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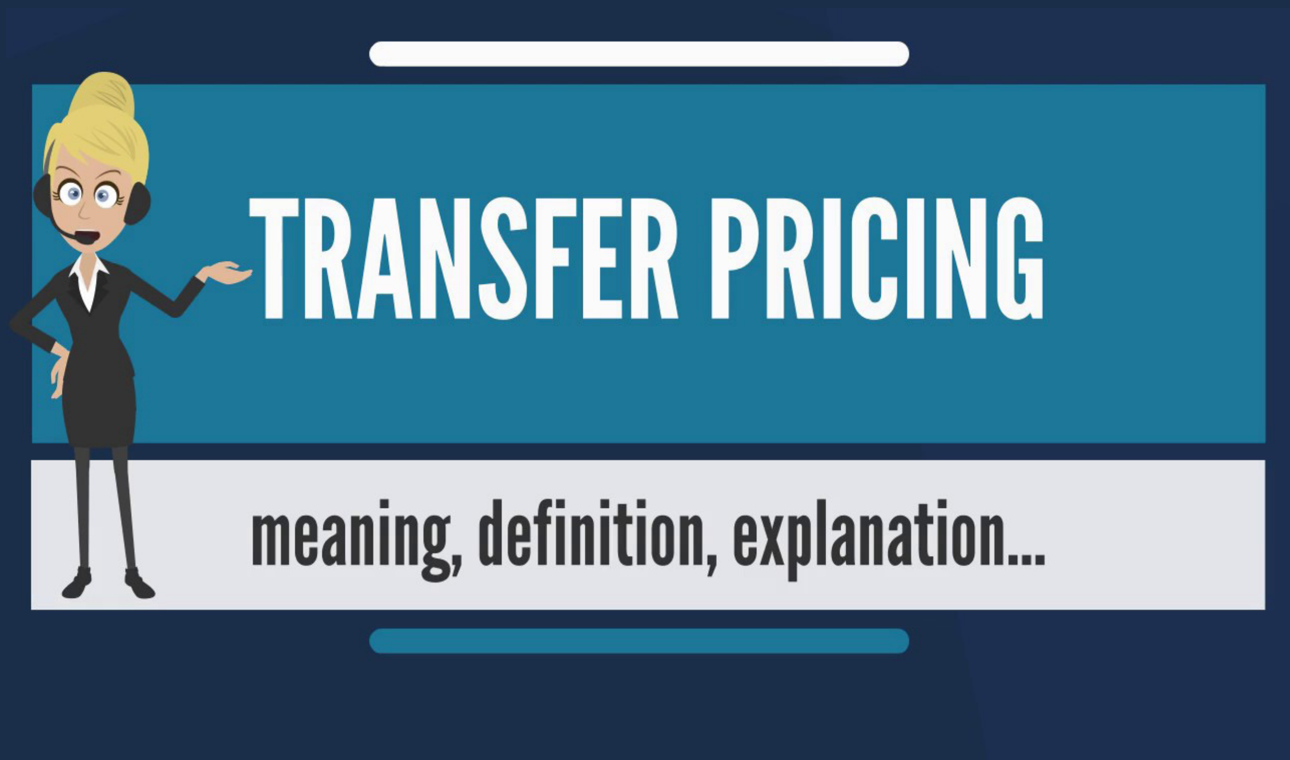
Transfer Pricing in Uganda

A Simplified Account



Cristal Knowledge Series

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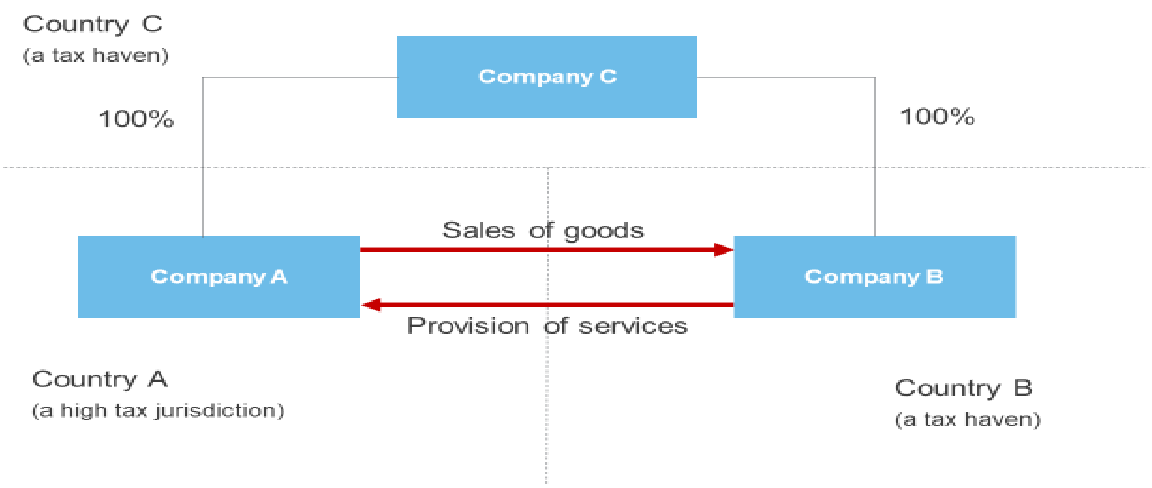
1. Introduction

In this short article, we look at some of the key tax issues that arise for businesses in Uganda in relation to cross-border transactions with respect to transfer pricing. The aim is not to provide a comprehensive guide to all relevant aspects of tax law and practice, but to highlight some key issues of which business owners and managers should be aware. In an earlier article, we dealt with cross border transactions in services and this can be found here http://cristaladvocates.com/?mdocs-file=22162.

2. What is transfer pricing?

A significant proportion (perhaps more than half) of all the cross-border transactions that take place globally each year are between parties that have some connection apart from the transaction itself; these are usually termed 'related parties'. Typically, they are part of a multinational group. 'Transfer pricing' is the term tax practitioners give to process of determining how to price transactions between related parties. This is illustrated by the image below:



Where transactions take place between related parties, like Companies A and B, prices may be influenced by factors other than the individual economic self-interest of the buyer and seller. For example, if Company C wishes to minimise the overall tax burden on its subsidiaries it may do so by instructing Company A to charge less than market price for the goods it sells to Company B and Company B to overcharge for services provided to Company A. In this way profits can be shifted from Country A (which has a high tax rate) to Country B (a low tax jurisdiction or 'tax haven'). In this case transfer prices are manipulated to reduce tax, a process sometimes referred to as transfer mispricing.

3. The arm's length standard

In order to reduce opportunities for tax to be avoided by mispricing of transactions between related parties, most tax laws, including Uganda's, contain transfer pricing rules[1]. In general, these give tax authorities the right to check whether the results of transactions are consistent with results that would have been realised in a transaction between independent persons dealing under the same conditions and acting *at arm's length*. In other words, each party should act in what it sees as its own individual best interests which should not be affected by the interests (or instructions) of any related party. This principle, *the arm's length standard*, is the foundation of most international transfer pricing laws and practice.

Uganda's transfer pricing rules require taxpayers to set prices for transactions with related parties in accordance with the arm's length standard and to document fully the basis for the prices used. Where the price charged between related parties is not considered to be equivalent to that which would apply to a similar transaction between unrelated parties operating at arm's length, transfer pricing rules give tax authorities such as the Uganda Revenue Authority ('URA') the power to adjust the tax liabilities of the parties for tax purposes so they are consistent with the arm's length standard.

1 Uganda's transfer pricing rules are contained in Section 90 of the Income Tax Act (Transactions between Associates) and The Income Tax (Transfer Pricing) Regulations 2011.

It is worth noting that transfer pricing rules in Uganda and many other jurisdictions may apply to domestic as well as cross-border transactions. This is to reduce the risk of profits being sheltered from tax by being shifted via transfer mispricing into entities with tax privileges or losses. There are also valuation rules for VAT and customs duty which may have a similar effect for relevant transactions though a discussion of these is beyond the scope of this article.

4. Transfer pricing methods

As transfer pricing has evolved, 5 main methods of determining arm's length prices for transactions with related parties have emerged and these are all available to Ugandan taxpayers under the 2011 Regulations. The first three focus on individual transactions:

- the *comparable uncontrolled price*, which refers to the price charged (or payable) for comparable goods or services sold to (or acquired from) an unrelated party. This might be based on transactions between the taxpayer itself and unrelated parties or between independent third parties.
- the *cost plus method*, where a margin is charged on the seller's costs based on the profit they would be expected to earn in an arm's length sale; and
- the *resale price method*, where the seller's profit is determined as an arm's length margin embedded in a third party sale price.

Such granular detail of third party transactions may not be readily available for comparison, so two other methods have evolved that focus on the overall profit generated from groups of similar transactions, which may be more easily identified in published information:

- the *transactional net margin method*, compares the net profit margin from a related party transaction with that generated on similar transactions with a third party, or on similar transactions between two unconnected third parties; and
- the *transactional profit split method*, which looks at how unconnected third parties would split their overall profit on a transaction or series of transactions between them.

Under the Uganda regulations, taxpayers are required to perform a transfer pricing study to select the most appropriate method for each affected transaction. Selection should take account of the terms of the transaction, the functions undertaken by each party, the risks each bears and the assets which it employs. A critical part of the study will be benchmarking the prices applied to intra-group transactions against results for transactions with, or between third parties. The method selection process and its application must be fully documented in accordance with a URA practice note issued in 2012. The URA may require such documentation to be provided to it once the relevant annual income tax return has been filed and there are stiff penalties for non-compliance, including imprisonment.

The selection and application of appropriate transfer pricing methods relies on objective evidence but ultimately involves a degree of subjectivity. For example, a typical transfer pricing study will produce a range of potential arm's length prices for any category of transactions rather than a single figure. Selection of the optimal in terms of reducing tax liabilities may become a source of conflict with tax authorities in the event of a tax audit. This underlines the need for thorough contemporaneous documentation to justify the rationale for the selection made.

5. Practical issues and recommendations

Transfer pricing rules have now been adopted by most countries and multinational groups will usually be required to prepare documentation demonstrating their adherence to the arm's length standard in all the jurisdictions where they operate. This should eliminate any need to 'reinvent the wheel' in each jurisdiction as (ideally!) a uniform and consistent global approach will have been adopted which may be relatively easy to adapt to local requirements.

Transfer pricing needs to be addressed holistically by multinational groups, rather than piecemeal on an individual country basis. Though the simple example above shows a tax haven as the counterparty, many transactions which will be subject to transfer pricing scrutiny involve counterparties that pay tax and have their own transfer pricing compliance requirements. Transfer pricing is s zero-sum game for tax authorities in such cases: an alleged tax underpayment in one jurisdiction implies an overpayment in another. If the relevant tax authorities cannot agree adjustments between them the impact may be double economic taxation, with profits being subject to tax in both jurisdictions. Robust documentation will reduce (though it cannot eliminate) such a risk. Many jurisdictions, including Uganda, provide for Advance Pricing Agreements ('APAs') so that companies can agree their transfer pricing approach in advance with the relevant tax authorities. APAs involving all the relevant tax jurisdictions can provide a high degree of certainty for taxpayers and tax authorities but are time consuming to negotiate. We are not aware that Uganda has participated in any such multilateral APAs to date.

Addressing transfer pricing should not be the sole responsibility of the tax function (whether in-house or outsourced). When we have seen multinational groups run into expensive transfer pricing problems it has often been because senior management has not been adequately involved. Transfer pricing should not be thought of as a compliance chore, to be addressed at the last possible moment with minimal effort and expense. Instead it should be fully integrated with business planning and day to day operations. To meet transfer pricing requirements adequately in any jurisdiction, including Uganda, the transfer pricing methods adopted for material transactions should be reflected in the way relevant transactions are carried out, not simply bolted on as an after-thought.

The preservation of 'corporate memory' is also an import area which companies often neglect to their cost. Key decision-makers may move on before the transactions they were responsible for become the subject of a tax audit. If thorough documentation is not maintained, it can be next to impossible to convince tax authorities that appropriate transfer pricing decisions have been taken if those individuals are not on hand to provide explanations.

The URA now has a specialist transfer pricing team which is working on a number of cases where tax is believed to have been underpaid as a result of transfer mispricing. Expectations of significant additional tax revenues are high, so the business community needs to be prepared! Cristal Advocates has provided tax training on transfer pricing to any tax practitioners and business leaders in Uganda (including members of the URA). We also provide consulting on the preparation of transfer pricing policies and documentation. If you need help, please get in touch Cristal Advocates and we'd be happy to assist you.

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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. ■

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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. ■

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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.

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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. ■

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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.

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