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All eyes on transfer pricing

Africa's economy has shown high growth potential in the past decade. The continent's biggest trading partners in terms of value are either the European Union or, to a lesser degree, the US.

In the past decade, trade between Organisation for Economic Co-operation and Development (OECD) countries and Africa has doubled in nominal value. Even though trade between Africa and OECD member countries has grown and will continue to grow, the rapid pace at which trade between Africa and non-OECD countries grows, through the likes of China, Russia and Brazil, signals that the emerging economies might surpass the OECD member countries in the imminent future.

Accordingly, we have seen numerous European member companies trying to tap into the profit potential in Africa. In doing so there are a lot of uncertainties regarding the tax and legal regulations of entering and extracting the expected profits to be repatriated.

Asian countries such as India and China were often the targets for low-cost and low-risk manufacturing and service arrangements as part of tax efficient supply chain structures. However, the tax authorities both in China and India have become more aggressive and increasingly have been attacking the low margins left in the Asian jurisdictions. Africa offers an alternative location to large multinationals due to its low labour cost and less mature transfer pricing systems and regulations.

Transfer pricing has been a focus of revenue authorities worldwide and we expect this focus will also move into Africa given the increasing number of groups setting up operations in the Africa region. It has been said that transfer pricing is the lowest-hanging fruit, because it can be subjective and most companies do not have adequate documentation to back up their in-house policies.

Over the past two decades Africa has moved into the transfer pricing age and recently many African countries have adopted the OECD guidelines on which to base their transfer pricing regulations. Almost all European countries have transfer pricing regulations in place.

There are a number of opportunities in Africa for large multinationals to achieve a more cost efficient structure and reduce the risk of being attacked by more aggressive tax authorities like in India and China. However, most African jurisdictions are putting in place OECD-compliant transfer pricing regulations. Therefore, it is important to look at the transfer pricing arrangements when moving functions or risk to Africa. Documentation is key.

Transfer pricing regulations might not be as advanced and tax authorities do not have the same level of experience as in other European jurisdictions, but African tax authorities are trying to up their game. As in most cases where regulations are in an infant state, documentation and compliance become the major focus, so it is important to put in place, test and document transfer pricing policies in case of an inquiry.

Trends show a number of multinationals expanding into Africa, which offers a growing market and a low cost-base for operations. However, when planning efficient supply chain structures, groups should learn from previous mistakes. Many of the structures currently under fire are the result of companies taking advantage of transfer pricing regulations that are not as advanced.

It is important to plan new structures with the view that, eventually, most African transfer pricing regulations will align themselves with the rest of the world. It is also true that the arm's length principle will not change. Therefore, transactions should always be priced based on functionality, risk and substance to reduce risk of future disputes.

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