Seychelles Revenue Commission

PUBLIC RULING - 2015-3

Subject Heading: Application of the Transfer Pricing arm's length principle available to the Revenue Commissioner under Section 54 of the Business Tax Act, 2009

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Any enquiry in relation to this Pubic Ruling can be addressed to the Seychelles Revenue Commission, PO Box 50, Orion Mall, Republic of Seychelles.

Preamble

1. This document is a ruling for the purposes of Section 58 of the *Revenue Administration Act 2009* (RAA). You can rely on the information presented in this document which provides advice on the operation of the transfer pricing provision available to the Revenue Commissioner under Section 54 of the *Business Tax Act 2009*.

What this Ruling is about

2. The purpose of this public ruling is to provide the Revenue Commissioner's view on when the application of Section 54 of the *Business Tax Act 2009* (BTA) will apply to a business to adjust a non-arm's length transaction.

3. This Ruling considers:

   a) When the Revenue Commissioner may make an adjustment to a transaction under Section 54 of the BTA.

   b) What criteria the Revenue Commissioner will look at when assessing if a person has entered into dealings which are considered to be arm's length.

   c) Which transfer pricing methods and comparable factors are considered by the Revenue Commissioner as being most applicable.

d) When the Revenue Commissioner will consider making a transfer pricing adjustment for service fees.

e) When the Revenue Commissioner will consider making a transfer pricing adjustment for payments of an intangible.

f) That transfer pricing documentation is expected of taxpayers.

g) That attribution of profits to a Permanent Establishment to be at arm's length

Legislative Framework

4. Section 54 of the Business Tax Act 2009 states as follows:

> *54.(1) The Revenue Commissioner may, in respect of —*
>
> *(a) a transaction between businesses carried on by persons who are associates;*
> *or*
> *(b) a transaction between businesses carried on by the same person,*
>
> *distribute, apportion, or allocate income or gain and expenses between the businesses as is necessary to reflect the outcome that would have arisen in a transaction between independent persons dealing with each other at arm's length.*
>
> *(2) In applying subsection (1), the Revenue Commissioner may be guided by international standards, case law, and guidelines on transfer pricing issued by international organization concerned with taxation.*

Ruling

Significance of the arm's length principle

5. Section 54 allows the Revenue Commissioner to adjust transactions to reflect an arm's length result between businesses carried on by associates or carried on by the same person. The Revenue Commissioner makes this determination based on application of the internationally recognised 'arm's length principle'.

6. The arm's length principle means transactions should be valued as if they had been carried out between non-associate parties who deal with each other wholly independently.

Transactions to be consistent with the arm's length principle

7. As per Section 54, when a person has entered into a transaction to which Subsection 54(1) applies, the Revenue Commissioner will expect the person to confirm its income and expenditure that results from the transaction to be consistent with the arm's length principle.

8. When the person does not comply with the arm's length principle, the Revenue Commissioner may make such adjustments as necessary to ensure that the income and expenditures of the person resulting from the transaction is consistent with the arm's length principle.

Determining consistency with the arm's length principle

9. In determining whether a result is consistent with the arm's length principle, the Revenue Commissioner will use the most appropriate transfer pricing method or a combination of methods having regard to the following –

    a) the respective strengths and weaknesses of the transfer pricing methods taking into consideration the circumstances of the case,

    b) the appropriateness of a transfer pricing method taking account of the nature of the transaction determined in particular, through an analysis of the functions undertaken, assets used and risks assumed by each person that is a party to the transaction,

    c) the availability of reliable information needed to apply a transfer pricing method, and

    d) the degree of comparability between the transaction and a similar transaction between non-associates, including the reliability of adjustments, if any, that may be required to eliminate differences between them.

Applicable transfer pricing methods

10. Even though a taxpayer is free to choose its own transfer pricing method (refer paragraph 23 below), the Revenue Commissioner considers the following transfer pricing methods (in preferential order), as being largely appropriate for use:

    a) the comparable uncontrolled price method

    b) the resale price method

c) the cost plus method

d) the transactional profit split method, or

e) the transaction net margin method

11. In line with Subsection 54(2) the Revenue Commissioner has chosen these above five methods in preference as per the guidance provided in the international standards and guidelines on transfer pricing issued by international organisations concerned with taxation, such as the OECD and the UN.

12. Even though each of the five methods are pronounced in more detail in the guidelines released by those organisaitons with more thorough explanations for taxpayers, the following are the Revenue Commissioners abridged descriptions of each method.

13. **Comparable Uncontrolled Price method** (also known as the CUP) is the transfer pricing method under which the price charged in the transaction is compared with the price charged in a comparable uncontrolled transaction.

14. A comparable uncontrolled transaction (a transaction that is not between associates) will be considered after taking account of the comparability factors to the controlled transaction, satisfying the following -

    a) the differences, if any, between the two transactions or between the persons undertaking the transactions do not materially affect the price, or

    b) if there are differences as referred to in paragraph (a) that do materially affect the price, reasonably accurate adjustments can be made to eliminate the effects of such differences

15. **Resale Price Method** (also known as RPM) is the determination of the price to be paid by a reseller for a product purchased from an associate which is then resold to an independent enterprise. The purchase price is set so that the resale margin earned by the reseller is sufficient to allow the reseller to cover its selling and operating expenses and make an appropriate profit.

16. **Cost Plus Method** (also known as C+ or CP) is the method under which the mark up on the costs directly and indirectly incurred in the supply of the good or service of the transaction is compared with the mark up on those costs directly or indirectly incurred in the supply of such goods or services in a comparable uncontrolled transaction (a transaction that is not between associates).

17. The mark up will be considered appropriate where the supplier is seen to have made an appropriate profit in the light of market conditions and functions performed by the supplier.

18. **Transaction Profit Split Method** (also known as Profit Split) is the method under which the split of profit and loss that a person realizes in the transaction is compared with the split of profit and loss that would be achieved in a comparable uncontrolled transaction (a transaction that is not between associates).

19. This method essentially works backwards from profit to price as it combines all profits and losses made from the transaction by all persons and seeks to determine the appropriate split of those profits and losses between the persons. The split will be based on using an economically valid defined basis that aims at replicating the split that would have been anticipated in an agreement made at arm's length.

20. **Transactional Net Margin Method** (also known as TNMM or CPM - Comparable Profit Method) is the method under which the net profit margin relative to the appropriate base (such as costs, sales or assets) that a person achieves in the transaction is compared with the net profit margin relative to the same basis achieved in a comparable uncontrolled transaction (a transaction that is not between associates).

21. The method seeks to determine the level of profits compared to a base that would have resulted from the transaction by reference to the return realised by a comparable non-associate person with a similar base (such as costs, sales or assets).

Comparability factors

22. In using the methods mentioned above, where there is a requirement to find a comparable transaction, the following factors can be used to determine whether two or more transactions are comparable. The Revenue Commissioner will not be limited to these factors alone and may use others where appropriate, however any factor will only be considered to the extent that they are economically relevant to the facts and circumstances of the transaction –

    a) the characteristics of the good or service supplied

    b) the functions undertaken, assets used, and risks assumed by the parties to the transaction

    c) the contractual terms of the transaction

    d) the economic circumstances in which the transactions take place, and

    e) the business strategies pursued by the parties to the transaction.

Using other transfer pricing methods

23. The Revenue Commissioner in examining as to whether income and expenditure resulting from the person's transaction is consistent with the arm's length principle will do so by basing the examination on the transfer pricing method used by the person.

24. A person is not compelled to apply the five preferred methods listed above and is able to choose additional methods where they believe it is more appropriate. However the Revenue Commissioner may still apply the five preferred methods where those methods were found to be more appropriate. Therefore where a person applies a transfer pricing method other than those five preferred methods, the Revenue Commissioner requests the person to establish that-

    a) for specific reasons none of the five preferred methods can reasonably be applied to determine whether the transaction is consistent with the arm's length principle, and

    b) the method used gives rise to a result that is more consistent with the arm's length principle.

When the Revenue Commissioner can make an adjustment for services

25. In determining whether to make a transfer pricing adjustment under Section 54 in relation to a fee charged for the provision of services by a person ("supplier") to an associate ("recipient"), the Revenue Commissioner can have regard to the following-

    a) whether the service has actually been provided

    b) whether the service provides or will provide the recipient with economic or commercial value that will enhance its commercial position

    c) whether the services are services that an independent person in comparable circumstances would be willing to pay for or would be willing to perform for itself in-house, and

    d) whether the fee corresponds to the fee that would have been agreed between independent persons for a comparable service in comparable circumstances

26. The Revenue Commissioner recognises there may be exceptional circumstances where it is beneficial for a member of a corporate group to be provided with services by other members of the group. The Revenue Commissioner prefers that such group services are charged on a direct basis in order to have proper regard to the considerations in paragraph 25

27. Where it is difficult to apply a direct charge method, due to costs being shared amongst a number of group recipients, an indirect charge method may be used where the service cost is allocated to each recipient on the basis of an appropriate allocation key.

28. In this regard, the Revenue Commissioner is guided by the *UN Practical Manual on Transfer Pricing for Developing Countries,* which states at paragraph 1.6.10:

> *If a direct charge method is difficult to apply, the business may apply the charge indirectly via cost sharing, by incorporating a service charge or by not charging at all. Such methods would usually be accepted by the tax authorities only if the charges are supported by foreseeable benefits for the recipients of the services, the methods are based on sound accounting and commercial principles and they are capable of producing charges or allocations that are commensurate with the reasonably expected benefits to the recipient.*

29. The Revenue Commissioner expects the same allocation key to be used consistently from year to year unless there are valid and documented reasons not to.

30. The Revenue Commission considers a service fee paid or payable by a person to an associate is not consistent with the arm's length principle when the fee is for any of the following costs incurred or activities undertaken by the associate -

    a) costs or activities relating to the juridical structure of the associate, such as shareholder meetings, the issuing of shares, or the costs of the associates board of directors

    b) costs or activities relating to the reporting requirements of the associated company, including the preparation of consolidated financial reports, or

    c) costs or activities relating to the raising of funds by the associate, except to the extent that the Seychelles business benefits directly (not indirectly) from the funds.

When the Revenue Commissioner can make an adjustment for intangibles

31. In determining whether to make a transfer pricing adjustment under Section 54 in relation to the consideration given by a person ("transferee") to an associate ("transferor") for a license, sale or other transfer of intangible property, the Revenue Commissioner can have regard to the following –

    d) the value and usefulness of the intangible property to the business of the transferee

    e) the price for which an independent person in similar circumstances of the transferor would be willing transfer the intangible for

f) the expected benefits to the transferee of the intangible

g) any geographical limitation on the use of the property by the transferee

h) whether the transferee's use of the property is exclusive or non-exclusive, and

i) whether the transferee has the right to participate in the further development of the intangible by the transferor.

Documentation requirements

31. The Revenue Commissioner expects a person to record, in writing, sufficient information and analysis to verify that their transactions which are applicable to Section 54 are consistent with the arm's length principle.

32. The Revenue Commissioner expects such documentation will be put in place prior to the due date for filing of the business tax return of the person and after that date should be able to be provided to the Revenue Commissioner within five days upon written request.

33. Such documentation is considered to be within the record-keeping obligation of a person specified in Section 57(4).

Attribution of profits to a Permanent Establishment to be at arm's length

34. When a business is carried on by a non-resident person through a permanent establishment in Seychelles, Section 5 of the BTA dealing with source and Section 11 of the BTA dealing with assessable income both apply for the purpose of determining the assessable income attributable to the permanent establishment of that non-resident person.

35. As a permanent establishment is not a separate person from its head office but is the same person carrying on the same business, it cannot legally transact with itself, that being the head office or other branches of the business.

36. However, in determining the assessable income and allowable deductions attributable to a permanent establishment, the Revenue Commissioner takes the view that a permanent establishment is to be treated as a separate person dealing at arm's length with its head office and other branches of the business. This view is consistent with Article 7 (Business Profits) of Seychelles Double Tax Treaties and the OECD commentary in the *OECD Model Tax Convention on Income and Capital.*

37. As a result, the views as outlined in this ruling can be applied to the attribution of profits of a non-resident person to its permanent establishment in Seychelles where such attribution is to reflect an arm's length outcome.

Date of effect

38. This ruling applies from the 25 May 2015