East Africa Tax Alert
Transfer Pricing Guidelines 2022

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PREAMBLE

On 20 January 2022, the OECD released the revised Transfer Pricing Guidelines.

Prior to this release, the 2017 guidelines had included significant changes following the OECD's work on Base Erosion and Profit Shifting (BEPS). While the 2022 revised edition also follows the OECD's work on BEPS, its main changes constitute the consolidation of changes to the 2017 edition resulting from guidance reports issued by the OECD since then.

The main changes include:

- *Revised Guidance on the Transactional Profit Split Method*
- *Guidance for Tax Administrations on Application of the Approach to Hard-to-Value Intangibles*
- *Transfer Pricing Guidance on Financial Transactions*

The consistency changes to the rest of the OECD Transfer Pricing Guidelines needed to produce this consolidated version of the Transfer Pricing Guide-lines.

These changes are relevant to East Africa as much as they are to the rest of the world. In this publication, we summarise these changes and how they impact the respective countries in East Africa.

Key revisions/updates

Consolidation of guidance on the transactional profit split method

The transactional profit split method seeks to establish arm's length outcomes or test reported outcomes for controlled transactions in order to approximate the results that would have been achieved between independent enterprises engaging in a comparable transaction or transactions.

The basic principle that the transactional profit split method should be applied where it is found to be the most appropriate method to the case at hand remains unchanged.

The key indicators of when the profit split method may be appropriate as provided for therein include:

- *each party makes unique and valuable contributions*
- *the business operations are highly integrated such that the contributions of the parties cannot be reliably evaluated in isolation from each other*
- *the parties share the assumption of economically significant risks, or separately assume closely related risks. There is also provision for the determination of the relevant profits to be split*

The changes introduced respond to the mandate under BEPS (Base Erosion and Profit Shifting) Action 10. This action point requires the development of rules to prevent BEPS by engaging in transactions which would not or would only very rarely occur between third parties.

This will involve adopting transfer pricing rules or special measures to clarify the application of transfer pricing methods, in particular profit splits.

NB/ These changes were approved by the OECD/G20 Inclusive Framework on BEPS on 4 June 2018. They replace the provisions of Section C of Part III, Chapter II of the 2017 OECD Transfer Pricing guidelines for Multinational Enterprises and Tax Administrations

HARD-TO-VALUE INTANGIBLES (HTVI)

BEPS Action Point 8 addresses transfer pricing issues relating to controlled transactions involving intangibles.

Intangibles are inherently difficult to value and can be easily transferred from one group member to another. Misallocation of profits engendered by intangibles has greatly aided base erosion and profit shifting. Action point 8 was developed to counter BEPS resulting from moving intangibles

The new changes in the Transfer pricing Guidelines relate to the outcome of the work on Actions 8-10(Aligning Transfer Pricing Outcomes with Value Creation) which is contained in the 2015 Final Report. That Section contains an approach consistent with the arm's length principle that tax administrations can adopt to ensure that tax administrations can determine in which situations the pricing arrangements as set by the taxpayers are at arm's length and are based on an appropriate weighting of the foreseeable developments or events that are relevant for the valuation of certain hard-to-value intangibles, and in which situations this is not the case.

NB/ These changes were approved by the OECD/G20 Inclusive Framework on BEPS on 4 June 2018 and have now been incorporated as Annex II to Chapter VI of the OECD Transfer Pricing guidelines.

Consolidation of transfer pricing guidance on financial transactions

BEPS action point 4 (Limiting base erosion involving interest deductions and other financial payments) and Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) authorized more work on the transfer pricing aspects of financial transactions. BEPS action point 4 particularly required development of transfer pricing guidance regarding the pricing of related party financial transactions.

The work carried out gives detailed transfer pricing guidance on:

- *Treasury functions (intra-group loans, Cash pooling, Hedging)*
- *Financial guarantees*
- *Captive Insurance (insurance undertaking or entity substantially all of whose insurance business is to provide insurance policies for risks of entities of the MNE group to which it belongs)*

Rwanda

The Rwanda TP regulations are largely in line with the OECD guidelines. Therefore, the tax authorities would expect taxpayers to observe the new rules in their transfer pricing documents.

For this reason, it is important that taxpayers should ensure compliance with the new rules.

Kenya

TP laws and regulations in Kenya are largely aligned to the OECD TP Guidelines and international best practices such as the OECD's Actions Plans on the Base Erosion and Profit Shifting (BEPS) Initiative. The specific areas and subjects addressed through the amendments and new provisions captured by the OECD TP Guidelines,2022 will no doubt advance Kenya's outlook on the same.

Kenya continues to align its taxation regime on cross border transactions and international trade in line with international best practices as evidenced through the introduction of Country-by-Country Reporting (CbCR) obligation and interest restriction provisions through the Finance Act, 2021.

Other amendments introduced through the Finance Act, 2021 with an impact on cross border transactions and international trade included comprehensively redefining permanent establishments (PEs) and control greatly akin to recommendations of the BEPS Action Plans.

Implications

The new changes will increase the compliance burden of taxpayers.

These changes will be implemented differently depending on the nature of tax laws of a particular country. We advise taxpayers to review their transfer pricing arrangements to check whether they comply with the new rules.

Uganda

Pursuant to Regulation 6 of the Income Tax (Transfer Pricing) Regulations 2011, the OECD Transfer Pricing Guidelines and their subsequent updates or revisions are regarded as a standard for transfer pricing regulation and practice.

While it may be asserted that these updates became relevant in their respective periods of release, their consolidation in the guidelines is still significant because not only does it solidify that relevance but also provides a contextualised update in terms of how to apply the guidance in line with the other provisions in the guidelines.

Tanzania

Regarding the new OECD Guidelines implications to the current Tanzania PT regulations, we noted that current TP regulations would require compliance with the new OECD guidelines, in this regard taxpayers are advised to comply.

Ethiopia

The OECD "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" is a relevant source of interpretation for Directive No. 43/2015.

In case of any differences or conflicts with the domestic law, however, the Income Tax Proclamation (ITP), the Trade Access Portal (TAP) and this Directive of Ethiopia will take precedence.

For any assistance, feel free to reach out to any of the following TP experts:

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