the Commissioner may make the necessary adjustments to ensure that the income and expenditures resulting from the transaction or transactions are consistent with the arm's length principle.

Transfer Pricing Risk Areas (TP Risk Flags)

a) Intellectual Properties

- Companies paying large management fees
- Companies paying royalties or other charges for the use of intellectual property

b) Structural issues

- Companies with innovative business structures
- Transactions with tax havens or shelters
- Loss making companies in commercial relationship with taxpayer where the loss is as a result of payments to that entity

c) Losses

- Companies making losses over a number of years
- Sustained losses by Tanzanian entities, but (overall) profits in the group
- Margins suddenly decrease with no rationale

d) Finance

- Debt levels, intra-group loans and guarantees that are 'un-commercial'
- No formal agreement for services or finance provision with no recharge of costs
- Secondments undertaken on 'un-commercial' terms (i.e. no recharge and no agreements)
- Trading debtor balances – intercompany, long term, interest free

Penalties and Fines

According to The Tax Administration (Transfer Pricing) Regulations, 2018; Section 7 and 4;

- A person who fails to comply with these Regulations commits an offence and is liable on conviction to imprisonment for a term not exceeding six months or to a fine not less than Shillings fifty million shillings or to both.
- In addition, the penalty for any transfer pricing adjustment made as part of a tax audit is 100% of the adjusted amount.

Nexia's transfer pricing experts



Maulik Doshi
India



Gian Luca Nieddu
Italy



Sujata Jaffer
Tanzania
East Africa



Rajesh Sharma
United Kingdom



Ed Morris
United States



Mufaddal Mohamedali
Tanzania



Bashier Adam
South Africa



James Nethersole
Australia



Catarina Breia
Portugal

CONTACT DETAILS

For further details, please do not hesitate to contact us at

Nexia SJ Tanzania

1st Floor, Oysterbay Plaza, Haile Selassie Road

P.O. Box 12729, Dar Es Salaam, Tanzania.

Email: admin@nexiasj.co.tz or info@nexiasj.co.tz

Telephone Numbers: +255 22 2926252/53, +255 713 444 254 & +255 756 444 25

Website: www.nexiasj.co.tz

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