

Graphene Economics

Transfer Pricing Advisory



CROSS-BORDER TAX IN AFRICA

Transparency, technology and trends –
a look at what 2022 may hold



> INTRODUCTION

In 2020, the world was rocked by the COVID-19 pandemic and the ripple effects continued through 2021. Cross-border transactions have been affected by trends including rapid digitisation, the global movement towards increased tax transparency, increasing business complexity and an uptick in tax controversy, among other things.

This report, based on both our research and anecdotal experiences at Graphene Economics, serves to round up some of the significant themes from the past year, as well as looking forward to what the future holds for 2022 and beyond, with a particular focus on multinational entities (MNEs) and revenue authorities.





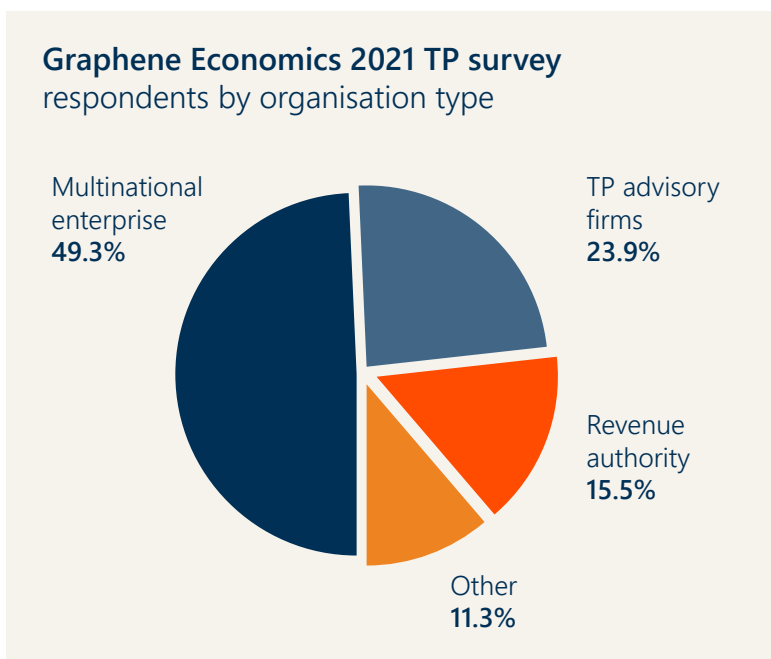
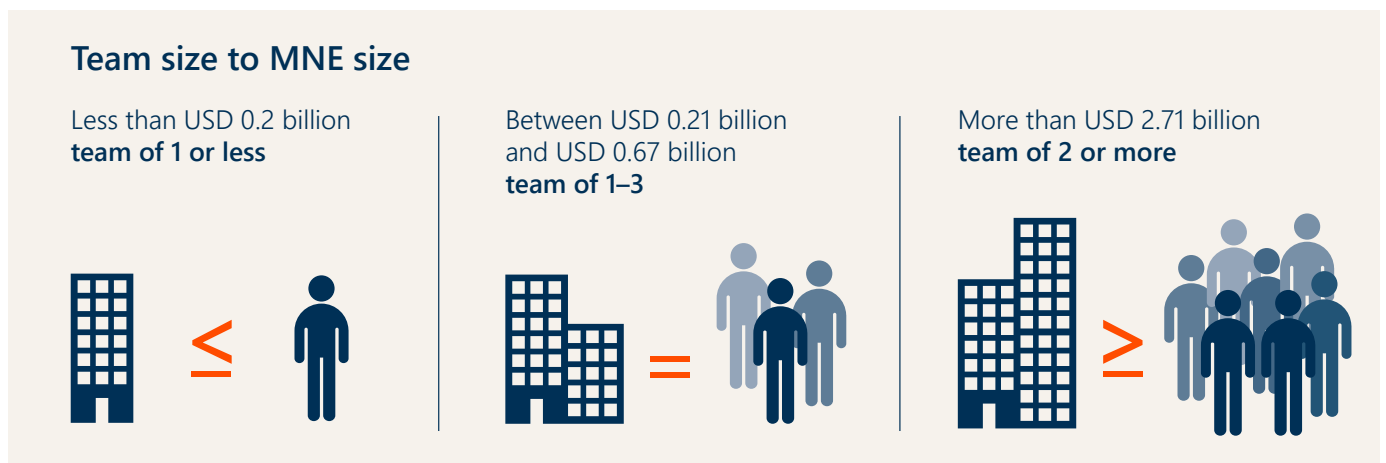
Graphene Economics 2021 Transfer Pricing Matters Survey

In 2021, Graphene Economics created what we hope will become an annual survey on transfer pricing (TP) in the African context. The long-term aim is to track trends in the industry to share with our clients, associates and the various stakeholders in our sector.

Given the niche nature of the TP industry, specifically within Africa, and the fact that this was one of the first surveys of its kind in the local market (to our knowledge), we were expecting a relatively small sample size. However, our total of 71 respondents comprised individuals from 15 countries and representatives from the full range of stakeholders, from MNEs to revenue authorities and tax consulting firms, among others.

SAMPLE DETAILS

As one would expect, the survey data showed a direct correlation between MNE size and the size of the organisation's TP team. For businesses of similar size, European MNEs tended to have larger TP teams than South African MNEs.





TP TRENDS AND CHALLENGES

Of MNE representatives surveyed, the top three most significant TP trends were listed (in order of significance) as more frequent and rigorous audits, global tax reform, adoption of technology.

3 Most significant trends



1st
More frequent and rigorous audits



2nd
Global tax reform



3rd
Adoption of technology

Least significant trends



9th
Intellectual property-related matters such as location and ownership of assets and control of risk



10th
Permanent establishment



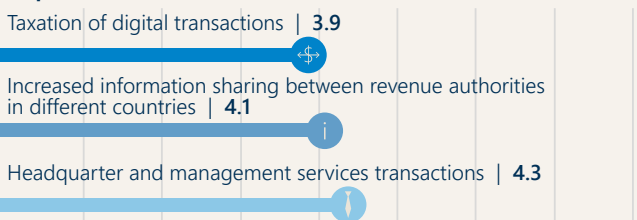
11th
Working-from-anywhere policies

However, when comparing service-based organisations and goods-based organisations there is a big change in which trends are affecting MNEs. When respondents are categorised in this way, the survey data shows the ranking of most significant trends changes as follows:

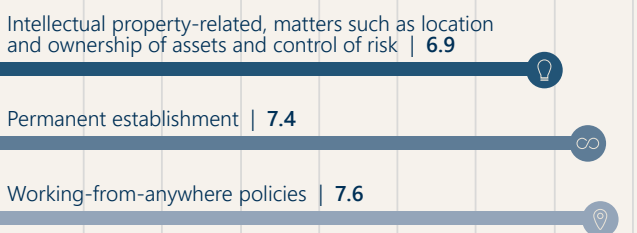


Services-focused MNE respondents
Average rank of the trends expected to play the biggest role in TP in 2022
average ranking per respondent

Top 3



Bottom 3

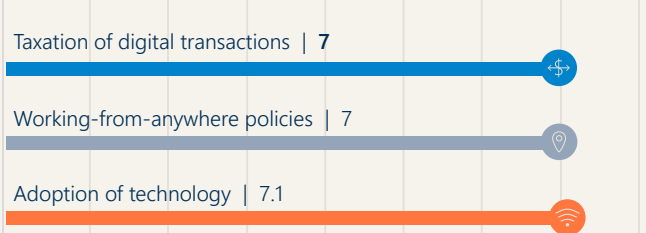


Goods-focused MNE respondents
Average rank of the trends expected to play the biggest role in TP in 2022
average ranking per respondent

Top 3



Bottom 3





When it comes to the challenges that respondents had experienced over the last 12 months, these also differed between service industries and goods industries:



Data quality seems to be a pervasive challenge across the board. Looking at the last 12 months, almost a quarter (24.24%) of respondents indicated that data quality was major challenge for their TP teams. This supports our anecdotal experience at Graphene Economics as we've found many of our clients are having to collect data from multiple sources and different ERP systems, and that's before factoring in the element of human error when it comes to data collection.

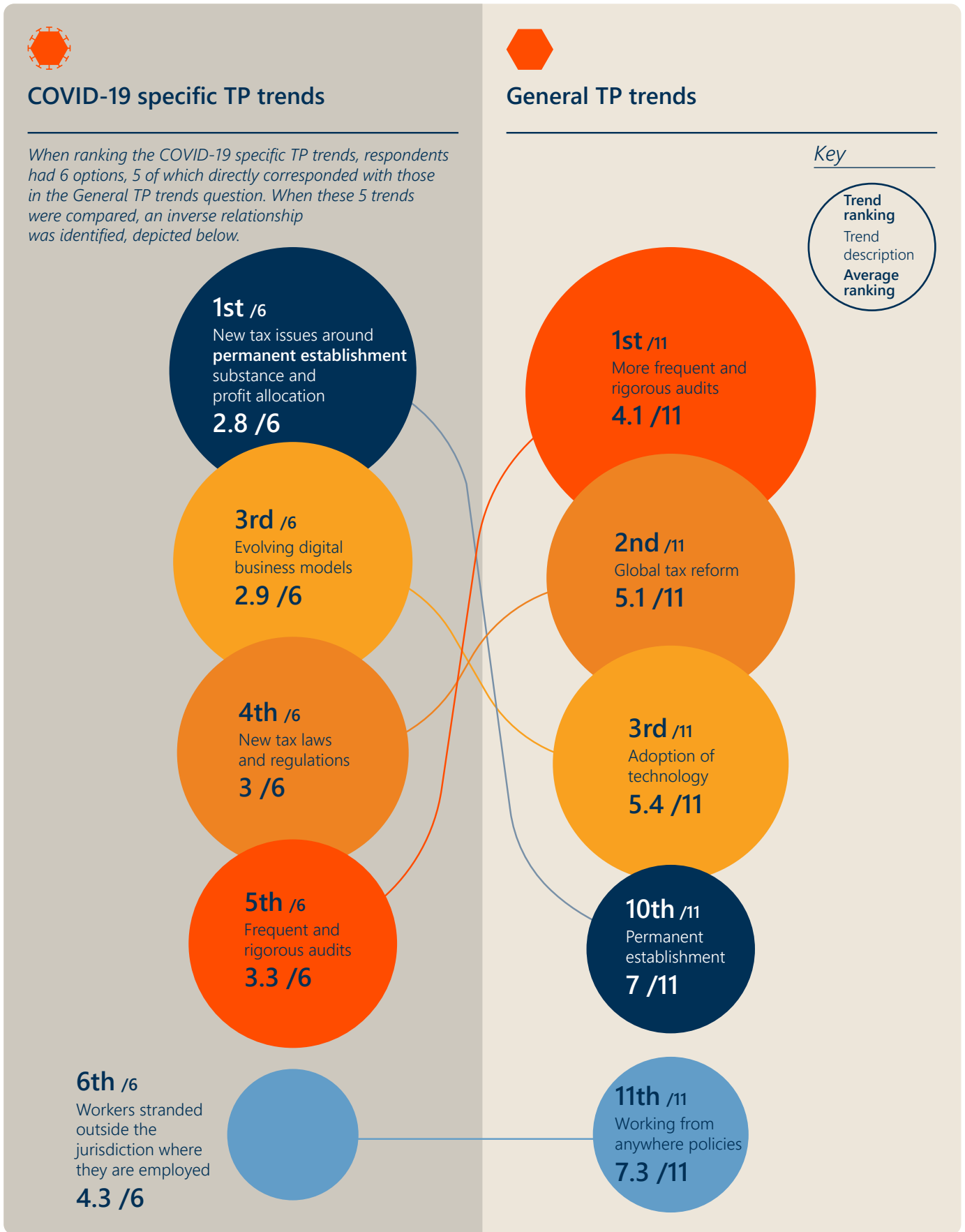
From the results, it is evident that there is a significant increase in the number and rigour of TP audits, regardless of whether companies are more focused on providing goods or services. Unsurprisingly, the factors affecting these goods and service companies are vastly different. This highlights the nuanced nature of any TP audit and indeed, any TP strategy that a company should focus on needs to take into account the differences of the nature of the business and its industry.





COVID CONSIDERATIONS

When we asked more specifically about TP issues arising from COVID-19, the answers differed substantially.



*Circle size is inversely proportional to the average ranking of importance. For example: the closer to 1, the larger the circle; the lower the average ranking, the smaller the circle.



While permanent establishment (PE) ranked high as a COVID-related challenge, it ranked low overall as a TP trend, whereas increasing and more rigorous audits ranked low as a COVID-related issue, but high as a general TP trend. Graphene Economics foresees that PE issues will become a contentious item in the future in light of COVID-19, which resulted in multinational companies rethinking their ways of working. Many MNEs opted to implement a flexible working model, allowing their employees to work remotely for an extended period of time (or indefinitely) from anywhere in the world. This flexible way of working should be carefully considered, since it may create PE risk.

For example, where employees move to another country and continue working for the company remotely, it might create a PE for the employer in the employee's country location. Once the PE is created, a profit attribution analysis will be required to determine the level of profits to be allocated to that PE. Depending whether the employees take on the key entrepreneurial risk-taking functions, the creation of the PE might create significant tax implications for the MNE. While the OECD did provide certain guidance for these scenarios, few countries in Africa provided any specific guidance or endorsement of the OECD guidance on COVID-19 considerations. From our experience of the detailed nature of TP audits in many countries across Africa, PE audits arising from COVID-19 circumstances are highly likely to be a factual matter rather than a theoretical consideration of an OECD paper. For example, questions are likely to be asked regarding whether individuals who worked remotely in another country during COVID-19 lockdowns continued to do so even after the relevant travel restrictions were lifted.

Goods industries
COVID-19 related TP challenges



HIGHEST PRIORITY: Evolving digital business models

LOWEST CONCERN: Adoption of technology

Drilling down to goods industries, evolving digital business models are cited as the highest-ranking COVID-related challenge, while adoption of technology is their lowest concern when looking at the standard trends responses. This could be viewed as being consistent with the rapid digitisation that the pandemic brought on, where technology adoption became a pressing business concern for many organisations that had not previously been focused on it.

PRIORITISATION OF TP

As could be expected, ranking of TP priority within respondents' organisations tended to differ between respondents based on their roles.

In TP advisory firms and tax consulting businesses, respondents generally rated TP as a high priority and felt this was appropriate.

Revenue authority representatives surveyed rated TP as a high priority, but still felt that it was not appropriately prioritised.

 **Time:** preparing TP documentation

 **Time:** Managing TP audits & controversy

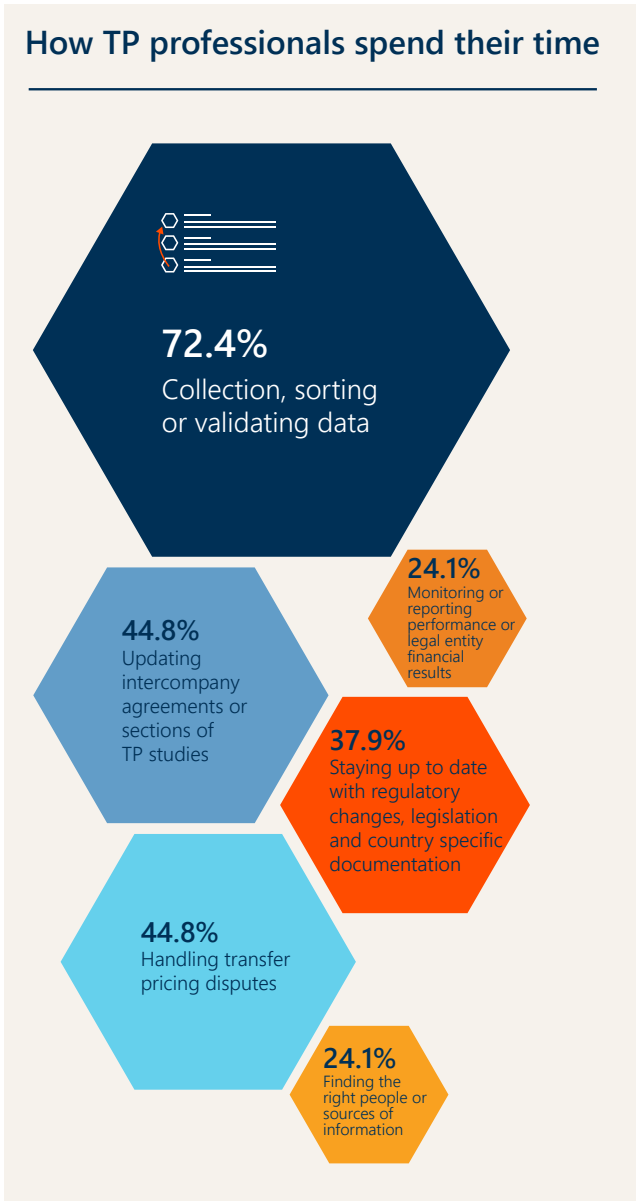
 **Experience:** 5-10 years or less

 **Experience:** 5-10 years or more

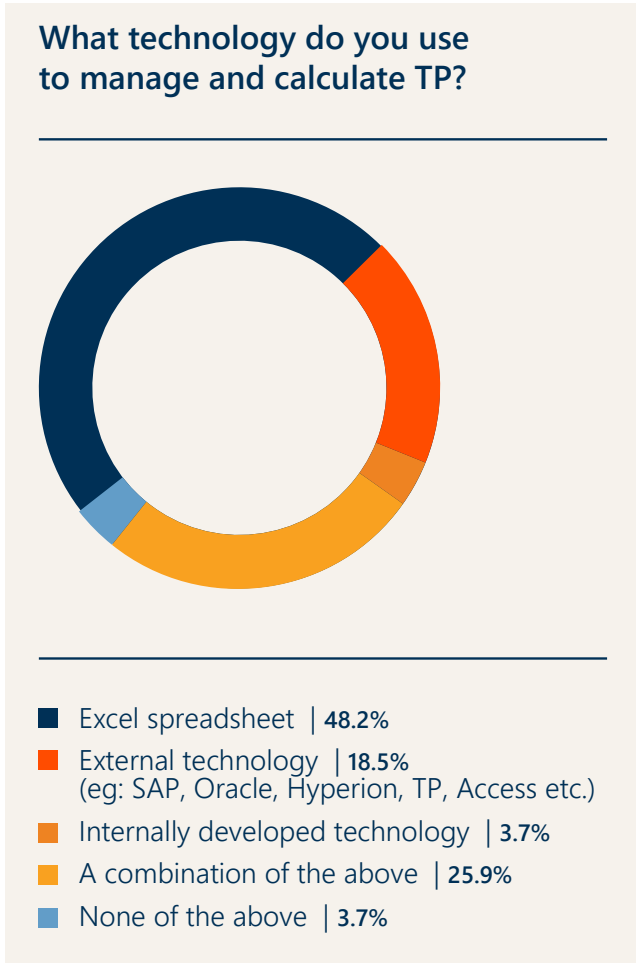
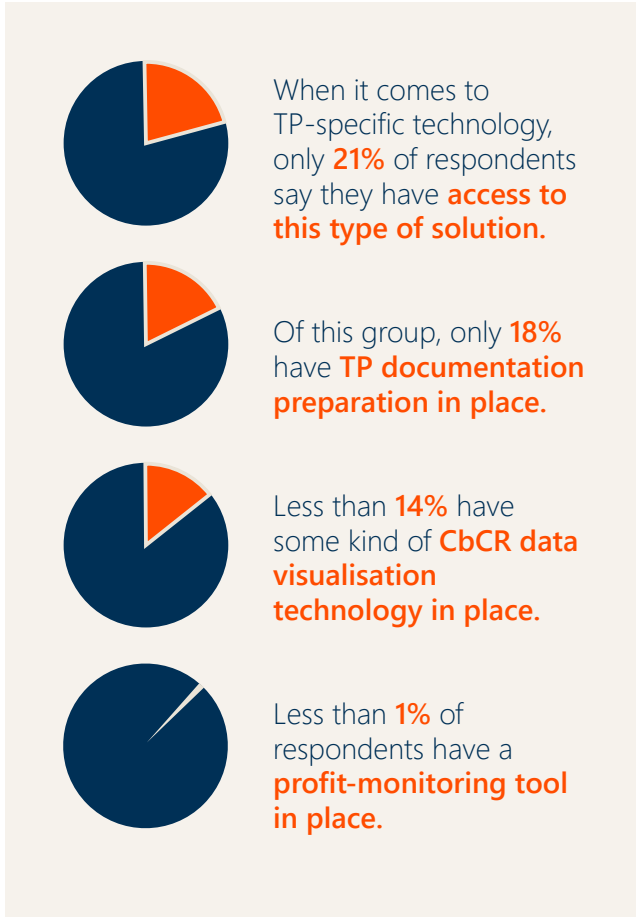


TP PRACTICALITIES

When it came to how TP professionals spend their time, 72% of respondents indicated that collecting, sorting or validating data was what occupied much of their time. Again, this bears out in the anecdotal experiences at Graphene Economics, where we've found many of our clients would prefer to have more time available for strategic thinking.



Various technology solutions have been developed to assist with increasing the efficiency and accuracy of collection, sorting or validation of data. However, only 18% of respondents said they are currently using any technology other than Microsoft Excel and only 3% have internally developed technology suited to their needs.





TRENDS IN TP: POLICY AND POLITICS

*By Prof Keith Engel,
Chief Executive of SA Institute of Tax Professionals*

In terms of transfer pricing, we've seen a steady build-up in resources at African revenue authorities over the last few years. It's clear that transfer pricing remains a political priority for revenue authorities. There's a view presented from some quarters, such as the OECD, Tax Justice Network and ATAF, that transfer pricing is where the tax leakage is and that many multinationals are not paying their fair share. And, unfortunately, the narrative of this "tax gap" has become mixed with the narrative of Government corruption. Transfer pricing might sometimes constitute tax avoidance, but it's certainly not evasion. But it's been politicised. There's a push to equate transfer pricing with illicit flows of the likes of government officials, criminals and other high-profile characters who secretly stash funds offshore.

When it comes to transfer pricing in Africa, the main thrust continues to be around mining because that's where the big money is. That's why there tends to be the biggest revenue authority mistrust given that the mining exports represent the biggest revenue outflows. The other two big areas of focus tend to be imports, particularly of consumer goods, and digital, although Africa doesn't necessarily have the same challenges in terms of digital.

I think one of the challenges in Africa is that revenue authorities have bought into the OECD narrative in full, but Africa's problems are not the same as in most OECD countries. For example, Africa tends to have much higher withholding taxes than in Europe. High withholding rates eliminate much of the incentive for transfer pricing.

As a general trend, transfer pricing seems to be pretty stable on the continent at present. Revenue authorities have updated regulations and now they're investing in capacity-building. More skilled revenue authorities will help to alleviate unjustified fears about transfer pricing. We're seeing a bit of easing in Tanzania and Zambia.

Mauritius (a perceived harmful tax jurisdiction) remains under pressure – revenue authorities still view it with suspicion, more so than, say Dubai (which has a complete zero rate of income tax). I

think there's a bit of an overemphasis on Mauritius. Certain countries like Zambia have cancelled their treaty with Mauritius, and I doubt whether new Mauritian tax treaties on the continent will be forthcoming unless these treaties represent a tightened approach on former treaties.

Overall, Africa is not a free-trade environment. Few tax treaties exist between African countries and most the rates tend to be fairly high. African countries appear to view each other with as much suspicion as external counter-parts despite the friendly rhetoric. While the African Free Trade Agreement should, in theory, be opening up free trade, we're really not seeing any action. We're just seeing a lot of repeated talk.

One of the problems for the region is that multinationals remain prone to double taxation. A lot of the battle becomes about record keeping. Where the record keeping isn't right, you're going to get denied the treaty relief. Sometimes the failure by one government to provide receipts or formal recognition of taxes paid causes tax credits to be denied in other countries.

It's a tough environment. I think multinationals really need to put more effort into transfer pricing compliance. Many times, they're not willing due to cost. The problem is transfer pricing compliance for cross-border transactions can cost a lot of money depending in the firm. Other times, cost arises because a solid due diligence of the facts is time-consuming. So, the documentation is often not quite up to scratch and then it's subject to easy challenge. Another old problem is making sure the transfer pricing documentation is consistent with underlying commercial agreements. A lot of times they're not. A further thing to watch out for is locations where there's no substance. We need more transfer pricing skills on the ground, doing site visits, meeting with the people – not just doing it remotely. Because with transfer pricing, a relatively small liability can become a repeated liability, and the interest and penalties can then outweigh profitability.

Multinationals need to factor transfer pricing and tax risk into their models. In Africa, if you set yourself up to be super tax efficient, I believe you're putting yourself at risk. It's better to be a bit more conservative in approach.



> One of the problems for the region is that multinationals remain prone to double taxation. A lot of the battle becomes about record keeping.





> Digitisation

The theme of digitisation has steadily climbed tax agendas over the past few years and is arguably one of the biggest taxation issues of this decade. Within the umbrella banner of digitisation, there are various areas that need to be considered, which include, among others, the taxation strategies that different countries will pursue with regards to digital services; the adoption of technology within revenue authorities, firms and tax practices; and the impact of digitisation on TP analyses. In the following section, we unpack some of these themes.

/ TAXATION STRATEGIES

In October 2015, the OECD released its final reports on the actions to address base erosion and profit shifting (BEPS). The reports were intended to address challenges relating to substance, transparency, and consistency across different jurisdictions. One of these actions points from the OECD was to deal with the effects of the digital economy. Six years and a global pandemic later, and the digital landscape has erupted and now we have every industry, from financial services, technology, entertainment, tourism, manufacturing, all the way through to mining talking about cloud-based solutions, platforms and remote services. This explosion in the use of technology, and particularly cross border use of technology, has focussed attention on the need for the taxation systems to catch revenues derived by a company that may have a digital presence in a certain market but not a physical presence.

According to Bloomberg, in the space of only six years we have seen 39 countries have either enacted or proposed a form of digital services taxes or withholding taxes. We have also seen regional organisations like the OECD, United Nations, European Union, and ATAF weigh in on the subject. Some have steered the conversation towards a global multilateral approach, others have focussed on a bilateral approach while many countries in the meanwhile have adopted a unilateral approach. Below is a brief explanation of the bilateral option, which has achieved less attention than the multilateral or unilateral options. Thereafter, a comparison of all three options is also provided.

/ APPROACHES TO DIGITISATION, SUMMARISED

*By Lutando Mvovo,
Executive Head: International Tax, Vodacom Group*

Understanding the bilateral approach

The New Article 12B of the United National Model Convention (the UN Model) was approved by the United Nations Committee of Tax Experts on 22 April 2021 and will be incorporated in the 2021 update of the UN Model Convention. This new article allows for cross-border taxation of automated digital services (ADS) by source state for payments made by a resident or by a non-resident with a permanent establishment (PE) or fixed base in that source state provided that the payments are borne by the PE or fixed base. The tax will be in the form of withholding tax and will be agreed by treaty partners bilaterally. Because the tax will be on a gross basis and may result in double or other excessive taxation, the UN Model recommends a rate of 3 to 4% of the gross amount. The UN model further provides an option to require taxation on a net basis on its qualified profits. This option is intended to provide relief for taxpayers that may have a lower tax liability or where the taxpayer has a global business loss or a loss in the relevant business segment during the taxable year.

Exclusion

Payments that already qualify as royalties; or fees for technical service and where the relevant ADS income is attributable to a PE in the source state, are excluded from the scope of the new Article 12B.

PROS AND CONS: COMPARISON OF THE THREE OPTIONS

Multilateral option

The scope of the OECD multilateral option is wider as it is not limited to automated digital services but extends to consumer facing businesses. The multilateral option also provides a benefit of foreign tax credit for taxpayers, dispute resolution mechanism and uniformity as it is likely to be adopted by more countries (with about 136 countries already having adopted it).



The disadvantage of this option is that it is complex and judging by how long it is taking most countries to implement BEPS 1 measures (including the BEPS MLI) its implementation process may take bit longer than the timelines set by the OECD Inclusive Framework.

Bilateral option

The UN option is less complex and easy to administer and also provides a benefit of foreign tax credit for taxpayers.

The disadvantage is that it is narrow in scope compared to the multilateral option. Countries adopting this option will need to introduce a domestic withholding tax on ADSs because tax treaties do not create taxes. The process of renegotiating tax treaties might take longer because some treaty partners may be reluctant to include this article in their tax treaties.

Unilateral option

The Unilateral DST option is easier to implement and amend than bilateral and multilateral options because a country adopting this option can determine the rates and the tax base without any need to renegotiate tax treaties.

However, the prevalent forms of DSTs are taxes on revenue resulting in double taxation without foreign tax credit for the taxpayer. Furthermore, they have the potential to trigger retaliation, such as import tariffs from other countries, where the taxpayers subject to these DSTs are tax resident.

WHAT SHOULD STAKEHOLDERS BE DOING?

Taxpayers that are likely to fall within the scope of these options need to prepare for cash leakage and possible double taxation with no corresponding credit/exemption with regards to the unilateral options. Consumers are most likely to carry the costs as the businesses will shift the costs due by them, resulting in the digital services becoming more expensive. Foreign digital companies will likely consider to include gross-up clauses in their contracts for the supply of digital services with parties resident in countries that impose DSTs. Long tax disputes between tax authorities and digital service companies will become the order of the day.

IMPACT OF DIGITISATION ON TRANSFER PRICING ANALYSES

Historically, brick and mortar businesses required considerable substance. Nowadays the use of technology and the cloud (even in traditionally labour-intensive sectors) means that less physical substance may be required for certain transactions. How has this increase in digitisation influenced the delineation of transactions and the substance required in different entities? Is the guidance in the OECD Transfer Pricing Guidelines still adequate for businesses that have become more digital?

Beyond its devastating health effects, COVID-19 has upset economies, upended supply chains and has had a far-reaching impact on business that will be felt for years to come. But, on the positive side, it has also accelerated digital transformation at a rate that few could have predicted. While this acceleration offers many benefits, whether in terms of communication technologies or entirely new product and service categories, it has also disrupted business models and value chains and will, therefore, affect taxation.

As McKinsey notes in its report, *Twenty-five years of digitisation: Ten insights into how to play it right*, sectors with a high level of digitisation also display the largest productivity growth. The report notes: "Industries that are ahead in digitisation tend to be services or sectors that deliver products that are less physical and more immaterial than physical. Other sectors that display more rapid digitisation include those with direct consumer links, faster capital turnover, and are more global than local. Among the sectors that are most advanced in digitisation are media and finance; among the laggards are pharmaceuticals, and large swaths of manufacturing."

Technological development and adoption will continue apace and taxation will need to adapt to accommodate this trend.



Shifting drivers of profitability

McKinsey reports that, by 2025, more than 50 billion devices will be connected to the Industrial Internet of Things (IIoT), generating 79.4 zettabytes of data yearly and 70 percent of manufacturers will be regularly using digital twins by 2022. It estimates that across industries, about 10 percent of today's manufacturing processes will be replaced by additive manufacturing (AM, which is 3D or 4D printing) by 2030.

With technology being used to a greater extent by businesses and as entire business models shift, some of the drivers of value and profitability are also changing. An easy example is how, just a few years back, it was common to visit a DVD store to rent a film to watch, whereas there's now widespread adoption of streaming services and technologies.

Previously, being in the home entertainment business might have meant renting physical stores and stocking them with physical DVDs, which would have to have been sourced from a supplier. Those products would have been licenced, manufactured and shipped – all part of a supply chain that has been largely disrupted in the past few years.

Now, consumers have access to movies and series through completely different channels. While previously the first step in accessing home entertainment was to purchase a TV and setup an aerial to receive signal from national broadcasters, the advent of cable TV saw a shift as consumers embraced paid-TV options, and then digital streaming. Today, you might watch something on a computer, tablet or even your phone, powered by internet connectivity, through a subscription to a service quite possibly located in another country or even continent. Another example of changing value drivers is the increasing cost of software in vehicles. Previously, cars were largely mechanical machines, but today they contain sophisticated automotive software and **EE Times** reports that the software development cost allocated to an average car is projected to grow from \$500-\$900 in 2020 to \$900-\$1,500 in 2030 (which includes the software value estimates flowing through the software supply chain).

Putting aside the question of what the appropriate way is for businesses to be taxed for their revenue derived from digital transactions (i.e., the discussions on the OECD Pillar 1 and unilateral digital services taxes), it is important to understand

within businesses what contributes to value creation. In many cases, it is clear that the relative importance of a physical presence is less than it used to be, and the value of technology or IP has increased.

What the OECD Transfer Pricing Guidelines¹ say

The OECD BEPS project had 15 Action Items, which were developed specifically to focus on the things that lead to base erosion and profit shifting. A big focus in Action 8 was intellectual property (IP). There was much work put into considering what regulations and guidance should be provided for TP purposes regarding the cross-border use of IP (including digital IP).

But while the latest version of the OECD Transfer Pricing Guidelines published in 2017 contain some additional considerations regarding IP, for the most part, the main transfer pricing principles that are applicable to transactions involving products and services are also applicable to transactions with digital aspects.

In particular, the arms-length principle (namely that the price applied between related parties should be consistent with the price that would have been in place between independent third parties) remains, as well as the fact that determination of the arm's length principle requires careful consideration of the functions performed, risks assumed and assets used by the parties. It's still important to consider the circumstances in which the transaction took place, as well as other factors, such as the broader strategy of the business.

In this regard, the six-step framework set out in Chapter 6 of the OECD Guidelines provides a useful structure for a transfer pricing analysis of digital transactions.

¹ Organisation for Economic Cooperation and Development's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*



Important TP questions MNEs need to ask

While the approach to a transfer pricing analysis remains the same, what has changed is the relative contribution of parties to each of these elements listed above and the value of those contributions. For example, while it's still necessary to consider the functions, assets and risks, within an MNE, the following must also be considered:

ARE ALL THOSE FUNCTIONS BEING PERFORMED IN THE SAME WAY BY THE SAME PEOPLE?

For example, stock counting may have been done in-person in the past, but is it now done virtually through the use of blockchain? To the extent that digitisation of a function has resulted in it being transferred to another entity in another country, it will be necessary to consider if that transfer should have been for a fee and what the potential tax implications would be.

ARE THE ASSETS THE SAME?

For example, is the entity still using as many offices and as much showroom floor in the various countries, or is there an online shop driving lots of sales, or is social media being used to channel e-commerce, etc?

HOW HAVE THE KEY RISKS CHANGED?

For example, as businesses have become more reliant on technology, they will need to factor things like POPI and cybersecurity into their risk assessments. It is also relevant to consider who is responsible for maintaining the digital IP and what the legal and economic implications will be for the owner and users of the system if it crashes.

It is necessary to obtain a clear understanding of the impact that the digitisation has had on the value chain of a particular business. For example, a bespoke system may have been developed to operate as a customer relationship management (CRM) process and rolled out for use by all affiliates within an MNE. Depending on the level of intelligence that the system produces and the value of the data, the CRM system may be more, or less valuable.

Conversely, an algorithm may have been developed to identify significant efficiencies in the supply chain or in the data that the MNE obtains and may therefore be considerably more valuable. Therefore, it is important to understand the nature of the digital IP, the value it provides to the organisation, as well as the roles and responsibilities of the parties in developing, enhancing, maintaining, protecting and exploiting it.

The growth in the level of digitisation will continue to increase, and this will give rise to other TP considerations too. For example, whether countries will adopt multilateral, bilateral or unilateral measures with regard to digital services tax.

But, as a starting point, MNEs should be interrogating how digitisation will affect their own businesses, and applying their minds to the effects of digitisation of not just their value chains, but also how this will affect their TP strategies into the future. Every MNE will be affected by digital transformation in some regard, and businesses cannot afford being caught asleep at the wheel when it comes to digitisation – they need to be embracing a forward-thinking approach.



Notable cross-border tax and related developments in 2021

TAX PACT

The OECD's 'two pillars' are ambitious proposals that seek to fairly determine both the tax base and method of taxing multinational enterprises in a 'digital world' where the traditional tax concept of a physical presence has now become outdated. In October 2020, 136 of the 140 members of the OECD G20 Inclusive Framework, including South Africa, agreed on a new set of global tax rules that will reform the world's tax system (dubbed the October agreement). Notably, two African countries that are members of the Inclusive Framework have not yet joined the agreement – Kenya and Nigeria. While the blueprints provide additional detail on the approach the OECD Inclusive Framework is taking to develop a universally acceptable framework for international taxation, there are still many areas that require further development and consideration prior to the issuance of the final recommendations. Certain technical discussions have only recently started. One focus is how to deliver the October agreement's promise to reallocate profits so that they're taxed in places where companies actually operate. Some of these include concerns that were raised by Africa Tax Administration Forum. (ATAF). For example, ATAF stated that resource-rich African countries price their minerals on their "inherent characteristics" and not on "market intangibles", and as such, taxing rights should go to the resource-producing country. The architects of the plan also have yet to spell out how they will deal with timing differences under the minimum tax.

Countries now have until 2023 to implement the new tax rules, navigating difficulties with regard to tax implementation due to capacity challenges in most African countries and issues with how the rules will impact on countries that are not members of the Inclusive Framework.

MANAGING THE TRANSITION TO RISK-FREE RATES

*By Adrian Maasch,
Transfer Pricing Advisory at Macfarlanes*

The sun has almost set on LIBOR, the most widely used reference rate for financing transactions globally. On 31 December 2021, all EUR and CHF, most GBP and JPY as well as the 1W and 2M USD LIBORs will give us their final salute as we thank them for their 35 five years of service. Remaining GBP and JPY LIBORs will fight on (synthetically) until 31 December 2022 and remaining USD LIBORs will leave us on 30 June 2023. Our expectation is that JIBARs still have a few good years of fight left in them, with a final send-off due in 2024.

In their place, a new breed of recruits will join the ranks in the form of risk-free rates (RFRs) which will be the reference rates used in new (or restated) financing agreements around the world for years to come. The most familiar retirees we have come to know over the years, GBP LIBOR and USD LIBOR, will be replaced by the Sterling Overnight Index Average (SONIA) and the Secured Overnight Financing Rate (SOFR) respectively. JIBARs will be replaced by the South African Rand Overnight Index Average (ZARONIA). What should be noted is that the transition to RFRs has already begun, with new market debt issuances already reflecting RFRs in their prospectuses.

Transition can be hard. It forces us to let go of the familiar and face the future with a feeling of uncertainty. The transition to RFRs is no different and simple replacement is not as straightforward as we would like to think. There are substantial differences between our tried and tested LIBORs / JIBARs and the new generation of RFRs. These differences will have a major impact for multinationals in their intercompany loan and cash pooling arrangements. Ultimately, taxpayers must ensure that a transition to RFRs in a particular intercompany arrangement does not result in a perceived "transfer of value" amongst associated enterprises as a result of "mispricing". This may present significant challenges for legacy intercompany loans which much be addressed. Overall, there are two key areas which must be considered in transitioning to RFRs.



Fallback language:

Fallback language refers to contractual provisions which specify the process of identifying, adjusting and implementing replacement rates if a benchmark rate is not available or ceases to exist. In transitioning to RFRs, and where fallback language is absent from intercompany loan agreements, tax authorities may take the position that the application of a replacement rate in the transition to an RFR is a significant modification of a contract and may be subject to scrutiny.

Term structures:

RFRs are overnight rates whereas LIBORs / JIBARs can be set up to 12 months where the benchmark rate is known over a future period. A term premium should be considered when transitioning to RFRs to prevent a transfer of value. There are currently two approaches being advocated by market participants in considering the term structure implications in a transition to RFRs. These two approaches are the construction of forward looking and backward looking RFR composites.

The backward looking RFR composite is determined by the average rate of an overnight RFR over a historical period. In contrast, the forward looking RFR composite considers current market conditions and expectations of future market conditions through the analysis of underlying swap markets. The forward-looking approach is considered weighted towards market participant subjectivity and the added complexity in constructing forward looking RFR composites based on underlying swap markets is expected to lead to a preference for the use of backward looking RFR composites in most cases. There is currently no official consensus between OECD member countries, or amongst tax authorities, as to which approach would be considered most appropriate for multinationals implementing an RFR transition for intercompany arrangements.

What this means for organisations

We may need a little more time to get to know our new recruits a bit better, however, the reality is that the transition to RFRs may affect your business and intercompany arrangements sooner than you think. We have summarised the following key actions that you can take now to ensure your intercompany loan and cash pooling arrangements remain in accordance with the arm's length principle:

- Identify all existing intercompany loan or cash pooling arrangements which reference LIBORs due for retirement and determine whether overlaps exist with respect to their maturities. This will assist you in determining the scale of effort which may be needed to ensure that sufficient time and resources are set aside to enable a smooth transition to RFRs. Bear in mind that intercompany agreements may require amendments to include appropriate fallback language in the event of overlaps.
- Appropriate economic analysis should be prepared and documented for RFR transitions in intercompany arrangements to support continuing adherence to the arm's length principle.
- All new intercompany loan or cash pooling arrangements should not overlap expected LIBOR retirement dates. The use of RFRs should be considered first in setting benchmark reference rates in new intercompany agreements. Where the use of LIBOR / JIBAR retirement dates are unavoidable, and an expected overlap in maturities exist, appropriate contractual fallback language should be included in intercompany agreements.
- Consider whether fixed rates may be feasible in shorter term lending arrangements where interest rate risk sensitivities can be lowered to acceptable levels in line with your risk appetite and your business's overall sensitivity to the interest rate environment.



Transition can be hard. It forces us to let go of the familiar and face the future with a feeling of uncertainty. The transition to RFRs is no different and simple replacement is not as straightforward as we would like to think.





Towards transparency

According to the OECD, "the key to international tax co-operation is effective exchange of information and the OECD has been at the forefront of international efforts to promote all forms of information exchange – including on request, spontaneous and automatic – since it first established its Working Party on Tax Avoidance and Evasion in 1971. Since then, enormous progress has been made to establish high standards of tax transparency and information sharing so as to improve tax authorities' ability to deter, detect and disrupt tax evasion and avoidance." Base Erosion and Profit Shifting (BEPS) has long been an area of concern for the OECD, and one of the key initiatives it has been driving in this regard is Country-by-Country Reporting (CbCR). In 2018, Graphene Economics wrote in an article on CbCR that "it has been hailed as the biggest corporate tax development of the decade, and has the potential to substantially affect multinationals' tax structures and reporting."

We pointed out that while CbCR information sharing would benefit revenue authorities looking to boost tax transparency, over the longer term it could also play a meaningful role in assessing the impact of tax policies.

Nevertheless, many MNEs were wary of CbCR, fearing the information contained in the reports might be used beyond what was intended. They worried about the increased administrative burden, tax audits and controversy. Thankfully, to date, these fears seem to have largely been unwarranted, if this LinkedIn poll by Chris Whitehouse, Partner at Questro International, is anything to go by.

Chris Whitehouse • 3rd+
Partner at Questro International
1mo • 🌐

For qualifying multinationals with a 31 December year end the deadline for submitting the FY20 Country-by-Country Report is fast approaching. There was quite a fanfare made of this OECD transparency initiative when it was first introduced, but as I support a number of Swiss clients with this time consuming administrative task it has made me wonder how much use this has really been to tax administrations around the globe.

I'm personally not aware of a single tax audit that has arisen directly as a result of the information submitted via Country-by-Country Reporting. I appreciate this may vary depending on the country and / or industry but I'd be interested to know what the experience of my fellow international tax practitioners has been. So whether you are working in industry or in an advisory role please take a moment to answer the poll.

[#internationaltaxation](#) [#transferpricing](#) [#tax](#) [#taxtransparency](#)

Are you aware of a tax audit arising as a result of the submission of CbCR
The author can see how you vote. [Learn more](#)

No	81%
A very limited number	14%
Multiple	5%

42 votes • Poll closed

Tax transparency continues to be an OECD priority, and new developments would seem to indicate that CbCR information is likely to be made public in future.

Map showing countries that are part of the OECD's Global Forum Africa Initiative





CBCR INFORMATION TO BE DISCLOSED BY EUROPEAN MNEs

On 11 November 2021, the European Parliament approved the European Union's public Country-by-Country Reporting directive requiring qualifying MNEs to publicly disclose their CbCR. The directive will be enforced 20 days after its official publication in the EU's Official Journal, which should take place in December 2021. The approval of this directive is a landmark announcement in global tax administrations' continued effort to increase corporate transparency and remove the secrecy around the operations and tax positions of large MNEs.

Based on the December 2021 enactment date, EU member states will have until 30 June 2023 (18 months) to include the Directive into their national law. The regulations set out by the directive will therefore come into effect from June 2024, applying to MNEs with financial years starting on or after this date.

The requirement will apply to MNEs with annual revenues exceeding EUR 750 million that are active in at least one EU country. Such MNEs will be required to publicly disclose their CbCR information for each EU country as well as countries included in the EU's list of non-cooperative jurisdictions for tax purposes. The format wherein this information is required to be submitted will remain consistent with the current CbCR regulations.

Despite the interesting result from the LinkedIn poll shared above, we expect that making CbCR data publicly available will further increase the scrutiny of MNEs. A key reason for this is that a broader set of stakeholders, other than revenue authorities, will have access to the information.

SHIFTING BORDERS

TAX INSPECTORS WITHOUT BORDERS, THE YEAR UNDER REVIEW

Tax Inspectors Without Borders (TIWB) is a joint initiative of the OECD and the United Nations Development Plan (UNDP). It was launched in July 2015 to strengthen the audit capacity of developing countries. TIWB recently issued their 2021 Annual Report (TIWB 2021 Report) providing valuable insights into the work conducted by TIWB, the challenges they face and their vision for the future. At its core, TIWB aims to deploy experts to tax administrators in developing countries (the Host Administration) to aid in capacity building by providing practical, hands-on assistance on actual tax audits and related international tax issues. This is achieved by TIWB partnering with tax administrations, called Partner Administrations, who provide tax experts to TIWB programmes. TIWB currently has 20 Partner Administrations globally including Canada, France, Germany, the Netherlands, the United Kingdom, and the USA to name but a few. Since July 2020 three additional Partner Administrations, namely Chile, Norway and Sweden, joined TIWB.

The TIWB 2021 Report notes that, since 2012, joint workshops by the African Tax Administration Forum (ATAF), the OECD, the World Bank Group and TIWB (after its launch) have led to increased tax revenues and tax assessments in participating countries. A total of USD 3.9 billion in tax assessments and USD 1.4 billion in additional revenues collected in participating countries is attributable to these endeavours across Africa, Asia, Eastern Europe, Latin America, and the Caribbean. The majority of the revenue collected emanated from Africa with a total of USD 2 726.9 million in tax assessments and USD 989.6 million in revenue collected across Africa.

The onset of the COVID-19 pandemic exacerbated the economic challenges faced by many developing countries. This has forced most countries to take on additional debt which may lead to precarious fiscal positions for these countries. Many tax administrations and tax policy makers in developing countries face enormous challenges in managing the fiscal impact of the COVID-19 pandemic and are actively looking for practical tools and assistance to do so.



TIWB itself faced many challenges associated with the COVID-19 pandemic and since March 2020 all onsite TIWB missions were halted. Furthermore, many of the Host Administrations' capacities have been constrained by lockdown measures resulting in the suspension or curtailment of audit activities. Despite these challenges, TIWB expanded its remote assistance programme implementation and developed virtual missions to replace onsite missions.

The TIWB 2021 Report indicates that, as of June 2021, TIWB completed 47 programmes with 43 ongoing programmes spanning 47 jurisdictions. Since the Covid-19 pandemic started affecting the TIWB operations in March 2020 and until 30 June 2021, 137 virtual missions have been delivered. This was done across 27 jurisdictions relating to 37 of the 43 ongoing programmes. From July 2020 until June 2021 a total of 12 new programmes were launched remotely. An additional 21 programme requests are in the pipeline, and it is anticipated that 13 of these programmes will be launched between July 2021 and December 2021. Africa accounts for more than half of all the TIWB programmes whilst at the same time there is a significant increase in programmes in Latin America. This is fuelled by well-established networks and collaborations with ATAF and the Inter-American Centre for Tax Administration (CIAT).

African countries often report transfer pricing as one of the biggest risks to their tax base. TIWB, ATAF and other role players have been assisting the Zambia Revenue Authority (ZRA) since 2014 with technical assistance resulting in the collection of additional taxes amounting to approximately USD 100 million. Furthermore, through collaboration with ATAF, TIWB recently expanded its existing support to the Federal Inland Revenue Authority (FIRS) in Nigeria by assisting in reviewing the FIRS' first Mutual Agreement Procedure case. This introduces a new area of assistance with the initiative in Nigeria.

Therefore, although TIWB has traditionally been focused on providing assistance in complex transfer pricing audits, the same model employed by TIWB is also finding application in other types of tax audits and investigations. With demand for programmes in different areas of tax, TIWB is increasingly focused on making progress in so-called pilot areas. This includes Tax Inspectors Without Borders for Criminal Investigation (TIWB-CI) and TIWB-AEOI focusing on the effective use of information obtained through Automatic

Exchange of Financial Account Information (AEOI). Currently there are 7 TIWB-CI pilot programmes underway in Armenia, Colombia, Honduras, Kenya, Pakistan, Tunisia and Uganda.

Going forward TIWB will undoubtedly continue to focus on expanding their operations. TIWB describes its ultimate aim as enhancing domestic resource mobilisation for developing countries and encouraging a more predictable investment climate for taxpayers.

The TIWB 2021 Report indicates that, some of the notable objectives of TIWB in the coming year includes meeting its objective of having 100 completed or ongoing programmes by the end of 2021, developing partnerships with at least 3 new partner administrations and implementing pilots for existing requests of eight criminal tax investigations and two effective use of AEOI data programmes, whilst exploring other emerging tax areas for TIWB.

From our perspective, the TIWB programme is very positive for Africa because a longstanding challenge has been a shortage of experienced transfer pricing and other tax specialists in many of the revenue authorities in the continent. Increased capacity for revenue authorities in the area of transfer pricing will hopefully result in shorter timeframes to complete audits while achieving greater alignment between interpretation of the relevant international guidance in countries across Africa and in the Partner Administrations.



Business considerations

Transfer pricing models should adapt as business evolves. Aside from digital transformation, which remains a clear focus for businesses globally into 2022 and beyond (along with the accompanying need for more attention to cybersecurity), MNEs – particularly those operating in Africa – need to consider the TP implications of issues like increasing compliance requirements, business structure and hidden costs of doing business in the countries in which they are active. However, just over 65% of survey respondents said their TP model had not changed since January 2020, despite the impact of COVID-19.

Has your MNE's transaction model changed since January 2020?

No | 65.5%



Yes | 20.7%



Not applicable | 13.8%



Interestingly, many are considering adapting their TP approach within the next 12 months, with key drivers of change including business model (68.97%), work-from-anywhere practices (34.48%) and external drivers, such as COVID-19 (34.48%).

What will drive changes to your organisation's approach to TP strategy over the next 12 months?

Answer choices	Responses
Business model	69.0%
TP controversy	62.1%
Supply chain	34.5%
External drivers like COVID-19	34.5%
Work-from-anywhere practices	31.0%
Environmental, social & governance (ESG) pressure	17.2%
Other (please specify)	6.9%

*multiple options could be selected





BUSINESS RESTRUCTURINGS: TRANSFER PRICING CONSIDERATIONS

The COVID-19 pandemic has disrupted African economies and businesses operating in this region, prompting many multinational entities (MNEs) to rethink their strategies and adjust their supply chains. Some industries were severely affected and organisations have had to sell off parts of their business or restructure operations to minimise losses, while others have thrived during the pandemic, recording their highest profits yet. Thankfully, within Africa, many economies have shown some signs of recovery. For example, according to Baker McKenzie's analysis of Refinitiv data, Africa's mergers and acquisitions activity soared in the first six months of 2021, with deals recorded worth more than USD 57.7 billion, up from USD 8.5 billion year-on-year.

However, industries are still finding their feet and where business restructurings are taking place within an MNE, it's necessary to evaluate the impact from a transfer pricing perspective.

A business restructuring does not necessarily relate to the sale or acquisition of operations. The Organisation for Economic Co-operation and Development (OECD) defines business restructuring as the cross-border reorganisation of the commercial or financial relations between associated enterprises, including the termination or substantial renegotiation of existing arrangements. For instance, a transfer of a business unit (e.g. a shared service centre operations) from a South African company to a related party in Kenya, or conversion of the manufacturing operations from a full-risk model to a limited-risk model would constitute a business restructuring for transfer pricing purposes.

Some countries have specific business restructuring regulations and definitions embedded in their local legislation. Within Africa though, most of the countries do not have a specific definition or regulations on transfer pricing aspects of business restructuring embedded in their legislation. Some countries, such as Zambia, have released a practice note containing a section about business restructurings. These guidelines are largely aligned with the OECD's interpretation and guidance.

Important transfer pricing considerations

To understand transfer pricing consequences of a business restructuring arrangement, the OECD indicates that the first step is to delineate the transactions comprising the business restructuring. This requires doing a functional analysis to identify economically significant activities and responsibilities undertaken, assets used, and risks assumed before and after the restructuring by the parties involved. Important considerations include:

- Understanding the risks assumed by the parties (because the transfer of risks from one entity to another is likely to impact the level of compensation)
- The business reasons for and the expected benefits of the restructuring. In most instances, business restructurings are commercially driven. They are initiated for a variety of reasons, including provision of a more centralised control and management of manufacturing, research and distribution functions, savings from economies of scale; efficiency and lower costs; integrations of newly acquired operations. The business restructuring needs to be considered from the perspective of the group as well as from the perspective of the individual entities to evaluate to what extent the parties are likely to benefit.
- Whether there are other options realistically available to the parties which may have been even more beneficial to that entity. This is important in evaluating what decision an entity would have undertaken if it was operating as a separate legal entity on an arm's length basis.

All of the steps above enable the parties to identify whether there should be compensation for the identified transactions. The OECD clarifies that when applying the arm's length principle to business restructurings, the question is whether there is a transfer of something of value or a termination or substantial renegotiation of existing arrangements and that transfer, termination or substantial renegotiation would be compensated between independent parties in comparable circumstances. A transfer of something of value might include tangible assets (for example, equipment), intangible assets (patents, trademarks, designs, copyrights, know-how, customer lists, and similar), or transfer of activity (functioning, economically integrated business unit). The compensation for transfer of these assets is usually determined by way of performing a valuation study.



Another important consideration, which became relevant during the COVID-19 pandemic, is the loss-making operations of a multinational group. In this regard, the OECD states that if the loss-making activity is transferred to a related party, there might be a situation where a transferee should in fact be compensated by the transferor for taking over a loss-making activity because financial costs and social risks of closing down the activity would be such that the transferor finds it more advantageous to pay a transferee, who will attempt to reconvert the activity and will be responsible for any redundancy plan that may be needed.

Risks associated with business restructuring transactions

It is evident that business restructurings are complex exercises and require collaboration between commercial divisions of the business and finance (tax) division. There are several risks associated if business restructurings are not implemented correctly. For example, assume a multinational group changes its pricing methodology by converting its operations in South Africa from a fully-fledged distributor to a limited risk distributor. Prior to the business restructuring, the company was making an average of 15% return on sales. The post-restructuring return on sales would reduce to 2%. Tax authorities perform a tax audit and determine that the change in pricing methodology is not consistent with the actual conduct of the parties, i.e., the local distributor continues to perform economically significant activities post-restructuring.

In this scenario, tax authorities are likely to re-characterise the transaction and adjust the return on sales of the distributor to the pre-restructuring level. Depending on the size of operations, this re-characterisation might result in significant additional income taxes to be paid by the local distributor, notwithstanding the penalties and late payment interest.

Another example might be where an MNE has set up operations in another jurisdiction but failed to move its employees performing these activities to that jurisdiction. In this case, the group is exposed to risk that any profits will be allocated to the country where the operational team is based. Non-arm's length compensation for the transfer of something of value could also create risks for multinational groups, especially where no detailed analysis was performed at the time of the restructuring. These risks should not be taken as

hypothetical ones. Over the last few years, several African countries have updated their transfer pricing documentation requirements, where taxpayers are required to disclose their business restructurings and transfers of intangibles in their annual transfer pricing compliance reports.

Due to the complex and unique nature of these arrangements, globally it is common for multinational groups to approach tax authorities in advance and enter into advance pricing agreement (APA) where the pricing methodology is agreed and cannot be challenged for an agreed period of time (subject to certain terms and conditions). Unfortunately, multinational groups operating in Africa can hardly use this avenue because most of the countries in Africa have not adopted the necessary regulations (please refer to the section on increasing TP audits and controversy for further details of the countries that do accommodate APAs).

Other considerations

In addition to transfer pricing considerations of business restructurings, there are often various local factors and tax considerations that need to be taken into account. For example, local legislation in certain African countries does not allow for the transfer of licenses or intellectual property. Exchange control regulations might also restrict business restructuring arrangements. Tax consequences of movement of personnel, in-country VAT regulations, and withholding taxes are other examples that MNEs should consider prior to entering into a business restructuring transaction. Multinationals should adopt a holistic approach by considering all of these aspects.

Outlook for business restructurings

It is clear that a business restructuring is a complex process. Given the immense pressure for tax authorities to collect additional tax revenues, it is likely to become a contentious item of controversy in the future.

Since transfer pricing is still perceived as a means of shifting profits out of the Africa region, multinationals should consider transfer pricing and other local tax and regulatory consequences before embarking on a business restructuring.



> It is evident that business restructurings are complex exercises and require collaboration between commercial divisions of the business and finance (tax) division. There are several risks associated if business restructurings are not implemented correctly.





HIDDEN TAX COSTS FOR SA MULTINATIONALS OPERATING IN AFRICA

South African headquartered businesses supporting subsidiaries in other African countries may be shocked when they examine the tax implications of supplying central support. When businesses expand and move into new locations, there are cross-border tax implications, which can be enormously costly and administratively burdensome if not considered upfront. This reality is something multinational enterprises (MNEs) are facing more frequently as revenue authorities deepen efforts to collect corporate taxes, as well as taxes associated with cross-border transactions, especially withholding taxes.

Several countries in Africa have introduced new transfer pricing regulations or updated existing legislation in recent years. Transfer pricing relates to the system of pricing between related parties transacting with each other. As modern transfer pricing regulations have developed, we've seen tax authorities shift their focus to MNEs and their pricing practices applied to intercompany transactions. There's been a notable increase in audit activity, with tax authorities performing extremely detailed transfer pricing reviews and audits, with a common focus on intra-group services.

These intra-group services, such as shared IT or HR services, are common within large MNEs. Groups use shared services for various reasons. It might be that certain skills are not widely available in each country in which the MNE operates, or to create synergies and uniformity within the group, or purely as a cost-saving measure.

Tax implications related to intra-group services

Graphene Economics has found that MNEs operating in various African countries are being subjected to increased scrutiny in relation to intra-group service costs and are being asked to provide evidence to support business decisions taken in respect of such costs.

For example, an MNE's centralised IT function may have sourced Microsoft 365 licences for all its subsidiaries, including one in Botswana. It will then on-charge a percentage of the total fee from Microsoft to the Botswana subsidiary, for which the subsidiary will claim a deduction.

The relatively new regulations in Botswana note that for the in-country entity to claim a deduction for the amounts, it needs to be able to provide the invoices from Microsoft and the calculation of the proportional amount allocated to the Botswana subsidiary, to ensure this amount reflects the exact amount is being claimed as a deduction by that subsidiary. Given that this was arranged as a bulk purchase and there may be other Microsoft services acquired as well, that won't necessarily be something that an MNE may be able to easily provide. Furthermore, it is expected that the MNE be able to show how it calculated the portion of the total cost allocated to the Botswana subsidiary. Another example we're seeing more and more is tax authorities querying the costs attributed to executive activities. The executives of an MNE group may spend 20% of their time working on protecting shareholder investment and 80% of their time on strategy and other actions to grow the group's revenue. The business might decide that this 80% of the executives' time should be charged out (plus an arms-length mark-up) to the various group entities. However, in recent audits performed by the Tanzania Revenue Authority (TRA), these types of charges have been challenged.

In such cases, MNEs are being asked to trace back executives' activities (sometimes as far back as six years ago) to justify what they have done for the benefit of the Tanzanian subsidiaries. Providing a high-level explanation of their activities has not proved adequate to satisfy the TRA that the service was rendered and the charge is appropriate. As a consequence, the groups may be at risk of losing their full tax deduction (or a part thereof). In the worst-case scenario, the TRA may even implement a transfer pricing adjustment and levy an equivalent penalty for the more recent years.



The tax implications of supporting subsidiaries in Africa can become very complex. Most businesses don't keep detailed timesheets for every employee or request an invoice per software licence purchased. Given that most tax audits also happen a few years down the line, it can often be difficult to remember why certain decisions were taken or to find specific physical evidence that tax authorities are requesting. Some SA-headquartered groups have queried whether it's worth charging out intra-group services to subsidiaries, given the difficulties involved. However, if they don't charge for these services, the South African Revenue Services (SARS) is likely to deem they ought to have done so, and may apply penalties in cases where amounts have not been charged out to African subsidiaries.

Another complicating factor is that there is currently no clear guidance in many countries regarding the specific evidence required to substantiate intra-group charges, and a level of subjectivity may be involved.

The most immediate solution for MNEs operating in Africa is to begin to obtain appropriate evidence to substantiate services rendered and to ensure that charges are warranted in a way that meets revenue authority requirements. This goes beyond having an intercompany agreement in place and requires actions such as ensuring all invoices are correctly captured and filed, business decisions are documented for future reference, and adequate levels of detail and actual evidence are available to justify services rendered.

Working with tax specialists who have experience with revenue authority engagements around the continent can also help in navigating queries and guarding against future disputes. As intra-group services within Africa continue to increase as groups look to drive intra-Africa trade, Hewson believes it is also imperative for policy solutions to be developed to address double taxation, which remains a pervasive issue on the continent, as well as ensuring greater alignment between countries in terms of their taxation approach to service transactions. This will ensure businesses are able to operate more efficiently, revenue authorities are able to collect taxes more effectively, and economies throughout the continent benefit in the long term.

As modern transfer pricing regulations have developed, we've seen tax authorities shift their focus to MNEs and their pricing practices applied to intercompany transactions.



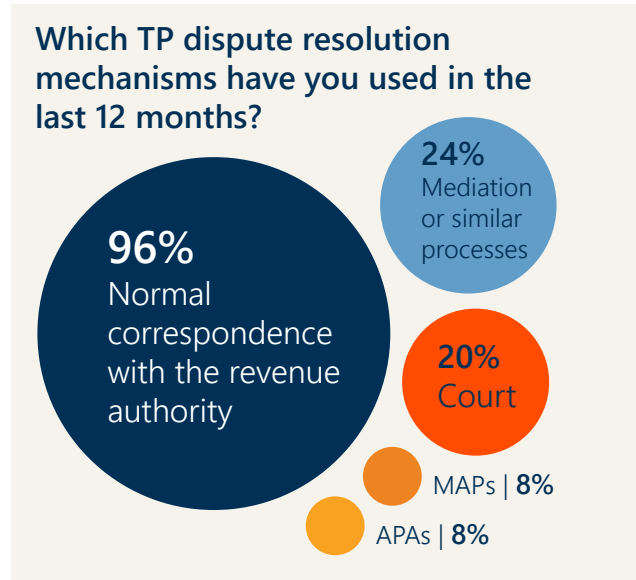
Increasing TP audits and controversy

Increasing TP audits and climbing tax controversy are issues that we've seen in our work with clients across the continent over the past few years, and challenges that were flagged by respondents in our survey too.



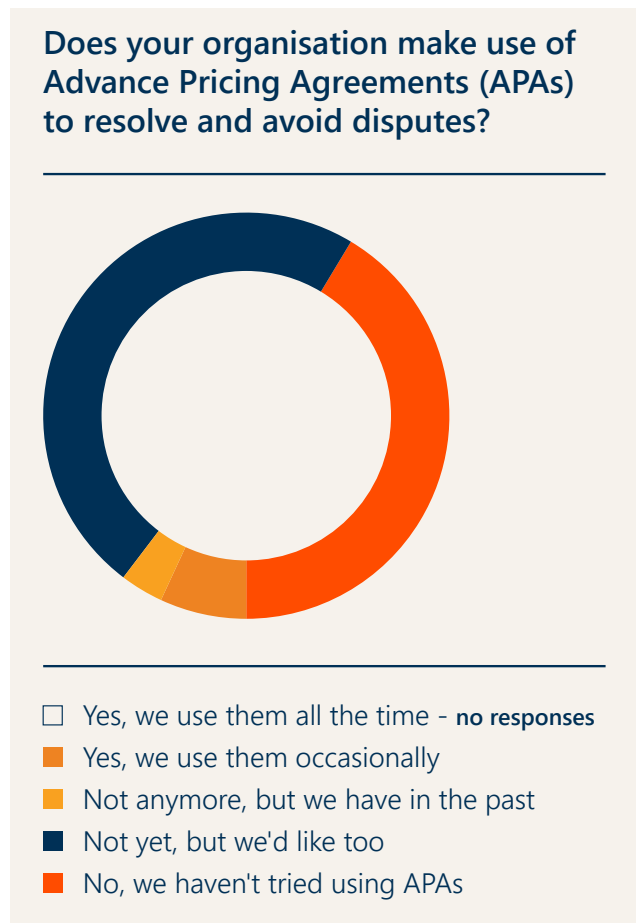
Various TP dispute mechanisms are available, including correspondence with the relevant revenue authority, advance pricing agreements (APAs), mutual agreement procedures (MAPs), mediation or similar processes and court procedures. Currently, the only countries in Africa that have provisions for APAs in their legislation are: Botswana, Burkina Faso, Congo Brazzaville, Egypt, Gabon, Nigeria, Morocco, Senegal, Tanzania, Tunisia, and Uganda. In December 2021, SARS released a proposed model for establishing an APA in South Africa. Hopefully, this will create opportunities for greater transfer pricing certainty in South Africa in the near future.

Among our survey respondents, normal correspondence with revenue authorities is the most common mechanism employed, while MAPs and APAs remain uncommon.



**multiple options could be selected*

However, there is appetite for these avenues of dispute resolution. Almost 50% (48.25%) of respondents said they are not using APAs, but would like to in future.



Of course, the most effective strategy remains avoiding disputes and TP audit shocks wherever possible.



FOUR STRATEGIES FOR AVOIDING TRANSFER PRICING AUDIT SHOCKS

Transfer pricing audits are on the increase, and pose a risk for multinational entities (MNEs) as they arrive years down the line, creating surprise exposure.

We believe MNEs need to actively seek to manage the risks that transfer pricing audits can pose – sometimes several years down the line, when exposure may have mounted.

As revenue authorities, particularly in Africa, look to maximise collections, corporate tax and specifically transfer pricing is increasingly coming under the spotlight. We're seeing an increasing number of transfer pricing audits. These may result in a tax amount payable, plus interest and penalties, which is often a substantial financial blow.

The increased focus on transfer pricing from revenue authorities is driven by the increasing capacity of tax authorities in specialist areas like transfer pricing, coupled with the increase in levels of transparency of MNEs' business. We recommend a four-pronged approach to managing transfer pricing risk:

1. PRIORITISATION OF TRANSFER PRICING

Managing transfer pricing risk is not simply about compliance and that avoiding shocks will require prioritising transfer pricing. MNEs need to allocate sufficient budget and resources, and support their tax teams. Executives need to be engaged in the process of internal price setting and management so that they can be aware of, and help to mitigate the risks that may arise from cross-border transactions.

2. OPERATIONALISATION

The second strategy is to operationalise. Transfer pricing involves price setting, which needs to be embedded into an MNE's operations. This may include the setup of operations and it may require going down to the level of unit pricing of goods and services. It also sometimes involves the setting of target prices or profitability levels.

There are also legal considerations. For example, legal agreements, and an understanding of which party will take the risk in certain transactions. For example, during the two weeks of unrest in South Africa in July 2021, if an MNE had goods in transit to another country and those were destroyed, the question becomes, "With whom does that risk rest?" MNEs cannot think about transfer pricing in isolation, but need to see it in relation to real-world issues. COVID-19 has shown us this. If we look at how it's accelerated remote working and digitisation, we start to realise that it's affected value creation in different countries, which has transfer pricing and tax implications. MNEs may have people living in one country and reporting into another, and that creates complexity from a tax perspective.

Monitoring is also critical. MNEs need to monitor the transactions and contributions of all their parties and entities to decrease the likelihood of needing to make a significant adjustment or large correction payment at the end of the year, which may be called into question. MNEs should leverage the monitoring capabilities of their internal audit teams to assist with this.



3. COMMUNICATION

Communication is critical internally to avoid transfer pricing risk. Communication facilitates the proper prioritisation of transfer pricing and understanding of the relevant principles. But communication is also critical beyond internal structures, for example with external auditors and the board of directors. We're seeing more CFOs proactively presenting how they're structuring cross-border transactions and managing their transfer pricing so there are no surprises at year-end. We're seeing more MNEs publishing tax and economic contribution reports, aimed at external stakeholders, where they proactively communicate what they're doing, where they're making money, what contributions they're making to local communities, etc. The idea is to proactively help manage the perception of their brand.

4. DEFENCE

Companies need to be able to defend their transfer pricing from various perspectives. With the advent of country-by-country reporting and additional disclosures required in many countries, transparency continues to increase and there's more and more exchange of information between revenue authorities. This, coupled with digitalisation, means that MNEs can be queried on many different fronts. They must be comfortable that will be able to satisfy those queries – to defend and substantiate their pricing.

This means having the required evidence available of contributions made by the different parties, as well as the extent of the value of those contributions.





> Conclusion

The rate of development within the tax environment continues apace, and TP and related issues are likely to remain priorities for revenue authorities on the African continent for the foreseeable future. The implication for MNEs is that the role of the tax function will become increasingly significant in managing business risk.

Our advice to MNEs from a cross-border transaction perspective is to work towards enhancing management and execution to deliver the best TP models for your organisation.

If you're looking for a partner to support you with your African cross-border transactions and related taxation and business matters, Graphene Economics is able to help you navigate the complexities involved.





> Contributors

GRAPHENE ECONOMICS CONTRIBUTORS

Thank you to our entire team for their contributions to this report, with special thanks to:

- Michael Hewson, Director
- Valdis Leikus, Executive Director
- Lisa di Domenico, Manager
- Jessie van der Vyver, Manager
- Muzi Shabangu, Assistant Manager
- Shaun Britz, Assistant Manager
- Henry Dicks, Assistant Manager
- Lungisa Ntombela, Senior Consultant

GUEST CONTRIBUTORS

Our thanks to our partners and associates who gave of their time, input and expertise towards this report:

Prof Keith Engel, Chief Executive of SA Institute of Tax Professionals

Keith is the Chief Executive of SA Institute of Tax Professionals. As CE, he is heavily engaged in tax at a policy, legislative and interpretative level by liaising with, among others, National Treasury, Parliament, SARS, the Davis Tax Committee and the private sector. Keith is an honorary adjunct professor at the University of Cape Town, North Western University and Rhodes University, and he has lectured at South African and international universities. Keith is well known for his leading roles in the formulation of tax legislation at the National Treasury from 2000 to 2013. Keith obtained his Masters of Laws of Taxation at Georgetown Law, and holds a professional doctorate (J.D) from Georgetown Law.

Adrian Maasch, Transfer Pricing Advisory at Macfarlanes

Adrian has seven years of financial services transfer pricing experience focused primarily on UK, EMEA and US markets. Adrian works with a portfolio of multinational banks, fund managers, private equity firms and insurers providing restructuring and transfer pricing policy advisory services. Adrian has also previously led the M&A function for financial services transfer pricing as a fully integrated specialist in due diligence for both buy and sell side opportunities and has been a transfer pricing specialist in the statutory audits of the UK's largest headquartered banks, fund managers and insurers within a Big 4 audit firm.

Lutando Mvovo, Executive Head: International Tax at Vodacom

Prior to joining Vodacom, Lutando was a director responsible for international tax, transfer pricing and tax treaties at the South African National Treasury.

He has over 16 years of international tax experience. He started his international tax career as a Tax Consultant at KPMG in South Africa in 2005. Lutando also served as South Africa's delegate to OECD Working Party 1 and Bureau and Ad Hoc Group on BEPS Multilateral Instrument, and represented South Africa as an observer to the UN Committee of Tax Experts.

Chris Whitehouse, Transfer Pricing Partner at Questro International

Chris is a chartered accountant by qualification with more than 20 years' experience as a professional advisor. Having spent 19 years with Big 4 consultancy firms in the UK and Switzerland he left as an Associate Partner and joined Questro in Zurich in February 2019.

Specialising in transfer pricing since 2005, he brings vast experience in analysing and delivering on complex (and more routine) transfer pricing topics across the full spectrum of industries and the transfer pricing life cycle.



> Contact details

If you would like to discuss African cross-border tax developments and their potential impact on your organisation or industry, please contact Graphene Economics.

Website
grapheneeconomics.com

Telephone
+27 82 345 1212

Email Address:
graphene@grapheneeconomics.com

Office Address
Block E, Hurlingham Office Park, Woodlands
Avenue, Sandton, 2196