TRANSFER PRICING CRITICAL

Transfer pricing will be seen as the most critical tax issue in two years' time, followed closely by indirect tax and tax minimisation, according to a preliminary study by Ernst & Young this year.

The study found the majority of multinational companies (71 percent) considered transfer pricing documentation to be more important than it was two years ago.

Transfer pricing involves the price at which transactions between units of a multinational firm take place, including intercompany transfer of goods, property, services and loans. The laws affect South African taxpayers with offshore operations such as foreign subsidiaries and holding companies.

The research was based on independent interviews with 40 participants in Anglophone Africa. This is the first time insight into transfer pricing trends and the views of multinational enterprises operating in Anglophone Africa have been disclosed.

Final report due next year

Jozua Loots, head of the technical African transfer pricing centre of excellence at Ernst & Young, said the study was preliminary and research was continuing. A final report would be released early next year. The results of the research would enable Ernst & Young to advise on transfer pricing in various African countries in which multinationals conducted business, he said.

"The bigger a transaction the more likely it is to trigger a transfer pricing dispute," Loots said this month at the Ernst & Young Africa Tax Conference in Gaborone, Botswana. "The more monetary value a financial transaction has, the more likely it is that the South African Revenue Service (SARS) will look into it."

This was one of the transfer pricing dispute 'red flags' raised by companies interviewed. SARS had improved its processes and collection mechanisms, and also enjoyed observer status at the Organisation for Economic Co-operation and Development (OECD).

Over the past two years SARS had conducted more than 50 transfer-pricing audits.

Certain transactions are more prevalent

"Certain transactions are more prevalent in Africa than others," Loots said. These included goods, services and financial transactions which amounted to nearly 80 percent of all transactions.

According to the report, 56 percent of transactions involving goods were regarded as material by organisations; 27 percent involving services and seven percent involving royalties were seen as material.

With more countries adopting transfer pricing, including the imposition of documentation requirements, risk management was a big consideration for multinationals, Loots said.

However, it was unfortunate that 21 percent of companies did not prepare transfer pricing documentation, according to the research. About 20 percent of documentation was prepared on a globally co-ordinated basis. Forty percent of companies tended to prepare their documentation for a single country and would modify it if necessary. The difficulty with this was that companies were then always reacting.

Three most important tax considerations

The research disclosed that companies tended to regard the three most important tax considerations as indirect tax, followed closely by tax controversy and then transfer pricing.

Susceptible transactions likely to trigger transfer pricing disputes included the transfer of goods and intragroup services (about 70 percent).

Only five countries in Africa had adopted transfer pricing rules to date. These were SA, Namibia, Mozambique, Kenya and Tanzania.

In the absence of transfer pricing legislation, African countries tended to use general anti-avoidance laws, Loots said. They also relied on the OECD guidelines for interpreting intercompany transactions

"The audit activity carried out by the tax authorities in African countries is not necessarily focused on industries," he said. "It could be industry and transaction specific." Transfer pricing audit activity had been seen in SA, Botswana, Nigeria, Kenya and Uganda.

Sean Kruger, head of tax at Ernst & Young, said SARS' transfer pricing unit was sophisticated. It had substantially expanded its knowledge and resources. In countries such as Namibia and Lesotho, transfer pricing was still new. "Many tax authorities rely on gut feel to ascertain whether the intercompany transactions are above board," he said.