

Investing now for the tax audit of the future

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Transfer pricing is one of the hottest tax issues globally, and Africa is no exception. Globally, transfer pricing has a bad reputation due to perceived deliberate mis-pricing of intra-group transactions for tax avoidance purposes. In its simplest form transfer pricing is how companies price intra-group transactions between different countries, therefore affecting taxable profits in those different countries. In this regard, transfer pricing is simply part of a multinationals tax compliance relating to its day-to-day intra-group commercial transactions.



Image source: Gallo/Getty

For some time now, because of perceived abuse in Africa, many African countries have introduced transfer pricing regulations and have been investing in transfer pricing capability. These initiatives have been complemented by the global dialogue on transfer pricing, and the tax environment in Africa has been further influenced by the OECD BEPS project and Africa's involvement under the Inclusive Framework.

Vicki Bales, transfer pricing director at DLA Piper UK, says, "African tax authorities have transformed their transfer pricing capabilities, and therefore their expectations in audits. This means companies need to respond and develop their own capability and experience in tandem, as the expectations of tax inspectors have changed. Taxpayers should prepare today for the future audit. This means collecting information now, whilst people are available and it's fresh in their minds. It also means anticipating the speed at which capacity is developing within tax administrations. Particularly countries benefiting from technical assistance from the OECD, World Bank, IMF, Tax Inspectors without Borders and bilateral assistance."

Ask yourself: Am I audit ready?

First, self-assess your risk by asking yourself: Do you have transactions with low tax countries, significant intra-group royalty, service or interest payments, or losses resulting from intercompany transactions? For all of your related party transactions, can you explain your pricing? Do you have good quality transfer pricing documentation, policies and evidence to demonstrate your position?

Secondly, once you've identified your risks, ask yourself: How do I prepare for a transfer pricing audit? Bales comments by saying: "Think about how you present your company and your position in tax audit. Many corporates we speak to believe that, in this tax environment of unprecedented change, now is the time for good compliance, good consistent implementation, good (or very good!) fact finding, and then proactively presenting all these to manage tax audits."

Third, build on-going governance processes to maintain and support your transfer pricing positions. This can be facilitated through an in-house annual cycle operated by tax or finance. The benefit is to check the facts underlying the original policy and pricing are still valid, and collect on-going facts to use as evidence in audit.

You're in an audit, now what?

During the audit, one of the most common issues is identifying, proving and agreeing on facts. As simple as it sounds, take time to make sure your facts and commercial story are clear, then, how do the transfer pricing and calculations follow from those facts. If you're in audit, and it feels like there's no progress, ask yourself, have the facts presented been understood, can you do anything to improve this. Bales adds: "In helping the tax inspector, you are probably helping yourself, because, if you don't provide information as needed, then assumptions may be made. Undoing wrong assumptions can be costly, time consuming and set a negative tone for the rest of an audit, when perhaps there was no need for this to happen."

Secondly, does the transaction fall under a double tax treaty? If it does and the audit isn't progressing, then, using the treaty as a basis to bring in the another tax authority can create a more balanced two sided review of the facts and transfer pricing. This is using the Mutual Agreement Procedure ("MAP") in the treaty.

Joel Cooper, partner at DLA Piper and co-author of the World Bank book on transfer pricing in developing countries, says, "MAP is something taxpayers need to push for, particularly in Africa. The way to do this is by filing MAP cases, not waiting for change. The resources and capacity of the tax administrations to deal with MAP will follow. Whilst the outcome of MAP may be uncertain, in terms of timing and result, the outcome of not filing MAP is often certain – double taxation."

Making a long-term investment in transfer pricing expertise

Every country in the world is responding to changes in transfer pricing, not just Africa. But the scale and pace of African capability development means Africa stands out. African tax authorities have been empowered by BEPS, the Inclusive Framework and their governments to challenge transfer pricing.

Whilst the global tax environment continues to evolve, companies are advised to take the risk self-assessment steps we describe above and consider partnering with a firm that combines its local tax capabilities in Africa with its international transfer pricing team.

African businesses are powering ahead and growing into regional groups; getting transfer pricing right when you're growing is an investment that pays off in the long term.

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