

Tax alert - Tanzania

Transfer Pricing Regulations 2014

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The Income Tax Transfer Pricing Regulations 2014

Contemporaneous transfer pricing documentation is required to be in place before tax returns are submitted – the implication of this is that all affected taxpayers should urgently review the status of their transfer pricing documentation

Opportunity to apply for **advance pricing arrangements** (APAs) may help provide certainty on tax treatment.

Significant penalties for non-compliance with transfer pricing documentation requirements and for transfer pricing adjustments.

Introduction

The much anticipated Tanzania Transfer Pricing Regulations (“the Regulations”) were publicly released in May 2014. The relevant instrument is Government Notice No 27 (“The Income Tax (Transfer Pricing) Regulations, 2014) published on and effective from 7 February 2014.

Since inception the Income Tax Act (“ITA”) 2004 has had a requirement that transactions between associates should be undertaken at arms’ length (Section 33 ITA 2004).

The Income Tax Regulations 2004 issued shortly after the publication of the ITA 2004 had included a regulation providing the possibility to enter into advance pricing agreements, and had also stated that the transfer pricing section in ITA 2004 “shall be construed in such manner as best secures consistency with the transfer pricing guidelines in the Practice Notes issued by the Commissioner”. However, until the recent issue of the Regulations no such guidance had been given.

Notwithstanding the absence of regulations, recent years have seen significant focus by the Tanzania Revenue Authority (“TRA”) on transfer pricing in terms of increased resources and training, as well as transfer pricing tax audits of many taxpayers.

Recent tax audits have highlighted a number of areas of disagreement

between taxpayers and the TRA with regards to technical matters relating to transfer pricing. Against this background the Regulations are to be welcomed. Nevertheless, a concern remains that the Regulations are too generic and so provide insufficient guidance in relation to the common areas of disagreement as regards the application of the arm’s length principle in the Tanzanian context.

Amongst other things, the Regulations impose specific documentation requirements as well as significant penalties and so do reinforce the need for taxpayers to take action to comply.

Detailed review

Scope

The Regulations explicitly state that they apply not only to cross border transactions but also to domestic transactions between associates.

Transfer pricing documentation

The Regulations require contemporaneous transfer pricing documentation to be prepared before the tax return is submitted. Although the transfer pricing documentation is not required to be submitted with the tax return, it should be provided to the tax authority within 30 days if requested. The Regulations also state the list of information that should be included in transfer pricing documentation.

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Penalties

The Regulations contain significant penalty provisions for non-compliance which include criminal sanctions.

The penalty for any transfer pricing adjustment made as part of a tax audit is 100% of the underpayment of tax. Given that the quantum of transfer pricing adjustments can be high and that there is a significant element of subjectivity in respect of transfer pricing, such a high automatic penalty does appear punitive.

In addition, the penalty for non-compliance with transfer pricing documentation requirement is, on conviction, imprisonment for a maximum of 6 months and/or a fine of not less than 50m Tanzanian shillings.

Advance pricing arrangement

The Regulation allows taxpayers to apply for Advance Pricing Arrangements (“APA”). These can be unilateral, bilateral and multilateral based on the specific requirement of the taxpayers. The Commissioner has the discretion whether to accept an APA request and whether to accept the taxpayer proposal, modify it or completely reject it.

A specified list of documentation is required to apply for an APA however the Regulations do state that any information submitted will be treated as confidential.

An APA is only valid prospectively and for a maximum period of 5 years during which there are yearly compliance requirements.

The advantage of an APA is that it does create an opportunity for taxpayers to obtain certainty (or more certainty) in respect to their intragroup transactions. However, experience from other countries does indicate that APAs can take a considerable time to be agreed (depending amongst other things on the complexity of the transactions and the number of jurisdictions involved).

Double taxation

The Regulations also contain some references to avoid double taxation.

Of relevance for cross border transactions are provisions to enable a “*corresponding adjustment*” in Tanzania in cases where a transfer pricing adjustment has been made by a tax authority of a country with which Tanzania has a double tax treaty. In practice, the benefits of this may be limited as Tanzania currently has few double tax treaties in place.

In addition, the Regulations still make such an adjustment conditional on the Commissioner agreeing that the adjustment made by the other country is in accordance with the arm’s length principle. Such a unilateral approach does seem inconsistent with the mutual agreement procedures normally provided for in double tax treaties.

Of relevance for domestic transactions are provisions for “*offsetting adjustments*”. However, such adjustments are not automatic but depend on a request being made by the other domestic party to the transaction.

Transfer pricing method

The Regulations state that the traditional transaction method should be used in the first instance and thereby imposes a hierarchy of method which is no longer the OECD position and goes against the global trend in transfer pricing.

OECD and UN guidelines

The Regulations state that further guidance can be obtained from both the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration as well as the UN Transfer Pricing Manual for Developing Countries. There is no guidance regarding which one should be used in case of inconsistency – something which may lead to uncertainty and confusion as OECD and UN guidelines do differ in certain aspects.

Power to make adjustments

The Regulations allow the Commissioner to make adjustments if he has reason to believe that a transaction has not been undertaken at arm’s length. However, the Regulations do not give any further guidance on how the tax authority

should conduct a tax audit and whether they should prepare their own study and benchmarking exercise to arrive at an adjustment.

Intragroup Services, Intangible Property and Intragroup Financing.

The Regulations have specific provisions dealing with intragroup services, intangible property and intragroup financing and which focus on the need to be able to demonstrate economic or commercial benefit to the business. In particular, the following services are expressly stated to be disregarded:

- shareholder or custodial services;
- duplicative services;
- services that provide incidental or passive association benefits;
- on call services

More intriguingly, it also provides for the disregarding of “*any other services the Commissioner may deem not appropriate*” - something that will increase the uncertainty faced by taxpayers in respect of management charges.

Other matters

The Regulations are silent on certain matters including:

- The interplay between transfer pricing and other taxes – for example, in the case of withholding tax whether a withholding tax credit would be available for any downward adjustments to management fees.
- The issue of lack of local comparables – currently a common challenge in tax audits.

- Guidance on what is considered to be the arm’s length range and to what point in a range would the tax authority target. Such guidance would have provided taxpayers with some additional certainty.

Conclusion

It is very positive that the Regulations have now been published and are now in force. Nevertheless, overall it may be seen to some extent as an opportunity missed, as there are a number of specific transfer pricing issues faced in practice by taxpayers and the tax authority that the Regulations do not address.

Let’s talk

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