B&E AKO LAW

Arusha
NSSF Mafao House
9th Floor| Left Wing
P.O.Box 1526
+255 786 532 222

Dar Es Salaam
Plot No. 30, House No. 7
Ursino Street, Regent Estate
P.O. Box 71748
+255 22 2771145

Mwanza
Plot No 7, Block D
Isamilo Area
Postcode No. 33104
+255 28 2542445

Litigating a Transfer Pricing (TP) Dispute? Brace yourself. Some tips/ lessons

This note aims at preparing businesses as they embark on what can be a protracted TP dispute against the Tanzania Revenue Authority (TRA).

A task force within TRA was created in 2019 to audit companies in the hospitality business. Amongst the major contentious issues are that the companies faulted the arm's length principle in their dealings with associates (agents) and intercompany loans.

The findings led to several of what we shall call TP assessments. Several objections to the TP assessments were lodged. There will be a lot of appeals too.

The hospitality industry will not be the last to experience this fate nor were they the first – others have/will in may be a different fashion.

TRA has a dedicated team within its International Taxation Unit (ITU) that deals with TP audits across many industries. The work of this special team has increased the number of TP assessments, objections, and appeals.

B&E Ako Law has represented/represents businesses in objections and appeals on TP disputes. We share our experience on how to prepare and what to expect.

1. Be aware of the times/ terrain

The late President Magufuli said (to paraphrase):

"gharama za uendeshaji wa makampuni zinaongezwa kwa udanganyifu kwa kupitia transfer pricing".

Authors

ALAN NLAWI KILEO
Managing Partner

NORBERT MWAIFWANI
Senior Associate

An unofficial translation is that TP manipulatively increases costs of production in companies therefore reduce the tax base. The full speech is available here.

What the late president Magufuli said is not unfounded. It is a view shared by many. And for that reason, there have been global efforts to curtail base erosion and profit shifting through TP e.g. the OECD Base Erosion and Profit Shifting (BEPS) project.

This informs us that the TP policies are viewed with skepticism especially by taxing authorities. That is the spirit of the times now and unluckily for taxpayers, objectivity seems to be often jeopardized because of the skepticism.

This skepticism/ spirit of the times is not lost in the minds of the arbiters (the judiciary). And naturally, we should presume the arbiters' minds are tilted when entertaining TP matters. Your primary task is to try to shift these minds to a neutral point and ultimately to your side.

2. Know what the courts have said

This is essential. Some useful lessons.

i. In TP disputes relating to intra-group services the view by the TRA and the courts is that TP documentation, agreements and invoices are not enough to prove arm's length pricing. Tax payers must prove that the costs of the services were incurred wholly and exclusively to produce income i.e. the so called "benefit test". As such, the the TRA and the courts apply section 11(2) of the Income Tax Act, 2004 (ITA) – a general deduction section together with TP regulations.

Section 11 (2) of the ITA is inescapable. The TRA and the courts have found invoices, agreements, and TP documentation as insufficient evidence.

We will cite two examples from the cases we litigated. One, Mbeya Cement Company Limited vs. TRA – Civil Appeal No. 160 of 2017. And two Coca-Cola Kwanza Limited vs. TRA, Consolidated Tax Appeals No 90 of 2015 and 20 of 2017.

During audit and objection stages the taxpayers in these cases provided agreements they had with their respective associates, invoices for the services received and TP documentation showing the pricing was at arm's length as evidence that services were rendered.

The courts observed that a mere agreement which lists services to be provided, invoices and TP documentation on standalone are not enough.

Our experience also shows that it is equally helpful to demonstrate that the services received from a sister company were commercially valuable to the entity and are not duplicative in nature i.e. not just any service was acceptable. We have seen in audit findings were the TRA questions the rationale of receiving assistance on tax, finance, and legal matters and the courts accepts TRA view – see Mbeya Cement case.

The TRA's view is that these services do not require expertise from abroad. Be ready to explain the rationale. B&E Ako Law is representing various taxpayers in courts on TP disputes where proof that services were rendered is the main issue.

It may seem like a small matter, but it matters a lot when dealing with arbiters whose mind we must assume conforms to the spirit of the times.

ii. Functional analysis is critical. In the case between TRA and Alliance One Tanzania Tobacco Limited – Tax Appeal No. 18 of 2018, the Tax Revenue Appeals Tribunal (the Tribunal) agreed that functional analysis is key in developing comparables. A company must be compared with those performing similar functions and not just the same line of business. This case is now at the Court of Appeal. The outcome might be different. But the principle here will never change. The foundation of benchmark study is a functional analysis which in turn informs what comparables to look for.

iii. The Tax board said in Mbeya Cement's case that, a TP study prepared by a taxpayer's advisor is questionable for the advisor is paid by the taxpayer. This argument did not permeate into the Court of Appeal. We do not think it is a serious argument. Just be wary. Courts' decision can surprise.

3. TRA's thinking

TRA's thinking is fluid and subjective in most cases but not unreasonable. A few examples.

i. TRA prefer old TP methods. This is in line with the TP Regulations. In as far as possible, conform.

ii. On a service transaction – TRA likes cost plus method. This tallies to the idea that the services have been provided and costs actually incurred. Therefore, there is a reference point to determine both, costs, and remuneration . A percentage of turnover as a price really irks the TRA. This is the case even t o group shared services where it is almost impossible to isolate services rendered to a local entity within a group. Much as the OECD Guidelines which also apply to Tanzania recognizes that impossibility, the TRA is still adamant that the tests in section 11 (2) of the ITA should apply ignoring the commercial benefit the local entity enjoys. And the courts seem to agree with that approach. This was evident in one of the cases we litigated – Aggreko International Projects Tanzania Limited vs TRA – Tax Appeal No. 90 and 91 of 2018.

iii. Overall, TRA executes policies according to law. Therefore, TRA is not immune either to what the government of the day wants. It must deliver. These are targets to meet and the pressure is always massive. TP audits and assessments are very lucrative to the TRA because TP adjustments are usually big.

Likelihood of success is higher because in its nature, there is a yes or no answer. It is judgmental and a matter of perception although objectivity is key. The spirit of the times (which could be changing at the time we write) suggests TRA will seem to be subjectively right on many occasions.

4. Advisors

Use good advisors. These are tax experts (TP) and tax lawyers. Use them both from an early stage of the dispute.

TP adjustments are big and the precedent set by courts can be devastasting in subsequent years not covered in the dispute. Whereas you could feel that you are spending good money after bad money, it is still important to have good advisors.

It increases your chances of winning – getting a good outcome. In addition, the lessons will not be lost anyway.

Lastly – brace yourself

There are going to be many TP audits in your company if you trade with related parties. Prepare yourself for the audits and the long court processes.

Whenever possible, try to get to an advance pricing arrangement to get a comfortable level of certainty. Or change your pricing to reflect in as far as possible the TRA's position from past audits.

Change contractual arrangements too. Or conduct an audit readiness assessment ("mock audit") to assess the robustness of your policy and prepare yourself just in case. Just be safe.

Between now and then, we recommend that much focus should be directed to the audit/investigation stage. Ensure that the tax queries are resolved and/or minimized before the assessment is issued.

This will avoid payment of a colossal amount of tax as one third in the event the Court stand by its decision of making waiver appeals incompetent before the Tax Appellate bodies.