



## Transfer Pricing

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The subject matter of Transfer pricing as dealt in Chapter XI A of the Income Tax Ordinance 1984, has been gaining importance gradually with the rapid growth of Inter-company business activities among the associated entities engaged in the international transactions across the globe, either as subsidiaries of Multinational Companies or as its branches doing business in different tax zones of the world with different set up of tax laws and rates of taxes. Some where the income is taxed at higher rate and somewhere it is taxed at low rate or zero rate under different tax facility allowed in those countries considering the economic development of such countries.

The transfer pricing of goods and services among the associated enterprises is supposed to be done at arm's length basis just like the same basis as practiced in the dealing between the independent entities which is considered acceptable as a genuine basis for tax purposes according to the Tax Justice Net Work (TJN) a U.K. based organization.

As per definition the arm's length price means a price in a transaction where the conditions such as price, margin or profit split do not differ from the condition that would have prevailed in uncontrolled transactions between independent entities

carried out under comparable circumstances.

This being the mechanism to be followed by associated enterprises, most often it is observed that the mechanism is being misused and through mispricing of goods and services it is the tendency of the associated enterprises to deflate the overall global profits accrued from their international trade.

The objective of the mechanism to be adopted in transfer pricing between the associated enterprises across the globe is therefore to discourage the tendency of the associated enterprises in mispricing of different goods and services and valuing the related assets inter-unit at some artificial price as per their mutual agreement instead of following the market forces where the price is determined by independent entities on the principle of arm's length price as per definition of the term in Income Tax Ordinance 1984. Under this situation the tax authority of concerned countries in the interest of their National Revenue is to ensure that the inter-company price is equivalent to arm's length price just to prevent the loss of tax revenue through evasion of tax and thereby enabling the flight of capital out of the country just like the malpractice of under invoicing and over-invoicing



adopted by the unscrupulous, people of a country. This being the stand of the tax Authority of the concerned country, the associated enterprises also on the contrary make an effort to pay less tax and to avoid double taxation of their profit as dealt in Chapter XI of Income Tax Ordinance 1984.

For the purpose of determination of transfer price of commodities and services by the associated enterprises in respect of their international transactions, the process of test of arm's length price on the basis of principle of arm's length in respect of arm's length transaction as per arm's length standard, shall have to be applied in the most appropriate method of computation mentioned in Section 107-C of I. T. ordinance 1984, subject to the condition that the price determined in the above manner and the profit resulted thereby shall not be less than the income that would have been resulted if the price at which the international transaction has actually been considered as the price charged for the said international transaction.

Under this complex situation of determination of transfer pricing in different countries, it may likely tempt some countries to impose penalties on multinational companies if they consider that they are being deprived of due taxes on income otherwise taxable as per law of the country.

However, since the participating countries in the International transactions as per definition in Section 107A, sub section (5) of Income Tax Ordinance 1984, are sovereign entities, it most often becomes tough to take legal action against such imposition of penalties in the absence of requisite data and relevant information therefor.

The tax laws of different countries being different and recognizing this fact most national and some sub-national income tax authorities have the legal authority to adjust prices charged between the related parties. Tax rules generally permit related parties to set prices in any manner they choose but permit adjustment with such prices or effects that are outside the set guidelines. Transfer pricing adjustments have been a feature of many tax systems since the 1930s. Both the USA and the OECD countries of which major industrial countries including the USA are members, have some guidelines by 1979. These sets of rules have ultimately become regulations in 1994. The OECD guidelines have been formally adopted by many European Countries with little or no modification. The two sets of rules issued by USA and the OECD countries are broadly similar and contain certain principles followed by many countries.

**“ SINCE TRANSFER PRICING OF GOODS AND SERVICES IS A COMPLEX MATTER, THERE EXISTS AGREEMENTS ENTERED INTO BY COUNTRIES EITHER ON UNILATERAL OR MULTILATERAL BASIS REGARDING THE SETTING OR TESTING RELATED PARTY PRICES. AS PER THESE AGREEMENTS THE COUNTRIES CONCERNED PREPARE THE DOCUMENTATION ON METHODOLOGY USED TO TEST THE TRANSFER PRICES. THESE AGREEMENTS ARE GENERALLY MADE FOR SOME PERIOD OF YEARS WITH RETROACTIVE EFFECT. ”**



Despite the differences in tax laws of different countries, most of the Govts. have granted authorities to adjust price charged between the related parties. Many such countries including those of the USA, UK, Canada and Germany allow domestic as well as international adjustments. Most of, if not all Govts. permit adjustments by tax authorities even when there is no intent to avoid or evade tax.

Since transfer pricing of goods and services is a complex matter, there exists agreements entered into by countries either on unilateral or multilateral basis regarding the setting or testing related party prices. As per these agreements the countries concerned prepare the documentation on methodology used to test the transfer prices. These agreements are generally made for some period of years with retroactive effect.

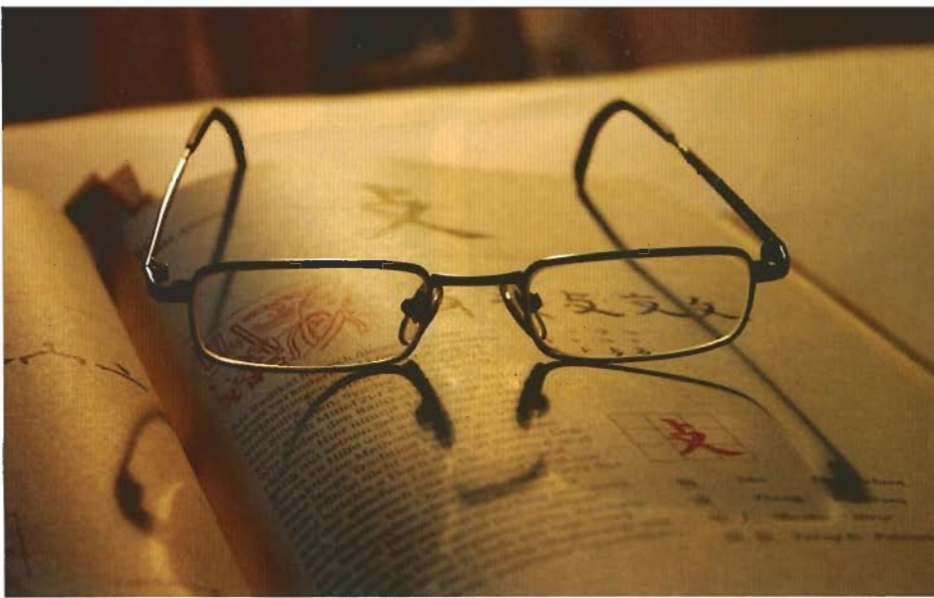
Having discussed the objectives of Transfer pricing to curb evasion of national revenue through mispricing of commodities and services and by adopting manipulation thereof and by transferring capital out of the country, it is now required to discuss the loss of national revenue

by the victim countries particularly Bangladesh and the remedies taken there against. As per survey of a Washington based Global Financial Integrity, Bangladesh lost \$1.4 billion a year which is equivalent to Tk. 11,200 Cr. Per annum (at current rate of conversion) between 2001-2010 in the form of capital flight from Bangladesh through mispricing of commodities and services and by evasion of Tax in Bangladesh by International Multinational Companies and by other means fraudulently practiced by unscrupulous business community of the country.

The govt, of Bangladesh and its tax wing, the NBR are trying to curb this malpractice of mispricing of transfer of commodities and services and to boost up its revenue collection which is now falling short of fiscal target every year. It may be mentioned here that the NBR missed collection target from Domestic Sources in the form of Tax and VAT for fiscal 2013-14 by an amount of Tk. 4,488 Cr. having collected a sum of Tk. 1,20,512 Cr. against target for Tk. 1,25,000 Cr. To achieve the desired result of Transfer Pricing the NBR has recently formed a cell

to implement the Transfer Pricing provision of Income tax Ordinance 1984 as introduced in 2012 with rules framed there under. The move of NBR started in December 2013 and set to go into action by July 2014 to curb the mispricing of goods and services in the International transactions. This move is going to be operative in the course of assessment of the multinational companies from assessment year 2014- 2015. The cell formed by NBR with five or six officials as part of the plan shall implement the law immediately. The cell will suggest and co-ordinate training to taxmen to help build capacity on TP issues so that they can audit transactions by foreign companies with related firms and determine the arm's length prices in relation to any international transaction between the associated entities. The concerned firms will need to provide proof that transactions have been done on the same basis of arm's length price a price at which two independent or unrelated entities would trade with each other without any bias or any influence.

Under section 107-C of Income Tax Ordinance 1984 the



appropriate method of determination of arm's length price as per Rule 70 is the Comparable Uncontrolled price method and for judging the comparability the factors as in Rule 71, shall have to be considered. Rule 72 of Income Tax Rules also provides the most appropriate method under the facts and circumstances that are materially significant, like comparable factors including characteristics of industry, its functions, risks, contractual terms, market level etc. that shall have to be considered under the situation of each case.

As per section 107 E of Income Tax Ordinance 1984 certain information and documents need to be kept for transfer pricing. In this respect Rule 73 provides the detailed nature of the information and documents that are required to be kept and maintained for a period of eight years in respect of international transactions entered into by the concerned assessee for an aggregate value as recorded in the books of accounts for a sum in excess of Tk. 3 crores in the relevant income year. Under Rule 74 it is required that a report from a certified accountant is to be furnished in the form prescribed in Rule 75.

The NBR officials are sure that because of their move in fixing the transfer price of the International

transactions based on arm's length price in respect of associated entities they will be able to collect more revenue from the companies in Bangladesh related with other firms abroad in respect of particular products or services dealt with internationally by and between them. It is expected that through adopting the most appropriate method of computation of arm's length price in respect of international dealings between the associated enterprises, the target set for fiscal 2014-15 for tax and VAT will be achieved to its full extent of Tk. 1,50,000 Cr. without any loss of collection target as happened in the fiscal 2013-14, mentioned earlier.

This move of NBR in relation to transfer pricing of the international transactions will assist the tax policy wing of NBR to make TP administrative guidelines for tax men and established contracts with tax authorities in other countries to exchange information on TP. The cell establish by NBR for administration and implementation of TP in relation to International transactions between companies in Bangladesh and their associates overseas will also collect data and build data base on the issue. The cell will also co-ordinate efforts to build awareness and train stakeholders on TP as per mechanism practiced in about 70 countries across the globe

including India and Srilanka in South Asia. Bangladesh Govt, also followed them and passed a law in this respect through insertion of a distinct chapter XIA in Tax Ordinance 1984 vide FA 2012 under the title Transfer Pricing and framed Rules there under in July 2012 and is going to act according to it from the July 2014.

To make the move a success NBR has assigned one of its Joint Commissioners to co-ordinate the TP efforts and to stop the capital flight through mispricing of goods and services adopted globally by the associated entities in respect to International transactions which caused the nation to lose huge sums of revenue referred to earlier.

The success of the newly introduced law will depend on how sincerely the related officials act upon it as per Rules framed for the purpose. If it is done efficiently, it can save a lot of revenue of the govt, by means of curb on capital flight from the country. Moreover, the extra collection of revenue under the scheme may help reduce the budget deficit every year to the extent of 4-5% of the total yearly budget outlay.

In the context of the slow implementation process of the law of the country let us hope for the success of this noble move of the Govt, and its revenue wing, the National Board of Revenue.

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