SUGGESTED APPROACH

to Drafting Transfer Pricing Legislation

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Series: ATAF’s International Taxation and Technical Assistance Publication

Version 2
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INTRODUCTION

About this Suggested Approach

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

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

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

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

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

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

Contact persons

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

Telephone: +27 12 451 8800
E-Mail: info@ataftax.org
1. TRANSFER PRICING LEGISLATION

Section XX

1. For the purposes of this Act, where

i) a person resident in [Country] engages directly or indirectly in one or more transaction, operation or scheme, in this section referred to as a “transaction” with a connected person or

ii) a person not resident in [Country] engages directly or indirectly in one or more transactions with a connected person not resident in [Country] where the transaction is in relation to a permanent establishment in [Country] of one of the two connected persons, the amount of each person’s taxable income shall be determined in a manner that is consistent with the arm’s length principle.

iii) The amount of such taxable income shall be consistent with the arm’s length principle if the conditions of those transactions do not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances.

2. Where, the conditions of a transaction between connected persons (“a controlled transaction”) to which paragraph 1 applies are not consistent with the arm’s length principle, and the effect of that inconsistency is reducing or postponing the liability to tax of any person for any tax year, then the taxable income of that person shall be computed as though the conditions of the transaction are consistent with the arm’s length principle.

3. The determination of whether the conditions of a controlled transaction are consistent with the arm’s length principle of paragraph 1, and of the quantum of any adjustment made under paragraph 2, shall be made in accordance with [insert relevant secondary legislation/regulation reference]

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

i) a resident person engages directly or indirectly in a transaction with a connected person or

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

Provided that in the case of goods exported from [Country] that are subsequently sold by a connected person to an unconnected person the price agreed upon between that connected person and the unrelated person (the agreed price) is higher than the quoted price at the above-mentioned date, the agreed price in this case will be considered as the sale price for the purposes of computing the seller’s taxable income in (Country) unless the person provides all of the evidence needed to show that adjustments are appropriate to that sale price to be consistent with the arm’s length principle.

6. For the purposes of Paragraph 5 the date of the transaction shall be deemed to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport unless the person provides reliable contemporaneous evidence of the actual pricing date agreed by the connected persons in the transaction and that the date accords with the date that would have been agreed if the persons had been dealing at arm’s length.

[Optional alternative to section 5 and 6 above] 7.

Notwithstanding the provisions of paragraph 1 and 2 where;

i) a resident person engages directly or indirectly in a transaction with a connected person or

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

Provided that in the case of goods exported from [Country] the price agreed upon between the group and unconnected person (the agreed price) is higher than the above-mentioned quoted price at the above-mentioned date, the agreed price in this case will be considered as the sale price for the purposes of computing the seller’s taxable income in (Country).

8. Notwithstanding the provisions of paragraph 1 and 2 where;

i) a resident person engages directly or indirectly in a transaction or

ii) a non-resident person engages directly or indirectly in a transaction relating to a permanent establishment in [Country] with a connected person for the acquisition of new or used assets from connected persons not resident in [Country], [Option A] the taxpayer upon written request from the Commissioner-General/Commissioner shall provide the invoice for the acquisition of the asset [Optional: and proof of payment] when it was purchased from an independent third party by the connected person [Option B] the purchase price of the asset shall be deemed to be nil for the purposes of computing the taxable income of the taxpayer unless the taxpayer provides the invoice
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to Drafting Transfer Pricing Legislation

for the acquisition of the asset [Optional: and proof of payment] when it was purchased from an independent third party by the connected person.

9. Every person who engages in a transaction to which subsection (1) applies shall keep the documentation required under [Insert Transfer Pricing Documentation Regulation reference]

10. Two persons are considered to be connected where [Countries should refer to their current domestic legislation to determine the definition of connected/related persons]

[Optional] 11. This section shall not apply in respect of transactions between connected persons where the persons are able to satisfy the Commissioner-General that they are members of a group whose total external (consolidated) turnover is less than XXXX.

12. [If wish to apply Approved OECD Approach (AOA)] The provisions of this section apply to the attribution of profit to a permanent establishment on the assumption that the permanent establishment and other parts of a legal person are treated as separate and independent enterprises.

12A. [If do not wish to apply AOA]. The provisions of this section apply to the attribution of profit to a permanent establishment on the assumption that the permanent establishment and other parts of a legal person are treated as separate persons dealing at arm’s length. No deduction shall be allowed in respect of amounts, if any, paid or payable (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents or other rights, or by way of commission, for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment.

[Optional] 13. Where a person engages in a transaction with a connected person that involves the transfer of rights in an intangible, other than the alienation of an intangible, the deduction allowable for tax purposes in that transaction shall not exceed X% of the [tax EBITDA + plus royalties payable] derived from the commercial activity conducted by the person in which the rights transferred are exploited.

(a) issue guidelines for the determination of the arm’s length value of a transaction for purposes of this section; or
(b) specify such requirements as he may consider necessary for the better carrying out of the provisions of this section.

[Optional] 15. To the extent that there is a difference between—
(a) any amount that is, after taking paragraph 2 into account, applied in the calculation of the taxable income of any resident that is a party to an affected transaction; and
(b) any amount that would, but for paragraph 2 have been applied in the calculation of the taxable income of the resident contemplated in paragraph (a), the amount of that difference shall, for purposes of paragraph 2 be deemed to be a dividend for the purposes of Section XX.
2. Proposed Transfer Pricing Regulations to be introduced in [Country]

1. Citation
2. Interpretation
3. Arm's length principle
4. Comparability
5. Transfer pricing methods
6. Evaluation of taxpayer's combined controlled transactions
7. Arm's length range
8. Sources of information on comparable controlled transactions
9. Services between associated persons
10. Transactions involving intangible property
11. Disregarding a controlled transaction for tax purposes
12. Corresponding adjustments for domestic transactions
13. Corresponding adjustments for international transactions
14. Relevance of OECD Transfer Pricing Guidelines
15. Application of Section XX to domestic transactions

<table>
<thead>
<tr>
<th>Citation</th>
<th>1. These Regulations may be cited as the Income Tax (Transfer Pricing) Regulations, 20XX.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interpretation</td>
<td>2. In these Regulations, unless the context otherwise requires -</td>
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<tr>
<td></td>
<td>“Controlled transaction” is any transaction between connected persons</td>
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<td></td>
<td>“Uncontrolled transaction” is any transaction between independent persons</td>
</tr>
<tr>
<td></td>
<td>“Comparable transactions” mean transactions that are comparable in accordance with Paragraph 4 of this Regulation</td>
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<td>“Financial indicator” means—</td>
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<td></td>
<td>(a) in relation to the comparable uncontrolled price method, the price;</td>
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<td></td>
<td>(b) in relation to the cost plus method, the mark up on costs;</td>
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<td></td>
<td>(c) in relation to the resale price method, the resale margin;</td>
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<td></td>
<td>(d) in relation to the transaction net margin method, the net profit margin; or</td>
</tr>
<tr>
<td></td>
<td>(e) in relation to the transactional profit split method, the division of the operating profit and loss;</td>
</tr>
<tr>
<td>Arm's length principle</td>
<td>3. (1) The determination of whether the conditions of a controlled transaction are consistent with the arm’s length principle of Section XXX of the Income Tax Act and of the quantum of any adjustment made under Section XXX (1), shall be made in accordance with the provisions of Regulation XXX.</td>
</tr>
</tbody>
</table>
4. (1) An uncontrolled transaction is comparable to a controlled transaction within the meaning of Section XXX (1) -
   (a) when there are no differences between them that could materially affect the financial indicator being examined under the appropriate transfer pricing method; or
   (b) when such differences exist, if a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison.

(2) To determine whether two or more transactions are comparable, the following factors shall be considered to the extent that they are economically relevant to the facts and circumstances of the transactions -
   (a) the characteristics of the property or services transferred;
   (b) the functions undertaken by each person with respect to the transactions, taking into account assets used and risks assumed;
   (c) the contractual terms of the transactions;
   (d) the economic circumstances in which the transactions take place; and
   (e) the business strategies pursued by each of the connected persons in relation to the transactions.

(3) For the purposes of determining whether two transactions are comparable, the allocation of risk between connected persons must take into account how economically significant risk is allocated in contracts between those persons; and
   a) which person assumes the financial risk;
   b) which person performs the relevant risk control and risk mitigation functions; and
   c) which person has the financial capacity to assume the risk.

In cases where the person contractually assuming the risk does not control the risk or does not have the financial capacity to assume the risk the risk must be allocated to the person who does control the risk and have the financial capacity to assume the risk and for tax purposes, the person contractually assuming the risk shall not be allocated the profits associated with those risks and will be entitled to no more than a risk-free return.

5. (1) The arm’s length remuneration of a controlled transaction shall be determined by applying the most appropriate transfer pricing method to the circumstances of the case.

(2) The most appropriate transfer pricing method shall be selected from among the approved transfer pricing methods set out in paragraph 5 (3), taking into consideration the following criteria -
   (a) the respective strengths and weaknesses of the approved methods;
   (b) the appropriateness of an approved method in view of the nature of the controlled transaction, determined in particular through an analysis of the functions undertaken by each person in the controlled transaction, taking into account assets used and risks assumed;
   (c) the availability of reliable information needed to apply the selected transfer pricing method; and
   (d) the degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.
(3) The following shall be the approved transfer pricing methods for purposes of paragraph 5(1) –

(a) the Comparable Uncontrolled Price Method, which consists of comparing the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction;

(b) the Resale Price Method, which consists of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions;

(c) the Cost Plus Method, which consists of comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction;

(d) the Transactional Net Margin Method, which consists of comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions;

(e) the Transactional Profit Split Method, which consists of allocating to each associated person participating in a controlled transaction the portion of common operating profit (or loss) derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction. When it is possible to determine an arm’s length remuneration for some of the functions performed by the associated persons in connection with the transaction using one of the approved methods described in paragraphs 5(5)(a) to (d), the transactional profit split method shall be applied based on the common residual profit that results once such functions are so remunerated.

[OPTIONAL] (4) It shall not be necessary to apply more than one method to determine the arm’s length remuneration for a given controlled transaction.

(5) A transfer pricing method other than the approved methods contained in paragraph 5(3) may be applied where the [Commissioner-General/Commissioner] is satisfied that -

(a) none of the approved methods can be reasonably applied to determine arm’s length conditions for the controlled transaction, and

(b) such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

(6) When a method other than the approved methods contained in paragraph 5(3) is used it shall be established that the requirements of paragraph 5(5) have been satisfied.

(7) Choice of Tested Party - When applying a cost plus, resale price or transactional net margin method, provided under paragraph 5, it shall be necessary to select the party, hereinafter referred to as the “tested party”, to the transaction for which a financial indicator, mark-up on costs, gross margin, or net profit indicator, is tested under the most appropriate transfer pricing method in the circumstance.
| (8) The selection of the tested party should be consistent with the functional analysis of the transaction. |
| (9) The tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the less complex functional analysis. |
| (10) Where the most appropriate transfer pricing method in the circumstances of the case, determined following the guidance at paragraphs 5, above, is a one-sided method, financial information on the tested party is needed in addition to the information referred to in paragraph 13 irrespective of whether the tested party is a domestic or foreign entity. |
| (11) Where the most appropriate method is a cost plus, resale price or transactional net margin method and the tested party is the foreign entity, sufficient information is needed to be able to reliably apply the selected method to the foreign tested party and to enable a review by the Commissioner the application of the method to the foreign tested party. |
| Evaluation of taxpayer’s combined controlled transactions |
| (6) If a taxpayer carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to (i) perform the comparability analysis set out in Paragraph 4 and (ii) apply the transfer pricing methods set out in Paragraph 5. |
| Arm’s length range |
| (7) An arm’s length range is a range of relevant financial indicator figures (e.g. price, resale margin, cost mark-up, net profit ratio or a split of profit.) produced by the application of the most appropriate transfer pricing method as set out in Paragraph 5 to a number of uncontrolled transactions, that are all comparable, and equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with Paragraph 4. |
| (2) Where the application of the most appropriate method results in a number of financial indicators for which the degree of comparability of each to the controlled transactions, and to each other, is uncertain, a statistical approach shall be used. Where such an approach is used, the interquartile range shall be considered to be an arm’s length range. |
| [Optional alternative wording for Para 7 (1)]: An arm’s length range is a range of relevant financial indicator figures (e.g. prices, margins or profit shares) produced by the application of the most appropriate transfer pricing method as set out in Paragraph 5 to a number of uncontrolled transactions, that are all comparable, and equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with Paragraph 4 provided that the highest point in the range is no more than 25% greater than the lowest point in the range. |
| [Optional alternative wording for Para 7 (2)]: Where the application of the most appropriate method results in a number of financial indicators for which the degree of comparability of each to the controlled transactions, and to each other, is uncertain, or the highest point in the range exceeds 25% of the lowest point in the range, a statistical approach shall be used. Where such an approach is used, the interquartile range shall be considered to be an arm’s length range. |
3. A controlled transaction, or a set of controlled transactions that are combined according to Paragraph 6 shall not be subject to an adjustment under Section XXX where the relevant financial indicator derived from the controlled transaction or set of controlled transactions and being tested under the appropriate transfer pricing method is within the arm's length range.

4. Where the relevant financial indicator derived from a controlled transaction, or from a set of controlled transactions that are combined according to Paragraph 6, falls outside the arm's length range, the taxable profit of the taxpayer shall be computed on the basis that the relevant financial indicator is the median of the arm's length range.

5. [Optional] For the purposes of paragraph 7(4), the median of the arm's length range shall be the 50th percentile of the financial indicator figures derived from the comparable uncontrolled transactions forming the arm's length range. For this purpose, the 50th percentile is the lowest financial indicator figure such that at least 50 percent of the financial indicator figures are at or below the value of that figure. However, if exactly 50 percent of the results are at or below a financial indicator figure, then the 50th percentile is equal to the arithmetic mean of that figure and the next highest figure.

Sources of information on comparable uncontrolled transactions

8. (1) Sources of information on comparable uncontrolled transactions may include –
   a. internal uncontrolled transactions, which are uncontrolled transactions where one of the parties to the controlled transaction is also a party to the uncontrolled transaction;
   b. external uncontrolled transactions, which are uncontrolled transactions to which neither of the parties to the controlled transaction is a party.

(2) Information concerning a comparable external uncontrolled transaction may not be relied upon by the [Commissioner-General/Commissioner] for the purposes of making an adjustment under Section XXX of the Income Tax Act if the information concerning the transaction is not available to the taxpayer.

(3) Information concerning a comparable uncontrolled transaction may not be relied upon by the taxpayer for the purposes of demonstrating the consistency a transaction with Section XXX of the Income Tax Act if the information on the transaction is not available to the [Commissioner-General/Commissioner].

(4) In the absence of information on uncontrolled transactions from the same geographic market as the controlled transaction, comparable uncontrolled transactions from other geographic markets may be accepted by the [Commissioner-General/Commissioner].
(5) A determination of whether comparables from other geographic markets are reliable has to be made on a case-by-case basis, and by reference to the extent to which they satisfy Paragraph 4 of this Regulation.

(6) Taxpayers or Commissioner using such comparables would be expected to assess the expected impact of geographic differences and other factors on the price and profitability.

<table>
<thead>
<tr>
<th>Services between connected persons</th>
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<tbody>
<tr>
<td>9. (1) A service charge between a taxpayer and a connected person shall be considered consistent with the arm’s length principle where –</td>
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<tr>
<td>(a) it is charged for a service that is actually rendered,</td>
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<tr>
<td>(b) the service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position,</td>
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<tr>
<td>(c) it is charged for a service that an independent person in comparable circumstances would have been willing to pay for if performed for it by an independent person, or would have performed in-house for itself, and</td>
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<tr>
<td>(d) its amount corresponds to that which would have been agreed between independent persons for comparable services in comparable circumstances</td>
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<tr>
<td>9. (2) A service charge made to a person shall not be consistent with the arm’s length principle where it is made by a connected person solely because of the shareholder’s ownership interest in one or more other group members, including for any of the following costs incurred or activities undertaken by such connected person -</td>
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<tr>
<td>(a) costs or activities relating to the juridical structure of the parent company of the first-mentioned person, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the parent company’s supervisory board;</td>
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<tr>
<td>(b) costs or activities relating to reporting requirements of the parent company of the first-mentioned person, including the consolidation of reports; and</td>
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<tr>
<td>(c) costs or activities related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by the first-mentioned person and the acquisition benefits or is expected to benefit that first-mentioned person.</td>
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<tr>
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<tbody>
<tr>
<td>9. (3) Where it is possible to identify specific services provided by a taxpayer to a connected person, the determination whether the service charge is consistent with the arm’s length principle shall be made for each specific service, subject to the provisions of Paragraph 9(4).</td>
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<tr>
<th>Services between connected persons</th>
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<tbody>
<tr>
<td>9. (4) Where services are rendered by a taxpayer jointly to various connected persons and it is not possible to identify specific services provided to each of them, the total service charge shall be allocated among the connected persons that benefit or expect to benefit from the services according to reasonable allocation criteria.</td>
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</tbody>
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### Transactions involving intangible property

10. (1) The determination of arm’s length conditions for controlled transactions involving the exploitation of an intangible must take into account the contractual arrangements and the following factors with regard to the development, enhancement, maintenance, protection and exploitation of the intangible asset:

- a) The functions performed by the person;
- b) The management and control of those functions;
- c) The contribution by the person of assets, including financial assets,
- d) The management and control regarding the contribution of assets, including financial assets;
- e) The risks assumed by that person;
- f) The management and control of those risks.
- g) The financial capacity to assume the risks.

In cases where the contractual arrangements diverge from the factors listed above, regards shall be taken of those factors in determining the arm’s length reward from the exploitation of the intangible.

(2) The determination of arm’s length conditions for controlled transactions involving licenses, sales or other transfers of intangible property between connected persons shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including in particular the pricing at which a comparable independent person would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.

(3) In applying the provisions of paragraph 4 to a transaction involving the license, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including -

- a) the expected benefits from the intangible property;
- b) the commercial alternatives otherwise available to the acquirer or licensee derived from the intangible property
- c) any geographic limitations on the exercise of rights to the intangible property;
- d) the exclusive or non-exclusive character of the rights transferred; and
- e) whether the transferee has the right to participate in further developments of the intangible property by the transferor.
4) Certain intangibles may be considered ‘hard to value intangibles’ either because at the time they are transacted there are:
   (a) No reliable comparables that exist; and
   (b) At the time of the transfer, the projection of future cash flows or income expected to be derived from the intangible or right, or the assumptions used in valuing the intangible or right, are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

In situations involving the transfer of Hard To Value Intangibles (HTVIs), the Commissioner-General/Commissioner may consider ex-post outcomes as presumptive evidence of the ex-ante pricing arrangements. The consideration of ex-post evidence should be based on a determination that such evidence is necessary to be taken into account to assess the reliability of the information on which ex-ante pricing has been based, and should not be used as the only basis for adjustment.

Disregarding a controlled transaction for tax purposes

11. (1) Where the arrangements made in relation to a transaction between connected persons, viewed in their totality, differ from those which would have been adopted by independent persons behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a price that would be acceptable to both of the parties taking into account their respective perspectives and the options realistically available to each of them at the time of entering into the transaction the actual transaction as structured by the taxpayer may be disregarded for the purposes of these rules, in which case the arm’s length position would be as if the transaction had not occurred. In other cases, if appropriate, the transaction should be replaced by an alternative transaction.

Corresponding adjustments for domestic transactions

12. (1) Where an adjustment is made by the [Commissioner-General/Commissioner] under Section XXX to the taxable income of a taxpayer in relation to domestic transaction, then, the [Tax Authority] shall make an appropriate adjustment to the taxable income of the other party to the transaction.

Corresponding adjustments for international transactions

13. (1) Where -
   (a) an adjustment to the conditions of transactions between a person resident in [Country] and a connected person is made or proposed by a tax administration in a country other than [Country];
   (b) this adjustment results in the taxation in that other country of an amount of income on which the person resident in [Country] has already been charged to tax in [Country];
   (c) the country making or proposing the adjustment has a treaty with [Country] that reflects an intention to provide for the relief of economic double taxation.

(2) The [Commissioner-General/Commissioner], shall after a request is made by the person resident in [Country], examine the consistency of that adjustment with the arm’s length principle provided for under section XXX, consulting as necessary with the competent authority of the other country.
(3) If the adjustment proposed or made by the other country is consistent with the arm's length principle both in principle and as regards the amount, the [Commissioner-General/Commissioner] shall make a corresponding adjustment to the amount of the tax charged in [Country] to that person on those profits, in order to eliminate the economic double taxation that would result from the inclusion of the same profits in the taxable income of both that person and the connected person.

(4) A request under paragraph 13(2) must include the information necessary for the [Commissioner-General/Commissioner] to examine the consistency of the adjustment made by the tax administration of the other country with the arm's length principle, including –

a. the name, registered address and, where applicable, trading name(s) of the connected person;

b. evidence of the tax residence of the connected person;

c. the year(s) in which the adjusted controlled transaction(s) took place;

d. the amount of the requested corresponding adjustment and the amounts of the adjustment made by the tax administration of the other country;

e. evidence of the adjustment made by the tax administration of the other country and the basis for the adjustment, including details of comparability analysis relied upon and the transfer pricing method applied;

f. confirmation that the related person party will not, or is unable to, pursue any further recourse under the domestic law of the other country that may result in the adjustment made by the tax administration of the other country being reduced or reversed;

g. any other information that may be relevant for examining the consistency of the adjustment with the arm's length principle.

(5) The request must be made within the applicable time period for making a request for the case to be resolved by way of mutual agreement procedure under the applicable tax treaty.

Relevance of OECD Transfer Pricing Guidelines

14. (1) [First option] The Organization for Economic Cooperation and Development (OECD) “Transfer Pricing Guidelines for Multinational Persons and Tax Administrations” are a relevant source of interpretation for these Regulations.

[Second option] These Regulations shall be interpreted in accordance with the Organization for Economic Cooperation and Development (OECD) “Transfer Pricing Guidelines for Multinational Persons and Tax Administrations” (OECD Guidelines). Where there is any inconsistency between the Act, these Regulations and the OECD Guidelines the Act and the Regulations shall prevail.

Application of Section XXX to domestic transactions

[Optional] 15 (1) Section XXX shall not apply where a person resident in [Country] engages directly or indirectly in any transaction, operation or scheme, with a connected person resident in [Country] except where the following Parts or Sections of the Income Tax Act apply to one or both of those persons:

[add relevant sections]
3. Proposed Transfer Pricing Documentation Regulation

ARRANGEMENT OF REGULATIONS

**Regulation**

1. Citation
2. Required documents
3. Language of documentation
4. Contemporaneous documentation
5. Time limit for submission of documentation
6. Power to request additional information

<table>
<thead>
<tr>
<th>Citation</th>
<th>1. These Regulations may be cited as the Income Tax (Transfer Pricing Documentation) Regulations, [20XX].</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required documents</td>
<td>2. (1) A taxpayer must have in place contemporaneous documentation that verifies that the conditions in its controlled transactions for the relevant tax year are consistent with the arm’s length principle.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2. (2) Documentation shall include:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. an overview of the taxpayer’s business operations (history, recent evolution and general overview of the relevant markets of reference) and organizational chart (details of business units/departments and organizational structure);</td>
</tr>
<tr>
<td>b. a description of the corporate organizational structure of the group that the taxpayer is a member (including details of all group members, their legal form, and their shareholding percentages) and the group’s operational structure (including a general description of the role that each of the group members carries out with respect to the group’s activities, as relevant to the controlled transaction(s));</td>
</tr>
<tr>
<td>c. General written description of the MNE’s business including:</td>
</tr>
<tr>
<td>Important drivers of business profit;</td>
</tr>
<tr>
<td>A description of the supply chain for the group’s five largest products and/or service offerings by turnover plus any other products and/or services amounting to more than 5 percent of group turnover. The required description could take the form of a chart or a diagram;</td>
</tr>
<tr>
<td>A list and brief description of important service arrangements between members of the group, other than research and development (R&amp;D) services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;</td>
</tr>
<tr>
<td>A description of the main geographic markets for the group’s products and services that are referred to in the second bullet point above;</td>
</tr>
<tr>
<td>A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used;</td>
</tr>
<tr>
<td>A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year.</td>
</tr>
</tbody>
</table>
|   | SUGGESTED APPROACH
to Drafting Transfer Pricing Legislation |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>d.</td>
<td>a detailed description of the business and business strategy pursued by the taxpayer including an indication whether the taxpayer has been involved in or affected by business restructurings or intangible transfers in the present or immediately preceding year and an explanation of those aspects of such transactions affecting the taxpayer</td>
</tr>
<tr>
<td>e.</td>
<td>a list of the taxpayer’s key competitors in [Country]</td>
</tr>
<tr>
<td>f.</td>
<td>description of the controlled transaction(s), and the context in which such transactions took place including an analysis of the comparability factors specified in Paragraph 4 of the <em>Income Tax Transfer Pricing Regulations, 20XX</em>;</td>
</tr>
<tr>
<td>g.</td>
<td>the amount of intra-group payments and receipts for each category of controlled transactions involving the taxpayer broken down by tax jurisdiction of the foreign payer or recipient</td>
</tr>
<tr>
<td>h.</td>
<td>identification of the connected persons involved in each category of controlled transactions, and the relationship amongst them.</td>
</tr>
<tr>
<td>i.</td>
<td>copies of all material intercompany agreements concluded by the taxpayer</td>
</tr>
<tr>
<td>j.</td>
<td>detailed comparability and functional analysis of the connected parties in relation to the controlled transaction. This should include details of assets in relation to the controlled transaction as well as risk assumed by each party.</td>
</tr>
<tr>
<td>k.</td>
<td>explanation of the selection of most appropriate transfer pricing method(s), and, where relevant, the selection of the tested party and the financial indicator;</td>
</tr>
<tr>
<td>l.</td>
<td>financial statements for the parties to the controlled transaction including where the tested party has been selected as a party outside the country.</td>
</tr>
<tr>
<td>m.</td>
<td>a summary of the important assumptions made in applying the transfer pricing methodology</td>
</tr>
<tr>
<td>n.</td>
<td>If relevant an explanation of the reasons for performing a multi-year analysis</td>
</tr>
<tr>
<td>o.</td>
<td>comparability analysis, including; description of the process undertaken to identify comparable uncontrolled transactions; explanation of the basis for the rejection of any potential internal comparable uncontrolled transactions (where applicable); description of the comparable uncontrolled transactions; analysis of comparability of the controlled transaction(s) and the comparable uncontrolled transactions (taking into account Paragraph 4 of the <em>Income Tax Transfer Pricing Regulations, 20XX</em>); and, details and explanation of any comparability adjustments made;</td>
</tr>
<tr>
<td>p.</td>
<td>a summary of financial information used in applying the transfer pricing methodology</td>
</tr>
<tr>
<td>q.</td>
<td>detail of any industry analysis, economic analysis, budgets or projections relied on;</td>
</tr>
<tr>
<td>r.</td>
<td>details of any advance pricing agreements or similar arrangements in other countries that are applicable to the controlled transactions;</td>
</tr>
<tr>
<td>s.</td>
<td>a conclusion as to consistency of the conditions of the controlled transactions with the arm’s length principle, including details of any adjustment made to ensure compliance; and</td>
</tr>
<tr>
<td>t.</td>
<td>summary of the taxpayer's financial accounts for the fiscal year concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied</td>
</tr>
</tbody>
</table>
### SUGGESTED APPROACH to Drafting Transfer Pricing Legislation

- **u.** information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements
- **v.** summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained
- **w.** any other documentation or information that is necessary for determination of the taxpayer’s compliance with the arm’s length principle with respect to the controlled transactions.

#### Language of documentation

3. Documentation may be submitted in XXXXX or English language.

#### Contemporaneous documentation

4. Documentation for a relevant tax year is considered to be contemporaneous where it is in place at the statutory tax return’s filing date

#### Time limit for submission of documentation

5. Documentation shall be provided to the [Commissioner-General/Commissioner] within 45 days of the written request being duly issued by the [Commissioner-General/Commissioner].

#### Power to request additional information

6. The obligation of the taxpayer to provide this documentation is established without prejudice to the power of the [Commissioner-General/Commissioner] to request additional information that in the course of audit procedures it deems necessary to carry out its functions.
Section 1 (i): This sub-section sets out the scope of the transfer pricing legislation. That is which transactions are within its scope. The wording in the section means that the transfer pricing legislation will apply to all transactions involving a person who is liable to tax in [Country] where the transaction is with a related person whether or not that person is liable to tax in [Country]. Therefore transactions between two related [Country] taxpayers (domestic transactions) will be subject to the transfer pricing rules as will cross border transactions.

It is considered necessary for the legislation to cover domestic transactions to ensure the tax administration is in a position to counter artificial profit shifting, through abusive transfer pricing, from a [Country] taxpayer who is subject to the statutory income tax rate to another [Country] taxpayer who is subject to lower level of tax in [Country] because they are for example granted a tax incentive. It will also address such profit shifting from a [Country] profit making company to a related [Country] loss making company where both taxpayers are subject to the statutory income tax rate.

The wording of the section is deliberately broad in terms of what constitutes a transaction to ensure it covers tax planning arrangements that try to circumvent the transfer pricing legislation by the arrangement not involving for example a written contractual controlled transaction.

For example in the case of DSG (Retail) Limited vs the Commissioners for Her Majesty's Revenue and Customs the Special Commissioners found in favour of HMRC’s argument that the UK transfer pricing legislation applied to the following arrangement.

The case related to the transfer pricing arrangements between the United Kingdom’s biggest electrical retailer, DSG Retail Ltd (DSG), and a captive insurer in the Isle of Man (DISL) in relation to the provision of extended warranty cover on products sold to UK customers in DSG’s shops. DSG’s retail outlets offered customers, at the point of sale, the opportunity to purchase extended warranties on electrical goods to cover the cost of repair or replacement within a specified period beyond the manufacturer's standard warranty period. Substantially all of the risk (and profit) on these arrangements was borne (and made) by DISL.

Before considering whether the arrangements were entered into on an arm’s length basis, it was necessary for the Special Commissioners to conclude on whether the UK transfer pricing legislation applied to the arrangements under review. One feature of the contractual structure was that DISL had no transactions with other group companies. Cornhill (an independent company) paid commission to a Dixons company for the sale of its policies; it paid fees to another Dixons company for repairs or replacements, and it ceded 95% of its risk (and premiums) to DISL.

DISL therefore contended the UK transfer pricing legislation did not apply as there were no controlled transactions. However because the legislation covered arrangements HMRC successfully argued this was an arrangement and therefore within the scope of the transfer pricing rules.

The section applies to both transactions entered into directly or indirectly by the two related persons. This ensures that the legislation will apply to transactions that are between two related parties but via an interposed third party. For example a back to back loan where the parent of the group makes a loan to a third party bank which on lends the money to a subsidiary of that parent.

Section 1 (ii): This sub-section is intended to ensure that transactions that relate to a permanent establishment are within the scope of the transfer pricing legislation.

Section 1 (iii): This sub-section creates the requirement for taxpayers to compute their taxable income in accordance with the arm's length principle. This is important as it ensures taxpayers have to comply with the arm’s length principle when submitting their Tax Return and may be subject to a penalty for an incorrect return if they fail to submit it on an arm’s length basis. It also sets out the definition of the arm’s length

1. DSG Retail Ltd v. HMRC, Special Commissioners, Decision TC0001 (30 March 2009)
principle. The application of the arm’s length principle is international best practice and accords with the requirements set out in the [Country] Transfer Pricing Regulations.

Section 2: This section makes it clear that where the actual conditions differ from the arm’s length conditions the taxpayer's taxable income must be computed based on the arm’s length conditions but only if this results in an increase in [Country] tax.

For example the [Country] company pays management fees of $1m when the arm’s length amount is $11m. Then in its Tax Return the [Country] company makes an adjustment to decrease its taxable profits by $10m. This may lead to double non-taxation if the related party to the transaction only recognises an income of the $1m. This section prohibits the taxpayer from making the $10m decrease in taxable profits in its Tax Return.

Section 3: This section makes it clear that the Transfer Pricing Regulations determine whether the conditions of a transaction are arm’s length and how to make an adjustment if they are not arm’s length.

Section 4: This section enables the Commissioner-General to apply the transfer pricing legislation to a transaction where one of the parties is located in a tax jurisdiction which the Commissioner-General considers is a beneficial tax regime. Many African tax administrations have reported that they often face risks of tax loss where the local taxpayer has a transaction with a low or no tax jurisdiction but they are unable to apply their transfer pricing legislation because the taxpayer contends the person in the low/no tax jurisdiction is unrelated and the tax administration are unable to obtain the evidence to show they are related. The section allows the Commissioner-General to apply the transfer pricing legislation in these circumstances. Clearly if the taxpayer satisfies the Commissioner-General that the other person is not related then by definition the transaction will be arm’s length.

If [Country] choses to have this section it will need to determine what constitutes a beneficial tax regime. Broadly other countries have taken one of the following approaches:

• Publishing a list of jurisdictions considered to be beneficial tax regimes – this has the advantage of providing certainty but can be politically sensitive.

• Providing a definition of what constitutes a beneficial regime. Some countries have used a simple statutory tax rate test e.g. where the jurisdiction has a statutory Corporate Income Tax rate of less than X%. This is simple to administer but may lead to some jurisdictions not being included where the statutory rate is higher but it has some very beneficial rules that mean the effective rate for most corporate taxpayers is significantly less than the statutory rate.

• The Commissioner-General makes the determination on a case by case basis. This provides the tax administration with the most flexibility but creates the most uncertainty for taxpayers.

[Country] will need to decide which option it wishes to use if it adopts this section.

Section 5 and 6: These sections are designed to address the difficulties many African tax administrations report they face from commodities being exported to a related party at under-valuation or imported from a related party at over-valuation both of which lead to a reduced level of taxable income in the African country. This is an issue faced by many resource rich countries in other parts of the world as well as in Africa.

Using the example of African mining companies it is often the case that the African mining company does not sell the commodity directly to the third party customer. Instead it contractually sells the commodity to a related party marketing hub located in a no or low risk tax jurisdiction and the marketing hub sells the commodity onto the third party customer. That customer might pay the marketing hub USD100,000 for the commodity but the marketing hub only pays say USD60, 000 to the African mining company contending it retains the USD40,000 as reward for the marketing activities it alleges to carry out. African tax administrations facing this issue report finding it very difficult to challenge the pricing as they struggle to obtain detailed information
SUGGESTED APPROACH
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on the activities that are actually undertaken by the marketing hub.

In Latin America some countries have attempted to address this risk through introducing rules often called the “sixth method”. It should be recognised that there is not a singular sixth method and different countries have different rules. However there is a common theme to the application of the various sixth methods. Argentina, Dominican Republic, Ecuador, Guatemala, Peru and Uruguay apply the sixth method, with some differences, to exports and imports of commodities between related parties through foreign intermediaries as set out in the above example.

Broadly these countries prescribe the mandatory use of the sixth method when all of the following conditions are met:

• **The imports and exports are between related parties**

• **The imports and exports are of goods with a publicly quoted price in a transparent market**, i.e. commodities. These can include: agricultural products (e.g. cereals, oil seeds and other products obtained from the land); hydrocarbons and derivatives thereof; non-renewable natural resources; and, in general, goods with public prices in transparent markets; and,

• **The imports and exports take place through a foreign intermediary**, who is not the final recipient of the goods. Under the regime in Argentina and the Dominican Republic, the foreign intermediary does not need to be related either to the exporter or to the final recipient of the goods.

The OECD/G20 BEPS project has led to revised wording to the OECD Transfer Pricing Guidelines (TPG) to reflect these types of approaches. The new guidance states that (i) the CUP method would generally be an appropriate transfer pricing method for commodity transactions between associated enterprises; (ii) quoted prices can be used under the CUP method, subject to a number of considerations, as a reference to determine the arm’s length price for the controlled commodity transaction; and, (iii) reasonably accurate comparability adjustments should be made, when needed, to ensure that the economically relevant characteristics of the controlled and uncontrolled transactions are sufficiently comparable.

Secondly there is a new provision on the determination of the pricing date for commodity transactions. This provision should prevent taxpayers from using pricing dates in contracts that enable the adoption of the most advantageous quoted price. It allows tax authorities to impute, under certain conditions, the shipment date (or any other date for which evidence is available) as the pricing date for the commodity transaction.

Section 6 and 7 of the proposed legislation for [Country] provides statutory force to the new provisions in the OECD TPG as set out above.

**Section 7:** This is an alternative option to sections 5 and 6. The main difference is that Section 7 uses the average monthly quoted price as the transfer price whereas section 5 uses the quoted price on the date of the transaction subject to the deemed date provision in section 6.

Zambia’s transfer pricing legislation applies the monthly average price approach. The ZRA report that this is an effective rule for addressing the risk from the under-valuation of its copper and other metal based product exports.

**Section 9:** This section simply provides a statutory requirement to keep the documentation set out in the Regulations

**Section 11:** This section applies an exemption from the transfer pricing legislation for related parties where the aggregated transactions between the related parties have a value below a specified amount. The objective of the section is therefore to reduce the compliance burden on taxpayers with only low value related party transactions which pose little risk to the [Country] tax base. [Country] will need to decide the monetary level to set for this exemption and whether the exemption should be expressed in [Country] currency or US Dollar to mitigate highly volatility in the exchange rate for the Kwacha.
Section 12: This section provides for how profits should be attributed where the transactions relate to a permanent establishment.

Section 13: Many African tax administrations have reported great difficulties determining arm’s length prices for royalties and other consideration relating to intangibles and consider they face significant risk to their tax base from excessive royalty and other intangible related payments to non-resident related parties. Section 13 provides an alternative approach of the tax deductible amount of the royalty being restricted to a percentage of the taxpayer's tax EBITDA plus the actual royalty payable for the year of assessment.

The following is an illustrative example of how mathematically the rule would work. The example uses a 1% ratio. However this is for illustrative purposes only and is not an indication of where the percentage should be set.

<table>
<thead>
<tr>
<th>Rule is 1% of EBITDA plus royalty payable</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA from activity relating to the intangible</td>
<td>1000</td>
</tr>
<tr>
<td>Plus royalty payable relating to the intangible</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1200</strong></td>
</tr>
<tr>
<td>Royalty allowed as tax deductible (1%)</td>
<td>120</td>
</tr>
<tr>
<td>Disallowed royalty</td>
<td>80</td>
</tr>
</tbody>
</table>

[Country] will need to decide the percentage level for this section. ATAF is not aware of any data available on such a rule set by any country. We would therefore advise that [Country] selects its largest corporate taxpayers and calculates the impact on tax revenue of applying different percentage rates based on their last three years tax returns to assess an appropriate percentage level.

Section 15: This section applies a secondary adjustment in addition to the primary transfer adjustment. The following illustrative example sets out how such a rule would work in practice.

Company A (liable to [Country] tax) pays 100 to Company B (a foreign related company not liable to [Country] tax) for Product X and claims a tax deduction of 100. Following an audit by the tax administration it is established the arm’s length price for Product X is 60 not 100. A primary transfer pricing adjustment is therefore made increasing Company A’s taxable income by 40.

If [Country] introduces Section 14 there will be a secondary adjustment as the 40 will be deemed to be a dividend and therefore the taxation rules in [Country] for a dividend payment to a foreign company will apply.

Secondary adjustment legislation is used by a number of countries including the USA and South Africa. Such rules are considered important by these countries as they can assist in stemming inappropriate capital flows out of the country. Without this protection companies could simply repatriate funds to its parent by excessive pricing which is then adjusted back to the arm’s length price in the tax return.

It should be noted that the deemed dividend rule would apply whether the transfer pricing adjustment was made by the taxpayer in its Return or later by the tax administration.
APPENDIX 1

Appendix 1 – Option to introduce Low value-added services provisions

Option – Low value-added services

Suggested approach if to adopt the revised OECD guidance on low value added services

1. An amount charged for the provision of a low value-added service between connected persons shall be considered to be arm's length provided that:
   - the amount is based on an allocation to each person that receives low value-added services of the total group costs of providing the services; and
   - the allocation of those costs is based on an appropriate allocation method; and
   - the cost-plus method is applied to those costs; and
   - the mark-up on those costs is 5%; and
   - the total amount charged to a COUNTRY taxpayer for all low value-added services within the scope of this paragraph does not exceed USD XXX
   - the taxpayer maintains the documentation described in paragraph 5 below, and makes that documentation available to the TAX AUTHORITY on request.

2. For the purpose of paragraph 1 above
   - ‘total group cost’ means the direct and indirect costs incurred by connected persons in providing the service to members of the group of companies to which a COUNTRY taxpayer belongs.
   - an ‘appropriate allocation method’ means a method that allocates a total group cost between members of the group in a way that is proportional to the benefits or expected benefits to each member of the group. [Note: For simplicity, this could specify an apportionment in proportion to, for example, turnover of each member of the group].

3. For the purpose of paragraph 1 above, a low value-added service is a service that:
   - is not provided by any member of the group of companies to unrelated customers,
   - does not use or create valuable intangible property,
   - does not involve the assumption, control or creation of significant risk.

4. The documentation referred to in paragraph 2 above consists of:
   - the identity of the providers and beneficiaries in COUNTRY of the low value-added services;
   - the reasons justifying that each category of services constitutes low value-adding intra-group services within the definition above;
   - the rationale for the provision of services within the context of the business of the group;
   - a description of the benefits or expected benefits to the COUNTRY enterprise of each category of services;
   - a description of the selected allocation keys and the reasons justifying that such allocation keys produce outcomes that reasonably reflect the benefits received, and confirmation of the mark-up applied;
- Written contracts or agreements for the provision of services and any modifications to those contracts. Such written contracts or agreements could take the form of a contemporaneous document identifying the entities involved, the nature of the services, and the terms and conditions under which the services are provided;
- Documentation and calculations showing the determination of total group cost, and of the mark-up applied, listing all categories and amounts of relevant costs, including costs of any services provided solely to one group member;
- Documentation and calculations showing the application of the specified allocation keys.

Safe Harbour for International Transactions Involving Routine Manufacturing Operations in [Country]

1. This article applies where:
   a. the taxpayer is party to one or more controlled transactions that compensate the taxpayer for ‘qualifying manufacturing activities’ that it carries on in COUNTRY; and
   b. the conditions in sub-articles 5 and 6 of this Article are met;

2. Where this article applies with respect to one or more controlled transactions:
   a. no adjustment will be made under [Section XX] with respect to those controlled transactions; and
   b. the requirements of the Transfer Pricing Regulations will not be applicable;

3. A taxpayer carries on a “qualifying manufacturing activity” if:
   a. that activity consists only of:
      i. the performance of manufacturing services on behalf of a connected person, or a number of such persons (“toll manufacturing”); or
      ii. the production of manufactured products for sale only to a connected person, or a number of such persons (“contract manufacturing”); and
   b. the taxpayer does not perform a manufacturing service for any unconnected persons or sell manufactured goods to any unconnected persons; and
   c. the taxpayer has entered into an arrangement with the connected person or persons under which the connected person or persons assume the principal business risks associated with the manufacturing activities of the taxpayer and agrees to compensate the taxpayer for its manufacturing activities at levels consistent with sub-article 5 of this Article; and
   d. the taxpayer does not engage in advertising, sales, marketing and distribution functions, credit and collection functions, or warranty administration functions with regard to the manufacturing service it performs and or products it manufactures;
   e. in the case of contract manufacturing, it does not:
      i. retain title to finished products after they leave its factory;
      ii. bear any transportation or freight expense with respect to such finished products; and
      iii. does not bear any risk of loss with respect to damage or loss of finished products in transit; and
f. the taxpayer does not engage in managerial, legal, accounting, or personnel management functions other than those directly related to the performance of its manufacturing activities; and

g. the taxpayer does not:

   i. own, or share in the ownership, of
   ii. have rights or reasonable claims to ownership, or a share in the ownership, of; or
   iii. share the cost in developing;
   iv. pay royalties for the right to exploit any valuable product, process or marketing intangibles (e.g. designs, patents, formulas, trademarks, brand names), including valuable know-how

4. For the purposes of sub-article 1(a) of this Article, transactions compensating a taxpayer for ‘qualifying manufacturing activities’ are:

   a. in the case of contract manufacturing, sales of manufactured products
   b. in the case of toll manufacturing, service fees received for the qualifying manufacturing activity

5. Condition 1 - The compensation received by the taxpayer for transactions related to that activity (but not for any other transactions conducted by the taxpayer) is not less than the applicable minimum amount:

   a. In cases where the taxpayer conducts a qualifying manufacturing activity that is contract manufacturing, the minimum amount of total compensation from the sale of the products in respect of the ‘qualifying manufacturing activity’ is the total costs of the qualifying manufacturing activity, excluding only net interest expense, currency gain or loss and any non-recurring or extraordinary costs, plus a XXX% mark-up.
   b. In cases where the taxpayer conducts a qualifying manufacturing activity that is toll manufacturing, the minimum amount of net income for the manufacturing service performed by the taxpayer is the total costs of the qualifying manufacturing activity, excluding only net interest expense, currency gain or loss and any non-recurring or extraordinary costs, plus a XXX% mark-up.

6. Condition 2- Documentation is maintained by the taxpayer and submitted to the Tax Authority within 45 days of a written request being duly issued by the Tax Authority. The documentation must include:

   a. a description of the activities of the taxpayer and, in particular, documents the consistency of the activities with sub-article 3 of this Article; and
   b. Calculations demonstrating that the transactions compensating a taxpayer for the ‘qualifying manufacturing activities’ are consistent with sub-article 5 of this Article.

7. Where this article does not apply to controlled transaction, the general rules outlines in this Regulation will apply.

   Application of this Article is without prejudice to the application of [Country’s] obligations under an applicable international treaty.

8. The mark ups specified in sub-article 6 of this Article may be reviewed periodically by the Ministry of Finance, taking into account Article 3 of this Regulation.
APPENDIX 2

Appendix 2 - Proposed controlled transaction schedule

ANNUAL RETURN ON TRANSFER PRICING

DRAFT

[COUNTRY TAX ADMINISTRATION]

ANNUAL RETURN ON TRANSFER PRICING

This return forms part of Form XXX and must be completed by those taxpayers with aggregate transactions within [Section XX] exceeding USDXXXXXX during the relevant fiscal period. In determining the aggregate value of transactions within [Section XX] for the relevant fiscal period, loan balances and capital transactions should be included and income and expenses may not be offset.

1. Name of taxpayer: ................................................................................................................................................

2. TIN Number............................................................................................................................................................

3. Contact person: ....................................................................................................................................................

4. Describe the taxpayer’s principal business activities.
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.....................................................................................................................................................................................

5. Describe the principal business activities of the ultimate parent company and its consolidated group.
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6. Particulars of connected persons with which the taxpayer had transactions with

<table>
<thead>
<tr>
<th>Name of connected person</th>
<th>Nature of relationship</th>
<th>Country of tax residence</th>
<th>Country of incorporation (where applicable)*</th>
<th>Description of transactions</th>
<th>Aggregate value of transactions**</th>
</tr>
</thead>
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</table>

* In the case of a legal person, the country under which laws the legal person was formed

** Income and expenses should not be offset
7. Details of the performance of the [Country] taxpayer and the consolidated group of the ultimate parent company (where applicable).

<table>
<thead>
<tr>
<th>[Country] Taxpayer</th>
<th>Holding Company (Consolidated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets</td>
<td></td>
</tr>
<tr>
<td>Operating Assets</td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td></td>
</tr>
<tr>
<td>Total expenses</td>
<td></td>
</tr>
<tr>
<td>Operating expenses</td>
<td></td>
</tr>
<tr>
<td>Operating profit</td>
<td></td>
</tr>
</tbody>
</table>

8. Details of controlled transactions that give rise to taxable income or tax deductible expenses:

<table>
<thead>
<tr>
<th>Category/Item</th>
<th>Purchases/Expenditure (ETB)</th>
<th>Sales/Revenue (ETB)</th>
<th>Transfer pricing adjustments (if any)</th>
<th>Percentage (%) for which transfer pricing documentation has been prepared</th>
<th>Transfer pricing method*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tangible property</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finished goods</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Goods in process</td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>Raw materials</td>
<td></td>
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<tr>
<td>Other</td>
<td></td>
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<tr>
<td><strong>Rents, Royalties and Intangible property</strong></td>
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</tr>
<tr>
<td>Rent</td>
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</tr>
<tr>
<td>Royalties</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>License or franchise fees</td>
<td></td>
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<tr>
<td>Other</td>
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<td></td>
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<tr>
<td><strong>Services</strong></td>
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<tr>
<td>Management</td>
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<tr>
<td>Administrative</td>
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</tr>
<tr>
<td>Marketing</td>
<td></td>
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<td></td>
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<tr>
<td>Engineering, technical,</td>
<td></td>
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<tr>
<td>construction, etc.</td>
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<tr>
<td>Research and development</td>
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<tr>
<td>Training</td>
<td></td>
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<tr>
<td>Commissions</td>
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<tr>
<td>Other</td>
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</tbody>
</table>
### SUGGESTED APPROACH to Drafting Transfer Pricing Legislation

#### Category/Item

<table>
<thead>
<tr>
<th>Category/Item</th>
<th>Purchases/Expenditure (ETB)</th>
<th>Sales/Revenue (ETB)</th>
<th>Transfer pricing adjustments (if any)</th>
<th>Percentage (%) for which transfer pricing documentation has been prepared</th>
<th>Transfer pricing method*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
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<tr>
<td>Guarantee fees</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Lease payments</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
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<tr>
<td>Other</td>
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<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Reimbursement of expenses</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Employment cost for expatriate employees</td>
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<tr>
<td>other (not included elsewhere)</td>
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<td></td>
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<tr>
<td>Total</td>
<td></td>
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</tbody>
</table>

* Please select from the following:

- CUP – comparable uncontrolled price method
- RPM – resale price method
- CPLM – cost plus method
- TNMM – transactional net margin method
- PSM – profit split method
- OTH – other method

**Note** - Where more than one method is applicable for a category of transaction, please specify the transfer pricing method applicable to the largest portion.

### 9. Details of loans to and from connected persons:

#### (a) Loans to connected persons

<table>
<thead>
<tr>
<th>Name of connected person</th>
<th>Opening balance</th>
<th>Closing balance</th>
<th>Interest bearing (Yes/No)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

#### (b) Loans from connected persons

<table>
<thead>
<tr>
<th>Name of connected person</th>
<th>Opening balance</th>
<th>Closing balance</th>
<th>Interest bearing (Yes/No)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>
10. Details of transactions with connected persons of a capital nature:

(a) Did you have any transactions with connected persons of capital nature in which you acquired interest in asset(s)?  Yes [ ] No [ ]

If yes, state the subject of the transaction (i.e. machinery, shares, intangible asset etc.) and the method(s) used to determine the purchase price.

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(b) Did you have any transactions with connected persons of capital nature in which you disposed of asset(s)?  Yes [ ] No [ ]

If yes, state the subject of the transaction (i.e. machinery, shares, intangible asset etc.) and the method(s) used to determine the disposal proceeds.

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11. Dealings with connected persons involving non-monetary or nil consideration:

(a) Have you received from or provided to a connected person any non-monetary consideration for the performance of services, transfer of property (tangible or intangible), processes, rights or obligations?  Yes [ ] No [ ]

(b) Have you provided to a connected person any services, transfer of property (tangible or intangible), processes, rights or obligations for which the consideration was nil?  Yes [ ] No [ ]

12. Has there been any change in the business structure during the year (changes to ownership structure or other business restructuring)?  Yes [ ] No [ ]

If yes, please provide details.

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.....................................................................................................................................................................................

Name of authorized official: .................................................................................................................................
Designation: ............................................................................................................................................................
Signature: ..................................................................................................................................................................... Date: .........................
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