

# EXPLORING SAFE HARBOUR REGIME AS A SIMPLIFICATION MEASURE- AN AFRICAN PERSPECTIVE

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ALEXANDER EZENAGU

([a.ezenagu@ictd.ac](mailto:a.ezenagu@ictd.ac))

PRESENTED AT THE 6<sup>TH</sup> INTERNATIONAL WORKSHOP ON DOMESTIC  
RESOURCE MOBILIZATION IN DEVELOPING COUNTRIES, BONN,  
GERMANY

# THE ARM'S LENGTH PRINCIPLE AND MULTINATIONAL COMPANIES (MNCs)

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- Intra-firm transfers central to profits of an affiliate
- The Separate entity treatment of members (affiliates) of MNCs
- Article 9 of Tax Treaties:
  - “Where
    - A) an enterprise of a contracting state participates directly or indirectly in the management, control or capital of an enterprise of the other contracting state, or
    - B) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state,
    - And in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.”

# TRANSFER PRICING

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- OECD Transfer Pricing Guidelines  
Introduced into domestic law/regulations even of non-OECD countries
- Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises. (OECD TP Guidelines 2017).
- Transfer pricing arises as a result of the taxation of the affiliates of a multinational enterprise in different countries on the basis of separate accounts, treating them as independent entities
- Transfer pricing determines a large part of the income and expenses, and therefore taxable profits of associated enterprises in different tax jurisdictions. It is vulnerable to manipulations and could lead to transfer mispricing.
- Five accepted transfer pricing methods: CUP; Cost Plus; Resale Price Minus; TNMM; Profit Split  
Sixth method (use of publicly quoted prices for commodities), needs adjustment to take into account, critical determinants of prices such as geography, volume and trade terms- World Bank 2017.
- All require analysis of functions of the affiliate, and attribution of profits based on “comparables”.  
Problem of lack of true comparables.

# LIMITATIONS OF TRANSFER PRICING METHODOLOGIES

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- Absence of comparables: due to lack of data, but also MNCs' unique technologies
- Absence of domestic resources and no African-developed database- reliance on Amadeus and Orbis.
- Requires detailed audit analysis of company's business model: subjective and discretionary
- Dearth of resources, especially human capital, and lack of experience in applying transfer pricing regimes
- Integrated production of highly specialised goods; unique intangibles; and the provision of specialised services- (OECD TPG 2017).
- Overemphasis on the contractual allocation of “functions, assets, and risks”, encouraging tax minimisation by fragmentation of functions. In essence, complexities involved with Functional Analysis Requirement: functions performed, assets employed, risks assumed.



# TRANSFER PRICING ABUSES

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- ❖ From 2009 to 2012, Apple got away with sending \$74bn in profits to its Irish subsidiaries, even though Apple products were designed in the United States, assembled mostly in China, and sold in Europe, Africa, Asia, and the Middle East, with relatively few sales in Ireland.
- ❖ According to Oxfam (2014), the United states alone lost an estimated \$90 billion in 2008
- ❖ In Kenya, the cases of Unilever v The Commissioner General, KRA and Karuturi Limited v Commissioner of Domestic Taxes are instructive of the transfer mispricing going on. See: Attiya Waris, “The Challenges Facing the Implementation of Transfer Pricing Rules and the Proposed BEPS Action 13 Recommendations in Kenya”
- ❖ In Nigeria, the Publish What You Pay Norway (PWYP Norway) reported that between 2000-2010, Nigeria’s crude oil export to the EU was overvalued to the tune of \$1.6 billion, ranking 5<sup>th</sup> among 30 countries of overvalued crude oil commodity sale

# WHAT ARE THE ALTERNATIVES?

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- Is the arm's length standard of income allocation suitable for developing countries?
- Are there alternatives to the arm's length standard and should they be considered?
- In terms of the search for comparables, should we resort to the use of the “**reasonable man's test (hypothetical uncontrolled transaction)?**”- **Canadian Supreme Court's decision in GlaxoSmithKline Inc.'s case.**
- Alternative minimum tax based on gross revenue?
- Are Safe Harbour Regimes effective in addressing the limitations of the ALS and use of TP Methodologies?

# WHAT ARE SAFE HARBOURS?

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- Broad Definition:  
India Income Tax Law: “circumstances in which the Tax Authority shall accept the transfer price declared by the taxpayer”.  
Similar approach in Nigeria: Regulation 15 of the TP Regulations, 2012.
- OECD Narrow Definition: “a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country’s general transfer pricing rules” (OECD TPGs 2017).
- OECD’s exclusions: APAs, thin capitalization rules

# FEATURES OF SAFE HARBOUR REGIME

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- An opt-in option by taxpayers who are bound to the safe harbour regime for a period of time (usually 3-5 years). For taxpayers who refuse to opt-in, requirement to present detailed TP documentation.
- Provides assurance that the prices fixed and returns filed will be accepted by the tax authority.
- Covers specific group of taxpayers or transactions, for example, manufacturing sector or low transfer pricing-risk sectors
- Attempts to set margins for transactions that are in line with the arm's length principle? How do you achieve this? Industry consultation is an option, however, there is fear of capture by influence-wielding corporations.



# BENEFITS OF SAFE HARBOURS

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- Reduces the need to find data on comparables and to perform benchmarking study
- Addresses the issues of unavailability or unreliability of information
- Simplifying compliance and reducing compliance costs for eligible taxpayers
- Provides predictability for both taxpayers and the revenue authorities
- They reduce the possibility of litigation and could increase FDI into a country.
- Providing certainty to eligible taxpayers that the price charged or paid on qualifying controlled transactions will be accepted by the tax administrations
- Limited audit or without an audit beyond ensuring the taxpayer has met the eligibility conditions of, and complied with the safe harbor provisions
- Permitting tax administrations to redirect their administrative resources from the examination of lower risk transactions to examinations of more complex or higher risk transactions and taxpayers
- Summary: Safe harbours achieve increased revenue collection, tax efficiency, certainty, simplicity and convenience

# ISSUES TO CONSIDER

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- May lead to taxable income being reported that is not in accordance with the arm's length principle
- May increase the risk of double taxation or double non-taxation when adopted unilaterally
- Potentially opens avenues for inappropriate tax planning and may raise issues of equity and uniformity
- Unilateral, bilateral or multilateral safe harbours? Issues of fiscal sovereignty, negotiation, time management, cost of negotiations, potential for corresponding adjustments by other tax authorities.
- Scope of safe harbours: for developing countries, should it be limited to low transfer pricing-risk sectors or based on importance of the sector to the economy? Should the guarantee of revenue collection be the influencing factor?
- Exclusions? For example, India excludes the application of safe harbour to transactions or taxpayers with connection with tax havens- no-or-low tax country/territory. See S. 94A of the Income Tax Law of India.