

**TRANSFER PRICING: AN ANALYSIS OF LEGISLATION IN  
THE SOUTHERN AFRICAN CUSTOMS UNION**

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## **ABSTRACT**

Transfer pricing is defined as the setting of the price for goods sold and services rendered between related entities. For example, if a subsidiary company sells goods or renders services to its holding company or a sister company, the price charged is referred to as the transfer price. Transfer pricing can be used to manipulate profits and facilitate tax evasion. Therefore, it is important that countries enact transfer pricing legislation to prevent this. The United Nations (UN) and Organisation for Economic Co-operation and Development (OECD) guideline documents form the basis for most global legislation and conventions dealing with transfer pricing. The over-arching goal of this research was to investigate whether transfer pricing legislation in the Southern African Customs Union (SACU) aligns between SACU countries and with the OECD Guidelines and the UN Manual.

The research applied a legal interpretive doctrinal research methodology and a qualitative research method. The data comprised primary legislation in the SACU countries, transfer pricing guidelines issued by revenue authorities in the SACU, OECD Guidelines, the UN Manual and journal articles.

It was found in this study that certain aspects of transfer pricing legislation in the SACU are not fully aligned to each other and to the OECD Guidelines and the UN Manual. This study proposed recommendations to improve transfer pricing legislation in the SACU. These improvements include the introduction of transfer pricing legislation in Eswatini and Lesotho, and updating transfer pricing legislation in Namibia and South Africa in terms of the latest versions of the OECD Guidelines and the UN Manual.

**Key words:** taxation, transfer pricing, transfer price, arm's length, international tax, Southern African Customs Union (SACU), Organisation for Economic Co-operation and Development (OECD) Guidelines, United Nations (UN) Manual

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## **List of abbreviations**

APA – Advance Pricing Agreement

Botswanan Income Tax Act - Income Tax Act 52:01

Botswanan Transfer Pricing Regulations - Income Tax (Transfer Pricing) Regulations 2019

BURS - Botswana Unified Revenue Service

CbCR - Country-by-Country Report

CPM - Cost Plus Method

CUP Method - Comparable Uncontrolled Price Method

Lesotho Income Tax Act - Lesotho Income Tax Act, No. 9 of 1993

MNE - Multinational Entity

Namibian Income Tax Act - Income Tax Act 24 of 1981

Namibian Transfer Pricing Rules - Practice Note 2 of 2006 (PN 2/2006)

NamRa - Namibia Revenue Agency

OECD – Organisation for Economic Co-operation and Development

OECD Guidelines - OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

PE - Permanent Establishment

PSM – Profit Split Method

R&D - Research and development

RPM – Resale Price Method

SACU – Southern African Customs Union

SARS - South African Revenue Service

SA Tax Administration Act - Tax Administration Act, No. 28 of 2011

SA Transfer Pricing Rules - Practice Note 7

SA Income Tax Act - Income Tax Act, No. 58 of 1962

TNMM - Transactional Net Margin Method

UN – United Nations

UN Manual – UN Practice Manual on Transfer Pricing for Developing Countries

USA – United States of America

# Contents

<b>Chapter 1: Introduction</b> .....	10
<b>1.1 Research context</b> .....	10
<b>1.2 Goals of the research</b> .....	12
<b>1.3 Methods, procedures and techniques</b> .....	13
<b>1.4 Ethical considerations</b> .....	14
<b>1.5 Overview of the thesis</b> .....	14
<b>Chapter 2: Understanding the concept of transfer pricing</b> .....	16
<b>2.1 Introduction</b> .....	16
<b>2.2 Introduction to transfer pricing</b> .....	16
<b>2.3 What is transfer pricing?</b> .....	17
<b>2.4 History of transfer pricing</b> .....	18
<b>2.5 Basic issues underlying transfer pricing</b> .....	19
<b>2.6 Conclusion</b> .....	21
<b>Chapter 3: Understanding the fundamentals of the arm's length principle</b> .....	22
<b>3.1 Introduction</b> .....	22
<b>3.2 History of the arm's length principle</b> .....	22
<b>3.3 Defining the arm's length principle and the rationale for its development</b> .....	23
<b>3.4 Reasons for adopting the arm's length principle</b> .....	25
<b>3.5 Difficulties in the application of the arm's length principle</b> .....	26
<b>3.6 Application of the arm's length principle</b> .....	26
<b>3.7 Conclusion</b> .....	27
<b>Chapter 4: Analysis of the transfer pricing methods used in calculating the arm's length price</b> .....	29
<b>4.1 Introduction</b> .....	29
<b>4.2 Transfer pricing methods</b> .....	29
<b>4.3 Selecting the appropriate transfer pricing methods</b> .....	30
<b>4.4 The comparable uncontrolled price method</b> .....	31
<b>4.4.1 When to use the comparable uncontrolled price method</b> .....	32
<b>4.4.2 Strengths and weaknesses of the comparable uncontrolled price method</b> .....	32
<b>4.5 The resale price method</b> .....	33
<b>4.5.1 When to use the resale price method</b> .....	33
<b>4.5.2 Strengths and weaknesses of the resale price method</b> .....	33

<b>4.6 Cost plus method</b> .....	34
<b>4.6.1 When to use the cost plus method</b> .....	35
<b>4.6.2 Strengths and weaknesses of the cost plus method</b> .....	35
<b>4.7 Profit split method</b> .....	36
<b>4.7.1 When to use the profit split method</b> .....	36
<b>4.7.2 Strengths and weaknesses of the profit split method</b> .....	37
<b>4.8 Transactional net margin method</b> .....	37
<b>4.8.1 When to use the transactional net margin method</b> .....	38
<b>4.8.2 Strengths and weaknesses of the transactional net margin method</b> .....	38
<b>4.9 Conclusion</b> .....	39
<b>Chapter 5: Issues relating to transfer pricing</b> .....	41
<b>5.1 Introduction</b> .....	41
<b>5.2 Global formulary apportionment</b> .....	41
<b>5.3 Arm’s length range</b> .....	44
<b>5.4 Burden of proof</b> .....	45
<b>5.5 Safe harbours</b> .....	46
<b>5.6 Advance pricing agreement</b> .....	48
<b>5.7 Transfer pricing documentation</b> .....	50
<b>5.8 Intra-group services</b> .....	53
<b>5.9 Conclusion</b> .....	56
<b>Chapter 6: Analysis of transfer pricing legislation in the Southern African Customs Union</b> .....	59
<b>6.1 Introduction</b> .....	59
<b>6.2 Transfer pricing legislation</b> .....	59
<b>6.3 The arm’s length principle in the South African Customs Union</b> .....	61
<b>6.4 Transfer pricing methods</b> .....	63
<b>6.5 Selecting a transfer pricing method</b> .....	65
<b>6.6 Global formulary apportionment in the Southern African Customs Union</b> .....	67
<b>6.7 Application of an arm’s length range in the Southern African Customs Union</b> .....	67
<b>6.8 Burden of proof in the Southern African Customs Union</b> .....	70
<b>6.9 Safe harbours in the Southern African Customs Union</b> .....	71
<b>6.10 Advance pricing agreements in the Southern African Customs Union</b> .....	72
<b>6.11 Transfer pricing documentation in the Southern African Customs Union</b> .....	73
<b>6.12 Intra-group services in the Southern African Customs Union</b> .....	75

<b>6.13 Conclusion .....</b>	<b>78</b>
<b>Chapter 7: Conclusion .....</b>	<b>85</b>
<b>7.1 Summary of findings.....</b>	<b>85</b>
<b>7.2 Instances of non-alignment .....</b>	<b>94</b>
<b>7.3 Recommendations .....</b>	<b>95</b>
<b>7.4 Limitations of scope and further research opportunities .....</b>	<b>96</b>
<b>References.....</b>	<b>97</b>

## List of tables

<b>Table 1: Transfer pricing legislation</b> .....	60
<b>Table 2: The arm's length principle and transfer pricing adjustments</b> .....	61
<b>Table 3: Transfer pricing methods</b> .....	64
<b>Table 4: Selecting a transfer pricing method</b> .....	65
<b>Table 5: Arm's length range</b> .....	68
<b>Table 6: Burden of proof</b> .....	70
<b>Table 7: APAs</b> .....	73
<b>Table 8: Transfer pricing documentation</b> .....	74
<b>Table 9: Intra-group services</b> .....	76
<b>Table 10: Transfer pricing methods</b> .....	87
<b>Table 11: Transfer pricing issues</b> .....	88
<b>Table 12: Analysis and findings</b> .....	91

# CHAPTER 1: INTRODUCTION

## 1.1 RESEARCH CONTEXT

The global economy has become increasingly interdependent. The process of globalisation has accelerated in recent decades due to a variety of factors, including the free movement of capital and labour, the shift of manufacturing bases from high cost to low cost locations, the gradual removal of trade barriers, and technological developments (OECD, 2015:9). In the book “America and cosmic man”, Lewis (1949:21) referred to the world as “one big village”. Some 70 years later, he may have been surprised to see how accurate his description is today. It is on the back of globalisation that the need for transfer pricing legislation was born.

Transfer pricing is defined as the setting of the price for goods sold and services rendered between related entities (UN Department of Economic and Social Affairs, 2021:30). The transfer price is therefore the price allocated to a transaction taking place between two related entities, normally within a multinational entity (MNE) operating with entities in multiple tax jurisdictions. For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price. Transfer pricing transactions are typically associated with physical goods, financial assistance, intangibles, or services. Transfer pricing is significant as it is estimated that 60% of all international trade consists of transactions between related companies (Lang, Melz, Kristofferson, & Ecker, 2009:837).

An MNE can easily shift its pre-tax profits from a high-tax jurisdiction to a low-tax jurisdiction by manipulating transfer prices (Abdallah, 2011:23). Transfer pricing is not illegal; it is one of the mechanisms used by related entities to transact with one another. Transfer pricing is neutral (neither bad nor good) until the setting of prices facilitates tax evasion. When this occurs, profit manipulation occurs, which is unacceptable. Transfer pricing manipulation, also known as transfer mispricing, refers to trade between related companies at prices that are meant to manipulate profits in order to facilitate tax evasion (Abdallah, 2011:23).

In order to prevent transfer pricing manipulation, inter-company transactions need to be conducted on an arm's length basis. The cornerstone of the transfer pricing model is the use of the arm's length price. The arm's length price is accepted globally as the price that should be charged between related entities (Troidler, 2019:3). The arm's length price is the price that would be agreed between unrelated third parties in comparable circumstances (Troidler, 2019:3).

As previously mentioned, transfer pricing can be used to facilitate tax evasion. Many countries have introduced transfer pricing legislation in order to prevent tax evasion (UN Department of Economic and Social Affairs, 2021:395). The United Nations (UN) and Organisation for Economic Co-operation and Development (OECD) guideline documents form the basis for most global legislation dealing with transfer pricing. Therefore, transfer pricing legislation worldwide shows some harmonisation in basic principles. However, material differences in transfer pricing regimes include disclosure requirements, submission requirements, and the arms-length range. Transfer pricing legislation may therefore differ from country to country because each country designs its transfer pricing legislation based on its economic objectives and fiscal policy (Joshi, 2010:3). For example, countries can design their transfer pricing legislation to attract foreign direct investment. Alternatively, countries can design their transfer pricing legislation to maximise their tax base. Material differences between countries transfer pricing legislation can cause double taxation and disputes between tax authorities. Therefore, it is important for legislation in various countries to maintain some form of parity (Joshi, 2010:3). According to Joshi (2010:3), a major risk arising from international trade with related entities is that revenue authorities may adjust transfer prices, resulting in double taxation for companies. The potential lack of alignment between the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines), UN Practice Manual on Transfer Pricing for Developing Countries (UN Manual) and transfer pricing legislation could result in the absence of parity, increasing the risk of taxpayers being subject to double taxation (UN Department of Economic and Social Affairs, 2021:395).

The countries that comprise the Southern African Customs Union (SACU) are Botswana, Eswatini, Lesotho, Namibia and South Africa. The lack of parity within transfer pricing legislation in the SACU could result in taxpayers being subject to double taxation and disputes. Material

differences between transfer pricing legislation, the OECD Guidelines and the UN Manual include the associated enterprises definition, the arm's length range, advance pricing agreement (APA) provisions and legislative requirements. Other differences include disclosure requirements, submission requirements, Country-by-Country reporting requirements, and thin capitalisation rules. Transfer pricing is relevant in the SACU because South Africa is home to Africa's largest MNEs (Multichoice, Vodacom, MTN and AECI) and non-African MNEs view South Africa as a gateway to the rest of Africa (these MNEs set up their manufacturing bases and service centres in South Africa to service the rest of Africa). South Africa's position as a base for MNEs results in significant cross-border related party activity in the SACU and therefore makes transfer pricing relevant in the SACU.

Is transfer pricing legislation aligned between the countries in the SACU and with the OECD Guidelines and the UN Manual? This study aims to understand the transfer pricing practices adopted by the countries that form the SACU and to compare such practices in the countries and to the OECD Guidelines and the UN Manual in order to identify possible areas of harmonisation. Existing literature with regard to transfer pricing seeks to evaluate the tax evasion aspect and effective transfer price planning. These studies do not consider transfer pricing legislation within the context of the SACU. This study seeks to address this gap in existing research.

## **1.2 GOALS OF THE RESEARCH**

The main goal of this study is to investigate whether transfer pricing legislation in the SACU aligns between SACU countries and with the OECD Guidelines and the UN Manual. To achieve this goal, the following sub-goals are addressed:

- to explain the arm's length principle;
- to discuss the methods applied in calculating an arm's length price;
- to discuss transfer pricing practices in the SACU;
- to compare transfer pricing practices within the SACU and to the OECD Guidelines and the UN Manual; and
- to identify areas requiring harmonisation.

This study should contribute to understanding the practical application of transfer pricing provisions in the SACU. This study's contribution will also include an assessment of transfer pricing in the SACU. The study will compare transfer pricing provisions in the SACU to the OECD Guidelines and the UN Manual in an effort to identify areas of key consideration and improvement both in legislation and practical application.

### **1.3 METHODS, PROCEDURES AND TECHNIQUES**

This study adopts an interpretative approach. Myers (2008) explains that interpretive researchers assume that access to reality is through social constructions such as language, shared meanings, and instruments. As the present research uses language, the shared "social meaning" of tax legislation enacted in a democratic process, and "instruments" in the form of documentary data, the interpretative paradigm is appropriate. Interpretivist researchers gain a deeper understanding of the subject under investigation, and its complexity in its unique context, instead of attempting to generalise the base of understanding for the whole population (Creswell, 2007).

An important methodological choice is whether a research study should follow a qualitative, quantitative or mixed-method research design (Saunders, Lewis, & Thornhill, 2012). Saunders *et al.* (2012) differentiate between quantitative research and qualitative research as the former being derived from numeric data and the latter from non-numeric data. The authors explain that the quantitative research approach is deductive, where most commonly, data are used to test a theory, while a qualitative approach mostly builds from an inductive approach to a richer theoretical perspective that already exists in the current literature. This study focuses primarily on analysing available legislation and other literature. Consequently, it is appropriate to adopt a qualitative approach in conducting the proposed study.

The research method that will be adopted for the study will be a legal interpretive approach, more specifically, a doctrinal research methodology. This methodology provides a systematic exposition of the rules governing a particular legal category (in the present case, the legal rules relating to transfer pricing), analyses the relationships between the rules, explains areas of difficulty and is based purely on documentary data (McKerchar, 2014). This study will be conducted in the form of an extended natural language argument supported by logical reasoning.

This study will entail an analysis of documentary data. Data sources will include primary legislation in the SACU countries, transfer pricing guidelines issued by revenue authorities in the SACU, the OECD Guidelines, the UN Manual, and journal articles. The documentary data will be accessed via online databases such as, but not limited to, the IBFD, LexisNexis library and OECD library.

In the case of doctrinal research, the credibility of the research is ensured by:

- placing evidential weight on legislation and the writings of acknowledged experts in the field;
- discussing opposing viewpoints and concluding, based on credible evidence; and
- the rigour of the arguments.

#### **1.4 ETHICAL CONSIDERATIONS**

The information used for the purpose of the research was publicly available. As all the information is publicly available, no ethical considerations arise in relation to its use.

#### **1.5 OVERVIEW OF THE THESIS**

Chapter one outlines the background to the study, the goals of the study and the research methodology governing the study.

Chapter two will provide an introduction to transfer pricing, a brief history of transfer pricing and a discussion of the issues underlying transfer pricing.

Chapter three will discuss the fundamentals of the arm's length principle, including its history, the definition, the rationale for its development and adoption, difficulties in applying it, the practical application of the principle, and a discussion of the guidelines for the calculation of the arm's length price.

Chapter four will discuss the methods for determining an arm's length price. In addition, the methodologies applied, the circumstances in which such methodologies are applicable, and the strengths and weaknesses of each method will be explained.

Chapter five will discuss various transfer pricing issues, including arm's length ranges, safe harbours, intra-group services, transfer pricing documentation, the burden of proof, APAs and the global formulary apportionment method.

Chapter six will discuss and compare transfer pricing legislation in the SACU and compare the SACU legislation to the OECD Guidelines and the UN Manual.

Chapter seven serves as a conclusion of the study and provides a summary of the key findings. The chapter explains how the research goals are addressed in each chapter and makes recommendations for improving transfer pricing legislation in the SACU.

# **CHAPTER 2: UNDERSTANDING THE CONCEPT OF TRANSFER PRICING**

## **2.1 INTRODUCTION**

The previous chapter provided an introduction to the study, set out the problem statement and research objectives, and described the research design adopted for the research. Before addressing the sub-goals of the research as set out in chapter 1, this chapter defines and elaborates on the concept of transfer pricing, including the history of transfer pricing and the issues underlying transfer pricing.

## **2.2 INTRODUCTION TO TRANSFER PRICING**

Transfer pricing is arguably the most relevant and challenging topic in international tax (Lang, Cottani, Petruzzi & Storck, 2019:23). According to Ernst & Young (2007), the number of countries with transfer pricing rules has increased more than twentyfold from a mere four countries in 1994 to over 100 countries in 2018. Increased interest in transfer pricing mainly stems from the fact that recent decades have seen extensive changes in international trade (Lang *et al*, 2019:24). Globalisation has constantly been changing international businesses and the way in which MNE's conduct their business (Lang *et al*, 2019:24). As a result of globalisation, MNEs choose to conduct their business in several countries through subsidiaries or permanent establishments (PEs), resulting in a complex network of related entities. More than 60% of the current worldwide business transactions are performed within MNEs, meaning that related party transactions are of significant importance for the functioning of entire economies (Lang *et al*, 2019:24). Transfer pricing is the by-product of the existence of MNEs, that is, the simple fact that entities forming part of the same group enter into transactions with each other requires the application of transfer pricing provisions (Lang *et al*, 2019:23).

In recent years, however, the outrage at the way that MNEs have used transfer pricing to avoid tax has given transfer pricing a somewhat pejorative meaning, leading some commentators to begin talking about “transfer mispricing” to refer to schemes aimed at allowing corporations to avoid

paying their fair share of taxes (Lang *et al*, 2019:23). The annual amount of tax revenue losses due to mispricing of transfer prices has been estimated to be several hundred billion dollars (Lang *et al*, 2019:23).

### **2.3 WHAT IS TRANSFER PRICING?**

Transfer pricing is the general term used for the pricing of transactions between related entities (UN Department of Economic and Social Affairs, 2021:30). In addition, transfer pricing refers to the setting of prices for transactions between related entities involving the transfer of goods or services (UN Department of Economic and Social Affairs, 2021:30). The transfer price is the price that one related entity charges another related entity for goods or services. For example, Company A and Company B are two related entities. Company A manufactures and distributes Iphone cases to Company B. Company A charges Company B ZAR 100 for an Iphone case. The transfer price is ZAR 100.

Transfer pricing has become increasingly relevant in the tax environment because it can be used to evade tax. An MNE has a certain amount of discretion in determining how to allocate income and expenses to its subsidiaries located in different countries (Lang *et al*, 2019:25). The profitability and the related tax liability of subsidiaries belonging to an MNE is highly dependent on the prices in which these subsidiaries exchange goods and services with other entities within the group (Lang *et al*, 2019:25). Therefore, changing these prices in order to reduce the profitability of subsidiaries located in high tax jurisdictions and to increase the profitability of subsidiaries located in low tax jurisdictions will reduce the tax liability of the MNE. For instance, when a shipment occurs from an entity in a high-tax jurisdiction to an entity in a low-tax jurisdiction, charging a relatively low transfer price implies reducing profits in the high-tax jurisdiction and increasing profits in the low-tax jurisdiction, thus shifting income towards the low-tax jurisdiction. Clearly, the MNE's tax liability will be reduced in the process. This phenomenon is one of the main elements of the so-called "profit shifting".

There is ample empirical evidence of such profit shifting. Various studies have produced evidence that MNEs engage in profit-shifting. Recent surveys were carried out by Gresik (2001), Devereux

(2007), Huizinga and Laeven (2008), and Maffini and Mokkas (2011). Their findings indicate that profit shifting (as described in the previous paragraph) occurs with the use of transfer prices.

In order to counter profit shifting, countries around the world have introduced transfer pricing provisions into their domestic tax systems (Lang *et al*, 2019:25). Many developed countries have recently tightened their transfer pricing legislation in order to address the issue of MNEs using transfer pricing to avoid tax (UN Department of Economic and Social Affairs, 2021:36). Some developing countries have introduced equally exhaustive transfer pricing regulations to keep their tax bases intact, while other developing countries are recognising that they need to effectively address the challenges of transfer pricing in some way (UN Department of Economic and Social Affairs, 2021:36).

## **2.4 HISTORY OF TRANSFER PRICING**

International trade has existed through the ages, but the first MNEs can be traced back to the sixteenth and seventeenth centuries (Shutov, 2001:8). The most well-known early MNEs are the Dutch East India Company, the Hudson Bay Company and the East India Company. Truly global MNEs were formed in the first half of the twentieth century, when technological development allowed corporations to spread their operations across the world (Shutov, 2001:8). The first truly global MNEs were American corporations and European corporations and include BASF, Bayer, Lever Brothers, Siemens and the American Singer Sewing Machine Company. The first truly global MNEs began to reject export sales in favour of manufacturing their products overseas to supply growing foreign markets (Shutov, 2001:8). Another reason for corporations to shift their operations abroad was high taxes in their home country, which almost always was the case for American companies and European companies (Shutov, 2001:8). The United States of America (USA) and certain European countries introduced transfer pricing legislation in the first half of the twentieth century because they were anxious to discourage tax evasion by the first truly global MNEs by means of their transfer prices to their affiliates abroad in low tax jurisdictions (Shutov, 2001:8). Transfer pricing legislation was first introduced by the USA in 1917 (Shutov, 2001:8).

Existing international transfer pricing rules emanate from multinational institutions, namely, the UN and the OECD. Transfer pricing rules are based on the provisions of the Associated Enterprises

Article (usually Article 9) of most bilateral tax treaties (UN Department of Economic and Social Affairs, 2021:35). The basic provisions of Article 9 and the arm's length principle on which that Article is based, were developed by the League of Nations in the 1920s. (UN Department of Economic and Social Affairs, 2021:35).

The UN and OECD guideline documents form the basis for most global legislation dealing with transfer pricing. The OECD Guidelines were first published in 1995 to provide an authoritative and internationally agreed interpretation of the OECD Model Tax Treaty and the largely identical provisions of the UN Double Tax Convention, both of which are based on the earlier League of Nations agreements (UN Department of Economic and Social Affairs, 2021:35). The 2017 publication of the OECD Guidelines followed previous OECD reports on transfer pricing in 1979, 1984 and 1995 (UN Department of Economic and Social Affairs, 2021:35).

The UN, along the lines of the OECD, published a practical manual on transfer pricing in 2013 (UN Department of Economic and Social Affairs, 2021:3). Currently, the third edition (2021) is available, which reflects the UN's experience and developments in the area of transfer pricing analysis and administration.

## **2.5 BASIC ISSUES UNDERLYING TRANSFER PRICING**

Transfer prices determine the income of entities involved in cross-border related party transactions. A higher price increases the seller's income and decreases the buyer's income whilst a lower price decreases the seller's income and increases the buyer's income. The transfer price, therefore, affects the tax base of both the country of the seller and the country of the buyer involved in a cross-border related party transaction (UN Department of Economic and Social Affairs, 2021:33). When one country's tax authority adjusts the profit of a subsidiary of the MNE by adjusting the transfer price of a related party transaction, this may have an effect on the tax base of another country. According to the UN Manual (UN Department of Economic and Social Affairs, 2021:33), the key issues in this regard are: which country should tax the income of the group entities engaged in the related party transaction, and what happens if both countries claim the right to tax the same income? If economic activities in more than one country contribute to the MNE's profits, should one of the countries give tax relief to prevent double taxation of the MNE's income, and if so,

which country should give such relief? Accordingly, cross-border related party transactions involve issues related to jurisdiction, allocation of income, and valuation (UN Department of Economic and Social Affairs, 2021:33).

MNEs operate on a worldwide scale, and the entities that make up the MNE may share resources and overhead costs (UN Department of Economic and Social Affairs, 2021:34). From the MNE's perspective, these resources and overhead costs need to be allocated with maximum efficiency in an optimal manner (UN Department of Economic and Social Affairs, 2021:45). From the tax authorities' perspective, the allocation of the MNE's resources and overhead costs is an important element in calculating taxable income (UN Department of Economic and Social Affairs, 2021:45). Therefore, there can be a dispute between countries in the allocation of the MNE's resources and overhead costs, as each of the countries will have the objective of securing the tax base in its jurisdiction (UN Department of Economic and Social Affairs, 2021:45). Double taxation can result where none of the relevant countries allow a tax deduction for expenses incurred by the MNE.

An added issue, according to the UN Manual (UN Department of Economic and Social Affairs, 2021:33), relates to the motivation for transfer pricing manipulation. MNEs may engage in practices that seek to reduce their overall tax bills, which may involve profit shifting through non-arm's length transfer pricing (UN Department of Economic and Social Affairs, 2021:33). However, while the reduction of taxes might be a motive influencing MNEs in setting transfer prices for intra-group transactions, it is not the only factor that determines transfer pricing policies (UN Department of Economic and Social Affairs, 2021:33). Other factors may influence transfer pricing decisions, such as production targets, bonuses and the imputation of tax benefits in the parent company's country of residence (UN Department of Economic and Social Affairs, 2021:33). Whilst a transfer price may have the effect of reducing an entity's tax liability, reducing the entity's tax liability might not be the underlying purpose of the transfer price.

Therefore, the basic issues underlying transfer pricing include the motivation for transfer pricing manipulation and the equitable allocation of income, expenses, and taxes amongst countries.

## **2.6 CONCLUSION**

The chapter discussed the background to transfer pricing by evaluating the basic transfer pricing problem, looking at the history of transfer pricing and the issues underlying transfer pricing. This chapter highlighted that transfer pricing is one of the most relevant topics in international tax. This chapter also established that the generally accepted meaning of transfer pricing is the pricing of transactions between related parties. The transfer price is the price that one related entity charges another related entity for goods or services. Furthermore, this chapter introduced the concept of “profit shifting” and its potential abuses. Transfer pricing can be used to shift profits and therefore evade tax. In order to counter profit shifting, countries around the world have introduced transfer pricing provisions and legislation into their domestic tax systems. This chapter also found that the basic issues underlying transfer pricing include the motivation for transfer pricing manipulation and the equitable allocation of income, expenses, and taxes amongst countries.

The following chapter will consider the fundamental aspects of the arm’s length principle and factors to consider in determining an arm’s length price.

# **CHAPTER 3: UNDERSTANDING THE FUNDAMENTALS OF THE ARM'S LENGTH PRINCIPLE**

## **3.1 INTRODUCTION**

In the previous chapter, the background to the concept of transfer pricing was discussed. Transfer pricing refers to the setting of prices for transactions between related entities involving the transfer of goods or services. In order to understand and apply transfer pricing provisions to a transaction, it is essential to firstly understand what is meant by the arm's length principle. This chapter addresses the first sub-goal of the research, that is, to explain the arm's length principle.

In this chapter, the fundamentals of the arm's length principle will be presented, including its history, the definition, the rationale for its development and adoption, difficulties in applying it, and the practical application of the principle.

## **3.2 HISTORY OF THE ARM'S LENGTH PRINCIPLE**

The origins of the arm's length principle can be traced back to the early twentieth century (KPMG, 2018). The arm's length principle was formally introduced into law by the USA and Canada in 1924, then by Sweden in 1928, and subsequently Italy in 1936 (KPMG, 2018). The arm's length principle was first incorporated into international tax law through the League of Nations Draft Convention on the Allocation of Profits and Property of International Enterprises in 1933 (Solilova & Nerudova, 2018:14). Thus, the arm's length principle became a major principle when dealing with transfer pricing issues. In 1963, the arm's length principle was added to Article 9 of the OECD Model Tax Convention (Solilova & Nerudova, 2018:14). In 1980, the UN also adopted the arm's length principle, and this is reflected in Article 9 of the UN Model Double Taxation Convention between Developed and Developing Countries (Solilova & Nerudova, 2018:14). The OECD started developing practical guidance for the implementation of the arm's length principle in 1979 (Solilova & Nerudova, 2018:14). According to the UN Manual (UN Department of Economic and Social Affairs, 2021:38), the arm's length principle is not new and has its origins in contract law.

### **3.3 DEFINING THE ARM'S LENGTH PRINCIPLE AND THE RATIONALE FOR ITS DEVELOPMENT**

The arm's length principle was established to prevent the manipulation of transfer prices. It represents a key pillar of transfer pricing rules and is a standard that has been used in the international tax field since 1933 (Solilova & Nerudova, 2018:9). According to Bloomberg Tax (2019), with the active encouragement of the OECD and UN, the number of countries with transfer pricing legislation based on the arm's length principle has tripled since 2003 and doubled since 2010, from 40 countries in 2003 to 59 countries in 2010 to 124 countries in 2019. The arm's length principle follows the approach of treating transactions between entities of an MNE as though they are separate independent entities (OECD, 2017:35). Under the arm's length principle, the price charged for goods or services that are exchanged between related companies must be the same as the price charged for similar goods or services exchanged between independent companies. Therefore, the arm's length price for a good or service that is exchanged between related companies is the price that is charged by independent companies for similar goods or services (OECD, 2017:35). For example, Company A and Company B are related companies. Company A manufactures and distributes Iphone covers to Company B. Company C is an independent company that manufactures and distributes similar Iphone covers for ZAR 100. The arm's length price is ZAR 100.

According to the OECD Guidelines (2017:35), the OECD Model Tax Convention provides an authoritative statement on the arm's length principle. This principle forms the basis for the OECD member countries' model bilateral tax treaties. Article 9 of the OECD model tax convention reads as follows:

Where conditions are made or imposed between the 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.

Article 9 of the OECD Model Tax Convention provides that when conditions are set between two related entities and those conditions differ from those that would apply between independent entities, any profits that do not accrue to an entity due to those conditions may be included in the profits of that entity and taxed accordingly OECD, (2017:35). What the paragraph is alluding to is the agreement between entities within an MNE to transfer profits so as to obtain a tax benefit. According to Miller and Oats (2009:36), the application of the arm's length principle ensures that the tax base of an MNE is fairly shared amongst the various tax jurisdictions in which it operates.

Ordinarily, when independent entities transact with each other, the conditions of their transactions are determined by market forces (OECD, 2017:33). When related entities transact with each other, their transactions may not be directly affected by market forces in the same way (OECD, 2017:33). The tax liabilities of companies and the tax revenues of countries that are party to a related company transaction may be distorted if transfer prices do not reflect market forces and the arm's length principle. Therefore, OECD member countries have agreed that the profits of related entities may be adjusted through a primary adjustment to correct any such distortions and thereby ensure that the arm's length principle is satisfied (OECD, 2017:34). When countries adopt the arm's length principle in their transfer pricing regime and there is a difference between the transfer price and the arm's length price, the transfer price is adjusted so that it equals the arm's length price. This adjustment is known as a primary adjustment. For example, the transfer price for a smart watch is ZAR 100 whilst the arm's length price for a comparable smart watch is ZAR 120. The revenue authority will adjust the transfer price to ZAR 120, that is the arm's length price, and tax the transaction on the basis that smart watch is valued at ZAR 120.

The introduction of the arm's length principle and its implementation into domestic tax frameworks is a matter not only for the OECD member countries but also for the UN member countries. The arm's length principle is also expressed in Article 9 of the UN Model Double Taxation Convention between Developed and Developing Countries (2017) in a form identical to the OECD Model Convention. According to the UN Manual (UN Department of Economic and Social Affairs, 2021:37), the basis of the arm's length principle is that transactions between two related parties should reflect the outcome that would have been achieved if the parties were not

related, that is, if the parties were independent of each other and the outcome (price or margins) was determined by market forces. The UN Manual (UN Department of Economic and Social Affairs, 2021:38) further goes on to state that the arm's length principle is thus the generally accepted guiding principle in establishing an appropriate transfer price and that under the arm's length principle, related party transactions are compared to transactions between unrelated entities under comparable circumstances to determine acceptable transfer prices.

The rationale for the arm's length principle is that because the market governs most of the transactions in an economy, it is appropriate to treat related party transactions as equivalent to those between independent entities (UN Department of Economic and Social Affairs, 2021:38). The UN Manual (UN Department of Economic and Social Affairs, 2021:38) concludes that the arm's length principle is argued to be acceptable to everyone concerned as it uses the marketplace as the norm.

The OECD Guidelines and the UN Manual provide similar guidance on the arm's length principle. The crux of the guidance is that under the arm's length principle, related entities must set transfer prices for related party transactions at the same prices that would be set by independent entities. When there is a difference between the transfer price and the arm's length price, the transfer price must be adjusted so that it equals the arm's length price.

### **3.4 REASONS FOR ADOPTING THE ARM'S LENGTH PRINCIPLE**

There are many reasons why OECD member countries and developing countries have adopted the arm's length principle. A major reason is that the arm's length principle provides broad parity of tax treatment for related entities and independent entities (OECD, 2017:36). Secondly, because the arm's length principle puts related entities and independent entities on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity (OECD, 2017:36). According to the OECD Guidelines (2017:36), the arm's length principle has been found to work effectively in the vast majority of cases. According to the UN Manual (UN Department of Economic and Social Affairs, 2021:38), an argument in favour of using the arm's length principle is that it is geographically neutral because it treats profits from different places in a similar manner.

### **3.5 DIFFICULTIES IN THE APPLICATION OF THE ARM'S LENGTH PRINCIPLE**

Some regard the arm's length principle as inherently flawed because it does not account for the economies of scale and interrelation of diverse activities created by integrated businesses (OECD, 2017:36). The application of the arm's length principle involves comparing related party transactions with independent transactions. Therefore, the application of the arm's length principle requires information on independent transactions. According to the OECD Guidelines (2017:37), the main issue with the arm's length principle is that it may be difficult to obtain information on independent transactions. This could be because independent entities may not engage in transactions similar to those undertaken by related entities. This would be the case where the entities trade in highly specialised goods, for example. Furthermore, due to confidentiality considerations, it may be impossible to collect information from independent entities. However, according to the OECD Guidelines (2017:38), the arm's length principle may not always be straightforward to apply in practice, but it does generally produce appropriate levels of income between members of MNEs, acceptable to tax authorities.

### **3.6 APPLICATION OF THE ARM'S LENGTH PRINCIPLE**

The following example illustrates a situation where the arm's length principle needs to be applied (UN Department of Economic and Social Affairs, 2021:39). Assume a Corporation P (parent) manufactures automobile seats in Country A, then sells the finished seats to its Subsidiary S in Country B, which in turn sells those finished seats to independent parties (e.g. the public at large) in Country B. In such a case, S's taxable profits are determined by the selling price of the seats to the unrelated parties, minus the price at which the seats were obtained from its parent corporation (cost of goods sold in the accounts of S, in this case, the transfer price) and its expenses other than the cost of goods sold.

If Country A, where the seats are manufactured, has a tax rate much lower than the tax rate in Country B, where the seats are sold to unrelated parties, then perhaps the group would have an incentive to record as much profit as possible in the hands of Corporation P in Country A by overvaluing the selling price of the seats (the transfer price) to its Subsidiary S in Country B. If the tax rate was higher in Country A than in Country B, then perhaps the group would have an

incentive to under-price the seats to Subsidiary S in Country B and thus concentrate the profits in Country B.

The arm's length principle, therefore, seeks to determine whether the transactions between related taxpayers (in this case Corporation P and its Subsidiary S) are appropriately priced to reflect their true tax liability by comparing them to similar transactions that take place at arm's length between unrelated taxpayers.

### **3.7 CONCLUSION**

In this chapter, the fundamentals of the arm's length principle were presented. The arm's length principle represents a key pillar of transfer pricing rules and it is a standard that has been used in the international tax field. The arm's length principle follows the approach of treating transactions between entities of an MNE as though they are separate independent entities (OECD, 2017:35). Under the arm's length principle, the price charged for goods or services that are exchanged between related entities must be the same as the price charged for similar goods or services exchanged between independent entities. Therefore, the arm's length price for a good or service that is exchanged between related entities is the price that is charged by independent entities for similar goods or services. When countries adopt the arm's length principle in their transfer pricing regime and there is a difference between the transfer price and the arm's length price, the transfer price is adjusted so that it equals the arm's length price. This adjustment is known as a primary adjustment.

The application of the arm's length principle avoids the creation of a tax advantage. A major reason for the adoption of the arm's length principle is that the arm's length principle provides broad parity of tax treatment for MNEs and independent entities. The arm's length principle can be difficult to apply because it can be difficult to find information on independent transactions. The arm's length principle has flaws, but it does generally produce appropriate levels of income between members of MNEs, acceptable to tax authorities.

The OECD Model Tax Convention provides an authoritative statement on the arm's length principle (OECD, 2017). The arm's length principle is also expressed in Article 9 of the UN Model

Double Taxation Convention between Developed and Developing Countries (UN Department of Economic and Social Affairs, 2021).

In the following chapter, the methods for calculating an arm's length price will be described.

# **CHAPTER 4: ANALYSIS OF THE TRANSFER PRICING METHODS USED IN CALCULATING THE ARM'S LENGTH PRICE**

## **4.1 INTRODUCTION**

As discussed in the previous chapter, the arm's length price is determined through the application of the appropriate methods used to calculate and test transfer prices. In addressing the second goal of the research - to discuss the methods applied in calculating an arm's length price - this chapter explains these methods. In this chapter, various methods of calculating and testing transfer prices will be discussed. In addition, the methodologies applied, the circumstances in which such methodologies are applicable, and the strengths and weaknesses of each method will be explained.

## **4.2 TRANSFER PRICING METHODS**

Transfer pricing methods are used to establish arm's length prices, and can also be used to test whether transfer prices are arm's length. The selection of, and the appropriate application of a transfer pricing method represents one of the most critical aspects for MNEs in developing the transfer pricing policy of the group (Lang *et al*, 2019:98). Indeed, tax authorities scrutinise both the selection of the transfer pricing method and its application in order to determine whether the prices that were charged in related party transactions reflect arm's length conditions (Lang *et al*, 2019:98).

The OECD Guidelines (OECD, 2017:97) and the UN Manual (UN Department of Economic and Social Affairs, 2021:127) recognise five transfer pricing methods. Transfer pricing methods are divided into two categories: the traditional transaction methods and the transactional profit methods (OECD, 2017:97). The first category consists of the comparable uncontrolled price (CUP) method, the resale price method (RPM), and the cost-plus method (CPM) (OECD, 2017:97). The second category consists of the transactional net margin method (TNMM) and the profit split method (PSM) (OECD, 2017:97). Therefore, as a general introduction to these transfer pricing methods, the CUP method compares prices, the RPM compares gross margins, the CPM compares

gross profit mark-ups on costs, the TNMM compares net margins and, lastly, the PSM compares the allocation of profits between the parties (Lang *et al*, 2019:98).

Another distinction is that some transfer pricing methods are one-sided, while others are two-sided. One-sided transfer pricing methods apply to one party to the transaction (Lang *et al*, 2019:98). Two-sided methods are effectively applied to both parties to the transaction (Lang *et al*, 2019:98).

Although the five transfer pricing methods described in the OECD Guidelines and the UN Manual are not intended to encompass all of the possible ways of determining whether transactions result in outcomes that are at arm's length, they are widely accepted by tax authorities (Lang *et al*, 2019:101). MNEs are free to use other transfer pricing methods that they deem more appropriate (Lang *et al*, 2019:101). In this scenario, however, the MNE must demonstrate that the OECD and UN recognised transfer pricing methods were regarded as less appropriate.

#### **4.3 SELECTING THE APPROPRIATE TRANSFER PRICING METHODS**

The OECD Guidelines (2017:99) and the UN Manual (2021:123) require that the transfer pricing method to be selected must be the one that is the “most appropriate method” (Lang *et al*, 2019:101). Likewise, the US Treasury Regulations require the application of the “best method rule” (Lang *et al*, 2019:101). In a transfer pricing analysis, selecting the most appropriate transfer pricing method is vital since there is a far higher chance of error or unreliable results from applying an inappropriate transfer pricing method than from applying the correct transfer pricing method with imperfect comparable data.

Even though the OECD Guidelines, as they read from 2010 onwards, do not establish a hierarchy of transfer pricing methods, they do express a preference for traditional methods (Lang *et al*, 2019:101). The traditional transaction method is preferable to the transactional profit method because it is regarded as the most direct means of establishing the arm's length outcome of a transaction (Lang *et al*, 2019:102).

In order to select the most appropriate transfer pricing method, several factors must be taken into account. Both the OECD Guidelines (2017:97) and the UN Manual (2021:123) state that the

strengths and weaknesses of each method, the nature of the transaction, the availability of reliable data and the degree of comparability should be taken into account when selecting a transfer pricing method.

Three considerations are discussed below with regard to the various transfer pricing methods – a description of what the method is, when to use this method, and its strengths and weaknesses.

#### **4.4 THE COMPARABLE UNCONTROLLED PRICE METHOD**

The CUP method compares the price charged for the goods that are transferred or services that are rendered in a related party transaction to the price that is charged for similar goods that are transferred, or services that are rendered in an independent transaction under comparable circumstances (Lang *et al*, 2019:104). The CUP method involves setting transfer prices according to the same or similar price that would be charged by independent entities (Li & Paisey, 2019:40). The US Internal Revenue Code states that the CUP can be more reliable than other transfer pricing methods because a more comparable result can be drawn (Li & Paisey, 2019:40).

An independent transaction is used for the application of the CUP method. An independent transaction involves the purchase or sale of the same or substantially the same product between a related entity and a non-related entity or between two non-related entities. Therefore, the CUP method includes the following two situations. The first situation involves the situation where a related entity purchases or sells a comparable product from or to another related entity and to an independent entity. As an example, assuming that the transaction meets comparable commercial facts and circumstances, a related company A purchases or sells comparable products from or to the related company B and independent company C. The price for the purchase or sale of the product from or to the related company A by independent company C provides a reference to determine the transaction price that should be charged between related company A and related company B.

The second instance involves the purchase and sale of comparable products between two independent entities. As an example, assuming that the transaction meets comparable commercial facts and circumstances, related company X purchases or sells to related company Y the same or

comparable products as are purchased or sold by independent company A to independent company B. Therefore, the price of the purchase or sale of the product from independent company A to independent company B can be used as a reference to determine the transaction price between related company X and related company Y. Therefore, the CUP method can be applied based on internal or external comparable transactions.

#### **4.4.1 WHEN TO USE THE COMPARABLE UNCONTROLLED PRICE METHOD**

The CUP method is generally appropriate only when the products that are sold or the services that are performed in a related party transaction are identical or similar to the products sold or the services performed in independent transactions (Lang *et al*, 2019:106). In practice, the CUP method is most likely to be used when internal comparable transactions exist (Lang *et al*, 2019:108). Apart from situations where an internal comparable is available, the CUP method is often the most appropriate transfer pricing method for pricing commodities and is also frequently used for financial assistance transactions (interest) and transactions for the use of intangibles (royalties) (Lang *et al*, 2019:108).

#### **4.4.2 STRENGTHS AND WEAKNESSES OF THE COMPARABLE UNCONTROLLED PRICE METHOD**

The following strengths are associated with using the CUP method (Solilova & Nerudova, 2018:26):

- the CUP method represents the most direct and reliable way to apply the arm's length principle;
- the CUP method creates a considerable amount of evidence to present to tax authorities; and
- the CUP method is easy to apply because it does not require the use of commercial databases.

The following weaknesses are associated with using the CUP method (Solilova & Nerudova, 2018:26):

- the CUP method requires very high comparability; and
- the CUP method can be difficult to apply because it can be difficult to find independent transactions that meet the strict comparability criteria of the CUP method.

## **4.5 THE RESALE PRICE METHOD**

In order to test whether a transfer price is arm's length, the RPM compares the resale margin (gross profit divided by net sales) that a purchaser of goods in a related party transaction earns from reselling those goods in an independent transaction with the resale margin earned in an independent transaction involving independent third parties (Lang *et al*, 2019:111). The arm's length price is obtained by decreasing the resale price (that is, the price of goods sold to a third-party where those goods were originally purchased from a related party) with the margin earned by an independent entity in an independent transaction (Lang *et al*, 2019:111).

For example, a Namibian entity distributes running shoes purchased from a related supplier in South Africa. The Namibian entity also purchases very similar running shoes from an unrelated supplier. The RPM can be applied to ensure the prices charged by the South African supplier to its related Namibian distributor are at arm's length. Under the RPM, the margin earned by the Namibian distributor from selling goods that it purchased from its related South African supplier must be the same as the margin that it earns from selling goods that it purchases from unrelated third parties. Say, for instance, that the Namibian distributor makes a gross profit of NAD 80 for each NAD 100 pair of running shoes purchased from its unrelated supplier. The gross margin is 80%. In order for the transaction between the Namibian distributor and the South African supplier to be arm's length, the Namibian distributor must earn a margin of 80% when reselling the goods purchased from the related South African supplier.

### **4.5.1 WHEN TO USE THE RESALE PRICE METHOD**

The RPM may be a suitable transfer pricing method where one of the related parties in a related party transaction performs ordinary distribution and selling functions and adds relatively little value to the goods (Lang *et al*, 2019:113). The RPM is typically applied to related party transactions involving marketing and distribution activities (Li & Paisey, 2019:44).

### **4.5.2 STRENGTHS AND WEAKNESSES OF THE RESALE PRICE METHOD**

The following strengths are associated with using the RPM (Solilova & Nerudova, 2018:26):

- the RPM is based partly on information found on the market, which is then supplemented with internal company information;
- because it uses gross margins, the comparability requirements of the RPM are slightly less stringent than with some of the other methods; and
- it is easy to apply the RPM where the reseller does not add substantially to the value of the product.

The following weaknesses are associated with using the RPM (Solilova & Nerudova, 2018:26):

- the RPM can be difficult to apply because of differences in the way accounting methods are applied across companies;
- the reliability of the RPM may be affected if there are material differences in the ways the related entity and independent entity carry out their businesses; and
- the RPM is difficult to use where, before resale, the goods are further processed or incorporated into a more complicated product.

#### **4.6 COST PLUS METHOD**

The CPM determines the arm's length price by adding a market-based mark-up (that is, a mark-up achieved by third-parties in an independent transaction) to the costs incurred by a related party for providing goods or services to another related party. Under the CPM, the first step in the analysis is to calculate the costs incurred by a related party seller in a transaction for goods or services transferred to a related party purchaser (Transfer Pricing Asia: 2017). Secondly, an appropriate mark-up must be added to this cost to make a profit that is appropriate in light of the functions performed (Transfer Pricing Asia: 2017). A price can be considered to be arm's length after adding this (market-based) mark-up to these costs. The CPM requires the identification of a mark-up on costs applied by an independent entity in a comparable independent transaction (Transfer Pricing Asia: 2017). Thus, the CPM refers to pricing in accordance with the cost and reasonable expenses as well as an appropriate profit mark-up (Li & Paisey, 2019:44).

The following example illustrates the CPM. Company A and Company B are related companies. Company A manufactures Iphone cases for Company B. Company C is an independent company that manufactures similar Iphone cases. In order to apply the CPM, Company A needs to identify the mark-up on costs applied by Company C. That mark-up should be added to the costs incurred by Company A for manufacturing Iphone cases for Company B. The result is the arm's length price.

#### **4.6.1 WHEN TO USE THE COST PLUS METHOD**

The CPM is generally applied to related party transactions involving the sale of goods, the provision of services, and financial assistance (Li & Paisey, 2019:44). The CPM is also usually used in related-party transactions involving a contract manufacturer, a toll manufacturer or a low-risk assembler that does not own intangibles and assumes little risk (UN Department of Economic and Social Affairs, 2021:153).

#### **4.6.2 STRENGTHS AND WEAKNESSES OF THE COST PLUS METHOD**

The following strengths are associated with using the CPM (Solilova & Nerudova, 2018:27):

- the CPM is simple to understand and easy to implement; and
- the comparability requirements of the CPM are less stringent than some of the other transfer pricing methods.

The following weaknesses are associated with using the CPM (Solilova & Nerudova, 2018:27):

- during the determination of costs, the issue arises that there is no discernible link between the level of costs incurred and a market price;
- the CPM, because of its simplistic nature, is not always the most reliable method for companies with more complex business models;
- the CPM requires extensive information about the cost base used in comparing the mark-up of the related party and independent transactions; and
- the mark ups used by the CPM could be distorted because some companies may record a particular expense in cost of sales whilst other companies might record the same expense in operating expenses.

## **4.7 PROFIT SPLIT METHOD**

Related entities may engage in very interrelated related-party transactions that cannot be examined on a separate basis. For these types of transactions, related entities generally agree to split the profits. The PSM starts by identifying the relevant profits, or losses, in relation to a related party transaction (UN Department of Economic and Social Affairs, 2021:178). It then seeks to split those profits or losses between the related entities involved on an economically reasonable basis in order to achieve an arm's length outcome for each related party (UN Department of Economic and Social Affairs, 2021:178). The PSM splits the profits between related parties in a related party transaction according to the division of profits that independent third parties would have realised from engaging in similar transactions. Alternatively, the PSM also splits the profits between related parties in a related party transaction by looking at the relative financial or other contributions made by each related party. A fair profit split is then determined based on those contributions.

The following examples briefly illustrate the PSM. Joint Venture 1 is owned by related companies A and B. Joint Venture 2 is owned by independent companies X and Y. Joint Venture 1 and 2 are similar in nature. In order to determine an arm's length outcome for the transactions related to Joint Venture 1, the division of profits from Joint Venture 2 should be applied to Joint Venture 1.

Company A and Company B are two related companies that form a joint venture to develop a new product. The two companies invested a total of 500 million to bring the new product to market. Company A contributed 375 million and Company B contributed 125 million. Because 375 million is 75% of 500 million, Company A will receive 75% of future profits, with Company B earning the remaining 25%.

### **4.7.1 WHEN TO USE THE PROFIT SPLIT METHOD**

According to the Valentium Group (2021), the PSM is applied by companies in complex industries with relatively high profits. These industries include the technology and pharmaceutical industry. The Valentium Group (2021) also states that the PSM is especially useful when dealing with intangible goods, such as intellectual property, because these transactions are often too complex

for the other transfer pricing methods to be applied. According to Li and Paisey (2019:45), the PSM is usually applied in cases where the related party transaction is highly integrated.

#### **4.7.2 STRENGTHS AND WEAKNESSES OF THE PROFIT SPLIT METHOD**

The following strengths are associated with using the PSM (Solilova & Nerudova, 2018:27):

- the PSM can be applied when other transfer pricing methods fail, namely, when no comparable transactions among independent entities can be identified;
- the PSM is based on internal company information; and
- the flexibility of the PSM, as it enables the specificities of the industry and possibly unique facts and circumstances to be taken into account.

The following weaknesses are associated with using the PSM (Solilova & Nerudova, 2018:27):

- it can be difficult to retrieve information from foreign related entities; and
- the PSM is considered to be complex and has strict data requirements.

#### **4.8 TRANSACTIONAL NET MARGIN METHOD**

In order to test whether a related party transaction is at arm's length, the TNMM compares the net profit earned by a related party in a related party transaction to the net profit earned by an independent entity in a comparable independent transaction (UN Department of Economic and Social Affairs, 2021:157). The TNMM examines the net profit margin relative to an appropriate base (for example, costs, sales, or assets) that a taxpayer realises from a related party transaction (UN Department of Economic and Social Affairs, 2021:156). The application of the TNMM requires the use of a profit level indicator. The profit level indicator that an entity realises from a related party transaction is compared with the net profit earned by third-parties in independent transactions. Applicable profit level indicators for the TNMM include the return on assets, return on sales and full cost mark-up (Li & Paisey, 2019:46).

The following example illustrates the TNMM. Company A and Company B are related entities. Company A provides distribution services. Company B asks Company A to provide distribution services. The profit level indicator is the return on sales. In order to determine whether the price

Company A charges Company B for distribution services is at arm's length, the return on sales earned by Company A from providing distribution services to Company B is compared to the return on sales earned by independent entities engaged in similar distribution activities.

#### **4.8.1 WHEN TO USE THE TRANSACTIONAL NET MARGIN METHOD**

According to Li and Paisey (2019:46), the TNMM is usually applied to related party transactions that involve the sale of tangible goods, provision of labour services, and the transfer of intangible assets. The UN Manual (UN Department of Economic and Social Affairs, 2021:175) states that the TNMM is the most commonly applied transfer pricing method in cross-border disputes, largely because of the unavailability of good comparables. The UN Manual (UN Department of Economic and Social Affairs, 2021:175) states that the TNMM may be appropriate for use in certain situations in which data limitations on independent transactions make it more reliable than traditional methods.

#### **4.8.2 STRENGTHS AND WEAKNESSES OF THE TRANSACTIONAL NET MARGIN METHOD**

The following strengths are associated with using the TNMM (Solilova & Nerudova, 2018:30):

- when no internal comparable data is available, the TNMM may be the only possible transfer pricing method;
- the application of the TNMM is relatively feasible and reasonable from a cost-benefit perspective; and
- the TNMM is frequently used in practice due to data being available from external databases.

The following weaknesses are associated with using the TNMM (Solilova & Nerudova, 2018:30):

- the TNMM is unlikely to be reliable if each party to the related party transaction makes unique and valuable contributions; and
- the application of the TNMM requires information about independent transactions that may not be available when the related party transaction is executed.

## 4.9 CONCLUSION

Transfer pricing methods are used to establish arm's length prices. Transfer pricing methods can also be used to test whether transfer prices are arm's length. The choice and the proper application of a transfer pricing method represent one of the most critical aspects for MNEs for determining the transfer pricing policy of the group. The OECD Guidelines and the UN Manual describe five transfer pricing methods that are classified respectively into traditional transaction methods and transactional profit methods. The first category consists of the CUP, the RPM, and the CPM. The second category includes the TNMM and the PSM. The CUP method compares prices, the RPM compares gross margins, the CPM compares gross profit mark-ups on costs, the TNMM compares net margins and, lastly, the PSM compares the allocation of profits between the entities. All of the methods have strengths and weaknesses.

The CUP method involves setting transfer prices according to the same or similar price that would be charged by independent parties. In order to test whether a related party transaction is at arm's length, the CUP method compares the price charged for goods or services transferred in a related party transaction to the price charged for comparable goods or services in an independent transaction, under comparable circumstances. The CUP method is often determined to be the most appropriate method for pricing commodities and is also frequently used for financial assistance transactions (interest) and transactions for the use of intangibles (royalties).

In order to test whether a related party transaction is at arm's length, the RPM compares the gross margin earned by a related re-seller with the gross margin achieved by independent re-sellers from comparable independent transactions. The arm's length price is obtained by decreasing the resale price with the margin earned by a third-party in an independent transaction. The RPM may be a suitable method in cases where one of the parties performs ordinary distribution and selling functions and adds relatively little value to the goods. The RPM is typically applied to marketing and distribution activities.

In order to test whether a related party transaction is at arm's length, The CPM compares the gross mark-up added to the direct costs incurred by a manufacturer or a service provider in a related

party transaction to the gross mark-up achieved by an independent manufacturer or service provider in comparable independent transactions. The CPM determines the arm's length price by adding a market-based mark-up to the costs incurred by a related party for providing goods or services to another related party. The CPM is usually applied to the transfer and usage of tangible goods, the provision of services, and financing.

The PSM first determines the relevant profits from one or more transactions between two related entities and splits these profits between the parties on an arm's length basis. The PSM is usually applied in cases where the related party transaction is highly integrated and it is difficult to evaluate the operating result separately.

In order to test whether a related party transaction is at arm's length, the TNMM compares the net profit margin realised from a related party transaction with the net margin realised by independent parties in comparable independent transactions. The TNMM is usually applied to the transfer and usage of tangible goods, provision of labour services, and the transfer of intangible assets.

Although the five transfer pricing methods described in the OECD Guidelines and the UN Manual are not intended to encompass all of the possible ways of determining whether transactions result in outcomes that are at arm's length, they are widely accepted by national authorities. Even though the OECD Guidelines, as they read from 2010 onwards, do not establish a hierarchy of methods, they do express a preference for traditional methods.

In the next chapter certain additional issues not central to arm's length transfer pricing, but nevertheless important considerations, are discussed. The particular issues are set out in the introduction to the next chapter.

# **CHAPTER 5: ISSUES RELATING TO TRANSFER PRICING**

## **5.1 INTRODUCTION**

In the previous chapters, the various transfer pricing methods and related matters were discussed. Although not central to the determination of an arm's length transfer price, there are a number of other issues to be considered. These include the global formulary apportionment method that has been suggested as an alternative transfer pricing method, the role of an arm's length range in the appropriate transfer price, the entity bearing the burden of proof, the establishment of safe harbours, APA's, transfer pricing documentation and intra-group services. The aim of this chapter is to discuss these matters.

## **5.2 GLOBAL FORMULARY APPORTIONMENT**

In a related party transaction, one entity provides goods or services and makes a profit whilst the other entities receive goods or services. Under the arm's length principle, the profit made by the entity providing goods or services must be determined by applying an arm's length price. Under the arm's length principle, MNEs determine their profits for each related party transaction separately. An alternative system, the global formulary apportionment method, allocates an MNE's total profit, including profit from related party transactions, across countries using a formula. The global formulary apportionment method is a non-arm's length method and has been suggested as an alternative to the arm's length principle (OECD, 2017:39).

The global formulary apportionment method allocates the global profits of an MNE from both related party transactions and independent transactions on a consolidated basis among all of the MNE's entities in different countries, based on a predetermined and mechanistic formula (OECD, 2017:39). The formula would involve allocating an MNE's profits amongst its subsidiaries in different countries based on its sales, assets or payroll in each country. For example, under the global formulary apportionment method, an MNE headquartered in the USA would allocate its profits across countries based on its sales in each country. The MNE would pay South African corporate tax on the share of its global profits allocated to South Africa based on its sales in South Africa.

There are a few advantages associated with the global formulary apportionment method. Supporters of the global formulary apportionment method argue that it provides greater convenience and certainty for taxpayers (OECD, 2017:39). These supporters also claim that the global formulary apportionment method is more in keeping with economic reality (OECD, 2017:39). For example, it could be argued that by attempting to divide an MNE based on its legal form into separate taxable entities, the arm's length principle ignores the underlying economic substance of the MNE. Advocates for the global formulary apportionment method also argue that it reduces compliance costs for taxpayers (OECD, 2017:39). However, OECD member countries do not accept these propositions and do not consider the global formulary apportionment method to be a viable alternative to the arm's length principle, for the reasons discussed below (OECD, 2017:40).

Double taxation can occur when using the global formulary apportionment method if different countries use radically different methods of allocating profit among jurisdictions. For example, an MNE operates in South Africa and Namibia. Both South Africa and Namibia use the global formulary apportionment method. The MNE generates 80% of its sales from South Africa and 20% from Namibia. Furthermore, the MNE holds 80% of its assets in Namibia and 20% in South Africa. If both Namibia and South Africa allocate profits according to sales and the MNE generated a profit of ZAR 100, the MNE's profits subject to tax will be ZAR 80 in South Africa and ZAR 20 in Namibia. However, if the MNE generated a profit of ZAR 100 and profits are allocated according to sales in South Africa and assets in Namibia, the MNE's profits subject to tax will be ZAR 80 in South Africa and ZAR 80 in Namibia, thus resulting in total taxable profit of ZAR 160 and double taxation. The most important issue with the global formulary apportionment method is that it can cause double taxation (OECD, 2017:40). There would have to be considerable international coordination and consensus on the predetermined formulae to be used to prevent double taxation (OECD, 2017:40). Reaching such an agreement would be difficult and time-consuming. It is far from clear that countries would be willing to agree to a universal formula.

The second major issue with the global formulary apportionment method is that it could cause disputes between tax authorities. Even if some countries were willing to accept the global

formulary apportionment method, there would be disagreements between countries because each country may want to emphasise different factors in the formula based on the factors that predominate in its jurisdiction (OECD, 2017:40). Each country would have an incentive to devise formulae that would maximise that country's tax revenue (OECD, 2017:40).

The third major issue with the global formulary apportionment method is that there is the potential for artificially shifting the factors used in the formula to low tax jurisdictions (OECD, 2017:40). For example, if physical assets determine the location of an MNE's profits, it could establish manufacturing activities in low-tax jurisdictions, thus ensuring that the majority of its profits are taxed in low-tax jurisdictions. The global formulary apportionment method can facilitate tax evasion to the extent that the components of the formula can be manipulated (OECD, 2017:40).

Contrary to the assertions of its advocates, the global formulary apportionment method may, in fact, present intolerable compliance costs and information requirements because information would have to be gathered about the entire MNE and presented in each country on the basis of the currency and the book and tax accounting rules of that particular country (OECD, 2017:42). Thus, the documentation and compliance requirements for applying the global formulary apportionment method would generally be more burdensome than under the arm's length principle (OECD, 2017:42).

For the preceding reasons, OECD member countries reaffirm their support for the consensus on the use of the arm's length principle that has emerged over the years among member countries and agree that the theoretical alternative to the arm's length principle represented by the global formulary apportionment method should be rejected (OECD, 2017:43). The UN Manual (UN Department of Economic and Social Affairs, 2021:398) states that virtually all developing countries have adopted the arm's length principle as the basis for their domestic transfer pricing legislation. A global formulary apportionment approach is currently used by some states of the USA, cantons in Switzerland and provinces of Canada (UN Department of Economic and Social Affairs, 2021:41).

### 5.3 ARM'S LENGTH RANGE

In some cases, it may be possible to apply the arm's length principle to arrive at a single figure (for example, price or margin) that can be used to determine whether a related-party transaction is at arm's length (OECD, 2017:163). However, because transfer pricing is not an exact science, there will also be occasions when applying the most appropriate transfer pricing method will produce a range of figures (that is, the arm's length range) all of which are relatively equally reliable (OECD, 2017:163). For example, the CUP method compares the transfer price for goods or services to the price charged by independent companies for similar goods or services. Company A and Company B are related companies, whilst Company C and Company D are independent companies. Company A distributes Iphone cases to Company B for ZAR 110. Company C and Company D distribute similar Iphone cases for ZAR 120 and ZAR 100. The arm's length price according to the CUP method ranges from ZAR 120 to ZAR 100. The arm's length range is between ZAR 120 and ZAR 100. Where the transfer price is within the arm's length range, it is usually accepted as being at arm's length.

The arm's length range is usually determined by using measures of central tendency (for instance, the median, the mean or weighted averages, etc., depending on the specific characteristics of the data set). For example, Company A and Company B are related companies. Company A distributes Iphone cases to Company B. A price list exists that identifies the prices charged by twenty independent companies that distribute similar Iphone cases. The arm's length range could fall between the upper quartile (seventy fifth percentile) and the lower quartile (twenty fifth percentile) of the twenty independent prices. The OECD Guidelines also provide guidance on extreme results within an arm's length range. Extreme results could include unusually high or low prices from independent companies that are being impacted by unique conditions. The OECD Guidelines state that extreme results should be excluded from the arm's length range (OECD, 2017:165).

The UN Manual and the OECD Guidelines provide similar guidance on the arm's length range. The UN Manual (UN Department of Economic and Social Affairs, 2021:112) states that a transfer pricing analysis may result in an arm's length range of financial indicators (prices or margins), all of which may be considered to be equally reliable. The UN Manual (UN Department of Economic

and Social Affairs, 2021:112) also states that some countries will specify how an arm's length range is derived, for instance, by using particular statistical techniques.

#### **5.4 BURDEN OF PROOF**

The burden of proof refers to the obligation of a party to prove something. From a transfer pricing perspective, the burden of proof refers to the obligation of either the taxpayer or the tax authority to prove that the transfer pricing in a particular case is correct. The burden of proof rules for tax cases differs among countries. In some countries the burden of proof is on the taxpayer, whilst in other countries the burden of proof is on the tax authority. For example, the burden of proof is on the taxpayer in Australia, India and South Africa (UN Department of Economic and Social Affairs, 2021:405), while the burden of proof is on the tax authority in France, Germany, the Netherlands and Japan (UN Department of Economic and Social Affairs, 2021:405).

The implications for the tax authority and the taxpayer of the rules governing burden of proof should be considered because the burden of proof plays an important role in deciding who should disclose what (OECD, 2017:175). For example, where the burden of proof is on the tax authority, the taxpayer may not have any legal obligation to prove the correctness of its transfer pricing unless the tax authority presents a *prima facie* case showing that the transfer price is inconsistent with the arm's length principle (OECD, 2017:175). Even in such a case, the tax authority might still oblige the taxpayer to produce the information that would enable the tax authority to conduct its examination (OECD, 2017:175). Where the burden of proof is on the taxpayer, the taxpayer is obliged to prepare transfer pricing documentation demonstrating that their related-party transactions are consistent with the arm's length principle.

The burden of proof is sometimes seen as a shifting burden. (OECD, 2017:175). For example, in some countries, the burden of proof rests initially on the taxpayer, as they are obliged to prepare transfer pricing documentation demonstrating that the conditions of their related-party transactions are consistent with the arm's length principle (UN Department of Economic and Social Affairs, 2021:405). Once the taxpayer discharges this burden, it may shift to the tax authority to prove whether transfer prices have been determined in accordance with the arm's length principle (UN Department of Economic and Social Affairs, 2021:405). Subsequently, the burden of proof may

return to the taxpayer in order to explain whether the assessment is incorrect and to confirm that the related-party transaction was conducted at arm's length (UN Department of Economic and Social Affairs, 2021:406).

When transfer pricing issues are present, the divergent rules on the burden of proof among countries presents serious problems if the legal rights implied by those rules are used as a guide for appropriate behaviour (OECD, 2017:175). For example, consider the case where the transaction involves one country in which the burden of proof is on the taxpayer and a second country in which the burden of proof is on the tax authority. If the burden of proof is the guiding behaviour, the tax authority in the first country might make an unsubstantiated assertion about the transfer pricing, which the taxpayer might accept, and the tax authority in the second country would have the burden of disproving the validity of the transfer pricing. It could be that neither the taxpayer in the second country nor the tax authority in the first country would be making efforts to set an acceptable arm's length price. This type of behaviour would set the stage for double taxation (OECD, 2017:175).

The UN Manual and the OECD Guidelines provide similar guidance on the burden of proof. The UN Manual (UN Department of Economic and Social Affairs, 2021:405) concludes its guidance on the burden of proof by stating that the issue of whether the tax authority or the taxpayer has the burden of proof should be handled within a country's domestic legal framework.

## **5.5 SAFE HARBOURS**

A safe harbour is a provision in a country's transfer pricing legislation that applies to a category of transactions or taxpayers. A safe harbour replaces a country's normal transfer pricing requirements with simplified ones. Furthermore, safe harbours relieve eligible taxpayers from certain obligations otherwise imposed by a country's transfer pricing legislation, including transfer pricing documentation requirements (OECD, 2017:205).

A safe harbour provision could, for example, allow a taxpayer to establish transfer prices in a simplified way, for example, by applying a mark-up provided by the tax authority (OECD, 2017:205). For example, in India, applying a mark-up of 24% on the cost of contract research and

development services relating to software development provided by one related company to another related company will exempt the transaction from the country's transfer pricing requirements (Deloitte, 2020). Alternatively, a safe harbour provision could exempt a category of transactions or taxpayers from applying all or part of a country's general transfer pricing rules (OECD, 2017:205). For example, both Mexico and the United Kingdom exempt small and mid-size enterprises from the requirement to apply transfer pricing rules if their revenue is below a monetary threshold (Ezenagu, 2019:14).

Applying transfer pricing rules poses great difficulties because finding information on independent companies can be difficult, resource-intensive, time-consuming and complex. If a safe harbour is applied, the taxpayer may either not need to prepare transfer pricing documentation or not account for a transaction in their transfer pricing documentation. Safe harbours can therefore be used to reduce the burden of tax compliance. Safe harbours benefit taxpayers by enabling them to price their transactions and file their income tax returns with lower compliance burdens and with greater certainty (OECD, 2017:204). Safe harbours benefit tax authorities by enabling them to manage their limited resources available for tax enforcement by shifting resources from smaller taxpayers and less complex transactions to more complex, higher-risk transactions (OECD, 2017:204).

Safe harbour provisions may raise issues such as potentially having adverse effects on the pricing decisions of entities engaged in related party transactions and a negative impact on the tax revenues of the country implementing the safe harbour (OECD, 2017:213). Furthermore, unilateral safe harbours may lead to double taxation or double non-taxation (OECD, 2017:213). For example (a hypothetical example, as neither country provides for a safe harbour), Company A and Company B are two related companies. Both companies belong to Group A. Company A is resident in South Africa whilst Company B is resident in Botswana. Company A provides management support services to Company B. Botswana does not have safe harbour provisions whilst South Africa provides a safe harbour provision that allows taxpayers to earn a mark-up of 10% on the cost of providing management support services to related companies. Company A applies the South African safe harbour provision and charges Company B cost plus a 10% mark-up for management support services. However, the Botswanan revenue authorities argue that an arm's length mark-up for management support services is 8% on the cost of providing management support services.

The Botswanan revenue authorities are of the opinion that the price paid by Company B for management support services is excessive. The Botswanan revenue authorities adjust the price paid by Company B for management support services received from Company A, resulting in double taxation for Group A.

In cases involving less complex transactions or smaller taxpayers, the benefits of safe harbours may outweigh the problems presented by such provisions (OECD, 2017:213). Furthermore, safe harbours will not cause double taxation or double non-taxation when they are implemented on a bilateral or multilateral basis (OECD, 2017:213). Therefore, the appropriateness of safe harbours can be expected to be most apparent when they are directed at taxpayers and transactions with low transfer pricing risks and when they are implemented on a multilateral or bilateral basis (OECD, 2017:204).

The UN Manual and the OECD Guidelines provide similar guidance on safe harbours. The UN Manual (UN Department of Economic and Social Affairs, 2021:245) endorses the use of safe harbours for low value-adding services. The UN Manual (UN Department of Economic and Social Affairs, 2021:245), like the OECD Guidelines, states that safe harbours can benefit taxpayers by reducing the costs of complying with transfer pricing requirements in a country whilst also benefiting tax authorities by enabling them to use their resources to concentrate on transfer pricing transactions in which significant tax revenue is at stake. Furthermore, the UN Manual (UN Department of Economic and Social Affairs, 2021:245), like the OECD Guidelines, notes that unilateral safe harbours may result in double taxation and states that if a bilateral or multilateral safe harbour is available, this is to be preferred as it reduces the risk of double taxation.

## **5.6 ADVANCE PRICING AGREEMENT**

An APA is an agreement between a taxpayer and one or more tax authorities to determine in advance the manner in which transfer prices will be set for related party transactions (OECD, 2017:214). For example, a taxpayer could enter into an APA with a tax authority to determine in advance which transfer pricing method will be used to test whether a specific related party transaction is arm's length. Tax authorities may not always agree with a taxpayer's transfer price, which can lead to audits, adjustments and disputes. APAs aim to avoid such adjustments and

disputes. Countries that have APA legislation in place include Russia, India, China, Australia, Canada, New Zealand, United Kingdom, Germany, Japan and the USA (SARS, 2020:4).

Taxpayers can either enter into a unilateral APA, bilateral APA or multilateral APA. A unilateral APA is an arrangement between the taxpayer and one tax authority. A bilateral APA is an arrangement between the taxpayer and two tax authorities whilst a multilateral APA is an arrangement between the taxpayer and more than two tax authorities. The OECD Guidelines (2017:215) state that unilateral APAs can result in double taxation. For example, Company A and Company B are two related companies. Both companies belong to Group A. Company A is resident in South Africa whilst Company B is resident in Botswana. Company A provides management support services to Company B. Hypothetically (as South Africa does not provide for APAs), Company A has entered into an APA with the South African tax authority to charge a mark-up of 10% on the cost of providing management support services to related companies. Company B has not entered into an APA with the Botswanan revenue authority. Company A applies the provisions of the APA and charges Company B cost plus a 10% mark-up for management support services. However, the Botswanan revenue authorities argue that an arm's length mark-up for management support services is 8% on the cost of providing these services. The Botswanan revenue authorities are of the opinion that the price paid by Company B for management support services is excessive. The Botswanan revenue authorities adjust the price paid by Company B for management support services received from Company A, resulting in double taxation.

Because of concerns over double taxation, most countries prefer bilateral or multilateral APAs, and some countries will not grant a unilateral APA (OECD, 2017:216). The bilateral or multilateral approach will prevent double taxation, will be equitable to all tax authorities and taxpayers involved, and will provide greater certainty to taxpayers (OECD, 2017:215).

The OECD Guidelines and the UN Manual provide similar guidance on APAs. The UN Manual provides the following additional guidance. According to the UN Manual (UN Department of Economic and Social Affairs, 2021:416), countries facilitate APAs through different legal forms. For example, in some countries, an APA could be a legally binding agreement between the

taxpayer and the tax authority, while in other countries, it may be a more informal agreement between the tax authority and the taxpayer (UN Department of Economic and Social Affairs, 2021:416).

The UN Manual (UN Department of Economic and Social Affairs, 2021:416) states that when implementing APAs, tax authorities have to bear in mind that the APA process is, in practice, a service to taxpayers. Consequently, appropriate capacity must be available in the tax authority to adequately respond to the demand for APAs, including in terms of response time, the volume of requests and the complexity of cases etc (UN Department of Economic and Social Affairs, 2021:416). Therefore, some developing countries choose not to offer APAs, at least for some time after their transfer pricing regime is put in place, because they may feel that they need to develop the capacity and skills before they can adequately offer APAs (UN Department of Economic and Social Affairs, 2021:416).

## **5.7 TRANSFER PRICING DOCUMENTATION**

Companies entering into related party transactions generally need to prepare transfer pricing documentation. However, in some countries, companies entering into related party transactions will only need to prepare transfer pricing documentation if the value of their related party transactions exceeds a monetary threshold. Transfer pricing documentation contains detailed information about a company's related party transactions. Transfer pricing documentation allows companies to demonstrate to tax authorities that their related party transactions are compliant with local transfer pricing regulations. Furthermore, transfer pricing documentation provides tax authorities with all of the information that they require in order to conduct an appropriately thorough review of the transfer pricing practices of entities subject to tax in their jurisdiction. The OECD Guidelines (2017:231) state that by requiring taxpayers to articulate convincing, consistent and cogent transfer pricing positions, transfer pricing documentation can help to ensure that a culture of compliance is created.

Transfer pricing documentation can consist of a local file, master file and Country-by-Country Report (CbCR). Some countries only require a local file or both a local file and a master file. Most OECD member countries require a local file, master file and CbCR. The OECD Guidelines

(2017:233) recommend that countries should adopt a three-tiered approach to transfer pricing documentation. This means that transfer pricing legislation should request taxpayers to produce transfer pricing documentation consisting of a master file, a local file and a CbCR (OECD, 2017:233). The three-tiered approach to transfer pricing documentation will provide tax authorities with relevant and reliable information to perform an efficient and robust transfer pricing risk assessment analysis (OECD, 2017:233).

A master file is prepared for the MNE as a whole. The OECD Guidelines (2017:234) state that the master file should provide an overview of the MNE's business, its transfer pricing policies, and its activities per jurisdiction. The master file is intended to provide tax authorities with an overview of the economic, legal, financial and tax arrangements within an MNE. The master file provides tax authorities with a blueprint of the operations of an MNE (OECD, 2017:234). The OECD Guidelines and the UN Manual have similar information requirements for the master file. The OECD Guidelines (2017:501) state that the following information should be included in the master file:

- a chart illustrating the MNE's legal and ownership structure and geographical location of entities;
- a description of the supply chain for the MNE's five largest products and/or service offerings by turnover, plus any other products and/or services amounting to more than 5% of group turnover;
- a list and a brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services;
- a description of the main geographic markets for the MNE's products and services;
- a brief written functional analysis describing the principal contributions to value creation by individual entities within the group, that is, key functions performed, important risks assumed, and important assets used;
- a description of business restructuring transactions, acquisitions and divestitures occurring during the fiscal year;
- a description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including the location of principal R&D facilities and the location of R&D management;

- a description of the group's transfer pricing policies related to R&D and intangibles;
- a description of how the group is financed, including important financing arrangements with unrelated lenders;
- a description of the MNE's general transfer pricing policies related to financing arrangements between related entities; and
- the MNE's annual consolidated financial statement for the fiscal year.

A local file is prepared for each subsidiary of an MNE that is involved in related party transactions. In contrast to the master file, which provides a high-level overview of the MNE's transfer pricing practices, a local file provides detailed information about a particular subsidiary's related party transactions (OECD, 2017:235). The information required in the local file supplements the master file and helps to meet the objective of ensuring that the taxpayer has complied with the arm's length principle in its transfer pricing positions (OECD, 2017:235). The OECD Guidelines and the UN Manual have similar information requirements for the local file. The OECD Guidelines (2017:505) state that the local file should include the following information:

- a description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the countries in which such individuals maintain their principal offices;
- a description of the business and business strategy pursued by the local entity, including an indication of whether the local entity has been involved in or affected by business restructurings or intangible transfers in the present or immediate past year and an explanation of those aspects of such transactions affecting the local entity;
- a list of key competitors;
- a description of the material related party transactions and the context in which such transactions take place;
- the amount of intra-group payments and receipts for each category of related party transactions involving the local entity, broken down by tax jurisdiction of the foreign payor or recipient;
- an identification of related entities involved in each category of transactions and the relationship amongst them;
- copies of all material intercompany agreements;

- a detailed comparability and functional analysis of the taxpayer and relevant related entities with respect to each documented category of transactions, including any changes compared to prior years;
- an indication of the most appropriate transfer pricing method with regard to the category of transaction and the reasons for choosing that method;
- an indication of which related entity is selected as the tested party, if applicable, and an explanation of the reasons for this selection;
- a summary of the assumptions made in applying the transfer pricing method;
- a summary of financial information used in applying the transfer pricing method;
- annual local entity financial accounts; if audited statements exist, they should be supplied, and if not, existing unaudited statements should be supplied; and
- schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

A CbCR is prepared for the MNE as a whole. The CbCR provides information relating to the MNE by jurisdiction, which includes, for example, the income earned, taxes paid, number of employees, capital, retained earnings, tangible assets and activities for each jurisdiction in which the MNE operates (OECD, 2017:235). The CbCR essentially breaks down key elements of the MNE's financial statements by jurisdiction. The CbCR is used by tax authorities for transfer pricing risk assessment purposes, evaluating base erosion and profit shifting related risks, and for economic and statistical analysis (OECD, 2017:235).

The UN Manual (UN Department of Economic and Social Affairs, 2021:455) endorses the OECD's three-tiered approach to transfer pricing documentation; that is, transfer pricing documentation should consist of a local file, master file and CbCR. Furthermore, the UN Manual and the OECD Guidelines recommend very similar local file, master file and CbCR information requirements.

## **5.8 INTRA-GROUP SERVICES**

MNEs generally need to provide their subsidiaries with a wide range of services in order for them to carry out their operations. These services can include administrative, finance, human resources,

information technology, management, marketing, procurement, research and development, and technical services, amongst others. These services are known as intra-group services and are provided by the parent company of an MNE, or by designated subsidiaries. According to KPMG (2017), the most common type of related party transaction in developing countries is intra-group services. According to the OECD Guidelines (2017:320), in order for an intra-group service to be at arm's length, the intra-group service must have, in fact, been provided and the intra-group fee for the intra-group service must be in accordance with the arm's length principle.

Under the arm's length principle, the question of whether an intra-group service has in fact been provided depends on whether the service provides the service recipient with economic or commercial value to enhance or maintain its business position (OECD, 2017:321). This can be determined by considering whether an independent entity in comparable circumstances would have been willing to pay for the service if performed for it by an independent entity, or would have performed the service in house for itself (OECD, 2017:321). This is known as the "benefits test". If the service is not one for which an independent entity would have been willing to pay or perform for itself, the service should not be considered as an intra-group service under the arm's length principle (OECD, 2017:321).

In some cases, an intra-group service may be performed for group entities even though those group entities do not need the service and would not be willing to pay for it if they were independent entities. Such a service would be one that a group entity performs solely because of its ownership interest. This type of service is known as shareholder activities and would not be considered an intra-group service, and thus would not justify a charge to other group entities (OECD, 2017:321).

Once it has been determined that an intra-group service has been rendered, it is necessary to determine whether the fee for the intra-group service is in accordance with the arm's length principle (OECD, 2017:321). The fee for intra-group services is at arm's length if it is the fee that would have been paid between independent entities.

There are two methods for charging intra-group services: the direct charge method and the indirect charge method. In some cases, intra-group services can be directly attributable to the service

recipient, that is, readily identifiable (OECD, 2017:326). These instances are where the MNE uses a direct-charge method, that is, where the service recipient is charged for specific services (OECD, 2017:326). The direct-charge method is practically convenient to tax authorities because it allows the service performed and the basis for the payment to be clearly identified (OECD, 2017:326). Thus, the direct-charge method facilitates the determination of whether the fee for the intra-group service is consistent with the arm's length principle (OECD, 2017:326).

Alternatively, the intra-group service may not be directly attributable to related entities that consume the service. In such instances, the MNE group may use an indirect-charge method. An indirect-charge method uses cost allocation and apportionment methods to determine the fee for intra-group services in accordance with the arm's length principle. The OECD Guidelines (2017:327) state that any indirect-charge method should be sensitive to commercial features, contain safeguards against manipulation, follow accounting principles, and be capable of producing fees for intra-group services that are commensurate with the actual or reasonably expected benefits to the recipient of the service.

The UN Manual also provides similar guidance on intra-group services. According to the UN Manual (UN Department of Economic and Social Affairs, 2021:212), under the arm's length principle, if an intra-group service has been provided between related entities, arm's length transfer prices should be charged. The test for determining whether intra-group services have been provided between related entities is whether one or more related entities have received or are expected to receive economic benefits from the service (UN Department of Economic and Social Affairs, 2021:212). Such an economic benefit exists if an independent entity in similar circumstances would be willing to pay for the service or perform the service itself (UN Department of Economic and Social Affairs, 2021:212).

The OECD Guidelines and the UN Manual both apply the benefits test. The benefits test is used to determine whether a member of the MNE has received a chargeable intra-group service from a related entity. Once the benefits test has been satisfied, there remains the question of the arm's length price for the service. The UN Manual and the OECD Guidelines, therefore, recognise that in order for intra-group services to be transfer pricing compliant, intra-group services need to, in

fact, have been provided (in terms of the benefits test), and the charge for intra-group services should be in accordance with the arm's length principle.

## **5.9 CONCLUSION**

This chapter discussed various issues associated with transfer pricing. The first issue discussed was the global formulary apportionment method. The global formulary apportionment method is a non-arm's length transfer pricing method that has been suggested as an alternative to the arm's length principle. The global formulary apportionment method allocates the profits of an MNE from both related party transactions and independent transactions on a consolidated basis among all of the MNE's entities in different countries, based on a predetermined and mechanistic formula. The major disadvantages associated with using the global formulary apportionment method is that it can cause double taxation, tax evasion, disputes between tax authorities and intolerable compliance costs for taxpayers. OECD member countries and developing countries reject the global formulary apportionment method because of its disadvantages.

The second issue discussed was arm's length ranges. Both the OECD Guidelines and the UN Manual confirm that transfer pricing is not an exact science; therefore, there will be many occasions when applying the most appropriate transfer pricing method produces a range of figures, that is, an arm's length range. In addition, the OECD Guidelines and the UN Manual support the use of measures of central tendency to determine the arm's length range. Lastly, the OECD Guidelines state that extreme results should be analysed and excluded from the arm's length range.

The third issue discussed was the burden of proof. The burden of proof refers to the obligation of a party to prove something. From a transfer pricing perspective, the burden of proof refers to the obligation of either the taxpayer or the tax authority to prove that the transfer pricing in a particular case is correct. The burden of proof rules for tax cases differs among countries. In some countries, the burden of proof is on the taxpayer, and in other countries, the burden of proof is on the tax authority. When transfer pricing issues are present, the divergent rules on the burden of proof among countries could result in conflict and double taxation.

The fourth issue discussed was safe harbours. A safe harbour in a transfer pricing regime is a provision that applies to a category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's transfer pricing rules. A safe harbour replaces a country's normal transfer pricing requirements with simplified ones. There are various advantages and disadvantages associated with safe harbours. Safe harbours benefit taxpayers by enabling them to price their transactions and file their income tax returns with lower compliance burdens and with greater certainty, whilst safe harbours benefit tax authorities by enabling them to manage their limited resources available for tax enforcement by shifting resources from smaller taxpayers and less complex transactions to more complex, higher-risk transactions. However, unilateral safe harbours can cause double taxation. The OECD Guidelines state that in cases involving smaller taxpayers or less complex transactions, the benefits of safe harbours may outweigh the problems raised by such provisions. The OECD Guidelines state that where safe harbours can be negotiated on a bilateral or multilateral basis, they may provide significant relief from compliance burdens without creating problems of double taxation or double non-taxation.

The fifth issue discussed was APAs. An APA is an agreement between a taxpayer and one or more tax authorities to determine in advance the manner in which transfer prices will be set for related party transactions. Tax authorities may not always agree with a taxpayer's transfer price, which can lead to audits, adjustments and disputes. APAs aim to avoid such adjustments and disputes. APAs could either be entered into unilaterally, multilaterally or bilaterally. However, unilateral APAs can result in double taxation.

The sixth issue discussed was transfer pricing documentation. Companies entering into related party transactions generally need to prepare transfer pricing documentation. Transfer pricing documentation allows companies to demonstrate to tax authorities that their related party transactions are compliant with local transfer pricing regulations. Transfer pricing documentation can consist of a local file, master file and CbCR. The OECD Guidelines and the UN Manual recommend that countries should adopt a three-tiered approach to transfer pricing documentation. This means transfer pricing documentation should consist of a local file, master file and CbCR. The OECD Guidelines and the UN Manual stipulate the information that should be included in the local file, master file and CbCR.

The seventh issue discussed was intra-group services. In order for intra-group services to be compliant in terms of the OECD Guidelines and the UN Manual, intra-group services have to be actually provided and the charge for intra-group services should be in accordance with the arm's length principle. The test for determining whether intra-group services have been provided between related entities is whether one or more related entities have received or are expected to receive economic benefits from the service. Such an economic benefit exists if an independent entity in similar circumstances would be willing to pay for the service or perform the service itself. The charge for intra-group services is at arm's length if the direct charge method or the indirect charge method is used.

In the following chapter, transfer pricing will be discussed in the context of the SACU. The chapter will discuss and compare the guidance issued by the national tax authorities in the SACU and determine how such guidance compares to the OECD Guidelines and the UN Manual.

# **CHAPTER 6: ANALYSIS OF TRANSFER PRICING LEGISLATION IN THE SOUTHERN AFRICAN CUSTOMS UNION**

## **6.1 INTRODUCTION**

In the previous chapters, the various transfer pricing methods and related issues were discussed. In this chapter, transfer pricing will be discussed within the context of the SACU. The main goal of this chapter is to investigate whether transfer pricing legislation in the SACU aligns between SACU countries and with the OECD and UN Guidelines<sup>1</sup>. This chapter addresses three sub-goals of the research:

- to discuss transfer pricing practices in the SACU;
- to compare transfer pricing practices within the SACU and to the OECD and UN Guidelines; and
- to identify areas requiring harmonisation.

## **6.2 TRANSFER PRICING LEGISLATION**

Transfer pricing legislation is legislation that covers a country's transfer pricing rules and regulations. Transfer pricing legislation may set out in great detail issues such as the definition of related parties, transfer pricing methodologies, transfer pricing documentation requirements and penalties. According to the UN Manual (UN Department of Economic and Social Affairs, 2021:394), transfer pricing rules were first introduced into legislation by the USA in 1917. The development of transfer pricing legislation was historically led by developed countries (UN Department of Economic and Social Affairs, 2021:394). In recent years, due to the growth and increasing complexity of cross-border related party transactions within MNEs, both developed and developing countries are introducing legislation to address transfer pricing issues (UN Department of Economic and Social Affairs, 2021:394). The UN Manual (UN Department of Economic and Social Affairs, 2021:395) states that countries should publish transfer pricing legislation to prevent

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<sup>1</sup> In this chapter, unless specific pages are referred to, the "OECD Guidelines" refer to the OECD (2017) publication, and the "UN Manual" refers to the UN Department of Economic and Social Affairs, 2021 document.

tax evasion. Many countries have introduced transfer pricing legislation in order to prevent tax evasion. The OECD Guidelines do not provide guidance on the implementation of transfer pricing legislation.

Table 1 indicates the presence of transfer pricing legislation in the SACU.

**Table 1: Transfer pricing legislation**

<b>Transfer pricing legislation</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>	<b>Lesotho</b>	<b>Eswatini</b>
Transfer pricing rules established in legislation and/or regulations	Section 31 of the Income Tax Act, No. 58 of 1962 (SA Income Tax Act), Tax Administration Act, No. 28 of 2011 (SA Tax Administration Act) and Practice Note 7 (SA Transfer Pricing Rules).	Section 36A of the Income Tax Act 52:01 (Botswanan Income Tax Act) and Income Tax (Transfer Pricing) Regulations 2019 (Botswanan Transfer Pricing Regulations).	Section 95A of the Income Tax Act 24 of 1981 (Namibian Income Tax Act) and Practice Note 2 of 2006 (PN 2/2006) (Namibian Transfer Pricing Rules).	Section 113 of the Lesotho Income Tax Act, No. 9 of 1993 (Lesotho Income Tax Act) contains an anti-avoidance transfer pricing provision. Lesotho does not have specific transfer pricing legislation and guidance.	Eswatini does not have specific transfer pricing legislation and guidance.

Source: Own formulation

As stated previously, the UN Manual (UN Department of Economic and Social Affairs, 2021:395) states that countries should publish transfer pricing legislation to prevent double taxation and tax evasion. Botswana, Namibia and South Africa have specific transfer pricing legislation and guidance. Eswatini and Lesotho do not have specific transfer pricing legislation and guidance. Eswatini and Lesotho have not followed the guidance provided by the UN Manual because they have not published transfer pricing legislation. The absence of transfer pricing legislation in Eswatini and Lesotho can cause double taxation and tax evasion in the SACU.

### 6.3 THE ARM'S LENGTH PRINCIPLE IN THE SOUTH AFRICAN CUSTOMS UNION

The OECD Guidelines and the UN Manual provide similar guidance on the arm's length principle. The arm's length principle represents a key pillar of transfer pricing rules and it is a standard that has been used in the international tax field. The arm's length principle follows the approach of treating transactions between entities of an MNE as though they are separate independent entities (OECD, 2017:35). Under the arm's length principle, the price charged for goods or services that are exchanged between related companies must be the same as the price charged for similar goods or services exchanged between independent companies. Therefore, the arm's length price for a good or service that is exchanged between related companies is the price that is charged by independent companies for similar goods or services. When countries adopt the arm's length principle in their transfer pricing regime and there is a difference between the transfer price and the arm's length price, the transfer price is adjusted so that it equals the arm's length price. This adjustment is known as a primary adjustment.

**Table 2: The arm's length principle and transfer pricing adjustments**

The arm's length principle	South Africa	Botswana	Namibia
The arm's length rule established in legislation and/or regulations	<ul style="list-style-type: none"> <li>Section 31 of the SA Income Tax Act requires that an arm's length price be paid or charged in respect of the cross-border supply of goods or services between related parties. Should the Commissioner for the South African Revenue Service (SARS) believe that an arm's length price has not been paid or charged, he is entitled to adjust the consideration for the transaction in order for it to reflect an</li> </ul>	<ul style="list-style-type: none"> <li>Section 36A of the Botswanan Income Tax Act recognises the arm's length principle. In terms of section 36A, taxable income from cross-border related party transactions should be determined in accordance with the arm's length principle. Cross-border related party transactions are at arm's length in terms of section 36A of the Botswanan Income Tax Act when the conditions of the transaction are the same as the conditions</li> </ul>	<ul style="list-style-type: none"> <li>Section 95A of the Namibian Income Tax Act grants the NamRa (Namibia Revenue Agency) the power to adjust any non-market related prices charged or paid by Namibian entities in cross-border transactions with related parties to arm's length prices and to tax the Namibian entity as if the transactions had been carried out at market-related prices.</li> <li>Paragraph 2.3 of the Namibian Transfer Pricing Rules states that section 95A of the</li> </ul>

	<p>arm's length price, resulting in a potentially higher tax liability for the taxpayer.</p> <ul style="list-style-type: none"> <li>• Paragraph 2.7 of the SA Transfer Pricing Rules states that section 31 of the SA Income Tax Act provides a mechanism by which the Commissioner for SARS adopts the internationally accepted "arm's length principle" for taxation purposes as the basis for ensuring that the South African fiscus receives its fair share of tax.</li> <li>• Paragraph 7.1 of the SA Transfer Pricing Rules states that transactions between connected persons are to be conducted at arm's length.</li> <li>• Paragraph 7.4 of the SA Transfer Pricing Rules states that South Africa has adopted the arm's length principle, which is the international norm, and that the Commissioner for SARS is of the opinion that application of this internationally accepted principle will minimise the potential for double taxation.</li> </ul>	<p>between independent entities.</p>	<p>Namibian Income Tax Act provides that the NamRa may, in the determination of the taxable income, adjust the consideration in respect of the international transaction to reflect an arm's length price.</p> <ul style="list-style-type: none"> <li>• Paragraph 5.1 of the Namibian Transfer Pricing Rules further states that this means that transactions between connected persons are to be conducted at arm's length. In other words, the transaction should have the substantive financial characteristics of a transaction between independent parties, where each party will strive to get the utmost possible benefit from the transaction.</li> </ul>
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<p>Transfer pricing adjustment</p>	<ul style="list-style-type: none"> <li>• In terms of section 31 of the SA Income Tax Act, if the taxpayer is party to a related party transaction that is not priced on an arm's length basis, the Commissioner for the SARS must adjust the pricing of the transaction to an arm's length amount. This is known as a primary adjustment. In addition, the primary adjustment attracts a secondary adjustment in the form of a deemed dividend.</li> </ul>	<ul style="list-style-type: none"> <li>• In terms of section 36 of the Botswanan Income Tax Act, if the taxpayer is party to a related party transaction that is not priced on an arm's length basis, the Commissioner of the Botswana Unified Revenue Service (BURS) must adjust the pricing of the transaction to an arm's length amount. This is known as a primary adjustment. Botswana does not have a secondary transfer pricing adjustment. However, interest and penalties could be levied on unpaid taxes.</li> </ul>	<ul style="list-style-type: none"> <li>• In terms of section 95A of the Namibian Income Tax Act, if the taxpayer is party to a related party transaction that is not priced on an arm's length basis, the Commissioner of the NamRa must adjust the pricing of the transaction to an arm's length amount. This is known as a primary adjustment. Namibia does not have a secondary transfer pricing adjustment. However, interest and penalties could be levied on unpaid taxes.</li> </ul>
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Source: Own formulation

The fundamental principle underpinning Botswanan, Namibian and South African transfer pricing legislation is the arm's length principle as set out in Article 9 of both the UN Model Double Taxation Convention and the OECD Model Tax Convention. Therefore, the countries in the SACU that have transfer pricing legislation consistently apply the arm's length principle in their transfer pricing regimes. To the extent that a related party transaction is not arm's length, revenue authorities in Botswana, Namibia and South Africa may apply a primary transfer pricing adjustment and adjust the pricing of the related party transaction to an arm's length amount. With reference to the arm's length principle, transfer pricing legislation in Botswana, Namibia and South Africa is aligned and in terms of the OECD Guidelines and the UN Manual.

**6.4 TRANSFER PRICING METHODS**

The OECD Guidelines (2017:97) and the UN Manual (UN Department of Economic and Social Affairs, 2021:127) prescribe five transfer pricing methods that can be used to determine and test an arm's length price. The transfer pricing methods are divided into traditional transaction methods

and transactional profit methods. Traditional transaction methods are the CUP method, the RPM, and the CPM. Transactional profit methods are the TNMM and the PSM.

Table 3 discusses the transfer pricing methods that are used in the SACU.

**Table 3: Transfer pricing methods**

<b>Transfer pricing methods</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
Guidance on transfer pricing methods established in legislation and/or regulations	Paragraph 9.2.4 of the SA Transfer Pricing Rules states that the Commissioner for SARS endorses the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. The SA Transfer Pricing Rules also note that the CUP method, RPM and CPM are known as the traditional transaction methods, and the TNMM and PSM are referred to as transactional profit methods.	Paragraph 5(a) of the Botswanan Transfer Pricing Regulations endorses the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. The Botswanan Transfer Pricing Regulations also note that the CUP method, RPM and CPM are known as the traditional transaction methods, and the TNMM and PSM are referred to as transactional profit methods.	Paragraph 7.2.4 of the Namibian Transfer Pricing Rules states that the Namura endorses the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. The Namibian Transfer Pricing Rules also note that the CUP method, RPM and CPM are known as the traditional transaction methods, and the TNMM and PSM are referred to as transactional profit methods.

Source: Own formulation

The OECD Guidelines (2017:97) and the UN Manual (2021:27) recognise the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. Furthermore, Botswanan, Namibian and South African transfer pricing legislation recognises the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. With reference to transfer pricing methods, transfer pricing legislation in Botswana, Namibia and South Africa is aligned and in line with the OECD Guidelines and the UN Manual.

## 6.5 SELECTING A TRANSFER PRICING METHOD

As previously mentioned, a transfer pricing method can either be used to determine an arm’s length transfer price, or it can be used to test whether an existing transfer price is at arm’s length. Therefore, it is important for taxpayers to properly assess and select the most appropriate transfer pricing method when analysing transactions with related parties. Furthermore, it is important that taxpayers select the most appropriate transfer pricing method in line with the guidelines set out by local transfer pricing legislation, the OECD and the UN. According to the OECD Guidelines (2017:97), the selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. According to the OECD Guidelines (OECD, 2017:97), the following factors should be taken into account when selecting a transfer pricing method: the strengths and weaknesses of each OECD recognised method; the appropriateness of the method given the nature of the transaction; the availability of reliable information needed to apply the selected method; and the degree of comparability between related party and independent transactions.

The UN Manual (UN Department of Economic and Social Affairs, 2021:123) states that the objective when selecting a transfer pricing method is to identify the most appropriate method. Similar to the OECD Guidelines, the UN Manual (UN Department of Economic and Social Affairs, 2021:123) states that the considerations involved in selecting a transfer pricing method include: the strengths and weaknesses of each method; the nature of the related party transaction; the availability of reliable information needed to apply the selected method; and the degree of comparability between the related party and independent transactions. No preference for particular methods is advocated in the UN Manual. Table 4 discusses the guidance provided on selecting a transfer pricing method in the SACU.

**Table 4: Selecting a transfer pricing method**

<b>Selecting a transfer pricing method</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
Guidance on selecting a transfer pricing	The following should be taken into account when selecting an appropriate transfer pricing method in	The following should be taken into account when selecting an appropriate transfer pricing method in	The following should be taken into account when selecting an appropriate transfer pricing method

<p>method established in legislation and/or regulations</p>	<p>terms of paragraph 9.1.3 of the SA Transfer Pricing Rules:</p> <ul style="list-style-type: none"> <li>• the nature of the activities being examined;</li> <li>• the availability, quality and reliability of the data;</li> <li>• the nature and extent of any assumptions; and</li> <li>• the degree of comparability that exists between the controlled and uncontrolled transactions where the difference would affect conditions in the arm's length dealings being examined.</li> </ul>	<p>terms of paragraph 5(2) of the Botswanan Transfer Pricing Regulations:</p> <ul style="list-style-type: none"> <li>• the respective strength and weakness of the approved method;</li> <li>• the appropriateness of an approved method in view of the nature of the transaction, determined, in particular, through an analysis of the functions undertaken by each person in the transaction, taking into account assets used and risks assumed;</li> <li>• the availability of reliable information needed to apply the selected transfer pricing method; and</li> <li>• the degree of comparability between the transactions.</li> </ul>	<p>in terms of paragraph 7.1.3 of the Namibian Transfer Pricing Rules:</p> <ul style="list-style-type: none"> <li>• the nature of the activities being examined;</li> <li>• the availability, quality and reliability of the data;</li> <li>• the nature and extent of any assumptions; and</li> <li>• the degree of comparability that exists.</li> </ul>
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Source: Own formulation

Additionally, both the OECD Guidelines and the UN Manual state that the strengths and weaknesses of each method, the nature of the transaction, the availability of reliable data and the degree of comparability should be taken into account when selecting a transfer pricing method. The factors that should be taken into account when selecting a transfer pricing method in Botswana, Namibia and South Africa are similar to the OECD Guidelines and the UN Manual. With respect to guidance on selecting a transfer pricing method, transfer pricing legislation in Botswana, Namibia and South Africa is aligned, and in line with the OECD Guidelines and the UN Manual. However, there are slight differences between the wording in South African and Namibian transfer pricing legislation and the OECD Guidelines and the UN Manual. This could be because South Africa's transfer pricing regulations were published in 1999, and Namibia's transfer pricing regulations were published in 2006, while the OECD Guidelines and the UN Manual were updated in 2017 and 2021. These differences do not result in double taxation or base

erosion and profit shifting, but could result in disputes between revenue authorities and taxpayers if there is a difference in interpretation between the guidance in the OECD Guidelines or the UN Manual and transfer pricing legislation.

## **6.6 GLOBAL FORMULARY APPORTIONMENT IN THE SOUTHERN AFRICAN CUSTOMS UNION**

The global formulary apportionment method was discussed in detail in Chapter 5. The global formulary apportionment method is a non-arm's length transfer pricing method that has been suggested as an alternative to the arm's length principle. The global formulary apportionment method allocates the profits of an MNE from both related party transactions and independent transactions on a consolidated basis among all of the MNE's entities in different countries, based on a predetermined and mechanistic formula. The major disadvantages associated with using the global formulary apportionment method is that it can cause double taxation, tax evasion, disputes between tax authorities and intolerable compliance costs for taxpayers. OECD member countries and developing countries reject the global formulary apportionment method because of its disadvantages. Transfer pricing legislation in the SACU does not provide guidance on the global formulary apportionment method. The absence of any guidance on the global formulary apportionment method by Botswana, Namibia and South Africa indicates that these countries reject the global formulary apportionment method. Therefore, with respect to the global formulary apportionment method, transfer pricing legislation in Botswana, Namibia and South Africa is aligned and in agreement with the OECD Guidelines and the UN Manual. Furthermore, the OECD Guidelines state that the global formulary apportionment method can cause double taxation. The risk of double taxation in Botswana, Namibia and South Africa is reduced because these countries do not adopt the global formulary apportionment method.

## **6.7 APPLICATION OF AN ARM'S LENGTH RANGE IN THE SOUTHERN AFRICAN CUSTOMS UNION**

As was stated in chapter 5, in some cases it may be possible to apply the arm's length principle to arrive at a single figure (for example, price or margin) that can be used to determine whether a related-party transaction is arm's length. However, because transfer pricing is not an exact science,

there will also be many occasions when applying the most appropriate transfer pricing method will produce a range of figures (that is, the arm's length range) all of which are relatively equally reliable (OECD, 2017:163).

Table 5 discusses the use of the arm's length range in the SACU.

**Table 5: Arm's length range**

<b>Selecting a transfer pricing method</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
Guidance on arm's length ranges established in legislation and/or regulations	Paragraph 7.7 of the SA Transfer Pricing Rules states that an arm's length price does not necessarily constitute a single price, but a range of prices, and the facts of each case will determine where, within that range, a specific arm's length price will lie. Similarly, paragraph 11.4.1 of the SA Transfer Pricing Rules states that transfer pricing is not an exact science; the application of the most appropriate method will often result in a range of justifiable transfer prices.	Paragraph 7(1) of the Botswanan Transfer Pricing Regulations states that an arm's length range is a range of relevant financial indicator figures such as prices, margins or profit shares produced by applying the most appropriate transfer pricing method.	Paragraph 5.5 of the Namibian Transfer Pricing Rules states that a range of prices can be used in the determination of an arm's length price.
Guidance on measures of central tendency established in legislation and/or regulations	Not stated.	Paragraph 7(4) of the Botswanan Transfer Pricing Regulations state that the median is the fiftieth percentile.	Not stated.
Guidance extreme results established in	Not stated.	Not stated.	Not stated.

legislation and/or regulations			
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Source: Own formulation

The OECD Guidelines and the UN Manual support the use of a range of figures when applying a transfer pricing method. Botswanan, Namibian and South African transfer pricing legislation supports the use of a range of figures when applying a transfer pricing method. With respect to the use of arm's length ranges, transfer pricing legislation in Botswana, Namibia and South Africa is aligned and in agreement with the OECD Guidelines and the UN Manual.

The OECD Guidelines and the UN Manual support the use of measures of central tendency to determine the arm's length range. Botswanan transfer pricing legislation provides guidance on using measures of central tendency to determine the arm's length range. However, Namibian and South African transfer pricing legislation does not provide guidance on using measures of central tendency to determine the arm's length range. The absence of specific and formal guidance by South Africa and Namibia on the use of measures of central tendency could result in double taxation. For example, in a cross-border transaction involving Botswana and South Africa, the taxpayer could use the 25<sup>th</sup> percentile, 50<sup>th</sup> percentile and 75<sup>th</sup> percentile to obtain an arm's length range. The BURS may accept the arm's length range, but SARS may reject the arm's length range. To obtain the arm's length range, SARS could use the 35<sup>th</sup> percentile, 50<sup>th</sup> percentile and 65<sup>th</sup> percentile. As a result, the selected financial indicator may fall out of range in South Africa; the transaction may be subjected to an adjustment in South Africa, thus resulting in potential double taxation. With regard to the use of measures of central tendency to determine the arm's length range, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to the use of measures of central tendency to determine the arm's length range, transfer pricing legislation in Namibia and South Africa is not consistent with the OECD Guidelines and the UN Manual.

In terms of the OECD Guidelines, extreme results should be analysed and excluded from the set of comparables. Botswanan, Namibian and South African transfer pricing legislation does not

provide formal and specific guidance on extreme ranges. This could result in double taxation. For example, in a cross-border transaction involving Botswana and South Africa, the taxpayer could exclude loss-making entities from the set of comparables because they are extreme. The BURS may accept the set of comparables. However, due to the lack of formal guidance on extreme results in the SA Transfer Pricing Rules, SARS may arbitrarily reject the exclusion of the loss-making entities and accuse the taxpayer of “cherry-picking” comparables. This could result in two arm’s length ranges (one in South Africa and one in Botswana). The transaction could fall out of the arm’s length range in South Africa and be subject to an adjustment by SARS, thus resulting in potential double taxation. With regard to the treatment of extreme results in an arm’s length range, transfer pricing legislation in Botswana, Namibia and South Africa is aligned, but not in agreement with the OECD Guidelines and the UN Manual.

## **6.8 BURDEN OF PROOF IN THE SOUTHERN AFRICAN CUSTOMS UNION**

The burden of proof refers to the obligation of a party to prove something. From a transfer pricing perspective, the burden of proof refers to the obligation of either the taxpayer or the tax authority to prove that the transfer pricing in a particular case is correct. In chapter 5 it was explained that the burden of proof may fall on different persons in different jurisdictions. In some countries, the burden of proof is on the taxpayer, and in other countries, the burden of proof is on the tax authority. When transfer pricing issues are present, the divergent rules on the burden of proof among countries could result in conflict and double taxation. Table 6 below reflects the entity on which the burden of proof rests in South Africa, Botswana and Namibia, and whether the burden of proof is established in legislation and/or regulations.

**Table 6: Burden of proof**

<b>Burden of proof</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
Rests on the taxpayer	Yes	Not stated.	Yes
Established in legislation and/or regulations	Section 102 of the SA Tax Administration Act and Paragraph 15 of the SA Transfer Pricing Rules.	Not applicable.	Paragraph 8.2 of the Namibian Transfer Pricing Rules.

Source: Own formulation

As previously mentioned, when transfer pricing issues are present, the divergent rules on the burden of proof among countries could result in conflict and double taxation. In both South Africa and Namibia, the burden of proof is on the taxpayer, therefore reducing the risk of conflict and double taxation between South Africa and Namibia.

The UN Manual (UN Department of Economic and Social Affairs, 2021:405) states that the issue of whether the taxpayer or the tax administration has the burden of proof should be handled within a country's domestic legal framework. The burden of proof in Namibia and South Africa is on the taxpayer and is created within the domestic legal framework, that is, each country's transfer pricing regulations. Namibia and South Africa have applied the guidance provided by the UN Manual because the burden of proof in each country is created within the domestic legal framework. Botswana has not stated in its transfer pricing legislation whether the taxpayer or the tax authority has the burden of proof, which can cause disputes between the BURS and taxpayers. Botswana has not observed the guidance provided by the UN Manual because it has not stated who has the burden of proof in its domestic legal framework. With regard to the burden of proof, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to the burden of proof, transfer pricing legislation in Botswana is not consistent with the OECD Guidelines and the UN Manual.

## **6.9 SAFE HARBOURS IN THE SOUTHERN AFRICAN CUSTOMS UNION**

A safe harbour in a transfer pricing regime, as explained in chapter 5, is a provision that applies to a defined category of taxpayers or transactions, and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules and substitutes simpler obligations for those under the general transfer pricing regime.

According to the SA Transfer Pricing Rules, various factors such as administrative simplicity, certainty and compliance relief support the use of safe harbours. However, the SA Transfer Pricing Rules also state that there are various disadvantages associated with safe harbours. Most importantly, the introduction of safe harbours can produce results that may be inconsistent with

the arm's length principle. The SA Transfer Pricing Rules conclude that the OECD Guidelines warn against the use of safe harbours and that the Commissioner for SARS supports this view.

However, the SA Transfer Pricing Rules were published in 1999, whilst the OECD Guidelines were last updated in 2017. According to the latest OECD Guidelines (OECD, 2017:213), in cases involving smaller taxpayers or less complex transactions, the benefits of safe harbours may outweigh the problems raised by such provisions. Furthermore, the OECD Guidelines state that the use of bilateral or multilateral safe harbours under the right circumstances should be encouraged (OECD, 2017:213). Therefore, the SA Transfer Pricing Rules have not been updated for the OECD's latest stance on safe harbours. The SARS current view on safe harbours is inconsistent with the latest OECD Guidelines. SARS could be depriving itself of relief from compliance burdens and administrative complexity by not using multilateral safe harbours or bilateral safe harbours for low-risk transfer pricing transactions. No country in the SACU adopts safe harbour provisions. Therefore, revenue authorities in the SACU are depriving themselves of relief from compliance burdens and administrative complexity by not using bilateral safe harbours or multilateral safe harbours for low-risk transfer pricing transactions.

The OECD Guidelines and the UN Manual state that unilateral safe harbour provisions can cause double taxation. The absence of unilateral safe harbour provisions in the SACU reduces the risk of double taxation in the SACU. With respect to safe harbour provisions, transfer pricing legislation in the SACU is aligned, but are not consistent with the OECD Guidelines and the UN Manual.

## **6.10 ADVANCE PRICING AGREEMENTS IN THE SOUTHERN AFRICAN CUSTOMS UNION**

An APA is an agreement between a taxpayer and one or more tax authorities to determine in advance the manner in which transfer prices will be set for related party transactions. APAs can either be entered into unilaterally, bilaterally, or multilaterally. However, unilateral APAs can result in double taxation. Therefore, the OECD Guidelines and the UN Manual both recommend multilateral APAs and bilateral APAs over unilateral APAs. Table 7 below reflects whether the APA process is established in legislation and/or regulations in the SACU.

**Table 7: APAs**

<b>APA</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
APAs established in legislation and/or regulations	Paragraph 16.2 of the SA Transfer Pricing Rules states that the APA process will not, in the foreseeable future, be made available to South African taxpayers. SARS did, however, release a discussion paper in 2021 assessing the feasibility of APAs.	The Botswanan Transfer Pricing Regulations grant the BURS the authority to enter into unilateral APAs or bilateral APAs with the taxpayer.	The APA process is not made available to Namibian taxpayers.

Source: Own formulation

Tax authorities may not always agree with a taxpayer’s transfer price, which can lead to audits, adjustments and disputes. APAs aim to avoid such adjustments and disputes. The OECD Guidelines and the UN manual recommend APAs because they can be used to avoid such transfer pricing adjustments and disputes. APAs are not available to South African and Namibian taxpayers which increases the risk of transfer pricing adjustments and disputes in the SACU. South Africa and Namibia have not observed the guidance provided by the OECD Guidelines and the UN Manual because they do not provide for APAs. Botswana’s transfer pricing regime does provide Botswanan taxpayers with the opportunity to apply for both unilateral APAs and bilateral APAs. Unilateral APAs can result in double taxation. Double taxation could occur in the SACU because Botswanan taxpayers may enter into unilateral APAs. With regard to APAs, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned and is not consistent with the OECD Guidelines and the UN Manual.

## **6.11 TRANSFER PRICING DOCUMENTATION IN THE SOUTHERN AFRICAN CUSTOMS UNION**

Companies entering into related party transactions generally need to prepare transfer pricing documentation. Transfer pricing documentation allows companies to demonstrate to tax authorities that their related party transactions are compliant with local transfer pricing regulations.

Transfer pricing documentation can consist of a local file, master file and CbCR. The importance of convincing, consistent and cogent transfer pricing documentation was emphasised in chapter 5.

Table 8 below reflects the transfer pricing documentation requirements in the SACU.

**Table 8: Transfer pricing documentation**

<b>Transfer pricing documentation</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
Transfer pricing documentation requirements established in legislation and/or regulations	According to Public Notice 1117 (SARS, 2017), South African taxpayers must submit a local file and a master file if the taxpayer's cross-border related party transactions exceed 100 million Rand. A CbCR must be submitted in South Africa if the taxpayer's consolidated group revenue exceeds 10 billion Rand. Therefore South Africa adopts the CbCR exemption recommended by the OECD Guidelines.	Paragraph 14 of Botswana's Transfer Pricing Regulations state that the local file should be filed together with the tax return on the prescribed return filing date for Botswanan taxpayers with cross-border related party transactions. The master file, however, will be required from only those taxpayers whose transactions with connected persons exceed 5 million Pula. Botswana does not have a CbCR requirement.	Paragraph 8.5 of the Namibian Transfer Pricing Rules states that it is in taxpayers' interest to prepare transfer pricing documentation to demonstrate that they have developed sound transfer pricing policies under which transfer prices are determined in accordance with the arm's length principle. Namibia does not have specific transfer pricing documentation requirements.

Source: Own formulation

The OECD Guidelines and the UN Manual recommend that countries should adopt a three-tiered approach to transfer pricing documentation. This means that transfer pricing documentation should consist of a local file, master file and CbCR. South Africa is the only country in the SACU to adopt the OECD's three-tiered approach to transfer pricing documentation. The lack of adoption of the OECD's three-tiered approach to transfer pricing documentation in the SACU could result in

taxpayer uncertainty, disputes, and tax authorities not having the proper means to carry out effective transfer pricing risk assessment (OECD, 2017:233).

The OECD Guidelines and the UN Manual stipulate the information that should be included in the local file, master file and CbCR. Botswana is the only country in the SACU with specific local file and master file information requirements. Paragraph 14(3) and 14(5) of the Botswanan Transfer Pricing Regulations details the information that needs to be included in the local file and master file. Botswana's local file and master file information requirements are aligned with the information requirements stipulated in the OECD Guidelines and the UN Manual. Paragraph 10.3.6 of the SA Transfer Pricing Rules stipulates what information is required to be disclosed in transfer pricing documentation, but does not specifically state what information is required in the master file and the local file. This could result in uncertainty for taxpayers and give rise to disputes between taxpayers and SARS. Namibia's transfer pricing regulations do not provide specific local file and master file information requirements.

Only Botswana's local file and master file information requirements are aligned with the OECD Guidelines and the UN Manual. The local file and master file information requirements in Namibian and South African transfer pricing legislation are not fully aligned with the OECD Guidelines and the UN Manual. This increases the potential for disputes between taxpayers and revenue authorities in the SACU. With regard to transfer pricing documentation, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to transfer pricing documentation, transfer pricing legislation in Botswana and Namibia is not consistent with the OECD Guidelines and the UN Manual.

## **6.12 INTRA-GROUP SERVICES IN THE SOUTHERN AFRICAN CUSTOMS UNION**

In chapter 5, the position with intra-group services was discussed in detail. Table 9 analyses the various intra-group service provisions in the SACU.

**Table 9: Intra-group services**

<b>Transfer pricing documentation</b>	<b>South Africa</b>	<b>Botswana</b>	<b>Namibia</b>
Intra-group services provisions established in legislation and/or regulations	Not stated.	Paragraph 9(1) of the Botswanan Transfer Pricing Regulations	Not stated.
Application of the benefits test	Not stated.	Paragraph 9(1) of Botswanan Transfer Pricing Regulations state that intra-group services are transfer pricing compliant if the intra-group services have been actually provided. Intra-group services are actually provided in terms of the Botswanan Transfer Pricing Regulations if the intra-group services meet the requirements of the benefits test, that is, the intra-group services must provide economic or commercial value to the recipient, and the recipient would have been willing to pay an independent entity for the services or perform the services itself.	Not stated.
Arm's length charge for intra-group services	Not stated.	Paragraph 9(1) of Botswanan Transfer Pricing Regulations state that the amount charged for intra-group services should correspond to an amount which would have been agreed	Not stated.

		between independent entities for comparable services in comparable circumstances.	
Shareholder activities	Not stated.	Paragraph 9(2) of the Botswanan Transfer Pricing Regulations also states that a charge for a service made to a person liable to tax shall not be consistent with the arm's length principle where it is made by a connected person solely because of the person's shareholder's ownership interest in one or more other group members.	Not stated.
Methodology for charging intra-group services	Not stated.	Paragraph 9(3) of the Botswanan Transfer Pricing Regulations state that the direct charge method should be used where an intra-group service is directly attributable to a group member. Alternatively, where an intra-group service is not directly attributable to a group member, the indirect charge method should be used, that is, intra-group services should be allocated to group members based on reasonable allocation criteria.	Not stated.

Source: Own formulation

In order for intra-group services to be compliant in terms of the OECD Guidelines and the UN Manual, intra-group services have to be actually provided and the charge for intra-group services should be in accordance with the arm's length principle. The test for determining whether intra-group services have been provided between related entities is whether one or more related entities have received or are expected to receive economic benefits from the service. Such an economic benefit exists if an independent entity in similar circumstances would be willing to pay for the service or perform the service itself. The test for determining whether intra-group services have actually been provided is known as the "benefits test". The charge for intra-group services is at arm's length if the direct charge method or the indirect charge method is used.

Botswanan guidance on intra-group services is fully aligned with the OECD Guidelines and the UN Manual. This is because Botswana's guidance on intra-group services states that intra-group services have to be actually provided and the charge for intra-group services should be in accordance with the arm's length principle. Furthermore, Botswana's guidance on intra-group services also endorses the "benefits test" for determining whether intra-group services have actually been provided. Lastly, Botswana's guidance on intra-group services endorses the direct charge method and the indirect charge method. The Namibian Transfer Pricing Rules and the SA Transfer Pricing Rules do not provide specific guidance on intra-group services. The absence of specific guidance on intra-group services in the Namibian and the South African transfer pricing rules could result in potential disputes between taxpayers and revenue authorities. With regard to intra-group services, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to intra-group services, transfer pricing legislation in Namibia and South Africa is not consistent with the OECD Guidelines and the UN Manual.

### **6.13 CONCLUSION**

This chapter discussed transfer pricing practices in the SACU and compared transfer pricing practices in the SACU to the OECD Guidelines and the UN Manual. This was done by analysing the main components of transfer pricing legislation.

The first component analysed was the adoption of transfer pricing legislation in domestic tax regimes. The UN Manual (UN Department of Economic and Social Affairs, 2021:395) states that countries should publish transfer pricing legislation to prevent double taxation and tax base erosion. The OECD Guidelines do not provide guidance on transfer pricing legislation. Botswana, Namibia and South Africa have specific transfer pricing legislation and guidance. Eswatini and Lesotho do not have specific transfer pricing legislation and guidance. Eswatini and Lesotho have not observed the guidance provided by the UN Manual because they have not published transfer pricing legislation. The absence of transfer pricing legislation in Eswatini and Lesotho increases the risk of double taxation and tax base erosion in the SACU.

The second component analysed was the arm's length principle. The fundamental principle underpinning Botswanan, Namibian and South African transfer pricing legislation is the arm's length principle. Therefore, the countries in the SACU that have transfer pricing legislation consistently apply the arm's length principle in their transfer pricing regimes. With reference to the arm's length principle, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in accordance with the OECD Guidelines and the UN Manual.

The third component analysed was transfer pricing methods. The OECD Guidelines (2017:97) and the UN Manual (UN Department of Economic and Social Affairs, 2021:27) recognise the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. Furthermore, Botswanan, Namibian and South African transfer pricing legislation recognise the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. With reference to transfer pricing methods, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in terms of the OECD Guidelines and the UN Manual.

The fourth component analysed was the selection of a transfer pricing method. The OECD Guidelines and the UN Manual both state that the strengths and weaknesses of each method, the nature of the transaction, the availability of reliable data, and the degree of comparability, should be taken into account when selecting a transfer pricing method. The factors that should be taken into account when selecting a transfer pricing method in Botswana, Namibia and South Africa are similar to the OECD Guidelines and the UN Manual. With regard to guidance on selecting a

transfer pricing method, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and complies with the OECD Guidelines and the UN Manual. However, there are slight differences between the wording in South African and Namibian transfer pricing legislation and the OECD Guidelines and the UN Manual. This could be because South Africa's transfer pricing regulations were published in 1999, and Namibia's transfer pricing regulations were published in 2006, while the OECD Guidelines and the UN Manual were updated in 2017 and 2021 respectively. These differences do not result in double taxation or base erosion and profit shifting, but could result in disputes between revenue authorities and taxpayers if there is a difference in interpretation between the guidance in the OECD Guidelines or the UN Manual and transfer pricing legislation.

The fifth component analysed was the global formulary apportionment method. OECD member countries and developing countries reject the global formulary apportionment method. Transfer pricing legislation in South Africa, Botswana and Namibia does not provide guidance on the global formulary apportionment method. The absence of any guidance on the global formulary apportionment method indicates that these countries reject the global formulary apportionment method. Therefore, with respect to the global formulary apportionment method, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in terms of the OECD Guidelines and the UN Manual. Furthermore, the OECD Guidelines state that the global formulary apportionment method can cause double taxation. The risk of double taxation in South Africa, Botswana and Namibia is reduced because these countries do not adopt the global formulary apportionment method.

The sixth component analysed was arm's length ranges. Both the OECD Guidelines and the UN Manual confirm that transfer pricing is not an exact science; therefore, there will be many occasions when applying the most appropriate method produces a range of figures. Botswanan, Namibian and South African transfer pricing legislation supports the use of a range of figures when applying a transfer pricing method. With respect to the use of arm's length ranges, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in terms of the OECD Guidelines and the UN Manual.

The OECD Guidelines and the UN Manual support the use of measures of central tendency to determine the arm's length range. Botswanan transfer pricing legislation provides guidance on using measures of central tendency to determine the arm's length range. However, Namibian and South African transfer pricing legislation do not provide guidance on using measures of central tendency to determine the arm's length range. The absence of specific and formal guidance by South Africa and Namibia on the use of measures of central tendency could result in double taxation. With regard to the use of measures of central tendency to determine the arm's length range, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to the use of measures of central tendency to determine the arm's length range, transfer pricing legislation in Namibia and South Africa is not consistent with the OECD Guidelines and the UN Manual.

In terms of the OECD Guidelines, extreme results should be analysed and excluded from the arm's length range. Botswanan, Namibian and South African transfer pricing legislation does not provide formal and specific guidance on extreme ranges. This can cause double taxation. With regard to the treatment of extreme results in an arm's length range, transfer pricing legislation in Botswana, Namibia and South Africa is aligned, but not in agreement with the OECD Guidelines and the UN Manual.

The seventh component analysed was the burden of proof. When transfer pricing issues are present, the divergent rules on the burden of proof among countries could result in conflict and double taxation. In South Africa and Namibia, the burden of proof is on the taxpayer, therefore reducing the risk of conflict and double taxation between South Africa and Namibia.

The UN Manual states that the issue of whether the taxpayer or the tax authority has the initial burden to prove that the pricing is in accordance with the arm's length principle should be handled within a country's domestic legal framework. The burden of proof in Namibia and South Africa is on the taxpayer and is created within the domestic legal framework, that is, each country's transfer pricing regulations. Namibia and South Africa have applied the guidance provided by the UN Manual because the burden of proof in each country is created within the domestic legal framework. Botswana has not stated in its transfer pricing legislation whether the taxpayer or the

tax authority has the burden of proof, which can cause disputes between the BURS and taxpayers. Botswana has therefore not observed the guidance provided by the UN Manual. With regard to the burden of proof, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to the burden of proof, transfer pricing legislation in Botswana is not consistent with the OECD Guidelines and the UN Manual.

The eighth component analysed was safe harbours. The OECD Guidelines state that in cases involving smaller taxpayers or less complex transactions, the benefits of safe harbours may outweigh the problems raised by such provisions. Botswana and Namibia's transfer pricing regimes do not provide guidance on safe harbours. South Africa's transfer pricing legislation notes the disadvantages of safe harbours but does not have specific safe harbour provisions. The advice provided by South Africa's transfer pricing legislation on safe harbours is based on an older version of the OECD Guidelines and is inconsistent with the latest version of the OECD Guidelines.

The OECD Guidelines state that where safe harbours can be negotiated on a bilateral or multilateral basis, they may provide significant relief from compliance burdens without creating problems of double taxation or double non-taxation. No country in the SACU adopts safe harbour provisions. Therefore, revenue authorities in the SACU are depriving themselves of relief from compliance burdens and administrative complexity by not using bilateral safe harbours or multilateral safe harbours for low-risk transfer pricing transactions.

The OECD Guidelines and the UN Manual state that unilateral safe harbour provisions can cause double taxation. The absence of unilateral safe harbour provisions in the SACU reduces the risk of double taxation in the SACU. With respect to safe harbour provisions, transfer pricing legislation in the SACU is aligned, but is not consistent with the OECD Guidelines and the UN Manual.

The ninth component analysed was APAs. The OECD Guidelines and the UN manual recommend APAs because they can be used to avoid transfer pricing adjustments and disputes. APAs are not available to South African and Namibian taxpayers which increases the risk of transfer pricing

adjustments and disputes in the SACU. South Africa and Namibia have not observed the guidance provided by the OECD Guidelines and the UN Manual because they do not provide APAs. APAs could either be entered into unilaterally, multilaterally or bilaterally. However, unilateral APAs could result in double taxation, according to the OECD Guidelines. Botswana's transfer pricing regime does provide Botswanan taxpayers with the opportunity to apply for both unilateral APAs and bilateral APAs. Double taxation can occur in the SACU because Botswanan taxpayers may enter into unilateral APAs. With regard to APAs, transfer pricing legislation in South Africa, Botswana and Namibia is not aligned and is not consistent with the OECD Guidelines and the UN Manual.

The tenth component analysed was transfer pricing documentation. The OECD Guidelines and the UN Manual recommend that countries should adopt a three-tiered approach to transfer pricing documentation. This means transfer pricing documentation should consist of a local file, master file and CbCR. South Africa is the only country in the SACU to adopt the three-tiered approach to transfer pricing documentation. The lack of adoption of the three-tiered approach to transfer pricing documentation in Botswana and Namibia could result in taxpayer uncertainty, disputes, and revenue authorities not having the proper means to carry out effective transfer pricing risk assessment.

The OECD Guidelines and the UN Manual stipulate the information that should be included in the local file, master file and CbCR. Botswana's local file and master file information requirements are aligned with the OECD Guidelines and the UN Manual. The local file and master file information requirements in Namibian and South African transfer pricing legislation are not fully aligned with the OECD Guidelines and the UN Manual. This increases the potential for disputes between taxpayers and revenue authorities. With regard to transfer pricing documentation, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to transfer pricing documentation, transfer pricing legislation in Botswana and Namibia is not consistent with the OECD Guidelines and the UN Manual.

The eleventh component analysed was intra-group services. In order for intra-group services to be compliant in terms of the OECD Guidelines and the UN Manual, intra-group services have to be

actually provided and the charge for intra-group services should be in accordance with the arm's length principle. Botswanan guidance on intra-group services is fully aligned with the OECD Guidelines and the UN Manual. The Namibian Transfer Pricing Rules and the SA Transfer Pricing Rules do not provide specific guidance on intra-group services. The absence of specific guidance on intra-group services in the Namibian Transfer Pricing Rules and the SA Transfer Pricing Rules could result in potential disputes between taxpayers and revenue authorities. With regard to intra-group services, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to intra-group services, transfer pricing legislation in Namibia and South Africa is not consistent with the OECD Guidelines and the UN Manual.

The next chapter is the concluding chapter and provides a summary of the research findings in addressing the goals of the research.

## **CHAPTER 7: CONCLUSION**

The main goal of this study was to investigate whether transfer pricing legislation in the SACU aligns between SACU countries and with the OECD and UN Guidelines. To achieve this goal, the following sub-goals were addressed:

- to explain the arm's length principle;
- to discuss the methods applied in calculating an arm's length price;
- to discuss transfer pricing practices in the SACU;
- to compare transfer pricing practices within the SACU and to the OECD and UN Guidelines; and
- to identify areas requiring harmonisation.

This chapter provides summaries of the findings and links these findings to the research goals of the thesis. Recommendations are also made for the harmonisation of transfer pricing guidelines between SACU countries and with the OECD Guidelines and the UN Manual.

### **7.1 SUMMARY OF FINDINGS**

The purpose of chapter 1 was to provide an introduction to the study, to set out the problem statement and goals of the research, and describe the research design adopted for the research. The research design was described as a legal interpretive doctrinal research methodology, with a qualitative research method.

The purpose of chapter 2 was to define and elaborate on the concept of transfer pricing, including the history of transfer pricing and the issues underlying transfer pricing. Chapter 2 highlighted that transfer pricing is one of the most relevant topics in international tax due to the expansion of global trade in recent decades. The chapter also established that the generally accepted meaning of transfer pricing is the pricing of transactions between related parties. Chapter 2 also noted that transfer pricing provisions can trace their origins to the early twentieth century. Chapter 2 explored the basic issues underlying transfer pricing and found that cross-border related party transactions

involve issues related to jurisdiction, allocation of income, valuation, and profit shifting (shifting profits from related entities in higher tax countries to related entities in relatively lower tax countries). In order to counter the problems of profit shifting and tax base erosion associated with cross-border related party transactions, countries around the world have introduced transfer pricing provisions into their domestic tax systems.

The purpose of chapter 3 was to discuss the fundamentals of the arm's length principle, including its history, the definition, the rationale for its development and adoption, difficulties in applying it, the practical application of the principle, and a discussion of the guidelines for the calculation of the arm's length price. Chapter 3 addressed the first sub-goal of the research, that is, to explain the arm's length principle. Chapter 3 noted that the arm's length principle represents a key pillar of transfer pricing rules and is a standard that has been used in the international tax field. The arm's length principle follows the approach of treating transactions between entities of an MNE as though they are separate independent entities (OECD, 2017:35). Under the arm's length principle, the price charged for goods or services that are exchanged between related companies must be the same as the price charged for similar goods or services exchanged between independent companies. Therefore, the arm's length price for a good or service that is exchanged between related companies is the price that is charged by independent companies for similar goods or services. When countries adopt the arm's length principle in their transfer pricing regime and there is a difference between the transfer price and the arm's length price, the transfer price is adjusted so that it equals the arm's length price. This adjustment is known as a primary adjustment. A primary adjustment involves adjusting the transfer price to the arm's length price. Chapter 3 also noted that a major reason for the adoption of the arm's length principle is that the arm's length principle provides broad parity of tax treatment for members of MNEs and independent entities. It was noted in the chapter that the arm's length principle can trace its origins to the League of Nations Draft Convention on the Allocation of Profits and Property of International Enterprises, in 1933. Chapter 3 also highlighted that the OECD Model Tax Convention and the UN Model Double Taxation Convention between Developed and Developing Countries provide an authoritative statement on the arm's length principle. Chapter 3 concluded that the arm's length principle has flaws, but it does generally produce appropriate levels of income between members of MNEs, acceptable to tax authorities.

Chapter 4 addressed the second sub-goal of the research which was to discuss the transfer pricing methods. Chapter 4 explained and discussed the various methods of calculating and testing transfer prices, the circumstances in which each method is applicable and the strengths and weaknesses of each method. Chapter 4 found that the OECD Guidelines and the UN Manual describe five transfer pricing methods that are classified respectively into traditional transaction methods and transactional profit methods. The traditional transaction methods consist of the CUP, the RPM, and the CPM. The transactional profit methods include the TNMM and the PSM. Chapter 4 concluded that although the five methods described in the OECD Guidelines and the UN Manual are not intended to encompass all of the possible ways of determining whether transactions result in outcomes that are at arm's length, they are widely accepted by national authorities. Table 10 provides a brief summary of each transfer pricing method covered in chapter 4.

**Table 10: Transfer pricing methods**

<b>Transfer pricing method</b>	<b>Description</b>	<b>Application</b>
CUP Method	The CUP method compares the price charged for goods or services transferred in a related party transaction to the price charged for comparable goods or services in an independent transaction, under comparable circumstances.	The CUP method is often determined to be the most appropriate method for pricing commodities and is also frequently used for financial assistance transactions (interest) and intangibles (royalties).
RPM	The RPM compares the gross margin earned by a related reseller with the gross margin achieved by independent resellers from comparable independent transactions.	The RPM may be a suitable method in cases where one of the parties performs ordinary distribution and selling functions and adds relatively little value to the goods. The RPM is typically applied to marketing and distribution activities.
CPM	The CPM compares the gross mark-up added to the direct costs incurred by a manufacturer or a service provider in a related party transaction to the gross mark-	The CPM is usually applied to sales, transfer and usage of tangible goods, the provision of services, and financial assistance.

	up achieved by an independent manufacturer or service provider in comparable independent transactions.	
PSM	The PSM first determines the relevant profits from one or more transactions between two related entities and splits these profits between the parties on an arm's length basis.	The PSM is usually applied in cases where the related party transaction is highly integrated.
TNMM	The TNMM compares the net profit margin from a related party transaction with the net margin realised by independent entities in comparable independent transactions.	The TNMM is usually applied to sales, transfer and usage of tangible goods, provision of labour services, and the transfer of intangible assets.

Source: Own formulation

Chapter 5 discussed various issues relating to transfer pricing. Table 11 provides a brief summary of each transfer pricing issue discussed in chapter 5.

**Table 11: Transfer pricing issues**

<b>Transfer pricing issue</b>	<b>Discussion</b>
Global formulary apportionment method	The global formulary apportionment method is a non-arm's length transfer pricing method that has been suggested as an alternative to the arm's length principle. The global formulary apportionment method allocates the profits of an MNE from both related party transactions and independent transactions on a consolidated basis among all of the MNE's entities in different countries, based on a predetermined and mechanistic formula. The major disadvantages associated with using the global formulary apportionment method is that it can cause double taxation, tax evasion, disputes between tax authorities and intolerable compliance costs for taxpayers. OECD member countries and developing countries reject the global formulary apportionment method because of its disadvantages.
Arm's length ranges	Both the OECD Guidelines and the UN Manual confirm that transfer pricing is not an exact science; therefore, there will be many occasions when applying the most appropriate transfer pricing method produces a range of figures, that is, an arm's

	length range. Measures of central tendency are generally used to determine the arm's length range.
Burden of proof	The burden of proof refers to the obligation of a party to prove something. From a transfer pricing perspective, the burden of proof refers to the obligation of either the taxpayer or the tax authority to prove that the transfer pricing in a particular case is correct. The burden of proof rules for tax cases differs among countries. In some countries, the burden of proof is on the taxpayer, and in other countries, the burden of proof is on the tax authority. When transfer pricing issues are present, the divergent rules on the burden of proof among countries could result in conflict and double taxation.
Safe harbours	A safe harbour in a transfer pricing regime is a provision that applies to a category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's transfer pricing rules. A safe harbour replaces a country's normal transfer pricing requirements with simplified ones. There are various advantages and disadvantages associated with safe harbours. Safe harbours benefit taxpayers by enabling them to price their transactions and file their income tax returns with lower compliance burdens and with greater certainty whilst safe harbours benefit tax authorities by enabling them to manage their limited resources available for tax enforcement by shifting resources from smaller taxpayers and less complex transactions to more complex, higher-risk transactions. However, unilateral safe harbours can cause double taxation. The OECD Guidelines state that in cases involving smaller taxpayers or less complex transactions, the benefits of safe harbours may outweigh the problems raised by such provisions. The OECD Guidelines state that where safe harbours can be negotiated on a bilateral or multilateral basis, they may provide significant relief from compliance burdens without creating problems of double taxation or double non-taxation.
APAs	An APA is an agreement between a taxpayer and one or more tax authorities to determine in advance the manner in which transfer prices will be set for related party transactions. Tax authorities may not always agree with a taxpayer's transfer price, which can lead to audits, adjustments and disputes. APAs aim to avoid such adjustments and disputes. APAs could either be entered into unilaterally, bilaterally, or multilaterally. However, unilateral APAs could result in double taxation, according to the OECD Guidelines.
Transfer pricing documentation	Companies entering into related party transactions generally need to prepare transfer pricing documentation. Transfer pricing documentation allows companies to demonstrate to tax authorities that their related party transactions are compliant with local

	transfer pricing regulations. Transfer pricing documentation can consist of a local file, master file and CbCR. The OECD Guidelines and the UN Manual recommend that countries should adopt a three-tiered approach to transfer pricing documentation. This means transfer pricing documentation should consist of a local file, master file and CbCR. The OECD Guidelines and the UN Manual stipulate the information that should be included in the local file, master file and CbCR.
Intra-group services	In order for intra-group services to be compliant in terms of the OECD Guidelines and the UN Manual, intra-group services have to be actually provided and the charge for intra-group services should be in accordance with the arm's length principle. The test for determining whether intra-group services have been provided between related entities is whether one or more related entities have received or are expected to receive economic benefits from the service. Such an economic benefit exists if an independent entity in similar circumstances would be willing to pay for the services or perform the service itself. The charge for intra-group services is arm's length if the direct charge method or the indirect charge method is used.

Source: Own formulation

The main purpose of chapter 6 was to investigate whether transfer pricing legislation in the SACU aligns between SACU countries and with the OECD and UN Guidelines. Chapter 6 addressed three sub-goals of the research and did this by discussing transfer pricing practices in the SACU, comparing transfer pricing practices within the SACU, and to the OECD and UN Guidelines, and identifying areas requiring harmonisation. Chapter 6 analysed components of transfer pricing legislation from a SACU perspective, and identified various instances where transfer pricing legislation in the SACU was either aligned or not aligned to each other and to the OECD Guidelines and the UN Manual. Table 12 below briefly discusses each transfer pricing component that was analysed in chapter 6.

**Table 12: Analysis and findings**

<b>Transfer pricing component</b>	<b>Findings</b>
Transfer pricing legislation in domestic tax regimes	Botswana, Namibia and South Africa have specific transfer pricing legislation and guidance. Eswatini and Lesotho do not have specific transfer pricing legislation and guidance. Eswatini and Lesotho have not observed the guidance provided by the UN Manual because they have not published transfer pricing legislation. The absence of transfer pricing legislation in Eswatini and Lesotho increases the risk of double taxation and tax evasion in the SACU.
Arm's length principle	The fundamental principle underpinning Botswana, Namibian and South African transfer pricing legislation is the arm's length principle. To the extent that a related party transaction is not arm's length, revenue authorities in Botswana, Eswatini, Namibia and South Africa may apply a primary transfer pricing adjustment and adjust the pricing of the related party transaction to an arm's length amount. With reference to the arm's length principle, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in accordance with the OECD Guidelines and the UN Manual.
Transfer pricing methods	Botswana, Namibian and South African transfer pricing legislation recognise the CUP method, RPM, CPM, TNMM and PSM as acceptable transfer pricing methods. With reference to transfer pricing methods, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in terms of the OECD Guidelines and the UN Manual.
Selecting a transfer pricing method	The factors that should be taken into account when selecting a transfer pricing method in Botswana, Namibia and South Africa are similar to the OECD Guidelines and the UN Manual. With respect to guidance on selecting a transfer pricing method, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and complies with the OECD Guidelines and the UN Manual. However, there are slight differences between the wording in South African and Namibian transfer pricing legislation and the OECD Guidelines and the UN Manual. This could be because South Africa's transfer pricing regulations were published in 1999, and Namibia's transfer pricing regulations were published in 2006, while the OECD Guidelines and the UN Manual were updated in 2017 and 2021 respectively. These differences could result in disputes between revenue authorities and taxpayers if there is a difference in interpretation between the guidance in the OECD Guidelines or the UN Manual and transfer pricing legislation.

Global formulary apportionment	<p>With regard to the global formulary apportionment method, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in terms of the OECD Guidelines and the UN Manual. Furthermore, the OECD Guidelines state that using the global formulary apportionment method can cause double taxation. The risk of double taxation in South Africa, Botswana and Namibia is reduced because these countries do not adopt the global formulary apportionment method.</p>
Arm's length ranges	<p>With regard to the use of arm's length ranges, transfer pricing legislation in South Africa, Botswana and Namibia accept the use of arm's length ranges, and is aligned and in terms of the OECD Guidelines and the UN Manual.</p> <p>Namibian and South African transfer pricing legislation does not provide guidance on using measures of central tendency to determine the arm's length range. The absence of specific and formal guidance by South Africa and Namibia on the use of measures of central tendency could result in double taxation. With regard to the use of measures of central tendency to determine the arm's length range, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to the use of measures of central tendency to determine the arm's length range, transfer pricing legislation in Namibia and South Africa is not consistent with the OECD Guidelines and the UN Manual.</p> <p>Botswanan, Namibian and South African transfer pricing legislation does not provide formal and specific guidance on extreme ranges. This could result in double taxation. With regard to the treatment of extreme results in an arm's length range, transfer pricing legislation in Botswana, Namibia and South Africa is aligned, but not in agreement with the OECD Guidelines and the UN Manual.</p>
Burden of proof	<p>In South Africa and Namibia, the burden of proof is on the taxpayer, therefore reducing the risk of conflict and double taxation between South Africa and Namibia.</p> <p>The burden of proof in Namibia and South Africa is on the taxpayer and is created within the domestic legal framework, that is, each country's transfer pricing regulations. Namibia and South Africa have applied the guidance provided by the UN Manual because the burden of proof in each country is created within the domestic legal framework. Botswana has not stated in its transfer pricing legislation whether the taxpayer or the tax authority has the burden of proof which can cause disputes between the BURS and taxpayers. Botswana has not</p>

	<p>observed the guidance provided by the UN Manual because it has not stated who has the burden of proof in its domestic legal framework. With regard to the burden of proof, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to the burden of proof, transfer pricing legislation in Botswana is not consistent with the OECD Guidelines and the UN Manual.</p>
Safe harbours	<p>The advice provided by South Africa’s transfer pricing legislation on safe harbours is based on an older version of the OECD Guidelines and is inconsistent with the latest version of the OECD Guidelines. No country in the SACU adopts safe harbour provisions. Therefore, revenue authorities in the SACU are depriving themselves of relief from compliance burdens and administrative complexity by not using bilateral safe harbours or multilateral safe harbours for low-risk transfer pricing transactions.</p> <p>The absence of unilateral safe harbour provisions in the SACU reduces the risk of double taxation in the SACU. With respect to safe harbour provisions, transfer pricing legislation in the SACU is aligned, but are not consistent with the OECD Guidelines and the UN Manual.</p>
APAs	<p>APAs are not available to South African and Namibian taxpayers which increases the risk of transfer pricing adjustments and disputes in the SACU. South Africa and Namibia have not observed the guidance provided by the OECD Guidelines and the UN Manual because they do not provide APAs. Double taxation can occur because Botswanan taxpayers may enter into unilateral APAs. With respect to APAs, transfer pricing legislation in South Africa, Botswana and Namibia is not aligned and is not consistent with the OECD Guidelines and the UN Manual.</p>
Transfer pricing documentation	<p>South Africa is the only country in the SACU to adopt the OECD’s three-tiered approach to transfer pricing documentation. The lack of adoption of the OECD’s three-tiered approach to transfer pricing documentation in Botswana and Namibia could result in taxpayer uncertainty, disputes, and revenue authorities not having the proper means to carry out effective transfer pricing risk assessments.</p> <p>Botswana’s local file and master file information requirements are aligned with the OECD Guidelines and the UN Manual. The local file and master file information requirements in Namibian and South African transfer pricing legislation are not fully aligned with the OECD Guidelines and the UN Manual. This increases the potential for disputes</p>

	between taxpayers and revenue authorities. With regard to transfer pricing documentation, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to transfer pricing documentation, transfer pricing legislation in Botswana and Namibia is not consistent with the OECD Guidelines and the UN Manual.
Intra-group services	Botswanan guidance on intra-group services is fully aligned with the OECD Guidelines and the UN Manual. The Namibian Transfer Pricing Rules and the SA Transfer Pricing Rules do not provide specific guidance on intra-group services. The absence of specific guidance on intra-group services in the Namibian Transfer Pricing Rules and the SA Transfer Pricing Rules could result in potential disputes between taxpayers and revenue authorities. With regard to intra-group services, transfer pricing legislation in Botswana, Namibia and South Africa is not aligned. Furthermore, with regard to intra-group services, transfer pricing legislation in Namibia and South Africa is not consistent with the OECD Guidelines and the UN Manual.

Source: Own formulation

**7.2 INSTANCES OF NON-ALIGNMENT**

With reference to the arm’s length principle, the global formulary apportionment method, arm’s length ranges, selecting a transfer pricing method and transfer pricing methods, transfer pricing legislation in South Africa, Botswana and Namibia is aligned and in terms of the OECD Guidelines and the UN Manual. However, transfer pricing legislation in the SACU countries is not fully aligned and is not aligned to the OECD Guidelines and the UN Manual. This gives rise to the risk of double taxation, base erosion and profit shifting, and disputes. The potential for double taxation, base erosion and profit shifting arises as:

- Eswatini and Lesotho do not include transfer pricing provisions in legislation or provide any transfer pricing guidance;
- Namibian and South African transfer pricing legislation does not provide guidance on using measures of central tendency to determine the arm’s length range;
- Botswanan, Namibian and South African transfer pricing legislation does not provide formal and specific guidance on extreme ranges; and
- Botswana provides taxpayers with the opportunity to enter into unilateral APAs.

The potential for disputes arises from:

- differences between the wording in South African and Namibian transfer pricing legislation and the OECD Guidelines and the UN Manual;
- the lack of adoption of the three-tiered approach to transfer pricing documentation in Botswana and Namibia; and
- the absence of specific guidance on intra-group services in the Namibian Transfer Pricing Rules and the SA Transfer Pricing Rules.

Differences arise between the OECD Guidelines, the UN Manual, SA Transfer Pricing Rules and Namibian Transfer Pricing Rules possibly because South Africa's transfer pricing regulations were published in 1999, and Namibia's transfer pricing regulations were published in 2006, while the OECD Guidelines and the UN Manual were updated in 2017 and 2021 respectively.

### **7.3 RECOMMENDATIONS**

For transfer pricing legislation in the SACU countries to be more aligned to each other and to the OECD Guidelines and the UN Manual:

- Eswatini and Lesotho should promulgate transfer pricing legislation that is based on the OECD Guidelines and the UN Manual;
- South Africa, and Namibia should update their transfer pricing regulations in accordance with the latest version of the OECD Guidelines and the UN Manual;
- revenue authorities in Botswana, South Africa and Namibia should consider expanding the legislation on transfer pricing and embodying certain basic principles in legislation; some aspects, such as basic documentation requirements, should be included directly in legislation; and
- as the OECD Guidelines and the UN Manual provide a number of practical examples with regard to most aspects of the transfer pricing, specifically, a number of relevant examples with regard to the application of the various arm's length methods. Transfer pricing guidance from Botswana, Namibia and South Africa does not provide practical examples. Additional examples are likely to be useful for taxpayers. Botswana, Namibia and South Africa should therefore consider providing practical guidance in transfer pricing legislation.

#### **7.4 LIMITATIONS OF SCOPE AND FURTHER RESEARCH OPPORTUNITIES**

The research was based on four primary sources. These are the OECD Guidelines, the UN Manual, national legislation in the countries examined, and practical guidance published by the countries examined. The research was also limited to the five countries selected. The research did not explore the effects of differences in the definition of associated enterprises. Most countries have their own associated enterprises definition. The OECD Guidelines (2017:23) and the UN Manual (2021:33) state that two enterprises are associated enterprises with respect to each other if they are related to each other by virtue of common ownership or control. Differences in the definition of associated enterprises may potentially lead to a wider tax net in certain regions. Future research may also focus on analysing the impact on taxpayers affected by the definition.

Future research may take a view on practical issues identified in relevant court cases. Bearing in mind the general geographic limitations of the study, other regions within Africa may provide further guidance and insight.

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