



# **SUGGESTED APPROACH**

to Drafting Transfer Pricing Legislation

An ATAF Publication



AFRICAN TAX  
ADMINISTRATION FORUM  
FORUM SUR  
L'ADMINISTRATION  
FISCALE AFRICAINE

## Copyright notice

### **Copyright subsisting in this publication and in every part thereof.**

This publication or any part thereof may not be reproduced, transmitted, transcribed or otherwise stored or translated into any language or computer language, in any form or by any means, without the prior written permission of the African Tax Administration Forum (ATAF), an international organisation with full legal standing and established, in terms of the Vienna Convention on the Law of Treaties, on 8 October 2012.

Any unauthorised reproduction or adaptation of this publication will constitute a copyright infringement and render the doer liable under both civil and criminal law.

### **Restrictions on use**

The information contained in this publication constitutes privileged information belonging to ATAF, any member country of ATAF and its subsidiaries. This information is furnished in confidence with the understanding that it will not, without prior written permission from ATAF, be used for purposes other than for what is intended.

The African Tax Administration Forum (ATAF) acknowledges the significant contribution of the World Bank Group whose support and specialised comments added significantly to the quality of this publication.

Series: ATAF's International Taxation and Technical Assistance Publication

Version 3



## INTRODUCTION

### About this Suggested Approach

ATAF members have reported that issues relating to transfer pricing represents one of the highest risks to the tax base of African countries. According to the United Nations Economic Commission for Africa, Africa is losing approximately USD 50 billion per year in illicit financial flows. Transfer mispricing is one of the primary sources of these losses.

Transfer pricing is the mechanism for pricing transactions between related legal entities within the same multinational enterprise (MNE). Various terms are used to describe such transactions but for the purposes of this Suggested Approach to Drafting Transfer Pricing Legislation used the term “controlled” transactions. Such transactions may include the purchase or sale of goods or intangible assets, the provision of services, the provision of financing, cost allocation, or cost-sharing agreements.

It is important note that transfer pricing is a normal and commercial practice that is used by all MNEs, to price their controlled transactions. However such transactions provide opportunities for profit shifting. To address such tax avoidance an international standard of the arm’s length principle. This requires that for the purposes of computing taxable income of the parties to the transaction the terms and conditions (including the price) of the controlled transaction are comparable to the “arm’s length” terms and conditions at which the transaction would have taken place between unrelated parties. However, transfer pricing may become abusive or illegal when related parties seek to distort the price to reduce their overall tax liability.

This paper, which has been prepared by the ATAF Cross Border Taxation Technical Committee and ATAF Secretariat, contains a suggested approach to the drafting of transfer pricing legislation. It is intended to provide African countries that are developing transfer pricing rules with a suggested structure and content for

their legislation. It provides a framework underpinned by the arm’s length standard which is the underlying principle of Article 9 of the ATAF Model Tax Convention on Income and on Capital (“the ATAF Model”) and the OECD and United Nations Model Double Taxation Conventions but adapted to meet the specific challenges faced by African countries. This includes a series of policy options for countries to consider which provide measures that aim to address the information asymmetries that often exist between MNE taxpayers and African tax administration by shifting the burden of proof from the tax administration to the taxpayer. Other policy options provide simplification measures that African countries may wish to consider using to address capacity constraints that make it difficult to price some of the more complex controlled transactions such as the pricing of controlled transaction involving the transfer of rights relating to intangibles.

Countries should consider these optional provisions in the light of their particular capacity constraints and policy objectives.

The draft language set out in the attached is intended to be flexible. The intention, is that the subject matter contained in each of the sections of the draft be considered by countries as they implement a transfer pricing regime based on the arm’s length principle. The explanatory notes at the end of the document describe in greater detail some of the reasoning underlying the draft legislation.

### Contact persons

Should you have questions or comments on the attached, please feel free to contact the ATAF Secretariat on:

Telephone: +27 12 451 8800

E-Mail: [info@ataftax.org](mailto:info@ataftax.org)



## 1. TRANSFER PRICING LEGISLATION

### Section XX

1. For the purposes of this Act, where
  - i) a person resident in [Country] engages directly or indirectly in one or more transaction, operation or scheme, in this section referred to as a “transaction” with a connected person or
  - ii) a person not resident in [Country] engages directly or indirectly in one or more transactions with a connected person not resident in [Country] where the transaction is in relation to a permanent establishment in [Country] of one of the two connected persons, the amount of each person’s taxable income shall be determined in a manner that is consistent with the arm’s length principle.
  - iii) The amount of such taxable income shall be consistent with the arm’s length principle if the conditions of those transactions do not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances.
2. Where, the conditions of a transaction between connected persons (“a controlled transaction”) to which paragraph 1 applies are not consistent with the arm’s length principle, and the effect of that inconsistency is reducing or postponing the liability to tax of any person for any tax year, then the taxable income of that person shall be computed as though the conditions of the transaction are consistent with the arm’s length principle.
3. The determination of whether the conditions of a controlled transaction are consistent with the arm’s length principle of paragraph 1, and of the quantum of any adjustment made under paragraph 2, shall be made in accordance with [Insert relevant secondary legislation/regulation reference]

[Optional] 4 (i). The provisions of paragraph 1 shall also apply where a person resident in [Country] engages in one or more transactions with a person located in a tax jurisdiction that the Commissioner-

General/Commissioner determines provides a beneficial tax regime, whether or not such a person is a connected person. All such transactions shall be deemed to be controlled transactions for the purposes of Section XX and [Insert relevant secondary legislation/regulation reference]

- ii) The provisions of paragraph 1 shall also apply where a person located in a tax jurisdiction that the Commissioner-General/Commissioner determines provides a beneficial tax regime, engages in one or more transactions that relates to a permanent establishment of a non-resident person in [Country] whether or not such a person is a connected person. All such transactions shall be deemed to be controlled transactions for the purposes of Section XX and [Insert relevant secondary legislation/regulation reference]

[Optional] 5. Notwithstanding the provisions of paragraph 1 and 2 where;

- i) a resident person engages directly or indirectly in a transaction with a connected person or
- ii) a non-resident person engages directly or indirectly in a transaction relating to a permanent establishment in [Country] with a connected person for the export or import, involving grains, oil seeds, other products obtained from the land, hydrocarbons and derivatives thereof, and, in general, goods where prices can be obtained at the date of the transaction from an international or domestic commodity exchange market, or from recognised and transparent price reporting or statistical agencies, or from governmental price-setting agencies, or from any other index that is used as a reference by unrelated parties to determine prices in transactions between them [hereinafter referred to as the publicly quoted price] that quoted price on the date on which the goods are shipped, regardless of the means of transport, shall be, without considering the price that was agreed upon with the connected person, the sale price used for the purposes of computing the taxable income of that person unless the person