

Transfer Pricing Alert

Alert 2 of the 'Transfer Pricing Alert' series

The laws surrounding transfer pricing are becoming ever more complex, as tax affairs of multinational companies are facing scrutiny from media, regulators and the public. Accordingly, Grant Thornton presents its insight on the matter in a series of alerts about transfer pricing, supported by local knowledge and experience of Rajesh Narasimhan, Taxation Partner.

The laws surrounding transfer pricing are becoming ever more complex, as tax affairs of multinational companies are facing scrutiny from media, regulators and the public. Well run businesses need to consider this new emphasis on compliance and audit activity. Although these laws may share common features across various countries, the interpretations can differ from one country to another.

It is to be understood that the right approach to compliance takes time and patience, as demands and penalties from authorities are increasing. The complexity increases as fiscal authorities continue to develop their transfer pricing laws. The principles are common, although interpretations differ from one tax authority to another. There is greater emphasis on examination and audit activity to encourage compliance and ignoring this issue is not an option for any well-run business.

At Grant Thornton, we can offer real insight in the following areas:

- **Audit support:** sophisticated economic arguments, research and databases can help defend transfer pricing policies before the tax authorities
- **Documentation:** using expert local knowledge to prepare country-specific documentation to satisfy local tax regulations
- **Planning:** the growth or restructuring of a company doing business internationally provides an opportunity to review transfer pricing and tax planning to minimise tax burdens
- **Supply chain re-engineering:** the critical analysis of the supply chain to gain operational efficiencies.

The 2013 **Transfer Pricing Risk guidelines** seek to ensure that documentation provides a genuinely informed basis for risk assessment by bringing documentation up to date with today's more globalised marketplace, creating a more consistent international approach and striking a better balance between transparency and the burden of proof.



Rajesh Narasimhan, Partner - Taxation

Documentation is seen as an anchor for best practice, assisting tax authorities with their risk assessment and providing information for a potential tax audit. The discipline of a more documented approach is also seen as leading to more robust policies and reducing risk within companies themselves ("mindful compliance").

The new standardised requirements would be based on a two-tier master file and local file set of templates, echoing the EU framework. In a much more prescriptive approach MNEs will be required to disclose key business and financial information using a bottom up entity-by-entity basis of preparation. Compliance issues include the higher focus on contemporaneous information and update of comparable financials annually, with a full re-run of benchmarking on a three year cycle. There is likely to be a lot more focus on the 'significant people functions' (i.e. the people carrying out and overseeing key activities). The proposals are given added impetus by being one of the first stages of the BEPS Action Plan, a much wider review of transfer pricing policy and oversight being ushered by the OECD under the auspices of the G20.

Enhancing transparency and standardisation is seen as a crucial bulwark in the OECD's drive to eliminate the gaps and mismatches in tax rules that it believes can allow profits to disappear or enable profits to be diverted to jurisdictions where there is little relevant activity. In short, the focus on documentation isn't just a paper exercise, but a key part of the international community's determination to close up tax loopholes.

We have noticed that several multinational operating in Botswana have been required to provide details to their head office. These country by country reporting enables revenue authorities to access information about the local company from their counterparts in foreign jurisdiction.

So, how much documentation is enough?

While there is no one-size-fits-all solution, we believe that a 'plan, implement and defend' approach that builds documentation into the wider risk management of tax and transfer pricing should enable companies to keep tax authorities on side without over burdening the business.

Transfer pricing policies should fully reflect the business model, have a justifiable rationale and be applicable at a local level. Effective documentation can help to reassure authorities that policies are robust and being enforced. Arguably, all inter-country transactions have some element of risk.

In practice, authorities will be looking most closely at higher risk transactions, such as those involving licensing arrangements, transactions with real or perceived 'tax haven' locations or those where there are persistent losses. They will also be targeting companies and transactions where there is no clear or consistent policy on how prices are apportioned.

An effective documentation framework binds the high level strategy and risk identification with application on the ground. Documentation should explain the policies in force and their rationale, focusing most closely on the higher risk areas. It should also demonstrate the consistency of the policies and underlying accounting procedures being applied

Practical application

The first step is to review the transfer pricing rationale and risk of each transaction. It is then important to check whether policies are consistent and being applied uniformly, as well as monitoring any changes in conditions. Factors to be considered include annual requirements, countries outside the OECD framework outlying policies and accelerated timelines for disclosure.

Geared up for change

It will be important to assess the impact on the business both directly and as part of the wider changes being developed under the BEPS Action Plan. There is no one size fits all approach. The areas to be weighed up include cost versus tax authority assurance and transparency versus confidentiality. In all cases, building documentation into a proactive and systematic approach to transfer pricing will help to minimise the potential for disputes, while curbing any unnecessary demands on the business.

Simply ignoring these developments or taking a reactive approach will heighten the risk of being targeted by tax authorities. It will also make it much harder to deal with audits and to contest potential sanctions. In short, documentation can be a burden, but it is also your best defense.

For a detailed assessment or assistance in addressing/resolving inter-company transfer pricing within your organization, please contact the Marketing, Communications and Business Development team on 395 2313, or Rajesh Narasimhan on rajesh.narasimhan@bw.gt.com.

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