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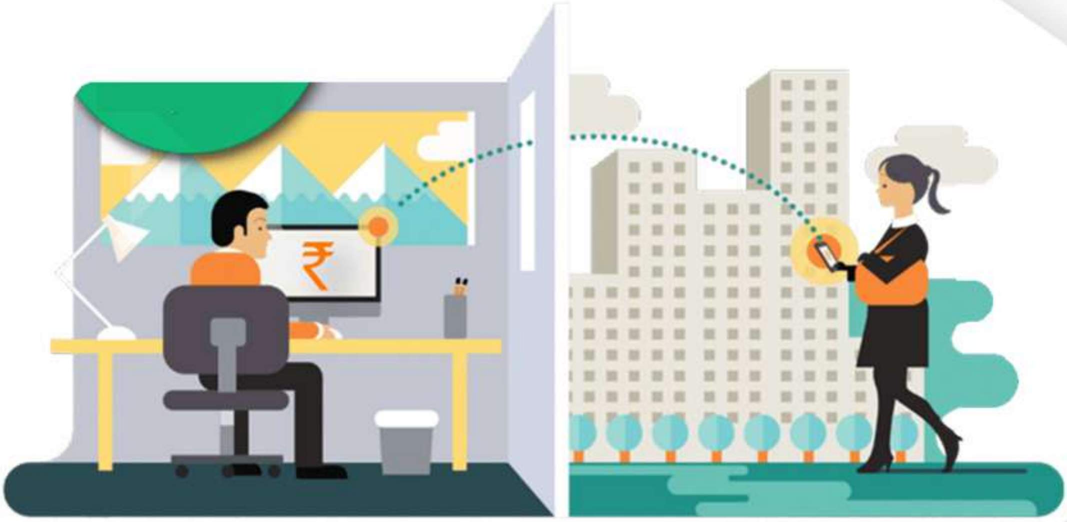


Tax Journal

TRANSFER PRICING ARTICLE

PART 1

Transfer pricing (TP) is one of the important tax issues globally. It is constantly under debate and scrutiny by the tax administrators in almost every country. Bodies such as the Organisation for Economic Co-operation and Development (OECD) and the United Nations (UN) try to govern and streamline the interpretation of transfer pricing issues globally by regularly updating their guidelines on TP to bring more clarity and transparency.

In Tanzania, TP was introduced in 2014 through Government Notice No. 27. However, prior to that, TP issues were dealt with under Sections 33 and 35 of the Income Tax Act (ITA) and Regulations 6 and 33 of the Income Tax Regulations. In 2018, the new TP Regulations, The Tax Administration (Transfer Pricing) Regulations, 2018 were introduced which revoked the previous Income Tax (Transfer Pricing) Regulations, 2014.

The recently introduced TP Regulations are more comprehensive and are aimed at enhancing the level of TP compliance for taxpayers. This was done by imposing huge penalties for non-compliance.

The new TP Regulations recognize the relevance of the OECD and UN model tax conventions on income and capital, the OECD transfer pricing guidelines for multinational enterprises and tax administrations, and the UN transfer pricing manual for developing countries. However, where there is an inconsistency between the local TP Regulations and the international regulations (OECD and UN), then the local regulations prevail.

The main aim of the TP Regulations are to manage and minimize profit shifting by companies operating in Tanzania that have transactions with associate entities established outside Tanzania and especially, those in low tax jurisdictions or tax havens.

The TP Regulations as well manage the mispricing between related entities. In simple terms, the entities involved in a related party transaction should be compensated fairly according to their input. The input can be measured by considering the functions performed, assets utilized and risks assumed by the entities in the related party transaction.

Transfer pricing applies to transactions between related entities which include:

- Associated enterprises;
- Branch and head office; and
- Subsidiary and parent companies.

The transactions covered under the Tanzania TP Regulations include cross border or domestic transactions.

The transactions that may trigger transfer pricing include the following:

The main concept of TP is that an" arm's length price" (ALP) should be charged when associated or related entities are transacting with each other. ALP is the price at which independent entities would transact and is determined through five recommended transfer pricing methods that are categorized into traditional transaction methods and the transactional profit methods.

Traditional Transaction Methods

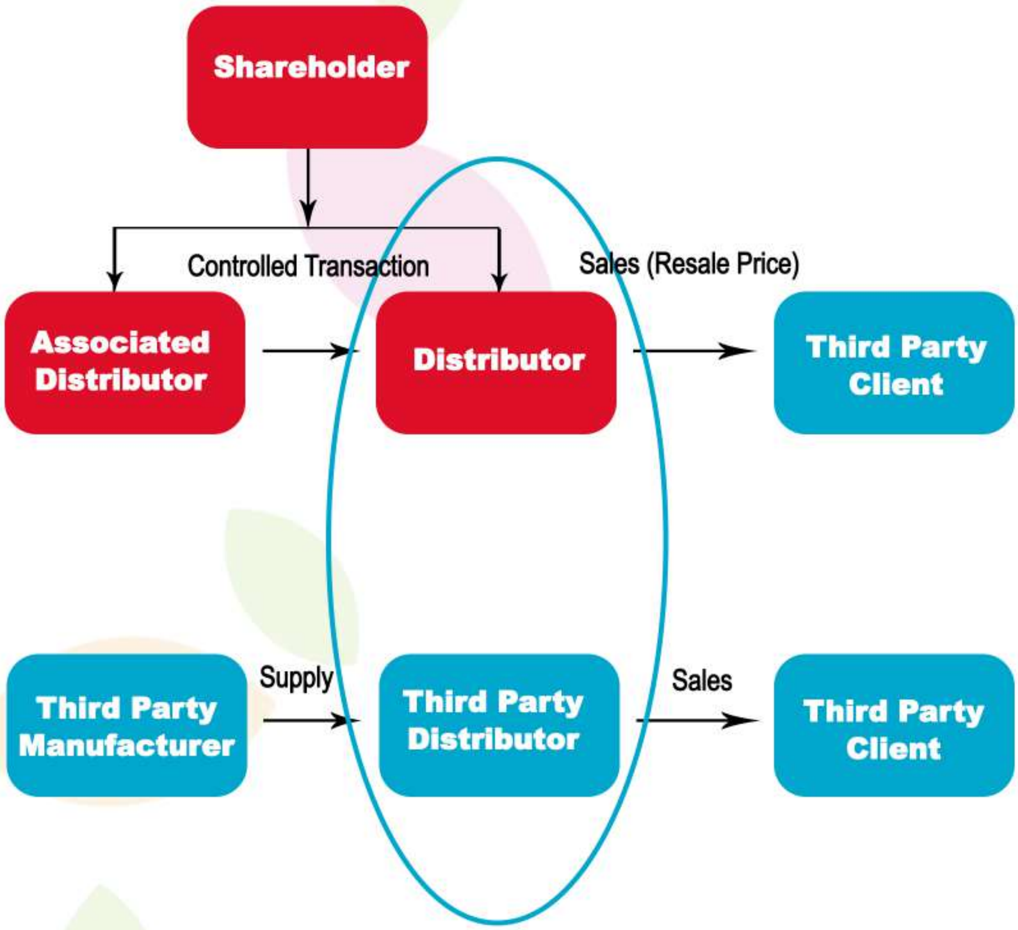
These methods include:

Comparable Uncontrolled Price Method

The Comparable Uncontrolled Price (CUP) is the most direct and simplest method to determine the ALP. A comparison is done between the price charged for goods, property or services in a related party transaction to the price charged in a comparable independent transaction under comparable circumstances. In this method, the goods, property or services compared should be closely similar in terms of quality, volume, geographic market, transaction date etc.

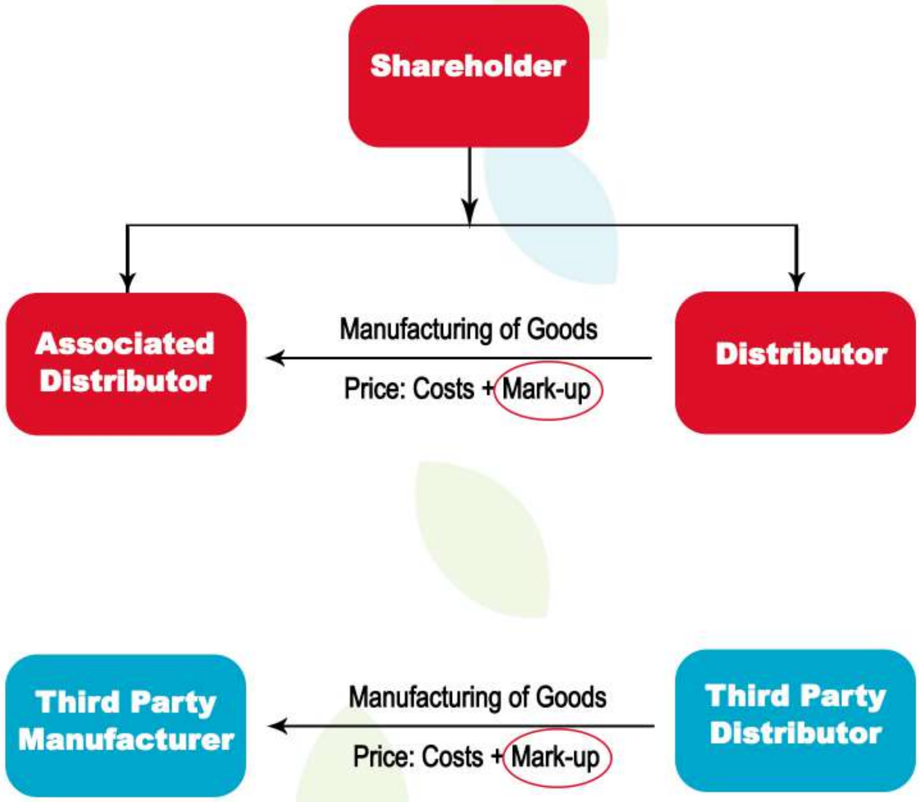
Resale Price Method

The Resale Price Method (RPM) is mostly applicable to distributors who purchase goods from related parties and sell to third parties without making any changes to the product. In applying the RPM, the gross margin earned in a related party transaction is compared to the gross margin earned in a third-party transaction.



Cost Plus Method

The Cost-Plus Method is mainly applicable to manufacturing entities, where semi-finished goods are traded or in the provision of services. It compares the mark-up earned on costs in a related party transaction to the mark-up earned in a similar third-party transaction.

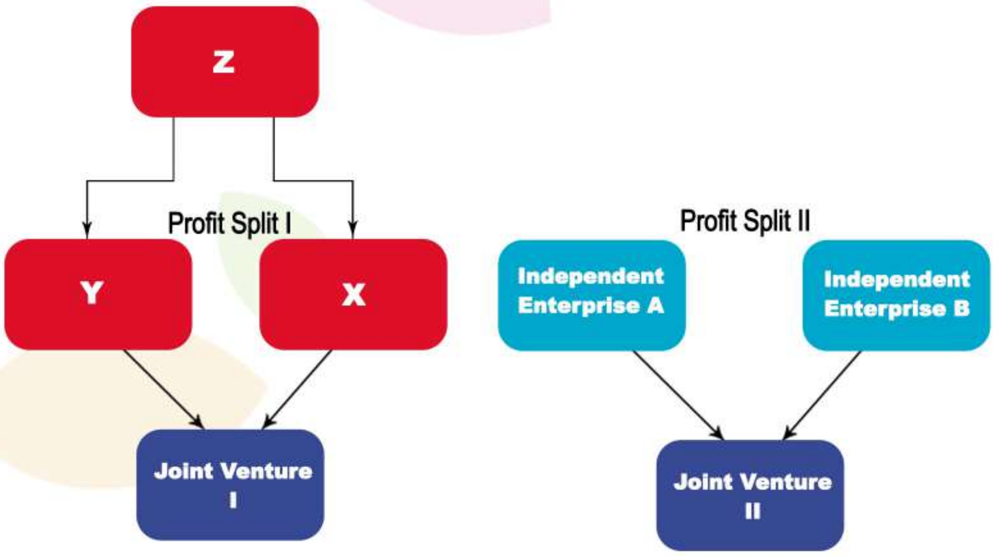


Transactional Profit Methods

These methods include:

Profit Split Method

The Profit Split Method (PSM) is used for highly integrated transactions or where both related parties make unique value contributions to the transaction. It allocates the combined operating profit or losses from the related party transaction in proportion to the relative contribution made by each party in generating the profit or losses.



Transactional Net Margin Method

The Transactional Net Margin Method (TNMM) is similar to the CPM and RPM methods in terms of application in that the TNMM tests the net operating profit margins of the tested party as opposed to the gross margins in the case of RPM and CPM. In applying the TNMM, the third parties identified have to be engaged in similar business activities and should be compared using various Profit Level Indicators (PLIs) depending on the nature of the transaction.

Examples of common PLIs are:

PLI	Applied in
Operating Margin	Distributors
Net Cost-Plus	Service providers and manufacturers
Berry Ratio	Marketing distributors who perform more selling and marketing than a simple distributor
Return on Assets	Manufacturers

Whenever determining the most appropriate method to arrive at the ALP, a person shall first apply the traditional transaction methods. The transactional profit methods shall only be applied where the traditional transaction methods cannot be applied. However, where both the methods cannot be applied, any other method which can be justified as the appropriate method can be applied.

Tanzania TP Regulations require for an entity with related party transactions to prepare contemporaneous TP documentation. Where the related party transactions during a year exceeds the threshold of TShs 10 Billion, it is mandatorily required to submit the document together with the entity's final return of income.

Entities having related party transactions below the above-mentioned threshold are required to prepare TP documentation prior to the date of filing the final return of income. The entity is supposed to submit the document to TRA within 30 days upon request. Failure to comply with the submission of policy will trigger a penalty of TShs 52.5 Million.

A contemporaneous TP document should include the following:

- Organisational Structure
- Nature of businesss/Industry and market condition
- Description of controlled transaction
- Strategies and assumption
- The actual computational workings
- Functional analysis
- Comparability analysis
- Selection and apllication of TP method, Tested party and financial indicator
- Supporting documents nd indices

The TRA have a right to reject TP documentation where it lacks any of the above requirements or fails to establish the arm's length price that they deem fit using the most appropriate TP method for any related party transaction. Where the TRA make any TP adjustments, a penalty of 100% of the adjustment is imposed.

Part 2 of the Transfer Pricing Article will be available soon.

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