

INCOME TAX ACT
(Cap. 52:01)

INCOME TAX (TRANSFER PRICING) REGULATIONS, 2019
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IN EXERCISE of the powers conferred on the Minister of Finance and Economic Development by section 145 of the Income Tax Act, the following Regulations are hereby made —

1. These Regulations may be cited as the Income Tax (Transfer Pricing) Citation
Regulations, 2019.

2. In these Regulations, unless the context otherwise requires — Interpretation
“comparable transaction” means any transaction that is comparable to another
transaction in accordance with regulation 4;

“contemporaneous documentation” means documentation for a relevant tax
year which is in place at the prescribed date for filing a tax return;

“controlled transaction” means any transaction between connected persons;

“financial indicator” means, in relation to the —

- (i) comparable uncontrolled price method, the price;
- (ii) cost plus method, the mark up on costs;
- (iii) resale price method, the resale margin;
- (iv) transaction net margin method, the net profit margin; and
- (v) transactional profit split method, the division of the operating profit
and loss;

“multi-national enterprise group”, hereinafter referred to as “MNE group”
means —

- (i) a group of two or more persons, whose tax residencies are in different jurisdictions; or
- (ii) any group that includes a person who, for tax purposes, is a resident in one jurisdiction and is also subject to tax in another jurisdiction as a result of having a Permanent Establishment in that jurisdiction; and

“uncontrolled transaction” means any transaction between independent persons.

Arm’s length principle

3. The determination of whether the conditions of a controlled transaction are consistent with the arm’s length principle under section 36A of the Act and of the quantum of any adjustment made under section 36A (3) of the Act, shall be made in accordance with the provisions of these Regulations.

Comparability

4. (1) An uncontrolled transaction is comparable to a controlled transaction within the meaning of section 36A (2) of the Act where —

- (a) there are no differences between the transactions that could materially affect the financial indicator being examined under the appropriate transfer pricing method; or
- (b) such differences exist, a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison.

(2) To determine whether two or more transactions are comparable, the following factors shall be considered to the extent that they are economically relevant to the facts and circumstances of the transactions —

- (a) the characteristics of the property or a service transferred;
- (b) the function undertaken by each person with respect to the transactions, taking into account assets used and risks assumed;
- (c) the contractual terms of the transactions;
- (d) the economic circumstances in which a transaction takes place; and
- (e) the business strategies pursued by each of the connected persons in relation to the transactions.

Transfer pricing methods

5. (1) The arm’s length price of a controlled transaction shall be determined by applying the most appropriate transfer pricing method to the circumstances of the transaction.

(2) The most appropriate transfer pricing method shall be selected from among the approved transfer pricing methods set out in sub-regulation (5), taking into consideration the following criteria —

- (a) the respective strength and weakness of the approved method;
- (b) the appropriateness of an approved method in view of the nature of the controlled transaction, determined in particular, through an analysis of the functions undertaken by each person in the controlled transaction, taking into account assets used and risks assumed;
- (c) the availability of reliable information needed to apply the selected transfer pricing method or other methods; and
- (d) the degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.

(3) Where the circumstances of the transaction require more than one appropriate transfer pricing method, a person may apply more than one method to determine whether the conditions of a given controlled transaction are consistent with the arm’s length principle.

(4) Where a person has used an approved transfer pricing method and the selection of that method is consistent with this regulation, the determination by the Commissioner General of whether the conditions of the person's controlled transactions are consistent with the arm's length principle shall be based on that transfer pricing method applied by the person.

(5) (a) The following shall be the approved transfer pricing methods for purposes of subregulation (1) –

- (i) the comparable uncontrolled price method, which is a method consisting of comparing the price charged for property or a service transferred in a controlled transaction to the price charged for property or a service transferred in a comparable uncontrolled transaction;
 - (ii) the resale price method, which is a method consisting of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions;
 - (iii) the cost plus method, which is a method consisting of comparing the mark up on the costs directly and indirectly incurred in the supply of property or a service in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or a service in a comparable uncontrolled transaction;
 - (iv) the transactional net margin method, which is a method consisting of comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions;
 - (v) the transactional profit split method, which is a method consisting of allocating to each connected person participating in a controlled transaction the portion of common profit or loss derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction; and
- (b) the approved transfer methods under paragraphs (i) to (iii) shall be classified as traditional methods and the methods under paragraphs (iv) to (v) shall be classified as transactional methods.

(6) Where it is possible to determine an arm's length price for some of the functions performed by the connected persons in connection with the transaction using one of the approved methods described in subregulation (5) (a) (i) to (iv), the transactional profit split method shall be applied based on the common residual profit that results once such functions are so priced.

(7) Where –

- (a) taking account of the criteria described in subregulation (3); and
- (b) an approved method described in subregulation (5) (a) (i) to (v) can be applied with equal reliability,

the determination of arm's length conditions shall be made using the comparable uncontrolled price method.

(8) Where, taking account of the criteria described in subregulation (3) and where a traditional method or transactional method can be applied with equal reliability, the determination of arm's length conditions shall be made using the traditional method.

(9) Subject to sub-regulation (3) it shall not be necessary to apply more than one method to determine the arm's length price for a given controlled transaction.

(10) A transfer pricing method other than the approved methods contained in subregulation (5) may be applied where the Commissioner General is satisfied that —

- (a) none of the approved methods can be reasonably applied to determine arm's length conditions for the controlled transaction; and
- (b) such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

(11) When applying a cost plus, resale price or transactional net margin method, provided under subregulation (5) it shall be necessary to select the party, hereinafter referred to as the "tested party", to the transaction for which a financial indicator, mark-up on costs, gross margin, or net profit indicator, is tested under the applicable transfer pricing method.

(12) The selection of the tested party should be consistent with the functional analysis of the transaction.

(13) Where a person uses a transfer pricing method to establish the payment of a controlled transaction and that transfer pricing method is consistent with the provisions of subregulation (2), then the Commissioner General's determination of whether the conditions of the taxpayer's controlled transactions are consistent with the arm's length principle shall be based on the transfer pricing method applied by the person.

Evaluation of
combined
controlled
transactions

6. Where a person liable to tax carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to —

- (a) perform the comparability analysis set out in regulation 4; and
- (b) apply any transfer pricing method set out in regulation 5.

Arm's length
range

7. (1) An arm's length range is a range of relevant financial indicator figures such prices, margins or profit shares produced by the application of the most appropriate transfer pricing method as set out in regulation 5 to a number of uncontrolled transactions, each of which is relatively equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with regulation 4.

(2) A controlled transaction, or a set of transactions that are combined according to regulation 6 shall not be subject to an adjustment under section 36A of the Act where, the relevant financial indicator being tested under the appropriate transfer pricing method is within the arm's length range.

(3) Where the relevant financial indicator derived from a controlled transaction, or from a set of transactions that are combined according to regulation 6, falls outside the arm's length range, the Commissioner General may adjust it pursuant to section 36A (3) of the Act, and any such adjustment shall be to the median in the arm's length range.

(4) For the purposes of regulation 5 (3), the median of the arm's length range shall be the 50th percentile of the financial indicator figures derived from the comparable uncontrolled transactions forming the arm's length range.

(5) For purposes of subregulation (4), a 50th percentile is the lowest financial indicator figure such that at least 50 per cent of the financial indicator figures are at or below the value of that figure:

Provided that, if exactly 50 per cent of the results are at or below a financial indicator figure, then the 50th percentile is equal to the arithmetic mean of that figure and the next highest figure.

8. (1) The following shall be possible sources of information on comparable uncontrolled transactions —

Sources of information on comparable uncontrolled transactions

(a) internal uncontrolled transactions, which are uncontrolled transactions where one of the parties to the controlled transaction is also a party to the uncontrolled transaction;

(b) external uncontrolled transactions, which are uncontrolled transactions to which neither of the parties to the controlled transaction is a party.

(2) The Commissioner General may not rely upon information concerning a comparable external uncontrolled transaction for the purposes of making an adjustment under section 36A of the Act where the information concerning the transaction is not available to a person liable to tax.

(3) A person shall not rely upon information concerning a comparable uncontrolled transaction for the purposes of demonstrating the consistency of a transaction with section 36A of the Act, where the information on the transaction is not available to the Commissioner General.

(4) The Commissioner General may, in the absence of information on an uncontrolled transaction from the same geographic market as a controlled transaction, accept a comparable uncontrolled transaction from other geographic market.

(5) A determination of whether comparables from other geographic markets are reliable shall be made on a case-by-case basis, and by reference to the extent to which they satisfy subregulation (2) and (3).

(6) A person using comparables in subregulation (5) shall assess the expected impact of geographic differences and other factors on the price and profitability.

9. (1) A charge for a service between a person liable to tax and a connected person shall be considered consistent with the arm's length principle where —

Services between connected enterprises

(a) the charge is for a service that is actually rendered;

(b) the service provides, or where rendered, was expected to provide, the person with economic or commercial value to enhance its commercial position;

(c) the charge is for a service that an independent enterprise in comparable circumstances would have been willing to pay for, if performed for it by an independent enterprise, or would have performed in-house for itself; and

(d) the amount charged corresponds to an amount which would have been agreed between independent enterprises for comparable services in comparable circumstances.

(2) A charge for a service made to a person liable to tax shall not be consistent with the arm's length principle where it is made by a connected person solely because of the person's shareholder's ownership interest in one or more other group members, including a service for any of the following costs incurred or activities undertaken by such connected person —

- (a) a cost or an activity relating to the juridical structure of the parent company of the person liable to tax, such as meetings of shareholders of the parent company, issuing of shares in the parent company and costs of the parent company's supervisory board;
 - (b) a cost or an activity relating to reporting requirements of the parent company of the person liable to tax, including the consolidation of reports; and
 - (c) a cost or an activity related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by the person liable to tax and the acquisition benefits or is expected to benefit that person.
- (3) Where it is possible to identify a specific service provided by a person liable to tax to a connected person, the determination whether the service charge is consistent with the arm's length principle shall be made for each specific service, subject to the provisions of subregulation (1).

(4) Where services are rendered by a person liable to tax to various connected persons and it is not possible to identify a specific service provided to each of them, the total service charge shall be allocated among the connected persons that benefit or expect to benefit from the service according to a reasonable allocation criteria.

(5) For the purposes of subregulation (4), an allocation criteria shall be viewed as reasonable where it is based on a variable that —

- (a) takes into account the nature of the service, the circumstances under which the service is provided and the benefits obtained or that were expected to be obtained by the persons for which the service is intended;
- (b) relates exclusively to uncontrolled transactions, rather than controlled transactions; and
- (c) is capable of being measured in a reliable manner.

10. (1) The determination of arm's length conditions for controlled transactions involving a licence, a sale or any transfer of intangible property between connected persons shall take into account —

- (a) the perspective of both the transferor of the property and the transferee;
- (b) the pricing at which a comparable independent enterprise would be willing to transfer the property; and
- (c) the value and usefulness of the intangible property to the transferee in its business.

(2) In applying the provisions of subregulation (2) to a transaction involving the licence, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including —

- (a) the expected benefits from the intangible property;
- (b) any geographic limitations on the exercise of rights to the intangible property;
- (c) the exclusive or non-exclusive character of the rights transferred; and
- (d) whether the transferee has the right to participate in further developments of the intangible property by the transferor.

11. Where an adjustment is made by the Commissioner General under section 36A of the Act to the taxable income of a person liable to tax in relation to a domestic transaction, then the Commissioner General shall make an appropriate adjustment to the taxable income of the other party to the transaction.

Transactions involving intangible property

Corresponding adjustments for domestic transactions

12. Section 36A of the Act shall not apply where a person resident in Botswana engages directly or indirectly in any transaction, operation or scheme with a connected person resident in Botswana except where Part XVI of the Act applies to one or both persons.

Application of section 36A to domestic transactions

13. (1) Where —

- (a) an adjustment to the conditions of transactions between a person resident in Botswana and a connected person is made or proposed by a tax administration in a country other than Botswana;
- (b) the adjustment results in the taxation in that other country of an amount of income on which the person resident in Botswana has already been charged to tax in Botswana; and
- (c) the country making or proposing the adjustment has a treaty with Botswana that reflects an intention to provide for the relief of economic double taxation,

Corresponding adjustments for international transactions

the Commissioner General shall after a request is made by the person resident in Botswana, examine the consistency of that adjustment with the arm's length principle provided for under section 36A of the Act, consulting as necessary with the competent authority of the other country.

(2) If the adjustment proposed or made by the other country is consistent with the arm's length principle both in principle and as regards the amount, the Commissioner General shall make a corresponding adjustment to the amount of the tax charged in Botswana to that person on those profits, in order to eliminate the economic double taxation that would result from the inclusion of the same profits in the taxable income of both that person and the connected person.

(3) A request under subregulation (1) shall contain the information necessary for the Commissioner General to examine the consistency of the adjustment made by the tax administration of the other country with the arm's length principle, including —

- (a) the name, registered address and, where applicable, trading name of the related person;
- (b) evidence of the tax residence of the related person;
- (c) the year in which the adjusted controlled transaction took place;
- (d) the amount of the requested corresponding adjustment and the amount of the adjustment made by the tax administration of the other country;
- (e) evidence of the adjustment made by the tax administration of the other country and the basis for the adjustment, including details of comparability analysis relied upon and the transfer pricing method applied;
- (f) confirmation that the related person will not, or is unable to, pursue any further recourse under the domestic law of the other country that may result in the adjustment made by the tax administration of the other country being reduced or reversed; and
- (g) any other information that may be relevant for examining the consistency of the adjustment with the arm's length principle.

(4) The request shall be made within the applicable time period for making a request for the case to be resolved by way of mutual agreement procedure under the applicable tax treaty.

14. (1) A person who engages in a transaction under section 36A of the Act shall keep documentation which is essential for explaining any transaction, including contemporaneous documentation that verifies that the conditions in the person's controlled transactions for the relevant tax year are consistent with the arm's length principle.

Required documents for transfer pricing

(2) A person who keeps documentation required under sub-regulation (1) shall when filing a tax return, submit the documentation with the tax return.

(3) The documentation that is required to be kept under sub-regulation (1) and submitted with a tax return as provided under sub-regulation (2) shall include the following —

(a) an overview of the person's business operations, which includes —

- (i) the history,
- (ii) recent evolution,
- (iii) general overview of the relevant markets of reference, and
- (iv) an organisational chart with details of business units or departments in the organisation's structure;

(b) a description of the organisational structure of the group that the person is a member of, including details of all group members, their legal form, and their shareholding percentages;

(c) a description of the group's operational structure including a general description of the role that each of the group members carries out with respect to the group's activities, which are relevant to the controlled transaction;

(d) a description of the general business and business strategy pursued by the person, which includes an indication of whether the person has been involved in a business restructuring or intangible transfer in the present or immediate past year and an explanation of the effects of such transaction;

(e) a description of the person's key competitors;

(f) a description of the controlled transaction, including analysis of the comparability factors in regulation 4;

(g) the amount of intra-group payments and receipts for each category of controlled transactions involving the person and the payments and receipts are broken down according to the tax jurisdiction of the foreign payer or recipient;

(h) an identification of connected persons involved in each category of controlled transactions and the relationship between them;

(i) copies of all material inter-company agreements concluded by the person;

(j) a detailed comparability and functional analysis of the person and relevant connected persons with respect to each documented category of controlled transactions, including any changes compared to prior years;

(k) an indication of which connected persons was selected as the tested party, if applicable, and an explanation of the reasons for the selection;

(l) financial statements for the parties to the controlled transaction including where the tested party has been selected as a party outside Botswana;

(m) a summary of the important assumptions made in applying the transfer pricing methodology;

(n) where relevant, an explanation of the reasons for performing a multi-year analysis;

(o) a list and description of selected internal or external comparable uncontrolled transactions, if any, and information on relevant financial indicators for independent persons relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information;

- (p) a description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method;
- (q) a summary of financial information used in applying the transfer pricing methodology;
- (r) information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements;
- (s) summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained;
- (t) explanation of the selection of the most appropriate transfer pricing method and where relevant, the selection of the tested party and the financial indicator;
- (u) comparability analysis, including —
 - (i) description of the process undertaken to identify comparable uncontrolled transactions,
 - (ii) explanation of the basis for the rejection of any potential internal comparable uncontrolled transactions, where applicable,
 - (iii) description of the comparable uncontrolled transactions,
 - (iv) analysis of comparability of the controlled transaction and the comparable uncontrolled transactions taking into account the comparability factors in regulation 4, and
 - (v) details and explanation of any comparability adjustments made,
- (v) details of any industry analysis, economic analysis, budgets or projections relied on;
- (w) details of any advance pricing agreements or similar arrangements in other countries that are applicable to the controlled transactions;
- (x) a conclusion as to consistency of the conditions of the controlled transactions with the arm's length principle, including details of any adjustment made to ensure compliance; and
- (y) any other information that may have a material impact on the determination of the person's compliance with the arm's length principle with respect to the controlled transactions.

(4) A person whose transaction or transactions, in a tax year with a connected person, within a MNE group exceeds P5 000 000 shall, upon a written request by the Commissioner General, furnish the Commissioner General with the following information —

- (a) a chart illustrating the MNE group's legal and ownership structure and geographical location of operating entities;
- (b) a description of the MNE group's business, including —
 - (i) important drivers of business profit,
 - (ii) a description of the supply chain for the group's five largest products or service offerings by turnover and any other products or services amounting to more than 5 percent of group turnover,
 - (iii) a list and brief description of important service arrangements between members of the MNE group, other than research and development services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services,

- (iv) a description of the main geographic markets for the group's products and services,
- (v) a brief written functional analysis describing the principal contributions to value creation by individual entities within the group, such as key functions performed, important risks assumed and important assets used, and
- (vi) a description of important business restructuring transactions, acquisitions and divestitures occurring during the tax year.

Language of documentation

15. Any documentation required to be kept under these Regulations shall be submitted in Setswana or English language.

Time limit for submission of documentation

16. A person shall, upon a notice in writing from the Commissioner General requesting the person to provide the Commissioner General with any documentation required to be kept under these Regulations, provide the Commissioner General with such documentation at such a time and place as may be specified in the notice.

Power to request additional information

17. Notwithstanding the requirements under regulation 14 and 16, the Commissioner General shall have the power to request additional information which the Commissioner General considers necessary to carry out his or her functions in the course of conducting audit procedures.

Relevance of OECD Transfer Pricing Guidelines

18. The Organisation for Economic Cooperation and Development ("OECD") "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" are a relevant source of interpretation for these Regulations.

MADE this 2nd day of July, 2019.

O. K. MATAMBO,
*Minister of Finance and
 Economic Development.*