Spotlight on Africa's transfer pricing landscape.

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In this special edition of Perspectives, Anthony Curtis and Ogniana Todorova from PwC US take a detailed look at transfer pricing in Africa.

Despite the recent global recession, Africa averaged annual GDP growth of 5.2% between 2001 and 2010[1] – a fact that underscores why so many investors increasingly see it as a destination for opportunity and growth. In its 3 December 2011, edition, The Economist summed up the global sentiment regarding the outlook for Africa's economy in its cover story, "Africa Rising."[2] As that article suggests, Africa's economy is expected to grow considerably in the near future. As that happens, multinational corporations (MNCs) will expand their footprint on the continent. With the prospect of their increased investment, transfer pricing is receiving more focus in the region.

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[1] The Africa Competitiveness Report 2011, World Economic Forum, the World Bank and the African Development Bank.

[2] *The Economist*, "Africa Rising," 3 December 2011.

The United Nations (UN), the Organisation for Economic Cooperation and Development (OECD), and the European Commission (EC) – as well as many African governments – are particulary focused on getting transfer pricing regimes established in Africa.

International organisations consider transfer pricing a development financing issue, because without adequate tax revenues, a country's ability to mobilise domestic resources for development might be hampered.[3] As a result, scrutiny of MNCs' tax footprints in Africa has increased recently.

Over the past few years, much debate about the most appropriate transfer pricing regime for developing countries has taken place. Some consider implementation of the arm's length standard (ALS) – the central feature of the transfer pricing regimes of most developed nations as well as the OECD Transfer Pricing Guidelines (OECD Guidelines) – prohibitively resource-intensive and costly for developing countries. Alternative approaches, like formulary apportionment or fixed margins of returns for intercompany transactions, have been suggested, but these approaches, while simpler to administer, do not have international acceptance and still require agreement on the formulae or fixed margin. As a result, no alternatives have been agreed to in practice at the international level and are not yet adequate substitutes for the ALS.[4] Although the UN historically has been reluctant to recommend the ALS, it recently endorsed the ALS in its Practical Manual on Transfer Pricing for Developing Countries (UN Practical Manual), stating that the ALS is "the accepted guiding principle in establishing an acceptable 'transfer price.'"[5]

Although there are significant challenges associated with the implementation of the transfer pricing regimes based on the ALS in developing countries, the benefits likely outweigh the perceived risks. Stable transfer pricing regimes have the potential to increase much needed tax revenues and attract foreign direct investment (FDI).[6] In addition, MNCs often perceive operating in countries with comprehensive transfer pricing regulations as presenting less tax risk than operating in countries in which the characterisation and tax treatment of an MNC's intercompany transactions are uncertain.

Several African nations – most notably Kenya, Egypt, Morocco and South Africa – have broad transfer pricing regimes based on the ALS, while several other African countries – such as Uganda – recently passed legislation adopting transfer pricing regulations based on the ALS.[7] Still other African nations that do not have comprehensive transfer pricing regimes – such as the Democratic Republic of Congo and Mozambique – have provisions in their tax code that reference the ALS.

However, while many African nations have transfer pricing regimes or provisions in their tax code based on the ALS, they often also have special tax rules and considerations for particular industries, especially mining, oil and natural gas. Many African governments recently noted that existing contracts allow MNCs to exploit their

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3 Sundarm, Jomo Kwame, "Transfer Pricing is a Financing for Development Issue," February 2012, at 1.
4 Id. at 6.
5 United Nations,"Practical Manual of Transfer Pricing for Developing Nations" Chapter 1.4. October 2012.
6 EuropeAid, Transfer Pricing and Developing Countries, at 1.
7 PKN Alert Uganda – "New Transfer Pricing Regulations," (8 March 2012). http://www.pwc.com/gx/en/tax/transfer-pricing/pricing-knowledge-network-pkn.jhtml

country's natural resources without providing adequate compensation. As a result, there is speculation that some resource-rich nations, like South Africa and Ghana, may impose a "super tax" on excess profits from mining.[8] Nigeria, a nation that is expected to pass transfer pricing legislation in the coming year, has claimed that it has lost $5 billion in tax revenue because of off-shore oil contracts.[9]

As Africa continues to grow and become more integrated into the global economy, it is anticipated that more African nations will adopt transfer pricing regulations based on the ALS. Although transfer pricing regimes in Africa are expected to be based on the OECD Guidelines and the UN Practical Manual, African governments' desire to protect revenues from natural resources will probably influence future transfer pricing legislation. In addition, African nations that have already adopted the ALS will likely move towards legislation that will allow for more Advance Pricing Agreements (APAs), tax treaties, and safe harbors as these nations seek to increase domestic tax revenue and make their countries more attractive to MNCs.

Transfer pricing regimes: Why they're important to African countries

Globalisation is causing MNCs to play a significant role in the economy of most nations. It has been estimated that approximately two-thirds of all business transactions worldwide take place between related parties.[10] African nations are no exception. In 2000, the UN developed Millennium Development Goals (MDGs) to tackle extreme poverty and to share the benefits of globalisation more equitably.[11] It is generally accepted that to meet the MDGs, developing countries need to strengthen their tax systems and increase domestic revenues.[12] It is for this reason that the development or expansion of transfer pricing regimes in developing nations, including many African nations, has become a priority.

In terms of tax policy generally, and, more specifically, transfer pricing policy, one of the main considerations for nations is how to protect their domestic tax base without disincentivising international trade and foreign direct investment (FDI). Jeffrey Owens, Director of the Centre for Tax Policy and Administration at the OECD, identifies the issue in the context of developing countries:

"Developing economies in particular are increasingly aware of the importance of establishing a robust legislative and administrative framework to deal with transfer pricing issues. The challenge for these countries is in essence the same as for OECD countries: protecting their tax base while not hampering foreign direct investment and cross-border trade." [13]

Although protectionist transfer pricing policies can impede FDI and cross-border trade, it is likely that the adoption and development of reasonable transfer pricing regimes in African countries, especially in countries that historically did not have transfer pricing rules, will attract FDI and increase cross-border trade by creating certainty and legitimacy. International consistency in transfer pricing regimes is beneficial in creating a basic worldwide structure and facilitating international trade. The UN has stressed that:

"…consistency is an important goal to be aimed at in terms of encouraging investment in a country and international trade that assists a country's development…" [14]

As African nations adopt transfer pricing standards that are consistent with international norms, MNCs likely will perceive less tax risk associated with operating in those countries, allowing for increasing FDI. Concurrently, transfer pricing rules will allow African nations to protect their domestic tax base by collecting appropriate revenues from MNCs operating within their borders.

8 *The Economist*, "Wish you were mine," 11 February 2012.
9 Id.
10 WB (2011a), "Transfer Pricing Technical Assistance Global Tax Simplification Program,, presentation by Rajul Awasthi in Brussels, 24 February 2011.
11 EuropeAid, Transfer Pricing and Developing Countries, at 5.
12 *Id.*
13 Jeffrey Owens, OECD Conference: Transfer Pricing and Treaties in a Changing World, Opening Speech, Pairs, 21-22 September 2009. http://www.oecd.org/dataoecd/18/25/43744164.pdf.
14 UN (2011), Transfer Pricing Practical Manual for Developing Countries (TP Manual), Working Draft Chapter I, n 8.4, http://www.un.org/esa/ffd/tax/documents/bgrd_tp.htm.

The World Bank and the African Development Bank note that "[m]easures to encourage regional integration and trade in Africa are likely to attract additional market seeking FDI."[15] Similar taxing regimes and certainty as to how MNCs will be taxed can be expected to increase regional trade and interaction. As more African countries adopt the ALS, MNCs will be able to determine where to invest based on differing comparative advantages, rather than being deterred from certain markets because of uncertainties in the tax regime.

Transfer pricing frameworks

Three predominant international players that have and will continue to affect the transfer pricing policies of African nations are the OECD, the UN, and the African Tax Administration Forum (ATAF).[16] While these organisations have distinct charters and goals, it appears that all three support the ALS as the foundation for transfer pricing policy.

1. OECD Guidelines

The tax authorities in the US and some other countries started paying considerable attention to transfer pricing in the 1960s and 1970s. The OECD member countries realised it would be helpful to provide some general guidance on transfer pricing to help prevent the damaging effect double taxation could have on international trade. This resulted in the OECD report and Guidelines on transfer pricing, issued in 1979, and subsequently revised and updated in 1995 and 2010.

The OECD has made considerable efforts to establish the ALS as the worldwide standard in transfer pricing regimes. Although transfer pricing regimes based on the OECD Guidelines have been implemented in several African nations, many African nations have been slower to implement comprehensive transfer pricing regimes, often because of a lack of capacity and resources or a hesitation to adopt a model based solely on the OECD Guidelines.

2. United Nations approach

Concerned that the OECD Guidelines are designed primarily to protect the interests of OECD member-countries, the UN sought to create a transfer pricing framework designed to address the concerns of developing countries. The United Nations Expert Committee in 2009 therefore began work on the UN Practical Manual, which deals with the basic questions regarding transfer pricing, including:

- How to draft transfer pricing legislation
- How to set up special transfer pricing units
- How to identify and work with transfer pricing databases
- How to pursue simplified strategies for testing the arm's length nature of a related-party transaction.

The UN has had a forceful impact on the consideration of whether the ALS is appropriate for developing countries. Attending the recent UN meeting, 'Transfer Pricing and Capacity Development in Tax Matters,"[17] Horacio Peña, PwC US and Americas Transfer Pricing Practice Leader, noted that "[t]he UN has drawn attention to the complexity and high cost burden that the implementation of the ALS presents to tax administrations of developing countries." The meeting focused on practical transfer pricing issues for developing countries to assist the Committee as it works on the forthcoming UN Practical Manual on Transfer Pricing.

3. African Tax Administration Forum

The ATAF was created to promote and facilitate mutual cooperation among African tax administrations with the goal of improving the efficiency of their tax legislation and administration.[18] The ATAF brings together the heads of African tax administrations and their representatives to discuss progress made, challenges faced, and possible new direction for African tax policy and administration in the

15 *Id.*
16 The International Monetary Fund (IMF) played a critical role in Egypt helping the government create the capacity to conduct TP audits.
17 14 March 2012, in New York. The meeting was hosted by the Committee of Experts on International Cooperation in Tax Matters.
18 *See* http://www.ataftax.net/about-us/overview.aspx.

21st Century. The ATAF was set up by 34 African tax commissioners to provide an African voice in taxation and promote learning and capacity-building in African tax administrations.

The ATAF should encourage African countries to adopt a pragmatic approach to transfer pricing. Critical to this concept is recognition that transfer pricing tends to be more of an art than a science. Developing countries therefore must become adept at negotiations with taxpayers. Because there generally is no single correct answer in transfer pricing, most disputes are resolved through negotiation and compromise.

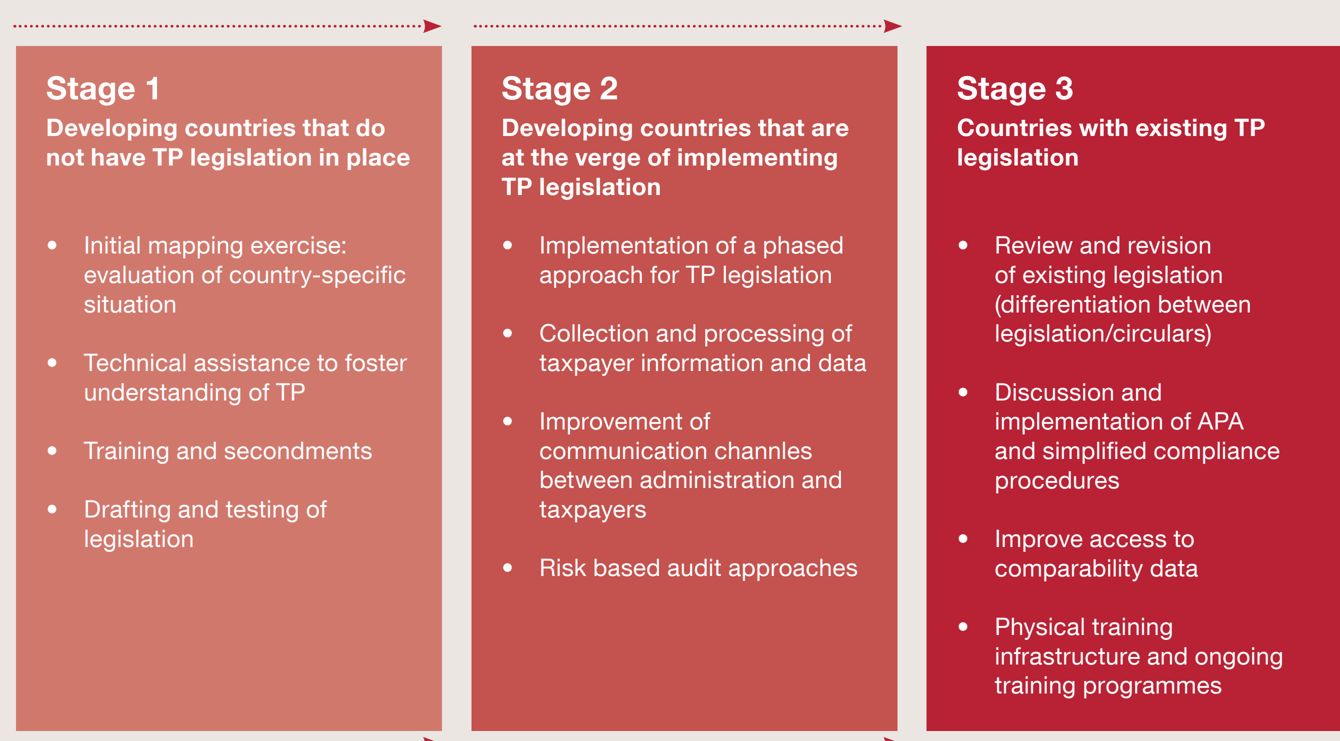
African countries should also try and create compliance regimes that are proportionate to the perceived risks from a MNC's perspective and take into account the realistic capacity and capability of each country's tax administration. African nations therefore should avoid creating unilateral, burdensome compliance requirements – anticipated benefits from such regimes likely would be outweighed by lost revenues from MNCs avoiding the market.

Current transfer pricing regimes in Africa

In its report titled "Transfer Pricing and Developing Countries," EuropeAid outlines a staged approach to introducing transfer pricing (TP) reform. Countries in Stage 1 are developing countries that do not have TP legislation in place; countries in Stage 2 are developing countries that are on the verge of implementing TP legislation; and countries in Stage 3 have existing transfer pricing legislation. Figure 3 summarises these three stages of TP development as defined by EuropeAid.

Stages of development outlined in the EuropeAid report give a basis for categorising the current type of TP regime in a given country, but the reality is there is a broad spectrum in terms of the level of TP development and sophistication among African nations. Countries like South Africa and Kenya maintain established transfer pricing regimes that serve as models for other African nations. Other countries are beginning to focus on transfer pricing, having recently passed transfer pricing legislation (e.g., Uganda) or expect to enact transfer pricing legislation in the near future (e.g., Nigeria and Zimbabwe). Still other countries, such as Algeria and Mozambique, have provisions in their tax code that mention transfer pricing and the ALS, but lack extensive regulations. Some countries, especially countries struggling with internal conflicts such as Libya and Sudan, have no transfer pricing regulations and no plans for enacting transfer pricing legislation in the foreseeable future. Figure 4 provides a summary of the TP legislative/regulatory status of 18 African nations. These countries were selected for this article based on the authors' ability to generate data connected with these nations.

Figure 3: Stages of TP Development[19]



19 EuropeAid, *supra* note 6 at 40.

Figure 4: Summary of TP regimes in Africa[20]

Country	Tax code provides some guidance on TP	TP regs	TP methods	ALS	Document requirement	Thin cap rules	Safe harbours	APA programme
Algeria	Yes	No	No	Yes	Yes	No	No	No
Angola	Yes	Yes	Yes	Yes	Yes	No	No	No
Congo, Republic of	Yes	Yes	No	Yes	No	No	No	No
Egypt	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Ghana	Yes	No	No	Yes	No	Yes	Yes	No
Kenya	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Malawi	Yes	Yes	Yes	Yes	Yes	No	No	No
Mozambique[21]	Yes	No	No	Yes	No	Yes	No	No
Namibia	Yes	Yes	Yes	Yes	No	Yes	No	No
Nigeria	Yes	Yes	Yes	Yes	No[22]	No[23]	No[24]	Yes
South Africa	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Tunisia	Yes	No	No	Yes	No	No	No	No
Uganda	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Zambia	Yes	Yes	Yes	Yes	Yes	No	No	No
Zimbabwe[25]	No	No	No	No	No	Yes	No	No

Each African nation's transfer pricing regime has unique aspects and rules that should be considered when conducting business in that jurisdiction. For example, some nations, like Nigeria and Uganda, have special tax rules in connection with industries such as oil and gas or mining. Also, it is important to consider tax treaties when entering and operating within Africa. Appendix A provides a summary of the current transfer pricing rules and considerations of the 18 African nations in Figure 4.

Challenges for transfer pricing regimes in Africa

A. Lack of comparable transactions

The ALS has been endorsed by both the OECD and the UN as the theoretical backbone of the world's transfer pricing regimes. However, implementing the ALS, especially in developing countries, can be challenging and costly to use profit-based transfer pricing methods such as the transactional net margin method (TNMM), independent companies engaging in functions comparable to those functions performed by a controlled party within a MNC must be identified. In developing nations, identifying these "comparables" is often time consuming and sometimes impossible.

The lack of local comparables is a recurrent problem throughout the developing world, often forcing tax administrations to use non-domestic comparables and adjust for local market differences.[26] The EuropeAid report found that it is often difficult to obtain sufficient information on comparables in developing countries for the following reasons:

- Generally there are fewer organised companies in any given sector than in developed countries.
- Existing databases for TP analysis focus on data from developed countries. While data exists from some developing countries, the data is less plentiful than from other regions in the world. The lack of data from developing countries in the same region can make it more difficult to perform benchmarking studies.
- The economies of developing countries may have opened up very recently or still may be in the process of opening up. For the many "first movers" that have come into existence in many sectors and areas hitherto unexploited or unexplored, there is an inevitable lack of comparables.[27]

20 Based on a survey of PwC offices in Africa, the transfer pricing regimes of 15 African nations were analysed for this article. The internal PwC survey was conducted February/March 2012.
21 TP rules were released in draft form in May of 2012 and all responses for Nigeria reflect the draft legislation.
22 Although there is no explicit documentation requirement in South Africa, taxpayers may be required to furnish detailed transfer pricing information within 14 days of a request by the South African Revenue Service.
23 Updated guidance is expected on the thin capitalisation guidelines.
24 Updated guidance is expected on safe harbors.
25 The introduction of TP legislation has been mentioned by Zimbabwe's Minister of Finance over the past two years. The draft law is still under consideration and may be promulgated in 2013.
26 OECD (2012), Dealing Effectively with the Challenge of Transfer Pricing, OECD Publishing at 73. http://dx.doi.org/10.1787/9789264169463-en
27 EuropeAid, Transfer Pricing and Developing Countries, at 9.

While the necessity of local comparables is certainly a valid subject for debate, it is clear that the availability of such data would make analyses simpler. One possible solution, at least in the near term, is to use non-local comparables, a practice that has been implemented in other developing regions, such as Latin America.

A number of African countries have started to address the issue of a lack of local data and are reviewing the available alternatives. Many are considering external databases as well as the idea of developing their own software. One possibility would be to subscribe to an external database in the short term while working to create proprietary software for the long term. This would allow immediate adjustable data, albeit imperfect, as well set in place a long-term plan. However, we believe that proprietary software should be developed by a coalition of African nations, not by each nation unilaterally.

The ATAF may be the best entity to undertake efforts to address the issue of non-local comparables, whether by subscribing to an external database or by leading the coalition to develop software. The ATAF currently is considering purchasing rights to use a commercial database for collective use by its members or developing its own database. The need for a computerised database of financial data of African companies is widely recognised, to the extent that it has prompted a discussion regarding the creation of a tax data center "cloud" over Africa.[28]

B. Lack of knowledge and resources

There is a general consensus that one of the main challenges facing developing countries in implementing the ALS is the lack of resources. The tax authorities of many African nations lack auditors, economists, and lawyers experienced in transfer pricing, financial databases used in transfer pricing analyses, and sufficient staff to process transfer pricing compliance and disputes.

One key to developing expertise in transfer pricing is to create transfer pricing-specific audit teams and committees, because transfer pricing expertise differs from general corporate tax expertise. To this end, Kenya has formed a transfer pricing unit within the Kenya Revenue Authority and Egypt is in the process of doing the same (having already selected certain individuals who have been trained by the ATAF, OECD, and UN). Ghana has created a committee to develop transfer pricing legislation. Liberia recently introduced an APA programme under which taxpayers may enter into unilateral APAs with the Government of Liberia.[29] A critical challenge, however, is for the government or taxing authority to retain the individuals it grooms to be transfer pricing specialists.

To address compliance and complexity concerns, developing countries may introduce a number of simplifying measures, such as safe harbors, fixed margins, or other simplification measures that allow taxing authorities to build technical capacity while simultaneously allowing MNCs to have certainty that a tax position will be respected.

A successful approach would involve elective safe harbours that allow companies to demonstrate the reasonableness of their TP. For example, distributors earning a certain ROS or contract manufacturers within a certain cost plus percentage could be free from adjustment under an applicable safe harbour. A more complex approach would be to apply default fixed margins for certain routine functions. Companies then would have the option to apply the default fixed margin or to choose a different result based on arm's length arguments.

As tax administrations develop capacity, these countries may transition into use of a more full-fledged arm's length model. Nevertheless, if African countries attempt these simplifying measures, it is important that they do so under the breadth of the ALS so that MNCs are comfortable operating within each nation's tax system and FDI is undisturbed.[30]

Horacio Peña (PwC US) suggests that "one way in which African nations can ease the complexities and reduce the implementation costs of the arm's length standard would be to take an industry specific approach in developing pricing methodologies and policies. Coffee exporters for example, could attempt to use a single method and common set of comparables for analysing common transactions. Potentially, firms operating in the same sector could seek a common ruling or APA for the entire sector or industry. One successful example of this approach was the study and APA that PwC prepared and obtained on behalf of the Maquiladora Industry Association in Mexico. That study served as the basis for implementing over 1,800 unilateral APAs. The study provided enormous certainty and value to both the taxpayers that we represented and the Tax Administration itself."

28 Rick Mitchell, "OECD Tax Rules Called Too Complex, Costly to Help Developing Countries Nab Evaders," 194 DTR J-1. (quoting Jeffrey Owens, director of OECD's Center for Tax Policy and Administration (CTPA).

29 See PKN Alert / TCDR Alert - "Liberia Enacts APA Provision," (25 April 2012). http://www.pwc.com/gx/en/tax/transfer-pricing/pricing-knowledge-network-pkn.jhtml

30 H. David Rosenbloom, "Where's the Pony? Reflections on the Making of International Tax Policy," *Canadian Tax Journal*, vol. 57, no. 3, 489, 493 (2009) ("The drafters are likely to find that policies they thought clear in concept may not be so easily expressed. And formulations, when chosen, may meet with distorted interpretations.")

C. The "intangible economy"

Value attributable to intellectual property (IP) – the so-called intangible economy – may skew more taxable income to developed countries at the expense of developing countries. There is a sentiment among some developing countries that certain applications of the ALS are not in their best interest, because most corporate value often is attributable to IP. Because developing countries generally lack valuable IP, in certain circumstances little income is attributable to these countries under the ALS. While it is widely agreed that for very profitable companies, the presence of IP is one main reason for their sustained profits and therefore it is reasonable for the owners of IP to retain the profit associated with their investment, the lack of IP in Africa makes gaining support for use of the ALS more difficult.

Resource-rich African nations have expressed particular concern regarding applications of the ALS that attribute significant value to IP. In the context of the mining and oil and gas sectors, there has been significant debate surrounding the appropriate share of revenues between MNCs and African governments. South Africa recently passed several amendments to its transfer pricing legislation in part to protect the country's natural resources. As other African nations, such as Ghana and Nigeria, pass transfer pricing legislation, it is expected that certain protectionist provisions will be put in place for resources-intensive industries so that tax authorities can ensure the collection of tax revenues based on their nation's natural resources.

D. Location savings

These are the net cost savings realised by a party in a high-cost location through outsourcing a certain activity to a low cost location. Tax authorities in countries that have relatively low costs of labour, such as India and China, often take the position that, because of location savings, routine activities should earn a higher margin than similar activities in jurisdictions that do not have location savings. In addition, in the context of business restructurings such as outsourcing, tax authorities in countries with low labour costs often claim that some of the excess profits resulting from the outsourcing should be taxable within their respective countries. The OECD Guidelines address location savings in the context of business restructurings:

"Where significant location savings are derived further to a business restructuring, the question arises of whether and if so how the location savings should be shared among the parties. The response should obviously depend on what independent parties would have agreed in similar circumstances. The conditions that would be agreed between independent parties would normally depend on the functions, assets and risks of each party and on their respective bargaining powers."[31]

As the tax authorities of African nations become more experienced and sophisticated with regard to transfer pricing audits, it is likely that location savings will become a more important consideration for tax authorities and taxpayers.

E. Tax treaties

Many African countries lack comprehensive tax treaty networks. The typical African country has a handful of treaties within Africa and several with non-African countries. This lack of a comprehensive treaty network places Africa at a disadvantage compared to other developing countries.[32] Treaties are crucial in developing economies – they reduce double taxation, increase information exchange, and allow for standardisation.[33]

Of course, negotiating tax treaties requires a certain level of technical knowledge on behalf of the taxing authorities, and some African countries may not yet be ready to negotiate double tax treaties. Nevertheless, African nations with limited capacity should be encouraged to negotiate double tax treaties among themselves. This would not only minimise double taxation within Africa and ease commerce between the nations, it could also help the participating nations gain experience in double tax treaty negotiations and develop expertise in common issues that arise based on competing interests. As the tax authorities of Africa continue to gain expertise, their ability and desire to negotiate double tax treaties will increase.

31 OECD Guidelines, 9.149.
32 This statement assumes that developing countries utilise double tax treaties in place; however, it is not uncommon for developing countries which have double tax treaties to ignore them in favor of domestic rules.
33 *See Generally* Daniel Hora do Paco and H. David Rosenbloom, "Thoughts on the Brazil-U.S. Tax Treaty Negotiations," 56 *Tax Notes Int'l* 475, 520 (Nov. 16, 2009)

Creating a tax treaty network can help standardise the manner in which MNCs are taxed in Africa.[34] By negotiating tax treaties, African countries may be able to induce further investment by enjoying the efficiency gains from entering into the "international tax regime."[35]

The future of transfer pricing in Africa

As more African countries begin to adopt transfer pricing regimes based on the ALS, the transfer pricing rules of African countries will naturally harmonise to some extent. To continue integrating into the global economy, African nations that have implemented comprehensive transfer pricing regimes will likely begin to consider programmes that allow for APAs.

To ease compliance and capacity issues, strategic safe harbours can also be employed. Under a safe harbour, a company may be free from adjustment if its profits fall within a preapproved range. An example of a simplifying safe harbour that is consistent with the ALS is the Services Cost Method (SCM) in the US transfer pricing regulations.

The SCM provides that for covered services, taxpayers may elect to treat the arm's length compensation for such services as the total services cost with no mark-up.[36] Balancing compliance costs with protection of the public fisc, the SCM was meant to simplify compliance for certain services that otherwise would generate little additional revenue.

Maybe as a response to the UN's growing influence, the OECD pledged to simplify transfer pricing worldwide, including a possible update to the OECD's existing guidance on safe harbours.[37]

African nations where transfer pricing legislation is a long-term goal should assess the preconditions identified in the EuropeAid report and work towards bolstering those preconditions to the extent they are lacking.[38] Institutional capacity, including economic, political, and legal preconditions are a necessary first step for developing countries lacking transfer pricing rules but interested in developing transfer pricing expertise. After institutional capacity is achieved, developing countries can build a sustainable transfer pricing regime. Although transfer pricing regimes in Africa are expected to be based on the OECD Guidelines and the UN Practical Manual, the desire of African governments to protect revenues from natural resources probably will influence future transfer pricing legislation. Also, African nations that have already adopted the ALS will likely move towards legislation that will allow for APAs, tax treaties, and safe harbours as these nations seek to increase domestic tax revenue and make their countries more attractive to MNCs.

34 Steven A. Dean, "More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime, "84 *Tul. L. Rev.* 125, 145-6 (2009). ("Double-tax treaties take two tax regimes that are similar and refine those similarities. Their coordination function and the viral process through which those treaties propagate mean that they encourage harmonisation in two ways. First, double-tax treaties create a limited, international law sphere of substantive harmonisation that prevents double taxation by ensuring that each state limits the application of its tax system in accordance with the same conception of the benefits principle. The other process by which tax treaties promote harmonisation is incidental to the elimination of double taxation. Because those treaties are reciprocal, essentially making each treaty a barter arrangement, they work best when each state's tax regime is similar. Because the costs of not having access to treaty benefits can be significant, treaties provide an incentive for nations to standardise their tax systems. This two-part process creates a pattern in which double-tax treaties both invite and produce symmetry.")

35 Reuven S. Avi-Yonah, "Commentary," 53 *Tax Law Rev.* 167 (2000) (arguing that the network of 1,500 bilateral tax treaties constitutes an international tax regime).

36 1.482-9(b)

37 Kevin A. Bell and Rick Mitchell, OECD, 20 *Transfer Pricing Report* 1199, "Secretary-General Pledges Group To Simplifying Transfer Pricing Provisions."

38 The necessary preconditions are broken down into three broad categories: economic and political preconditions (e.g. ,economic growth and diversification, open economy, and FDI; legal preconditions (e.g., comprehensive income tax law, tax treaty network, existing transfer pricing legislation if applicable); and preconditions related to the tax administration (e.g., some level of specialisation within the tax administration). EuropeAid at 2.

Appendix – Country summaries

1. Algeria

a. General

Transfer pricing has not yet become a priority for the Algerian government. As a result, there has been little transfer pricing formal enforcement in Algeria.

b. Transfer pricing rules

The Finance Bill of 2007 brought into effect Article 141 of the direct and assimilated tax code, which specifies the arm's length principle for intercompany transactions and also defines related parties. This article enforces transfer pricing (the arm's length principle) for both international and domestic related-party transactions and makes it applicable to all companies including subsidiaries and branches. In addition, the arm's length principle is embedded in most of Algeria's tax treaties, while the domestic Algerian rules generally follow the approach adopted in France.

c. Methods

Although no transfer pricing methods currently are specified in the Algerian tax code, the OECD methods generally are viewed as acceptable by the tax authorities. Article 141 of the Algerian tax code is based on Article 9 of the OECD Model Convention. The draft circular issued by the Algerian tax authorities states that all OECD transfer pricing methods are acceptable.

c. Documentation requirements

All entities registered with the tax department responsible for multinational companies (the Direction Des Grandes Enterprises) must submit documentation to support their transfer pricing practices within 30 days after a request is made by the Algerian tax administration. The recommended documentation to be maintained includes accounting and financial statements and documents listing all domestic and overseas group entities as well as those evidencing the nature of relationship between the various group entities. Other documentation that should be maintained includes justification of the transfer prices established and copies of contracts (as per Article 161).

d. Penalties

If the tax administration deems that prices are not at arm's length, the tax authority has the power to adjust profits, in accordance with what it deems to be arm's length. Penalties (including for non-maintenance of documentation) could be up to 25% of the taxpayer's adjusted profits.

Payments for services, such as head office services or anything characterised more generally as a "management" service are the most common areas of focus with regard to TP adjustments.

e. Reforms

The Algerian government has launched major reforms to improve the country's business environment and to encourage private investment. These reforms are designed to facilitate corporate formation and to improve the regulatory and judicial framework, and increase competition.

These reforms include changes to the commercial code, simplification of trade registration accession procedures, and tax simplification. In addition, industrial areas are being developed to attract new investors and legislation is being revised with respect to governing access to land. Specific measures also have been put in place to encourage the creation of small and medium-size enterprises. In 2010 the government adopted reform of the public procurement code, aimed at automating all fiscal and customs procedures.

Despite the appetite for reform in Algeria, transfer pricing does not appear to be a priority for the Algerian government. As such, no changes to the Algerian transfer pricing regime are expected in the near future.

2. Angola

a. General

Although Angola has no formal transfer pricing regulations, the country's tax code (CIT) provides for the ALS. Detailed transfer pricing legislation is expected to be published in the near future (FY 2012); draft legislation is currently being circulated. The legislation is expected to generally follow the OECD model, although it will not provide as comprehensive a model.

b. Draft legislation

The draft legislation permits only the traditional transaction methods: the comparable uncontrolled price method, the resale price method, and the cost plus method. Deviating from the OECD model, the draft legislation does not provide for the transactional profit methods (the residual profit split method and the transactional net margin method).

The draft legislation appears to be a preliminary draft, and may require more consideration as Angola's transfer pricing capacity develops.

c. Documentation and penalties

The draft legislation contains documentation requirements but not transfer pricing-specific penalties. There are no general anti-avoidance rules in place, perhaps inhibiting the tax authority's ability to enforce its requirements. Nevertheless, the tax authorities may challenge intra-group transactions, such as by disallowing the deductibility of certain costs among related parties.

3. Botswana

Botswana has no formal transfer pricing rules.

4. Congo

a. Transfer pricing rules

Congo's transfer pricing rules recently were added to the General Tax Code by the 2012 Finances Act (Law No. 36-2011 of December 29, 2011) under Articles 120 to 120 H.

Article 120 of the General Tax Code law:

- States that profits indirectly transferred to related companies either by increase or decrease of the purchase/sale price, or by any other means are incorporated into the profits of the transferee;
- Defines the relationship between parties for transfer pricing rules to apply;
- Provides that the tax authority may request any information relating to the amount, date, and form of payments made, to determine taxable income; and
- Stipulates that if there are no accurate documents that can allow the tax authority to determine the profit of the companies, or reassess them as provided in this article, taxable profit will be determined in accordance with similar transactions.

b. Methods

The General Tax Code deals only with general principles. There are no transfer pricing-specific methods endorsed in the General Tax Code.

c. Documentation requirements

Documentation is required for Congolese registered companies with annual turnover (net of taxes) above 100,000,000 FCFA (152,449.01 Euros). The required documentation comprises:

1. General information about the group of associated companies, including:

- A general description of the activity carried out, including changes during the audited period;
- A general description of the legal and operational structures of the group of affiliated companies, including identification of affiliated companies of the group engaged in the controlled transactions;
- A general description of the functions performed and risks assumed by affiliated associated companies as they affect the audited company; and
- A general description of the transfer pricing group.

2. Particular information concerning the audited company, including:

- A description of the activity carried out, including changes observed during the audited period;
- A description of the transactions with other affiliated companies, including the nature and amount of flows including royalties;
- A list of cost-sharing agreements and a copy of prior agreements with respect to transfer pricing and confirmation of the Congolese tax authority relating to the determination of transfer prices that affect the audited company's results;
- A presentation of the methods for determining transfer prices in compliance with the arm's length principle, including an analysis of functions performed, assets used, and risks assumed, and an explanation of the selection and application or the methods used; and
- An analysis of comparative elements considered to be relevant by the company, when required by the chosen method.

d. Penalties

A readjustment resulting from a transfer pricing audit may result in the taxing authority recharacterising the transaction. A recharacterisation results in a 20% penalty (tax on dividends).

e. APAs

APAs appear to be available under the General Tax Code but none has been negotiated.

5. Egypt

a. General

Egypt formally recognises the OECD transfer pricing methods and the ALS in its 2005 law (Income Tax Law no. 91 of 2005). Transfer pricing guidelines – Executive Regulations, Articles (38), (39) and (40) – were published in 2010, retroactive to 2005.

b. Transfer pricing capacity

The Egyptian tax authority has not firmly decided whether it will subscribe to an external database, such as SMART or Amadeus, or attempt to develop its own. The taxing authority is making substantial investment in strengthening its transfer pricing capacity, including collaborating with the IMF and the OECD. It also has developed a specialised transfer pricing team within the taxing authority to conduct transfer pricing-specific audits. The tax authority currently boasts more than 40,000 tax inspectors.

c. Audits

The taxing authority only recently has begun to audit transfer pricing issues. MNCs should be aware that Egypt's tax audits are quite different from what MNCs may be used to in other countries. There is no formal audit process and most tax audits are settled in person. Responses and dialogue between the tax authority and taxpayers often are only oral.

d. Tax treaties

Egypt has four tax treaties with African nations and approximately 50 tax treaties worldwide.

6. Ghana

a. General

Ghana does not have any formal transfer pricing rules in place. However, the Internal Revenue Act (IRA), 2000 (Act 592), as amended and the technology transfer regulations provide general guidance for transactions between related parties. The IRA does not provide specific transfer pricing methods.

c. Documentation

The IRA does not require transfer pricing documentation. Nevertheless, documentation may be useful when the Commissioner-General challenges a related-party transaction under a general tax audit.

d. Thin cap rules

Ghana's thin capitalisation rules disallow deductions for any interest paid on "debt" in excess of a debt to equity ratio of 2:1.

e. Penalties

Ghana's general anti-avoidance penalty empowers the tax authorities to adjust transactions deemed to have been conducted as part of a tax avoidance scheme.

f. The draft policy

The Ghana Revenue Authority has released a draft policy on transfer pricing, with plans to introduce legislation based on the draft policy.

This draft policy suggests that:

- Transfer pricing regulations in Ghana will apply to both non-resident and resident related-party transactions (including transactions between a branch and a head office and the attribution of profits to a permanent establishment).
- The legislation will add a provision in section 70 (the ITA section on transfer pricing) to state that the arm's length principle is fashioned after article nine of the OECD and United Nations Model Tax Conventions. The term "associated enterprise," however, has been replaced by "connected person" in the proposed Ghana legislation to widen the scope of application of the transfer pricing regulations to include individuals, corporations, and unincorporated bodies.
- Ghana will adopt the standard transfer pricing methods recognised by the OECD Guidelines. When a taxpayer wishes to use a transfer pricing method other than "an approved method," the taxpayer will need to apply to the Commissioner-General in writing of its intention to apply the method.
- Additionally, the draft policy does not specifically request TP documentation, but it states that sufficient information and analysis should be available for verification of the selection of transfer pricing method, application of method, the global organisation structure, and so on. This essentially is the information contained in transfer pricing documentation.

g. Building capacity

The Ghanaian Revenue Authority has set up a committee to spearhead the development of transfer pricing legislation. The committee has begun sending national tax officials abroad, including to South Africa and Kenya, to gain experience. However, extensive training will still be needed.

A major impediment to capacity-building appears to be funding, including acquisition of databases, IT upgrades, training, and the costs of implementing policies. The donor community is expected to play a role in partially funding these costs.

h. Oil and gas

The discovery of oil in Ghana has led to an influx of FDI in the oil and gas industry. Ghana has a special tax regime for the oil and gas industry, so foreign entities seeking to enter this industry should be aware of its unique taxation.

i. Tax treaties

Ghana has only one tax treaty with an African nation, South Africa. In addition, Ghana has entered double tax treaties with Belgium, Denmark, Germany, France, Italy, The Netherlands, Sweden and the United Kingdom.

j. Miscellaneous

Entities entering particular industries may be required to register with a regulator and ensure compliance with their regulations before beginning operations in Ghana. For example, contractors in the oil and gas industry must be registered with the Ghana National Petroleum Company (GNPC) and must operate under a petroleum agreement with the government of Ghana and the regulator.

7. Kenya

a. General

Section 18(3) of the Kenya Income Tax Act (ITA) sets forth Kenya's adherence to the arm's length principle. Further guidance was provided in 2006 via the Income Tax (Transfer Pricing) rules. Kenya's rules follow the OECD method, including a "most appropriate method." Nevertheless, it appears that the Kenya Revenue Authority (KRA) prefers the CUP method when comparables exist, although the majority of transfer pricing policies employ profits-based methods.[39] This disparity may result in a large number of disputes with the KRA.

b. Documentation

Kenya transfer pricing rules require the maintenance of documentation demonstrating:

- Selection of the most appropriate transfer pricing method and the rationale for such selection;
- Application of the method, including calculations made and price adjustments;
- Assumptions, strategies, and policies in selecting the transfer pricing method; and

39 Isaac Ireri, "An Overview of Transfer Pricing in Kenya," 19 *Transfer Pricing Report* 1357 (21 April 2011).

- Other background information as may be required by the Commissioner regarding the transaction.

c. Thin capitalisation rules

Thin capitalisation rules are in place, with the prescribed ratio of debt to equity of 3:1.

d. Kenya Revenue Authority

In 2010/2011, the KRA collected KES 606.4 billion. Although we did not obtain specific information on the contribution of MNCs to total tax revenue and GDP, MNCs tax revenue is believed to represent around 80% of the KRA's total tax receipts.

The Kenyan government recently sought to fund its expenditures through tax revenues. The KRA has been successful at raising revenues – total tax revenues approximate 22% of GDP. The KRA has become quite aggressive recently in revenue collection.

In 2009, the KRA established a transfer pricing unit. As of May 2011, the unit had 17 employees. This unit currently is auditing a significant number of MNCs operating in Kenya.

The KRA routinely challenges downward income adjustments or recharges. A general view in Kenya has been that MNCs purposely structure their local entities to be low-profit entities. This structure is achieved through such tactics as stripping distributors and manufacturers of risk.

d. Capacity

The KRA appears to be on the forefront of transfer pricing in Africa. To this end, it has:

- Established a transfer pricing unit;
- Subscribed to Pan-European databases (e.g., Amadeus);
- Become a member of ATAF; and
- Taken a transfer pricing case to court (Unilever Kenya Ltd. v. The Commissioner of Income Tax)

One complaint from the KRA, recurrent throughout Africa and most of the developing world, involves the difficulties of using non-local comparables and the application of country-risk adjustments.

e. The UN model

From informal discussions, it appears that the KRA believes that the UN transfer pricing rules will be more fair to developing countries than the OECD Guidelines. There is a general perception that the OECD Guidelines are inappropriate for developing countries and that the UN Model may better reflect the needs of developing countries.

f. Penalties

There are no transfer pricing-specific penalties in place in Kenya. However, the Commissioner for Domestic Taxes may conduct an audit and make adjustments to the taxable profit when applicable. Any tax arising from such a transfer pricing adjustment is subject to additional penalties under sections 72D and 94 of the ITA. Section 72D of the ITA states that late payments of tax will be subject to a 20% penalty. Section 94 of the ITA imposes a 2% interest charge on the amount of tax for more than one month.

There are also general anti-avoidance rules, although they are rarely used.

g. Tax treaties

Kenya has entered into tax treaties with eight countries worldwide: Canada, Denmark, Germany, India, Norway, Sweden, the UK and Zambia. In addition, Kenya has signed a treaty with Italy, but it has not yet been ratified. Kenya also has signed a treaty with the East Africa Partner States – Uganda, Tanzania, Rwanda, and Burundi. This treaty also has not been ratified.

h. Miscellaneous

Firms should consider whether a branch or subsidiary is more appropriate given the specific circumstances. Remittances of profits by a branch to its parent company are not subject to withholding tax, but dividend payments by subsidiaries to parents are subject to withholding tax. However, branches are subject to a higher corporate tax rate and certain recharges from a head office are not deductible.

i. Practical knowledge

i. Differences in successful and unsuccessful entrances into Kenya

MNCs that have had success often seek strong local partnerships, whether through actual joint ventures, strong local management, or partnerships with local distributors. Strong local partnerships appear to be a critical characteristic of successful entrances; merely outspending local companies has not been sufficient to capture local consumer trends/patterns.

ii. East African integration

Under the East African Community (EAC), Kenya, Burundi, Rwanda, Tanzania, and Uganda have officially formed a free trade area and a customs union. Sometime in 2012, businesses and persons will be allowed free migration among the countries of the EAC. The EAC plans to unveil by 2015 a common currency, the East African Shilling.

8. Libya

There are no formal transfer pricing rules in place in Libya.

9. Malawi

a. General

Malawi has transfer pricing legislation in place. Malawi follows the OECD guidance as to methods and method selection. However, the OECD Guidelines are viewed merely as guidance and are not binding or formally adopted.

b. Documentation requirement

Documentation is required in Malawi.

c. Penalties

There are no transfer pricing-specific penalties in place. Nevertheless, the regulations state that the provisions of the Taxation Act relating to fraud, failure to provide returns, and underpayments of tax apply to transfer pricing-related transactions.

d. Tax authorities

Malawi's Tax Authority consists of 500 employees in more than 15 field offices.

The Malawi Tax Authority recently increased its transfer pricing enforcement. This aggressive enforcement has disclosed that many MNCs are not fully compliant with Malawi's transfer pricing rules. There have been a number of audits over the past few years, but none has been resolved.

e. Capacity building

There is a serious interest in capacity building to create a staff capable of handling transfer pricing issues in Malawi.

f. Tax treaties

Malawi has one tax treaty with an African country and eight countries worldwide.

10. Mozambique

The Mozambican Corporate Income Tax Code (CIRPC, in Portuguese) has a basic regime on transfer pricing. The regime, which is covered by a single article, provides only general guidance and does not address any further regulation or provisions regarding transfer pricing implementation or methods.

Although it is likely the country will implement the OECD principles and methods, it is unclear whether Mozambique's current transfer pricing regime will be expanded upon in the near future. In addition, it is possible that provisions of the UN Practical Manual on Transfer Pricing may be endorsed.

a. Current transfer pricing rules

Article 49 of the CIRPC states that the tax authority can perform adjustments deemed necessary to ascertain the taxable profit for tax purpose whenever:

"by virtue of special relations between the taxpayer and other entity, different conditions were established from those that would normally be agreed between independent entities resulting in non-arm's length profits."

Under article 52.2, special relations between a resident and a non-resident entity may exist if:

- The non-resident entity holds, either directly or indirectly a participation of at least 25% of the share capital of the Mozambican company;
- Though holding less than 25%, the foreign entity has a significant influence on the Mozambican company's management; or
- Both the Mozambique taxpayer and the non-resident entity are under control of one entity that has participation in their share capital, either directly or indirectly.

b. Methods

There are no formal methods in place in Mozambique. The Mozambique tax authorities may be waiting to implement the transfer pricing regime until it better develops internal and administrative capacity. However, there are cases in which the tax authorities have referred to transfer pricing practices in their audits, although only as an issue for consideration.

c. Documentation requirement

There is no transfer pricing documentation requirement in Mozambique.

d. Thin capitalisation

According to article 52 of the CIRPC, thin capitalisation exists when there is excessive indebtedness between a resident entity and a non-resident entity with which it maintains a special relation (as defined under article 52.2, described above), whenever any of their relevant debt to equity ratios exceeds a factor of two. No industry/sector is specified, so the rule applies to all sectors.

So, in such circumstances, the interest paid to specially related non-residents that corresponds to the excessive indebtedness is not allowed as a tax deductible cost for the Mozambican company unless the company can prove that it could have obtained the same level of indebtedness at comparable conditions from unrelated parties, taking into account the nature of its business, its sector of activity, and other relevant criteria.

e. Penalties

There are no transfer pricing-specific penalties in place other than the above referred corrections to taxable income. It is important to note, however, that the general penalties regime establishes that fines vary between 100 to 200% of the amount of tax due, subject to some reductions.

11. Namibia

a. General

Namibia established transfer pricing legislation in May 2005, through Section 95 of the Income Tax Act. Section 95A, however, does not prescribe any particular methodology for determining an arm's length result. It is our understanding that the use of the OECD methods is preferred.

b. Documentation requirement

Transfer pricing documentation is not required, although it is advisable to maintain.

c. Penalties

An additional tax of up to 200% may be levied on underpaid tax. Late payment penalties of 10% and interest penalties also may apply.

d. Tax authorities

The tax authorities currently are not auditing transfer pricing aggressively. Nevertheless, the taxing authorities are in discussions with the South Africa Revenue Service regarding information exchange policies.

There are five regional offices across Namibia, as well as several satellite offices. Recruiting skilled staff continues to be a challenge for the taxing authority.

12. Nigeria

a. Recent developments

The Nigeria Tax Authority, Federal Inland Revenue Service (FIRS), recently issued draft transfer pricing regulations.[40] The final version is expected to be published in 2012. The draft regulations are consistent with the OECD transfer pricing guidelines.

b. Current transfer pricing regime

Although Nigeria does not perform specific audit relating to transfer pricing, FIRS pays attention to related-party transactions during normal audits, which are carried out every six years.

A general anti-avoidance rule empowers tax authorities to adjust related-party transactions that, in their opinion, have not been conducted at arm's length. In addition, MNCs may seek agreements in advance on prices in certain transactions, but there are no specific rules guiding the process of initiating such agreements. The FIRS currently relies on the National Office for Technology Acquisition and Promotion (NOTAP) for determining the pricing of certain transactions between related parties.

c. Challenges

There are many potential challenges to successfully implementing a transfer pricing regime in Nigeria. FIRS staff will need transfer pricing-specific training as well as access to transfer pricing resources. Computerisation is an ongoing project at FIRS, but no current plan to get FIRS access to transfer pricing-specific online databases has been announced. Considering Nigeria's unique economy, it likely will be difficult to identify sources of potentially comparable companies that can be used for benchmarking arm's length prices. In addition, because many companies operating in Nigeria have a limited understanding of transfer pricing, it may be difficult to get taxpayers to prepare documentation.

d. Entry into Nigeria

Important considerations include:

i. Incorporation

Branch operations are permissible only under very restrictive conditions. Foreign persons intending to carry on business in Nigeria must be

40 See PKN Alert - "Nigeria releases transfer pricing regulations," (16 May 2012). www.pwc.com/pkn

incorporated. Failure to comply is a violation of the law and could render signed contracts void.

ii. Foreign exchange regulations
Foreign exchange is highly regulated in Nigeria. The Central Bank of Nigeria (CBN) specifies eligible transactions for which foreign exchange can be sourced. For example, a Certificate of Capital Importation (CCI) must be obtained within 24 hours of transferring funds as evidence of imported funds (debt/equity) and to ensure capital can be repatriated and dividends or interest remitted. Approvals must be sought from the CBN for ineligible, unspecified transactions.

iii. Registration with relevant regulatory authorities
Registration with relevant regulatory authorities is very important. For business permits, companies likely must register with the Corporate Affairs Commission and/or National Investment Promotion Council; in the oil and gas sector, companies must register with the Department of Petroleum Resources; and all companies must register with the tax authorities.

iv. Choosing a commencement date for tax purposes
Commencement rules are applicable on the taxation of corporate profits in the first three tax years. These rules subject accounting profits to tax twice due to overlapping tax basis periods. Choosing a commencement date as well as the accounting year-end can be used as a tax planning tool to avoid double taxation of profits.

vi. Tax incentives
Possible tax holidays and tax exempt profits, such as export profits reinvested, exist. It is important for companies to understand the available tax incentives, which may include tax holidays and tax exemption of certain profits, such as export profits that are reinvested.

vii. Changes in accounting date rules
Specific rules apply when a company changes its accounting date.

viii. Minimum tax
Minimum tax is payable by companies with zero tax due. It is also payable by companies with tax due less than the minimum tax, but exempted if they have a minimum imported capital (evidenced by a CCI) of 25% or are agro allied companies.

ix. Excess dividend taxation
It is generally not advisable to "stack" companies in Nigeria because of the excess dividend taxation rule, which seeks to tax companies that distribute profits in excess of their taxable profits or have no tax payable in the tax year of distribution. For example, a subsidiary will have to pay entity-level taxes before paying out dividends to its Nigerian holding company. The profits will be further taxed in the hands of the holding company because it has no other trading profits. Thus, there are double layers of taxes on one profit stream. For these circumstances, the choice of a holding company is critical in avoiding tax leakages.

e. Special considerations

i. Oil and gas
In Nigeria, it is particularly difficult to gain entry into the oil and gas industry. For example, winning contracts requires compliance with specific industry regulations such as the local content requirement, which specifies thresholds for local resources employed in the industry (e.g., subsidiaries of foreign multinational companies are required to show that they own at least 50% of the equipment used in execution of oil and gas projects).

In addition, it has been reported that Nigeria may renegotiate off-shore oil contracts. The government claims that it has lost $5 billion in revenue, citing "unfair fiscal terms."[41]

13. South Africa

i. General

Although South Africa first implemented transfer pricing legislation in 1995, only recently has the South African Revenue Service (SARS) begun to focus on transfer pricing. The transfer pricing rules are contained in Section 31 of the Income Tax Act 58 of 1962 (ITA). SARS has issued Practice Note 7 (PN 7), which provides taxpayers with guidelines regarding transfer pricing. It is expected that PN 7 will be replaced in the near future with a new Interpretation Note.

ii. Documentation

Documentation is not technically required, although practically, taxpayers should maintain contemporaneous documentation. PN 7 states that maintaining documentation is in the best interest of taxpayers, yet recognises that appropriate documentation may differ for each taxpayer, depending on the facts and circumstances. The documentation suggestions in PN 7 generally reflect Chapter V of the OECD Guidelines. If SARS asks to see a company's transfer pricing documentation, the taxpayer generally is given 7-21 days to produce the documentation.

iii. Thin capitalisation

For years of assessment commencing prior to 1 April 2012, Section 31(3) of the ITA, read together with Practice Note 2, contained thin capitalisation rules with a safe harbour for debt/equity ratios up to 3:1. The thin cap rules no longer are separately addressed in the legislation, but simply form part of the general transfer pricing provisions, and will apply to transactions that occur in years of assessment commencing on or after April 1, 2012.[42] Thus, taxpayers must apply an arm's length analysis to any transaction between a resident and a non-resident related person.

iv. Penalties

There are no specific transfer pricing penalties in place, but adjustments may be subject to general penalty provisions. Penalties can range from 0 to 200% of the tax payable as a result of the transfer pricing adjustment.

v. Audits

The Finance Minister has repeatedly suggested that transfer pricing is one of the key focus areas in greater revenue collection. The steps SARS has taken to increase the revenue collected include concentrating on aggressive tax planning, transfer pricing, and offshore arrangements. SARS also plans to hire more experts. SARS has undertaken numerous transfer pricing audits in recent years, and none has proceeded to court. All have been resolved through negotiated settlements.

vi. Recent Changes

Recently, the legislative power of SARS has been broadened to determine compliance with the ALS with reference to either price or profit. In addition, a greater burden of proof has been placed on taxpayers to demonstrate compliance with the ALS.

vii. Transfer pricing capacity

SARS invests significantly in transfer pricing core capacity and development. SARS employs approximately 15,000 people. The transfer pricing team currently consists of about 15 people; SARS is looking to increase that to 30-40 people in the near future. In addition, as is the case for the revenue authorities in other African countries, SARS experiences difficulties related to a lack of local comparables. Minister of Finance Pravin Gordhan recently confirmed that a focus area for SARS in 2012 will be the development of a local comparable database.

vii. Tax treaties

South Africa enjoys the most comprehensive treaty network in Africa, consisting of 19 tax treaties with fellow African countries and 51 tax treaties with non-African countries.

14. Sudan

Sudan has no formal transfer pricing rules, but the ALS is used as a basis for making assessments.

15. Tunisia

i. General

Tunisia introduced a transfer pricing provision as part of the 2009 law (Article 51). Article 48 of the tax law defines the ALS and what constitutes related parties.

ii. Documentation

Tunisia currently has no documentation requirements.

iii. Penalties

Tunisia has no transfer pricing-specific penalties. However, general tax penalties may apply, including a 1.25% per-month tax for each month an adjustment remains outstanding.

iv. Tax Treaties

Tunisia has tax treaties with ten African nations and 50 other countries worldwide.

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41 *The Economist*, "Wish you were mine," 11 February 2012

42 *See* PKN Alert - "Amendments to the South African transfer pricing legislation," (10 April 2012). www.pwc.com/pkn

v. Special considerations
Political uncertainty combined with low recent revenue collection could result in the tax authorities aggressively focusing on revenue targets.

16. Uganda

i. General
Uganda's tax regime has remained relatively robust over the past few years. Revenue collections have continued to grow and do not appear to fluctuate based on political disruptions. The majority of these revenues are generated by MNCs. By one estimate, MNCs contribute as much as 80% of the tax revenues collected in Uganda. In 2010, the Uganda Revenue Authority (URA) collected $1.7 billion in taxes.

In 2011, Uganda released transfer pricing regulations based on the OECD model that came into effect on 1 July 2011. Uganda fully adopts the OECD methods.[43]

ii. Documentation requirement
Although documentation generally has been ignored in the past, with the implementation of the new regulations, documentation is now required, so taxpayers are advised to maintain documentation.

iii. Transfer pricing capacity building
Like many developing countries, Uganda recognises the difficulties associated with a lack of local comparables. For this reason, the URA subscribes to Pan European databases for information regarding comparables, including Amadeus. The URA's investment in Amadeus, its participation in several transfer pricing seminars, and consultation with ATAF demonstrate Uganda's intent to strengthen its transfer pricing capacity.

While it is not clear whether the URA is actively monitoring the UN initiative on transfer pricing, it appears that the URA would be open to the UN model if it results in greater revenue recognition in Uganda, especially in light of the fact that the OECD model is believed to favor Western nations.

iv. Target areas
Over the next few years, the tax authorities are expected to increase focus on transfer pricing. This is especially so in the oil industry, as discussed below. In addition, management fees have been a consistent target of the taxing authorities. During an assessment, the URA typically requests financial information (e.g., statutory and management accounts), previous tax returns, invoices related to downward adjustments or recharges, headcount data, and job descriptions for both resident and non-resident related parties.

v. Recent events
One item that stands out is that Uganda's regulations provide for APAs, although there have been no APAs negotiated at this point.

vi. Tax treaties
Uganda has entered into tax treaties with Zambia and South Africa. It also may benefit from the East African Treaty (Uganda, Kenya, Tanzania, Rwanda and Burundi), which is awaiting ratification.

vii. Oil
The discovery of oil in Uganda has significant implications for the future of the Uganda market. There is an expected increase in oil revenues, which will naturally result in an expected increase in tax revenues. In fact, the oil industry has already been the subject of significant tax disputes in Uganda, which can only be expected to intensify in the future.

17. Zambia

i. General
Zambia fully adopts the OECD Guidelines. The Zambia Revenue Authority (ZRA) requires documentation supporting transfer prices, but there is no specific guidance regarding what is considered sufficient documentation. Because there are no specific transfer pricing penalties, transfer pricing issues are addressed under general anti-avoidance provisions.

As the ZRA does not have its own transfer pricing database, it will most likely use Amadeus, as done by South Africa. Particular areas commonly reviewed by the ZRA are management fees, royalties, and purchase of trading goods. The ZRA is investing in developing specialist expertise through training locally and abroad (in the UK, Australia and South Africa). Nevertheless, there has been no move to establish a transfer pricing-specific unit within the ZRA.

ii. Special considerations
Taxpayers should carefully plan their entrance into Zambia. While branches and subsidiaries are subject to the same statutory rates, differences exist in the treatment of transfers of funds to related parties. Specifically, a branch may repatriate funds to a related party free of withholding tax. A subsidiary, on the other hand, absent a treaty, must declare a dividend, subjecting the funds to a withholding tax of 15%. Thus, locating a holding company in a treaty country is advisable.

43 Uganda's transfer pricing is discussed in a PKN Alert Uganda - "New transfer pricing regulations," (8 March 2012). www.pwc.com/pkn

18. Zimbabwe

i. Developments

Zimbabwe currently has no formal transfer pricing rules in place. However, over the past two years the country's Minister of Finance has mentioned the introduction of transfer pricing legislation. The draft law is currently under consideration, and it is anticipated that transfer pricing regulations will be introduced in Zimbabwe in 2013.

In addition, a questionnaire regarding the proposed TP regs in Zimbabwe has been circulated to accounting firms and other interested stakeholders aimed at compiling a list of MNCs and their international trading activities as they relate to transfer pricing.

In preparation for the implementation of transfer pricing legislation, resources have been channeled towards the construction of a MNC database of related-party transactions and staff training. Some of the tax authority staff have been seconded to South Africa to learn more about transfer pricing procedures, audits, and investigations, and it is anticipated that transfer pricing training for the general public will commence soon. In addition, a questionnaire regarding the proposed TP regulations in Zimbabwe has been circulated to accounting firms and other interested stakeholders aimed at compiling a list of MNCs and their international trading activities as they relate to transfer pricing.

It appears that Zimbabwe's transfer pricing rules are going to be based on the OECD model. Zimbabwe's tax authority already uses the OECD Guidelines with respect to the anti-avoidance rules of section 98 of the Income Tax Act, which currently is the closest thing in Zimbabwe's Income Tax Act to transfer pricing rules. Section 98 applies the arm's length principle. Currently, all transactions involving inter-group transactions of MNCs to the extent they relate to anti-avoidance provisions may be scrutinised by the tax authority.

ii. Current TP regime

The rules under the current income tax law likely will be accommodated in the new transfer pricing legislation. The Income Tax Act currently includes the following thin capitalisation provisions:

- Interest charged on loans when the debt/equity ratio exceeds 3:1 will be disallowed. Disallowed interest will be treated as a dividend subject to the appropriate withholding taxes.
- Management fees in excess of two-percent of cost paid/payable to a foreign parent company will be disallowed as an expense. The excess will be treated as dividends subject to withholding taxes. The two-percent rule cuts across all sectors/industries.
- The Zambian Exchange Control legislation also has thin cap rules; these generally are lower than for income tax. Ratios of 1:1 (in respect of mining) and 2:1 (for other sectors) are advocated, but may be altered when negotiating with The Zimbabwe Investment Centre (ZIA) or The Exchange Control Authority.

As noted above, Section 98 of the Income Tax Act basically uses the arm's length principle. The tax authority appears to regularly attempt to enforce this anti-avoidance legislation, which has become an integral part of the investigation activities related to MNCs; the investigation arm of the Revenue Authority has a special team focusing on MNCs. Currently, however, there are no transfer pricing audits per se except when captured under anti-avoidance provisions.

iii. Challenges

The most significant challenge Zimbabwe will face regarding its transfer pricing regime likely will be the availability of financial resources required to educate the general business community regarding transfer pricing, adequately train the tax authority staff, and acquire transfer pricing-related resources, such as transfer pricing databases. There is concern that Zimbabwe will enact transfer pricing legislation without adequate notice or preparation provided to businesses or the tax authorities. VAT was introduced with little warning and very little training for the public or revenue officials.

iv. Special considerations – mining

Zimbabwe is desperate to obtain fresh capital to recapitalise its manufacturing and agricultural sectors. However, potential investors should take into account competition from imports, especially from China and South Africa.

The Zimbabwe government has been focusing on the mining sector because of the need to create employment and generate export earnings.

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