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Managing Transfer Pricing
The Case of Uganda

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1. Introduction

A significant proportion of international trade in goods and services takes place within multinational groups. Estimates vary between one and two thirds of total trade volumes. The ability of multinationals to manage transfer prices between their subsidiaries in order to minimise their overall tax burden has long been the focus of legislators and tax authorities and most jurisdictions now have transfer pricing rules at their disposal to combat abusive transfer pricing. Despite this, some commentators continue to claim that abusive transfer pricing is causing African countries to lose large amounts of tax revenue though the evidence is less clear-cut than some of the more lurid claims imply[1]. As a result, transfer pricing continues to be a key focus for the tax authorities across Africa and Uganda is no exception to this.

In a recent article at this link https://drive.google.com/open?id=1SOE6F0-JVXLz8Ssq3Idz1P9GctUyvblt, we looked at current international developments in the field of transfer pricing. This article takes a closer look at some of the specific issues which face companies in managing transfer pricing in a Ugandan context.

2. Uganda's transfer pricing rules

Section 90 of the Income Tax Act ('ITA') provides the Uganda Revenue Authority ('URA') with the basis to adjust for tax purposes, the results of transactions between associates where it considers these to be consistent with the arm's length principle (see below). This is amplified by way of Regulations and a Practice Note introduced in 2011 which together with the ITA, provide a detailed framework for the administration of transfer pricing in Uganda.

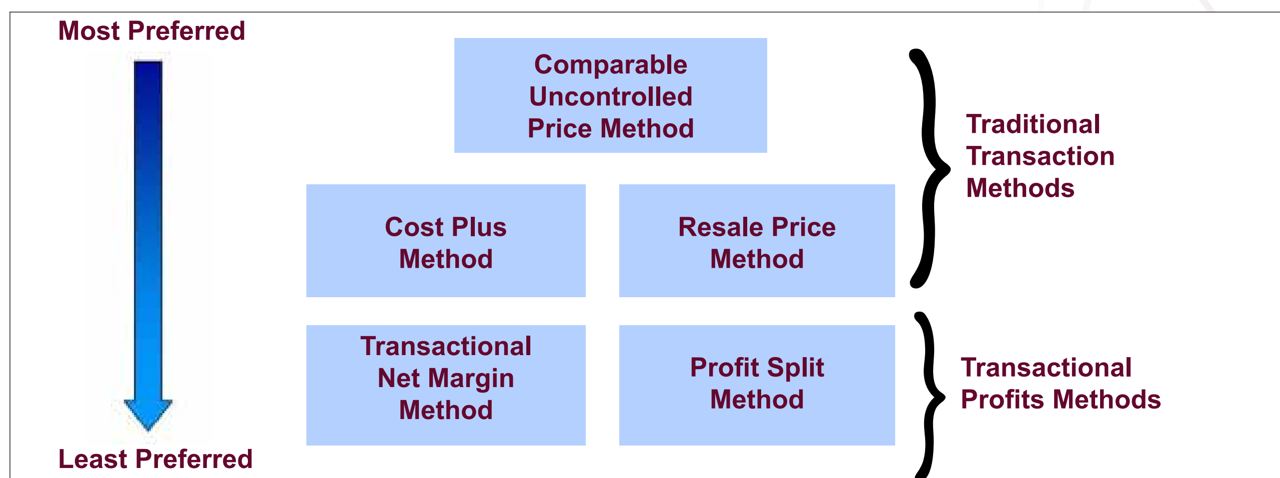
The 2011 Regulations, which are implemented via a statutory instrument and have the force of law, apply to all 'controlled transactions', defined as transactions between associates. The definition of 'associate' is provided by section 3 (1) of the ITA and applies to any relationship where one party, 'acts in accordance with the directions, requests, suggestions, or wishes of another person, whether or not they are in a business relationship and whether those directions, requests, suggestions, or wishes are communicated…' The only exclusion provided by the law relates to employment: employees not being associates of their employer and vice versa.

Subsection 3 (2) of the ITA provides 9 specific situations where parties are treated as associates, though it does not limit the application of subsection 1. For multinational groups the most commonly encountered 'associate' relationship is likely to be that between subsidiaries of the group, which includes companies with 50% or more common control. The Regulations apply to both cross-border transactions and those that take place within Uganda and make clear that intra-company transactions between a Ugandan branch and its foreign head office are within the scope of the rules.

The key provision is Regulation 7 which requires that a person entering into a controlled transaction 'shall determine the income and expenditures resulting from the transaction…in a manner that is consistent with the arm's length principle'. The Regulations do not themselves provide an explanation of the arm's length principle, but instead refer to documents issued by the Organisation for Economic Co-operation and Development ('OECD'), specifically the Transfer Pricing Guidelines and the Model Tax Treaty.

The effect of applying the arm's length principle to transactions between associates is to substitute pricing and other conditions which would be agreed between non-associated parties acting independently where any of those terms have been affected by the relationship between associates. Where transactions between associates do not conform to the arm's length principle, the URA has the right to make appropriate adjustments.

The Regulations list five methods that may be used to determine the arm's length price in the case of a controlled transaction. These are consistent with the OECD Transfer Pricing Guidelines:



- The comparable uncontrolled price method requires the price in a controlled transaction to be set by reference to the price used in a comparable transaction with a party that is not associated with the taxpayer. Detailed comparability factors are set out in Regulation 4 and include contractual terms and the characteristics of the property or services supplied.
- The resale price method applies mainly to goods purchased and then resold by a taxpayer and requires the price in a controlled transaction to be set by reference to the margin earned on the purchase and sale of similar goods to a party that is not associated.
- The cost plus method requires the price in a controlled transaction to be set by reference to the margin earned on the sale of similar goods and/or services to a party that is not associated.
- The transactional net margin method requires the net profit margin on a controlled transaction to be set by reference to the net margin earned on a sale of similar goods and services to a party which is not associated. This may be more practical than the cost plus method when profits are being benchmarked against those earned by third parties as publicly available information on individual transactions may be limited.
- The transaction profit split method requires overall profits in a chain of transactions between associates to be shared consistently with how this would be done were none of the parties associated.

The Regulations state that the selection of the most appropriate method should be made by the taxpayer in the first instance and should be based on careful consideration of the functions performed, availability of reliable information, the degree of comparability and the reliability of any adjustments required to eliminate differences between the benchmark transaction and that being priced. Other methods are permitted if none of the five methods listed is considered to give a reliable result and the alternative method gives a result that is consistent with the arm's length principle.

The Regulations provide a mechanism for the negotiation of advance pricing agreements ('APAs') so that a taxpayer can agree in advance with the URA that its pricing for specified future transactions satisfies the arm's length principle. The provision does not explicitly recognise APAs involving tax authorities in other jurisdictions (e.g. those in the home jurisdiction of an associated company selling goods or services to a Ugandan affiliate). We are not aware that any APAs have been finalised by the URA so far.

The Regulations also provide that Uganda may make an adjustment to the tax liability of a Ugandan taxpayer where an associate is subject to a transfer pricing adjustment in its home jurisdiction in respect of transactions with the Ugandan taxpayer, provided the URA is satisfied that the adjustment is consistent with the arm's length principle. This only applies where the associate is resident in a jurisdiction with which Uganda has a double tax treaty. The implication is that this would only be applied to reduce a tax liability in Uganda and we are not aware of any cases of it being applied in practice.

Contravention of the requirement of Regulation 7 may lead to up to 6 months imprisonment or a fine of up to Uganda Shilling ('UGX') 500,000 (approx. USD 135).

3. Documentation

The Regulations provide little guidance on the documentation required to justify transfer prices used by a taxpayer. Taxpayers should record in writing, 'sufficient information and analysis to verify that the controlled transactions are consistent with the arm's length principle'.

This documentation should be prepared before filing the income tax return for the relevant year of income but should not be submitted to the URA unless specifically requested. A person who upon request by the URA fails to provide records in respect of transfer pricing within 30 days after the request, is liable to a penal tax equivalent to UGX 50 Million.Non-compliance with maintaining transfer pricing documentation is further subject to imprisonment for up to 6 months or a fine not exceeding UGX 500,000. The Regulations give the URA Commissioner General the authority to issue a notice providing more details.

On 5 May 2012, the URA issued a Practice Note setting out in detail the documentation required in respect of Ugandan taxpayers which are part of a multinational group or which have transactions with associates of at least UGX 500 million (approximately USD 135,000) in a tax year. Interestingly, Practice Notes are not legally binding per se, though the wording of this Practice Note is prescriptive.

The transfer pricing documentation required is comprehensive and consistent with international norms including details of:

- Ownership and organizational structure of the group;
- Participants in related party transactions;
- Overview of the group's history;
- Operational aspects including details of functions, risks and assets;
- Factors influencing price setting;
- Controlled transactions (e.g., terms and conditions, copies of contracts, methodology for allocating overheads, etc, etc);
- Data on comparable, third party transactions used in setting related party prices;
- Relevant economic conditions (e.g., geographical location, business planning, economic and legal factors affecting pricing decisions);
- Pricing method selection process, including benchmarking of comparable transactions and any relevant pricing adjustments made;

- Role of intangibles in the business (such as trademarks);
- Functions and risks undertaken by relevant entities;
- Any cost contribution arrangements within the group;
- Business strategy issues affecting pricing decisions, including sharing of profits and losses between different parts of a group; and
- The source and application of debt and equity funding.

Where transfer price benchmarking results in a range of potential values (as it generally will), the practice note requires the process to be documented and justification for the selection of a particular price within the range to be provided. All documentation must be available in English.

4. Benchmarking

A key part of the process of deriving an arm's length price for a transaction between associates is benchmarking the price used or profit derived against comparable transactions between independent parties. For traded commodities like crude oil, price information may be relatively straightforward to obtain from public sources, though differences in factors like quality, quantity and contractual terms need to be considered. For other types of goods and services it may be more difficult, particularly where unique and valuable intangibles such as a trade mark, know-how or patent are involved.

There are various proprietary databases which may be used to access granular information to assist with benchmarking, but the process of identifying comparable transactions is complex. A significant constraint is the availability of data as the ultimate source is public-domain information derived from published financial statements and other documents such as filings with the US Securities and Exchange Commission. This means that for most jurisdictions in Africa (including Uganda) only limited information is available as company financial statements filed with the registrar are not publicly available.

As a result, taxpayers in Uganda may need to rely on comparable data from other markets, making adjustments for differences in market conditions. Determining how to make those adjustments usually requires input from economists with specialised training. The output from such a benchmarking exercise will not result in a single 'correct' arm's length price: rather there will be a range of values and determining how to select the most appropriate answer from that range may be challenging. The URA will have access to information from other taxpayers in the country which is not publicly available, and though the OECD and United Nations ('UN') discourage the use of so-called 'secret comparables' this may put taxpayers at a disadvantage in negotiations.

On the positive side, members of multinational groups will not need to 'reinvent the wheel' when preparing their transfer pricing documentation for Uganda. Multinational groups, with very few exceptions, will be required to prepare comprehensive transfer pricing documentation, including benchmarking studies, by their home jurisdictions and the other countries where they operate.

Countries which have implemented the recommendations of BEPS action 13 will require groups based in their jurisdiction to prepare a master file covering the group as a whole and individual country reports which address transfer pricing aspects of local operations. Tailoring these to the Ugandan requirements should be relatively straightforward in most cases.

5. URA's access to information from other jurisdictions

A major frustration of tax authorities dealing with transfer pricing, particularly in developing countries, has been their limited access to information from other jurisdictions. Multinationals may be reluctant to make information related to operations in other jurisdictions available to subsidiaries under audit due to concerns about confidentiality/security of sensitive commercial data. Whilst this is a legitimate concern, it may be interpreted simply as a delaying tactic by the audit team (and sometimes perhaps it is!). It isn't clear how the URA can enforce the requirements under the Practice Note, particularly in respect of specific information from a sister company over which a Ugandan taxpayer has no authority.

An alternative approach is to seek information directly from the tax authorities in the relevant jurisdiction. Up to 2015 the only route available was under double tax treaties, of which Uganda has a limited number[2]. Such treaties normally provide for exchange of information between tax authorities regarding not only the application of the treaty itself but also the assessment and collection of tax. It is understood that the URA has made only limited use of this power to date and of course it is only available in respect of companies which are resident in the nine treaty partner countries.

Recent developments significantly expand the options available to the URA: in 2015 Uganda signed the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ('the Convention)' This currently has 127 signatories worldwide and provides a framework for signatory states' tax authorities to share information in order to enhance the operation of their domestic tax rules in assessment and collection of taxes. It also provides a mechanism for joint tax audits. The implementation of BEPS[3] action 13 creates a body of information that the URA could potentially access using the Convention. Action 13 recommends countries participating in the BEPS initiative to introduce domestic legislation requiring the ultimate parent company of a multinational groups with a turnover of at least 750 million euros (or equivalent) to prepare a country-by-country report for accounting periods starting on or after 1 January 2016. The report is intended to provide tax authorities with basic information on the financial performance of a multinational in each jurisdiction where it has activities, specifically:

- Total revenues split between transactions with related and unrelated parties;
- Profit (or loss) before income tax;
- Income tax accrued for the year and payments made;
- Equity capital;
- Undistributed profits;
- Number of employees; and
- Tangible assets (excluding cash and similar).

The report template prepared by the OECD also requires a list of each entity in a group and the jurisdiction(s) in which each operates along with information on the nature of the business activities performed. The OECD has been at pains to point out that this information by itself is not sufficient to form the basis for a transfer pricing adjustment but is intended to be useful in detecting potential issues for further investigation and could certainly be used in this way by the URA.

6. The URA's approach to transfer pricing audits

The URA has established a dedicated transfer pricing team and since 2016 has received support from the African Tax Administration Forum ('ATAF'), OECD and World Bank in developing its capacity to address international tax issues including transfer pricing. In addition to training support, personnel from Tax Inspectors Without Borders ('TIWB')[4] have participated

in capacity building assisting in the conduct of transfer pricing audits. We understand that the URA has also subscribed to at least one proprietary transfer pricing databases to assist it in carrying out benchmarking studies.

To date the main focus of URA audit activity has been information gathering and we understand that a number of multinationals operating in Uganda have been asked to provide transfer pricing documentation, but it does not appear that many, if any, detailed transfer pricing audits have been completed to date. A significant focus of the URA so far has been on ensuring that reverse charge VAT and withholding tax has been correctly accounted for the proof of performance of the underlying transactions. We are also aware of challenges in respect of the deductibility of management fees paid to affiliates in low tax jurisdictions.

Given the volume of information gathered by the URA's transfer pricing team to date, it seems likely that audit activity will intensify in the coming months and taxpayers should ensure that they are ready.

7. Dispute resolution options

Transfer pricing is a complex area and even the most comprehensive economic studies still require taxpayers to take subjective decisions on where to fix transfer prices within the range of available options. It is therefore inevitable that transfer pricing audits will result in differences of view between tax authorities and taxpayers. Ideally these should be settled by negotiation, but this is not always possible, and it may be necessary to consider other methods of settling disputes.

The Tax Procedures Code Act 2014 ('the TPCA') gives the URA the power to issue an additional assessment where a taxpayer's self-assessment is considered inadequate. The general time limit for such assessments is three years after the filing deadline for the relevant income tax return (six months after the end of the relevant tax year), but there is no time limit for the issuance of such an assessment in cases of fraud, gross or wilful neglect or when, 'new information has been discovered in relation to the tax payable by the taxpayer for a tax period'. This is broadly interpreted so taxpayers should anticipate that the URA would not feel themselves constrained by a time limit in a transfer pricing audit.

If an assessment is issued in these circumstances, the taxpayer has 45 days to object to the Commissioner General of the URA. The URA then has 90 days to reach a decision on the objection, though this limit is waived in case a review of the taxpayer's records is necessary to resolve the matter (which would generally be the case where transfer pricing is the subject).

If an objection decision is disputed, the taxpayer has a further 30 days to appeal the matter to the Tax Appeals Tribunal ('TAT'), an independent quasi court which deals exclusively with tax matters. The TAT Act provides that a taxpayer who has lodged a notice of objection to an assessment shall, pending final resolution of the objection, pay 30 percent of the tax assessed or that part of the tax assessed not in dispute, whichever is greater. Decisions of the TAT may be appealed by either a taxpayer or the URA to the High Court and thence to the Court of Appeal and ultimately to the Supreme Court.

At the time of writing, the TAT and other courts in Uganda have very limited exposure to transfer pricing issues and it is not clear how they will address the complex technical issues implied.

8. Conclusion

The implementation of the 2011 Transfer Pricing Regulations is work-in-progress for the URA, but their efforts are clearly gathering momentum and whilst the resources at their disposal are limited, they have wide powers. Taxpayers should comply diligently with their obligation to maintain documentation and be ready to defend their pricing decisions on audit. Consistency of approach across a multinational group will also be important given the potential for reports filed in other jurisdictions to be made available to the URA via the Convention and double tax treaties.

Recognising the critical importance of transfer pricing to business in Uganda, Cristal Advocates plans to run a transfer pricing workshop in Kampala in June 2019 to help taxpayers familiarise themselves with the rules and to prepare for audits by the URA. Further information can be found on our website (www.cristaladvocates.com).

(Endnotes)

1 *For a fascinating insight into the debate see https://hiyamaya.net/2019/04/24/2-7-of-gdp-another-big-number-to-take-with-a-huge-pinch-of-salt-on-multinational-tax-avoidance-in-africa/#more-3458*

2 *Treaties currently in force are with Denmark, India, Italy, Mauritius, Netherlands, Norway, South Africa, UK and Zambia.*

3 *In 2012 the G20 mandated the OECD to prepare an action plan to combat aggressive tax planning by multinationals using Base Erosion and Profit Shifting (BEPS) techniques. This is being implemented by all 129 countries which have signed The Inclusive Framework on BEPS. Uganda is not currently a signatory.*

4 *TIWB is a joint initiative of the Organisation for Economic Co-operation and Development (OECD) and the United Nations Development Programme (UNDP) supporting countries in building tax audit capacity.*

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Contacts for this Publication

Bill Page
(Author)
bpage@cristaladvocates.com

Bill is a Senior Advisor with Cristal Advocates. He has concentrated on working with energy companies with a particular focus on cross border transactions and M&A since 1989 and is a leading global energy and tax practitioner with wide international experience. Between 1986 and 1998, he worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan working across the Caspian region with Deloitte. He was in the region at the time it was developing its infrastructure for crude oil production with international investment following the collapse of the Soviet Union.

From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

Denis Yekoyasi Kakembo
dkakembo@cristaladvocates.com
+256 751 834 168

Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates, he had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

He holds a Master of Laws degree in Petroleum Taxation and Finance from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

John Teira
jteira@cristaladvocates.com
+256 704 493 997

John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

He holds a Bachelor of Laws degree from Makerere University and a Post Graduate Diploma in Legal Practice from the Law Development Centre and various other qualifications. ■

Dickens Asiimwe Katta
dasiimwe@cristaladvocates.com
+256 772 370 021

Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

Francis Tumwesige Ateenyi
ftumwesige@cristaladvocates.com
+256 702 540 936

Francis leads the litigation and dispute resolution practice at the firm. He is an Advocate of the High Court of Uganda with expertise in oil and gas, infrastructure and dispute resolution. He has been part of teams advising on projects in Uganda, Tanzania, Mozambique and South Africa. He specializes in regulatory compliance, national content, health and safety and dispute resolution.

He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

He holds a Master of Laws degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom and various other qualifications. ■

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Contact us

Cristal Advocates
32 Lumumba Avenue
4th Floor, Padre Pio House
Lumumba Avenue

P.O. Box 1769 Kampala, Uganda
Tel: +256 (414) 671 274
Email; admin@cristaladvocates.com
www.cristaladvocates.com