



Dedicated to finding the best possible tax solutions for your business

Documenting a Transfer Pricing Policy that Withstands the Test of Time – Series I: Intragroup Services

Revenue authorities in East Africa are increasingly focusing on receipt of intercompany services by taxpayers from their related parties. From a transfer pricing (TP) perspective, the amount paid by the local taxpayer for intercompany services should be just and reasonable. It should be similar to the price that similar services cost in open market.

As an initial step, revenue authorities in East Africa are focusing on whether the service was actually provided prior to evaluating whether the cost that was paid for the services is just and reasonable. From a tax perspective, the burden of proof is on the taxpayer. As such, a taxpayer must prove the following:

- That the service was actually provided/received; and
- That the amount paid for the services is just and reasonable.

Failure to prove the above would result in additional tax liabilities, penalties and interest.

1. How to prove that an intercompany service has been provided/received

This is mainly done through the following key tests:

Test	Description
Reality Test	<p>The taxpayer should provide evidence of the <i>mode and place</i> of service delivery. For example:</p> <ul style="list-style-type: none"> • If the service is offered virtually, the taxpayer should maintain the relevant email communications and other correspondence with the related parties; • Maintain copies of the documents, reports, manuals and any other documents received from the related parties in the course of provision of intercompany services; and • If the service is offered physically, maintain evidence of physical visits. <p>The above evidence should be maintained for each category of service received. In the <i>Coca Cola Kwanza Limited vs Commissioner General of Tanzania, Income Tax Appeal No. 90 OF 2015 & 10 of 2017</i>, the taxpayer lost the case due to failure to provide proof that the services were actually rendered. This resulted in significant additional tax liabilities.</p>
Benefit Test	<p>Revenue authorities in East Africa require taxpayers to justify how the services they receive from their related parties enhanced its economic position (i.e. demonstrate the benefit it derives from the services received). This is determined by considering the following:</p> <ul style="list-style-type: none"> • The reason for purchasing the service and the expected benefit to be derived by the service recipient from such a service on an ongoing basis; and • If the related service provider stopped providing the services, would the taxpayer be willing to pay a third party a similar amount paid to its related parties?

<p>Duplication Test</p>	<p>Duplication of services occurs where an intragroup service provided by a group member already exists in the group entity receiving the service. Duplicated services do not qualify as intragroup services. A service received by a taxpayer is considered to be duplicated if the taxpayer:</p> <ul style="list-style-type: none"> • Has employees at the local level providing or capable of providing a similar service; or • The taxpayer receives a similar service from a third party at the local level. <p>Revenue authorities in East Africa require taxpayers to provide evidence that the intercompany received from their related parties are not duplicated. The taxpayer should prepare a summary distinguishing the services received from their related entities and those available at the local level.</p>
<p>Shareholder Costs or Shareholder Activity Test</p>	<p>Shareholder costs are costs relating to an activity performed by a group member (usually the parent company) solely because of its ownership interest in the group entities. Shareholder activities are not considered to be intra-group services. In consequence, the shareholder costs should not be allocated to group entities. Costs relating to the following are considered to be shareholder costs:</p> <ul style="list-style-type: none"> • Meetings of shareholders of the Parent Company and costs of the supervisory board; • Parent Company's investor's relationship; • Reporting requirements (financials and audit) of the Parent Company including costs relating to preparation of consolidated accounts for the group; and • The compliance of the parent company with the relevant tax laws. <p>Revenue authorities in East Africa often require taxpayers to provide a breakdown of all the fees paid to their related parties for intercompany services and the breakdown of all the services provided to ensure that no such services relate to a shareholder activity.</p>

2. Proving that the cost paid for intercompany services is just and reasonable

The basic principle for intra-group charges is to determine whether independent parties would be willing to accept similar charges paid by the taxpayer for similar services.

In line with the above, revenue authorities in East Africa often prefer the use of the Cost plus Mark-up (CPM) method as the most appropriate method in determining a reasonable price for intercompany services. Under the CPM method, the service provider should calculate the cost incurred in providing services to its related parties and then add an appropriate mark-up to arrive at the amount it should charge the related parties for provision of such services.

The costs incurred by the service provider would include direct costs (such as staff costs of the staff providing the intercompany services) as well as indirect costs relating to the intercompany services (such as printing, telephone, training and office overheads). The mark-up to be included should be determined through a benchmarking study.

Where intercompany services are provided by several Group entities, the cost of providing the services should be allocated to the Group entities using appropriate cost allocation keys (CAKs). The CAKs should be relevant to the type of service and may include.

- Number of personal computers for information technology (IT) services;
- Number of licenses for business management software;
- Number of employees for human resources (HR) services and related matters such as training, health and safety;
- Net sales or size of balance sheet for accounting, marketing and related matters; and
- Number of cars for vehicle fleet management.

3. Conclusion

In the light of increased scrutiny of intercompany transactions by revenue authorities, tax and transfer pricing compliance is critical for companies. In the next series of articles, we will focus on other intercompany transactions and the measures taxpayers should put in place to ensure compliance with tax and transfer pricing legislation in Eastern Africa.

Should you need specific guidance on the above or other transfer pricing issues, kindly feel free to contact any of the below or your usual RSM contact who will be always available to offer guidance and assistance that you need.

Ashif Kassam
Executive Chairman
akassam@ke.rsm-ea.com

Lina Ratansi
Group Chief Executive
lratansi@tz.rsm-ea.co.tz

Samuel Maina
Transfer Pricing Specialist
smaina@ke.rsm-ea.com

Caveat

This newsletter has been prepared for general guidance, and does not constitute professional advice. Accordingly, RSM (Eastern Africa) Consulting Ltd, its associates and its employees and agents accept no liability for the consequences of anyone acting, or refraining from acting, in reliance on the information contained herein or for any decision based on it. No part of the newsletter may be reproduced or published without prior written consent. RSM (Eastern Africa) Consulting Ltd is a member firm of RSM, a worldwide network of accounting and consulting firms. RSM does not offer professional services in its own name and each member firm of RSM is a legally separate and independent national firm.