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## ICAZ Tax Update Seminar

# *An introduction to Transfer Pricing (TP)*



# *New transfer pricing provisions*

## *Introduction – What is transfer pricing*

- The price charged for the transfer of:
  - goods
  - services
  - intangibles
  - financing
- Affected transactions?
  - Cross border
  - Domestic
- Arm's length principle (ALP)



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# ***New transfer pricing provisions***

## ***Arm's length principle***

### ***Key: the Arm's Length Principle (ALP)***

The ALP - the international standard for determining transfer prices for tax purposes (OECD)

Distortion of tax liabilities of enterprises and tax revenues of host countries

- Comparability analysis – controlled vs uncontrolled
- Functional analysis – functions, assets and risk

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## ***Arm's Length Principle (ALP)***

### **Statement of the ALP**

### **Article 9 of the OECD Model Tax Convention**

*“[When] conditions are made or imposed between...two[associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”*

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## *New transfer pricing provisions*

### *Goods and services widely defined*

#### *Goods*

Corporeal moveable things, fixed property, real rights in these things and fixed property (raw material/semi finished goods/finished goods)

#### *Services*

Anything done or to be done, includes core business services, support services (technical, R&D, IT, HR, admin, accounting, management etc.), financial assistance, etc

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# ***New transfer pricing provisions***

## ***Introduction***

### ***Why introduce TP legislation in Zimbabwe?***

- Increasing world trade – over 60% of world trade by MNCs
- Tax authorities competing for tax share of MNC profits
- Tax authorities aggression US/Canada/Japan/Australia
- Exchange controls relaxation by developing economies
- Non existence of legislation is a weakness in the tax system

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## *Transfer pricing – The international consensus*

- Transfer pricing in the tax world is governed by **specific rules** and has **specific methods** to determine what is arm's length.
- These have been set out in:
  - the OECD Guidelines, subject to periodic revision and expansion, and are **OECD accepted methods**; and
  - the UN TP guidelines. Substantially overlap of OECD:
    - 5 factors of comparability
    - 5 methods
- Any countries which do not follow the OECD?
  - Brazil

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## ***New transfer pricing provisions*** ***OECD Guidelines***

### ***Organisation for Economic Co-operation and Development***

- International Economic Organisation located in Paris, created in 1961
- Provides setting for international discussion
- Co-ordinate domestic and international policies
- 34 members signed the OECD Convention
  - ✓ Produce two thirds of world's goods and services
- OECD Guidelines not legislation but sets out commonly agreed principles
- Encourages member and non member countries to follow guidelines
- Zimbabwe not a member country of the OECD



# ***New transfer pricing provisions*** ***OECD Guidelines***

Transfer pricing methods

The arm's length principle

Comparability analysis

Administrative approaches to avoiding and resolving tax disputes

Documentation

Special consideration for intangible assets

Special considerations for intra-group services

Cost contribution arrangements

Transfer pricing aspects of Business Restructurings

Appendices

***What's  
in it?***

# ***New transfer pricing provisions***

## ***OECD Guidelines***



## **Transfer pricing methods**

- Comparable Uncontrolled Price (“*CUP*”) Method;
- Resale Price (“*RP*”) Method;
- Cost Plus (“*CP*”) Method;
- Profit Split Method (“*PSM*”);
- Transactional Net Margin Method (“*TNMM*”) or Comparable Profits Method (“*CPM*”) ; and
- Unspecified Methods (Only in US legislation)

## OECD Methods – commercial rationale

<i>Method</i>	<i>Method Type</i>	<i>Commercial Rationale</i>
CUP or CUT	Traditional transaction	If I sell/buy at \$ x to/from a third party, why don't I sell/buy at the <u>same price</u> to/from a related party?
Resale Price	Traditional transaction	If I sell/buy at x% off end sales price to/from a third party, why don't I sell/buy at the <u>same discount</u> to/from a related party?
Cost Plus	Traditional transaction	If I sell at x% on (production) cost to a third party, why don't I sell at the <u>same mark up</u> to a related party?
Profit split	Transactional profit	If the overall system profit is x, how do we <u>share</u> it?
TNMM	Transactional profit	If other companies in the market earn between x% and y%, why shouldn't I achieve the <u>same operating margin</u> ?

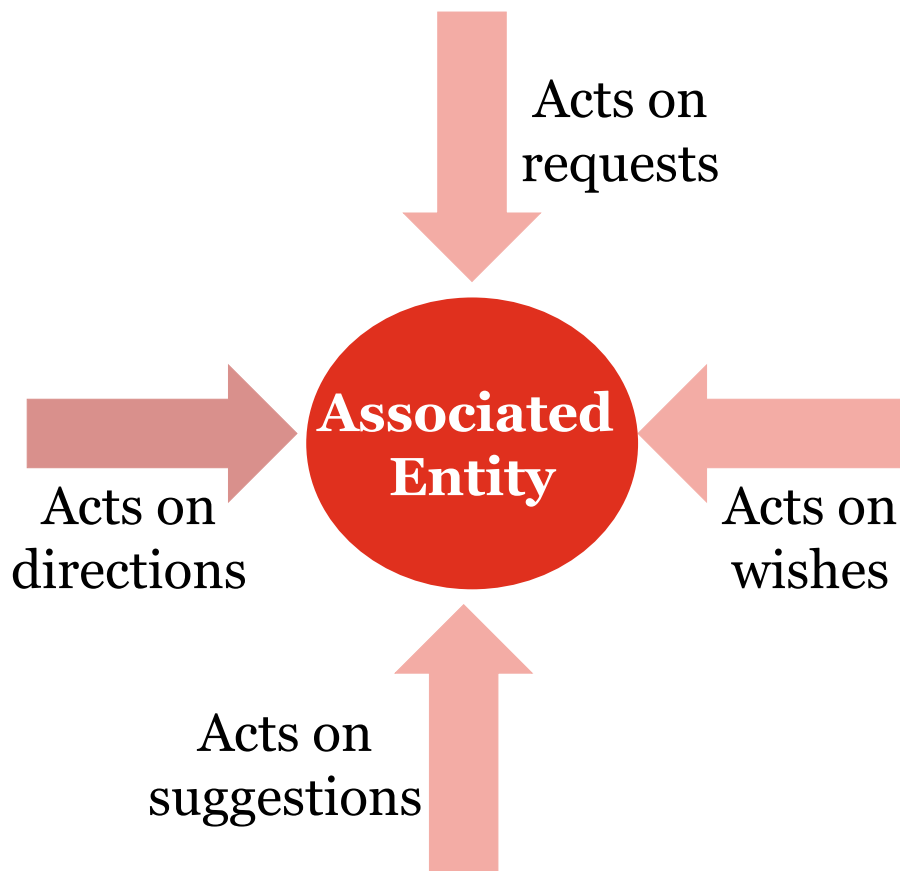
## ***New transfer pricing provisions*** ***Zimbabwean Legislation***

### ***Section 2A and 2B***

- New legislation introduced wef 1 January 2014
- Being applied retrospectively
- The following definitions were added:
  - When persons deemed to be associates (S 2A)
  - When person deemed to control company (s 2B)

## *Associated entities (S 2A)*

### General Definition



### Specific inclusion examples:

- Near relative of a person
- Partner in a p/ship
- Trustee of a trust

## ***New transfer pricing provisions*** ***Zimbabwean Legislation***

### ***Section 2B***

- Deemed to have control where a person:
  - ✓ Controls majority voting rights (directly or indirectly)
  - ✓ Has direct or indirect influence resulting in factual control

## ***New transfer pricing provisions Zimbabwean Legislation***

### ***Section 98A***

- Income splitting
  - Transfer of **income** directly or indirectly to an associate
  - Transfer of **property** that produces income (directly or indirectly to an associate)
  - For the sole or main reason of a tax benefit
  - Commissioner may adjust the taxable income of the taxpayer and the associate

## ***New transfer pricing provisions Zimbabwean Legislation***

### ***Section 98B***

- Transactions between associates, employers and employees
  - Transactions to reflect the arm's length principle
  - Income from transfer or licence of intangible property
- The Commissioner has the right to:
  - ✓ distribute, apportion, allocate income, deductions or tax credits
  - ✓ Re-characterise the source of income or nature of payment



## ***New transfer pricing provisions Zimbabwean Legislation***

### ***Other points***

- No detailed guidelines provided by ZIMRA yet
- No specific industry or sector focus
- Currently no specific transfer pricing forms
- No specific transfer pricing questions on the current return

## ***New transfer pricing provisions Zimbabwean Legislation***

### ***Implications of the new legislation***

- Domestic and cross border transactions - arm's length
  - Management fees,
  - Intangibles – royalty fees,
  - Fixed property,
  - Financing arrangements – debt vs equity,
  - Hybrid mismatch arrangements,
- TP documentation file at the tax authorities request
- Limited time for presenting the TP documentation file to ZIMRA.
- ZIMRA adjustments to reflect market values

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***New transfer pricing provisions***  
***Current scenarios at ZIMRA***

TP assessments raised using S98 – general anti avoidance rules

Transfer pricing specialists previously sent for TP training have returned.

Increase in number of queries and assessments

Detailed questionnaires sent out by ZIMRA

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## ***New transfer pricing provisions*** ***Documentation***

### **Why preparing TP documentation?....**

No explicit statutory requirements,  
However, documentation addresses:

- ✓ Unilateral TP adjustments
- ✓ Taxpayer's onus to prove arm's length
- ✓ Penalties
- ✓ Pricing certainty
- ✓ avoid frustrations and disputes between Group companies
- ✓ TP policy document should therefore be readily available
- ✓ Consistency – legal agreements, financial statements, substance of transaction

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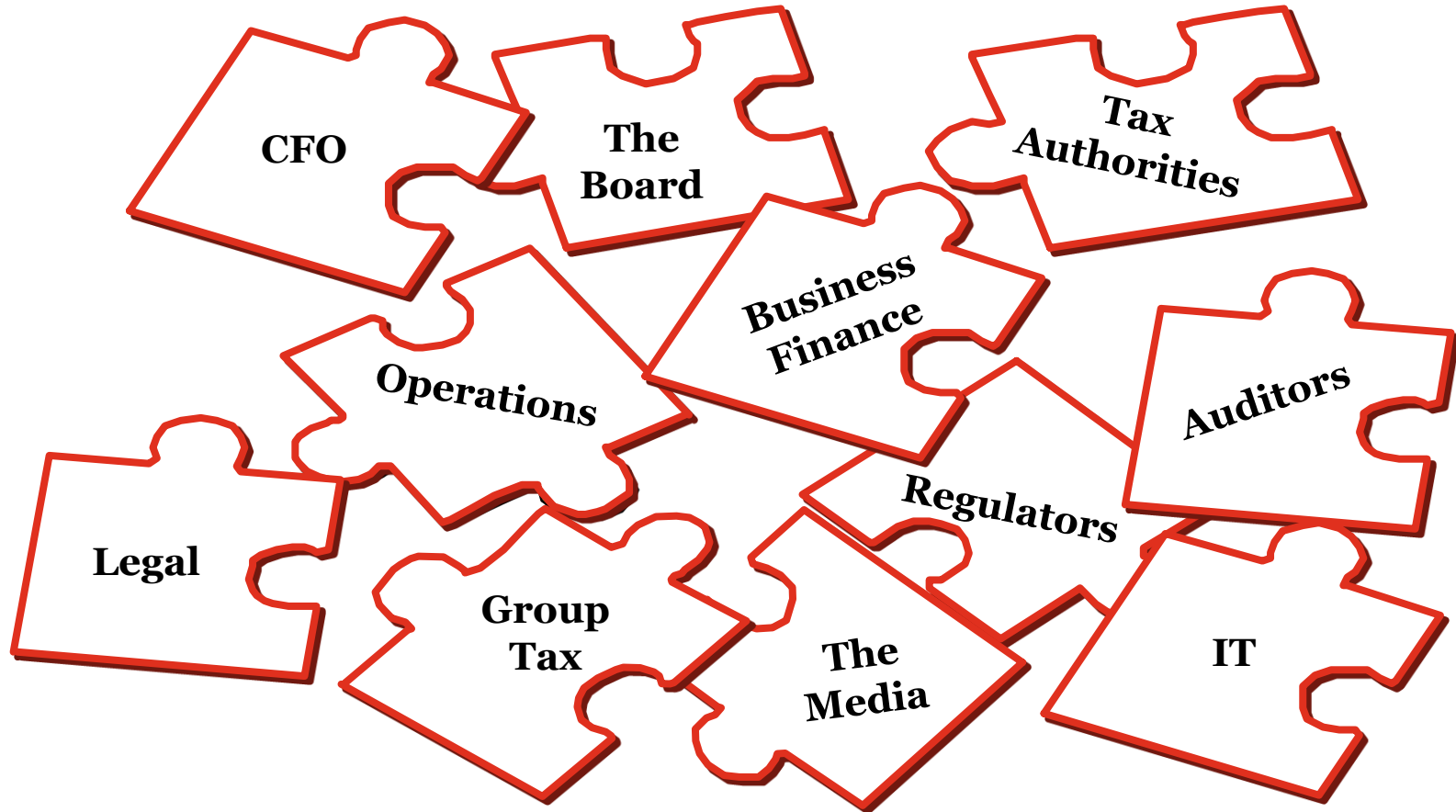
## *Documentation*

### Different types of TP Document

- Transfer Pricing Compliance Document
  - Submitted to Revenue authority (on request or i.t.o law)
- Transfer Pricing Policy Document
  - Discloses TP policies of group
  - Usually used internally
- Transfer Pricing Planning Document
  - Documents proposed or “to be” transactions
  - Justifies new TP policies introduced
- Transfer Pricing Defence document
  - Used in defence of TP policies in dispute

# *Managing TP risk on a day to day basis*

## *Understanding the issue*



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## ***New transfer pricing provisions***

### ***Conclusion***

#### ***What is the way forward?***

- Preparation of local transfer pricing documentation
- Leveraging upon any group transfer pricing documentation
- Development and implementation of transfer pricing policies.
- Analysis of implications of proposed group business restructurings
- Design of tax efficient business models and assistance in their implementation
- Analysis of intercompany agreements in order to identify and address transfer pricing issues

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# *Questions*





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