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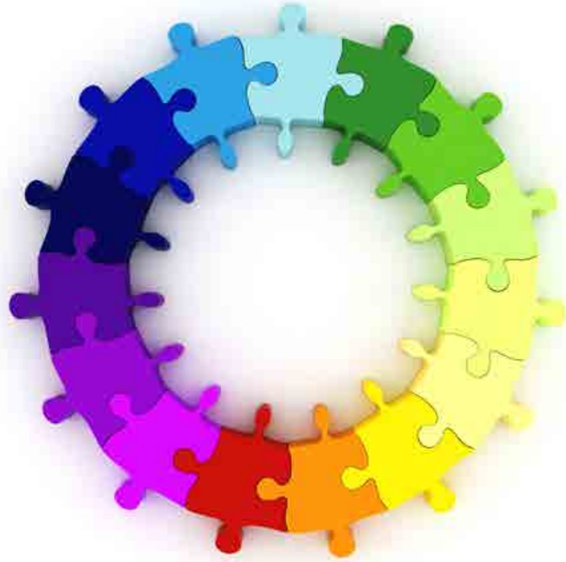

Transfer pricing and the shifting burden of proof

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Taxation is not perfect science, it has never been. Consequently, establishing tax liabilities often means that there is a dispute, of facts or law, as to how you are arrive at the correct liability. This is especially true for tax systems like Tanzania's, which have a self-assessment architecture; that is, taxpayers estimate their tax position and the revenue authority comes to test it later. There is therefore an element of negotiation, justification and deliberation between the taxpayer and the revenue authority on what the make-up of the total liability should constitute.

At the heart of this debate is the question of who bears the burden of proof. Transfer pricing is particularly prone to this question as it deals with information that concerns multiple countries. I want to argue that the burden of proof is titling increasingly towards the taxpayer, and this trend is unlikely to change. I will explain why this is the case and also touch on what businesses can do to ensure enough information is available.

Providing too little information can impede accurate risk analysis and audits. However, too much information can also do the same. In fact, too much information punishes the taxpayer (they have to prepare the information) without necessarily benefitting the tax authority. Optimal levels of information is what each party needs. In fact, the Organisation for Economic Cooperation and Development (OECD) recommends that a taxpayer should provide sufficient information on the related party transaction that enables the tax authority to do three things. The first, proving that the taxpayer gave appropriate consideration to transfer pricing requirements. Secondly, providing tax administrations with sufficient information necessary to conduct an informed transfer pricing analysis. Lastly, providing tax authorities with useful information to employ in conducting a thorough audit.

Looking at the evolution of documentation requirements, one notices that there is a clear move towards requirements for taxpayers to provide more, not less information. Prior to the current OECD guidelines, taxpayers were only required to prepare one set of transfer pricing documentation. They were not required to provide Masterfiles or country-by-country reports, and their disclosure requirements were typically limited to the countries in which they operate. But the above additional requirements are now a reality, and it is likely that the provision of more information will now move to the realm of digital access to information and a freer flow of information among tax authorities themselves.

Here in Tanzania, prior to the release of the 2018 Regulations, it used to be sufficient to document the related party transactions, perform a benchmarking study and submit the documentation. The new regulations now require that computational workings used to determine transfer prices be provided. Documentation must also include 'financial indicators, financial statements of the parties to the controlled transaction, including where the tested party has been selected outside the country'. This is not mentioning the hefty penalties one has to suffer if they fail to provide the documentation in the first place.

It is therefore clear that the shifting of the burden of proof is likely to require taxpayers to put a greater focus on ensuring that transfer pricing positions are documented appropriately. For obvious reasons, I anticipate that the revenue authority may be more aggressive in transfer pricing disputes as it is effectively unshackled from its burden to prove an alternative position.

Taxpayers will likely be faced with the prospect of being told that they have not adequately proven their positions, especially if facts are disputed and external benchmarking is not directly on point. As I pointed out earlier, this is not Tanzanian specific phenomena, but a global one.

Prudent taxpayers would do well to ensure that for every related party transaction, they have at least the following bases covered. First is a proper contract or agreement that fully explains the related party transaction. Second is comprehensively detailed transfer pricing documentation backed by a contemporaneous benchmarking study. Third, is a very detailed breakdown of costs incurred by the related party in the provision of the goods/services as well as evidence of actual services provided. Making sure that the three identified 'defences' are in place will help minimise transfer pricing related risks.

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