The Transfer Pricing Regime In Tanzania

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With the entry into the East African Community Common Market Protocol and the anticipated reduction in customs duty collection, the Tanzania Revenue Authorities (TRA) is poised to intensify transfer pricing reviews as a way of augmenting revenue collection.

Nonetheless, Tanzania's transfer pricing regime remains vague and largely untested. In fact, the TRA is yet to issue detailed guidelines on how the rules will be applied. Of particular consequence is the standard by which the "arm's length principle" enshrined in section 33 of the Income Tax Act 2004 (the "Act") will be applied to controlled transactions. The OECD and the United Nations Tax Committee have both endorsed the "arm's length" principle and it is widely used as the basis for bilateral treaties between governments.

Simply stated, the arm's length principle prescribes that compensation for any inter-company transaction conform to the level that would have applied had the transaction occurred between unrelated parties, all other factors remaining constant.

Accordingly, section 33(1) of the Act provides: "[i]n any arrangement between persons who are associates, the persons shall quantify, apportion and allocate amounts to be included or deducted in calculating income between the persons as is necessary to reflect the total income or tax payable that would have arisen for them if the arrangement had been conducted at arm's length."

Further, section 33(2) provides: "[w]here in the opinion of the Commissioner, a person has failed to comply with the provisions of subsection (1), the Commissioner may make adjustments consistent with subsection (1) and in doing so the Commissioner may (a) re-characterise the source and type of any income, loss, amount or payment; or (b) apportion and allocate expenditure […] incurred by one person in conducting a business that benefits an associate in conducting a business to the person and the associate based on the comparative turnover of the businesses."

Regulation 6 of the Income Tax Regulations, 2004, provides: "[s]ection 33(1) of the Act shall be construed in such a manner as best secures consistency with the transfer pricing guidelines in the Practice Notes issued by the Commissioner."

While the arm's length principle can be simply stated, the practical determination of what constitutes arm's length compensation is notoriously complicated. Key factors affecting the determination include the type of transaction under consideration and the economic circumstances surrounding the transaction. Quite apart from influencing the amount of the compensation, these factors may in fact impinge on the form of the compensation. Evidently, Regulation 6 contemplates the issuance of transfer pricing guidelines by the TRA. Yet, none exist. The TRA has, in fact, issued no practice notes to clarify what approach it will follow to effectuate the transfer pricing provisions.

As in other areas of the law, it is vital to publish in advance, clear guidelines regarding any legal requirements that will be applied with respect to transfer pricing. This is not only important for the TRA, which needs such guidelines to apply the law properly and equitably, but also for taxpayers, who must comply with the law. Clear guidelines could help prevent unexpected and inconsistent results, which could otherwise pose significant problems for both the TRA and taxpayers. They could also minimise controversy and reassure potential investors. Nonetheless, guidelines can serve these purposes only if they are clear and sufficiently detailed to be understood by both the tax administration and taxpayers. Insofar as no detailed transfer pricing guidelines exist in Tanzania, the TRA has indicated that it will follow the OECD transfer pricing guidelines with regard to the standard by which the arm's length principle will be applied.

Tanzania tends to follow Kenya's lead in situations involving new approaches to tax enforcement. Hence, the TRA has indicated that it will follow the approach taken by the Kenyan High court in the landmark case of Unilever Kenya Limited v.The Commissioner for Income Tax (Income Tax Appeal No. 753 of 2003).

In the Unilever case, the Kenyan High Court acknowledged that the OECD guidelines represented internationally accepted principles, which could not be disregarded in applying transfer pricing legislation and which are to be applied in the absence of specific guidelines in the legislation. The detailed methodology to be applied under the transfer pricing rules therefore is that provided in the OECD guidelines1.

Should Tanzania, in fact, follow Kenya's lead, Tanzania's transfer pricing regime might allow persons to choose from a list of specified methodologies to determining the arm's length price. These approaches might include the Comparable Uncontrolled Price Method (CUPM), the Resale Price Method (RPM), the Cost Plus Method (CPM), the Profit Split Method (PSM) and the Transactional Net Margin Method (TNM).

Other features that might be reasonably anticipated in Tanzania could be a well defined set of the types of transactions that might come within the ambit of the transfer pricing rules, sweeping powers granted to the Commissioner to request information from taxpayers, including books of accounts and other documents relating to relevant transactions.

Furthermore, the transfer pricing rules might place the burden of proving that prices are at arm's length on the taxpayer, so that a taxpayer who fails to provide transfer pricing documentation to support the arm's length nature of its prices would be at risk that the TRA will conduct a transfer pricing audit and examine its transfer pricing policies in detail. In the event the TRA, as a result of the examination, adjusts the transfer price adopted by the taxpayer, the lack of adequate documentation would make it difficult for the taxpayer to rebut the adjustment.

Pronouncements by the TRA to the effect that they will follow the OECD guidelines, while somewhat comforting, remain merely pronouncements. Without proper, clear and detailed guidelines, issues of fairness to the taxpayer may arise, when the application of general principles to related party pricing is ambiguous and unpredictable. If the result is not perceived as being fair and predictable, this may create significant controversy, placing further strain on an already challenged administrative regime and leaving potential investors to view the lack of transfer pricing guidance as an unfavorable factor. Any arbitrary departures from the arm's length principle would yield an increased risk of double or unanticipated taxation, with no sound prospect of cross-border relief. Needless to say, this would unduly increase the cost of doing business in Tanzania and not only discourage cross-border trade and investment, but also impair sustainable development in the long run.

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