TRANSFER PRICING

An introduction

BETTER POLICIES FOR BETTER LIVES

Importance of transfer pricing

- Transfer pricing affects the amount of revenue and profit recognised in members of multinational groups
- MNEs may use their transfer pricing for tax planning – recognising taxable profit in low tax (or tax sheltered) jurisdictions
- Other motives than tax planning: customs duties, price and exchange controls and dividend policy
- Transfer pricing is seen as one of the most important issues facing MNEs

Impact of transfer pricing rules

Transfer pricing rules generally:

- Require taxpayers to calculate their taxable profit in accordance with the arm's length principle
- Give powers to the tax authority to adjust the calculation of taxable profit where arm's length pricing has not been used

Administrative components

- Documentation regulations
- Information powers
- Penalties
- Rulings
- APAs
- Safe harbours

Aligning rules to international principles

- Why align domestic transfer pricing rules to the internationally accepted approach?

Transfer pricing methods

- The OECD Guidelines specify five methods,
  - With the most appropriate method to be applied
- Each method compares the relevant condition(s) in controlled transaction(s) with condition(s) in comparable uncontrolled transaction(s)
- No one method is suitable in all situations
- Other methods may be applied where they are the ‘most appropriate’ and provided the results produced satisfy the arm’s length principle

Transfer pricing methods

- Comparable Uncontrolled Price (CUP) method
- Resale price method
- Cost plus method
- Transactional net margin method (TNMM)
- Transactional profit split method

Arm’s length range

- Application of the arm’s length principle may produce
  - a single figure (price / margin),
  - but in many cases, an arm’s length range may result, i.e. a range of figures all of which are **relatively equally reliable**
- No adjustment where the financial indicator of the controlled transaction falls within the range
- If it falls outside the range, the tax administration may adjust to within the range – to a point that best reflects the circumstances of the case

Adjustments

Taxpayers are encouraged to use arm’s length pricing in their actual transactions.

Where they do not:

- Taxpayer may make an adjustment in their accounts, or
- Taxpayer may make adjustment in computation of taxable profit
- Tax authority may make adjustment in computation of taxable profit

Adjustments – example

- Company A’s actual profit: $10m
- If it had used arm’s length pricing, its profit would have been $12m
- Therefore a $2m adjustment to profit, for tax purposes, is needed.
  - Depending on circumstances, this may be recorded as increase in assessable income or decrease in deductions
- This may be voluntary, or imposed by the tax authority as a result of an audit.

Comments?

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