

HEAVY TRANSFER PRICING TAX FINES NOW EFFECTIVE: By Jonathan Hore

As I write this article, multi-national enterprises (MNEs) who file income tax returns for periods ending after 1 July 2019 are required to file such returns together with detailed transfer pricing (TP) documentation. Whilst transfer pricing legislation took effect on 1 July 2019, it could only be implemented upon publication of the TP regulations on 12 July 2019, which stipulated how MNEs would comply with the new law. Two tier tax penalties of P500 000 and 200% of underpaid tax await MNEs which do not comply with the stipulations of the TP regulations and such penalties are already effective.

The essence of TP

Transfer pricing is the analysis of the prices at which MNEs transfer goods and services between and among them. Taxmen worldwide, BURS included, worry that MNEs can use their relationships with subsidiaries to engage in tax base erosion and profit shifting, resulting in illicit funds flows and reduction of local taxes. In essence, TP laws seek to ensure that MNEs trade with each other as if they were independent, a concept commonly referred to as the arm's length principle. Put simply, if a Botswana subsidiary of an RSA entity sells a particular piece of furniture to its independent clients at P10 000, the company should apply that same price when it sells to its holding company in RSA. Further, if the RSA entity charges the Botswana company management fees, it should apply a charge which any other person would levy if they were dealing with an unrelated entity.

What constitutes MNEs

MNEs are companies which operate in more than one country, i.e. they may have a head office in South Africa or USA and a subsidiary in Botswana. They could also be Botswana head-quartered entities with subsidiaries outside the country. For entities to be affected by TP rules, one of the companies should control the other by holding at least 51% shareholding. IFSC and their related entities are also equally affected by TP rules. The term MNE shall henceforth be assumed to include both real MNEs and IFSC group entities.

TP documentation

The regulations require that all MNEs which file returns for periods ending after 1 July 2019 must keep transfer pricing documentation which stipulates how the prices of the goods and or services they trade among each other are arrived at. TP documentation preparation is a complex task which is handled by tax practitioners or TP specialists. The law requires detailed analysis of how the prices were arrived at as well as narration of which databases were relied on in arriving at the prices used for such inter-company transactions.

The 1st penalty

As stated above, one key requirement of the TP regulations is that MNEs shall also attach their TP documentation when they file income tax returns. Failure to do so exposes them to two tax penalties, the first one being a flat P500 000 which BURS may levy for failure to produce such TP documentation. Whilst taxpayers may negotiate the penalty downwards, they cannot have it reduced beyond P250 000. In other words, the penalty is fixed at anything between P250 000 and P 500 000. That certainly is not a small figure considering that it is paid as a penalty which does not bring any dividends to the MNEs.

The 2nd penalty

MNEs also face a 200% penalty of the tax underpaid due to mispricing goods or services sold or inflated costs, especially management fees they pay offshore. This penalty can be levied when BURS assesses a tax return of such MNE or during a tax audit. For example, if

BURS establishes that management fees charged to a local entity where overstated by P10m, for example, it will issue a TP assessment in the amount of P2.2m (i.e. 22% by P10m) and it can levy a penalty of P4.4m, bringing the final tax liability to P6.6m. BURS also charges effective interest of 18.96% (compound 1.5%/month or part thereof), on such assessments.

Way forward

Given that the above-stated tax penalties are already effective, every MNE must ensure that it has TP documentation by the time of filing its income tax return to avoid the P500 000 penalty. If delays in finalizing such documentation is foreseen, then an extension of time within which to file the tax returns may be useful. Further, such taxpayers must ensure that they make adjustments to their tax computations to ensure that tax is not underpaid due to mispricing of goods or services. This helps them avoid the above-mentioned 200% tax penalty.

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