

Application of the Arm's length principle under Ghana's New TP Rules



Part 2 of 3

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This is the second of my three part series of articles on the newly enacted Transfer Pricing ('TP') Regulations in Ghana. In the first article, I provided background and a high level summary of the new TP framework. The new TP Regulations, 2020, L.I. 2412 ('New TP Rules') was introduced in November 2020 to repeal the earlier version - TP Regulations 2012, L.I. 2188 ('Old TP Rules').

In this part, I discuss the provisions of the New TP Rules on a principle central to controlled transactions - the Arm's length Principle ('ALP') and some major changes to some provisions that existed under the Old TP Rules.

1. What arrangements are subject to the ALP?

As we have already seen, the New TP Rules have maintained the requirement that all arrangements between 'persons in a controlled relationship' are subject to the ALP. In effect, any transaction including supply of services, goods or property of any kind between persons in controlled relationships constitute the arrangements which are subject to the ALP requirement.

The New TP rules rely on the definition of persons in controlled relationships in section 128 of the Income Tax Act, 2015 (Act 896).

While Act 896 provides us with the list of persons subject to the ALP requirement from a direct tax perspective, the Value Added Tax Act, 2013 (Act 870) and laws on Customs and Excise, also do so for the purposes of indirect tax.

2. Process of determining ALP

In simple terms, the process of applying the ALP consists of determining the most suitable comparables (comparable third-party entities engaged in transactions comparable to those entered into by the taxpayer in question) and then determining the most suitable financial indicator such as price, financial ratio, etc. to use for that comparison.

In finding adequate and reliable comparables, it is necessary to conduct a comparability analysis based on the five comparability factors stipulated in Regulation 3 of the New TP Rules. It is worth noting that the New TP Rules give special consideration to the allocation of the economically significant risks between the relevant parties. This is an interesting development and we foresee more challenges in the future on benchmarking and non-comparability on the basis of the allocation of significant risks.

3. Selection of the most appropriate TP method

The prescribed list of TP methods to be used for the pricing of arrangements and transactions affected by the New TP Rules remain the same as in the Old TP Rules and are as follows: Comparable Uncontrolled Price ('CUP'), Cost-Plus Method ('CPM'), Resale Price Method ('RPM'), Transactional Net Margin Method ('TNMM'), and Transactional Profit Split Method ('TPSM'). Like the Old TP Rules, the New TP Rules give affected persons the option to request approval from the Commissioner-General ('C-G') of the GRA to use an alternative TP method in certain situations.

When preparing the TP documentation for a particular transaction, the New TP Rules now require a comparative analysis on why one TP method was chosen over the other prescribed TP methods.

Affected persons must ensure that their analyses and conclusions for choosing one TP method over the others are robust and borne out of the facts and circumstances underlying the transactions, the nature of business engaged in by the persons and other key terms and conditions of the arrangements, lest they be challenged by the GRA.

4. Testing of single transactions or grouping transactions?

It is often the case that testing transactions individually is unreliable or almost impracticable as they are either economically closely linked or form a continuum. The New TP Rules allow for transactions of that nature to be treated as one for the purposes of performing a comparability analysis and applying an appropriate TP method. While this aligns with best practice globally, taxpayers should be mindful of the indirect tax (such as VAT and Customs Duty) consequences that may arise when these transactions are combined for TP purposes.

5. Selection of tested party

Some of the TP methods cannot effectively be utilised without the identification and selection of tested parties – that is, entities whose financial results will be compared to that of the independent third-party comparables. The New TP Rules have stipulations which are consistent with international standards, and these require that the tested party can either be the resident or non-resident related entity.

6. The arm's length range

The New TP Rules define an arm's length range to include the interquartile range of a three-year weighted average measurement of specified financial indicators.

7. Specific provisions on intra-group services

The general conditions required to exist for an intra-group service to be considered as being at arm's length under the Old TP Rules have been maintained in the New TP Rules. However, some additional provisions similar to the OECD's TP Guidelines' conditions for an intra-group service to be considered as having been 'rendered' have to be complied with.

Examples of intra-group service payments not considered as being arm's length include duplication of services already being received and incidental benefits derived by a resident person for services provided to other members of the same group.

8. Specific provisions relating to the owning and use of Intangible Property ('IP')

Additions to the previously existing provisions on Intangible Property ('IP') transactions in the Old TP Rules are mainly focused on considerations relating to contractual arrangements surrounding the development, enhancement, maintenance, protection and exploitation of IPs, commonly known as 'DEMPE' within the transfer pricing world. The New TP Rules recommend that considerations be given to the allocation of risks and commercial alternatives available to the buyer/licensee as some of the key factors in setting an arm's length price for IP transactions.

Issues expected to be of challenge for both taxpayers and the GRA are compensation for marketing intangibles, business case/rationale, royalty rates and availability of alternatives.

Want to know more? Let's talk.

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