

THE TAX INTELLIGENCE SERIES

TRANSFER PRICING ON TRIAL



HOW AUDITS, EVIDENCE AND LITIGATION
SHAPE ARM'S LENGTH OUTCOME

DR DANIEL N ERASMUS

EDITED BY PALESA SANSOLE

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TRANSFER PRICING ON TRIAL

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PREFACE

AND DISCLAIMER

The information contained in this book is intended for informational purposes. This book draws from my expertise in transfer pricing audits, trials and the law of evidence, enriched by my experiences in African courts yet providing practical global applicability. Many of the principles discussed are derived from English common law jurisdictions and thus are applicable for jurisdictions that have similar legal systems. It has a casual tone, breaking down some of the knowledge required in an easy-to-understand way, covering everything from fundamental concepts to detailed strategies. It assumes some existing transfer pricing knowledge. For experienced readers, I share practical advice, strategies, and tips for managing audits and documentation.

It should not be construed as legal or professional advice. Readers must seek the guidance of qualified legal and/or other professional advisors to ensure full compliance with the laws and regulations applicable in their respective country(ies). It is crucial to take appropriate measures to prevent any potential damage, loss, or suffering that may arise from the use of information obtained from this book. The content herein cannot be relied upon in support of any contentions, arguments, or submissions to any revenue authority or regulatory body on any matter. This disclaimer is not exhaustive. The author and publishers disclaim any responsibility or liability for any damage, loss, or suffering incurred by any individual or entity who relies on or attempts to implement the information provided in this book, despite having obtained appropriate legal and/or professional advice.

Special thanks to Palesa Sansole (our editor), Gilbert Ferreira, Anna-Maree Rose, Frances Louw, Okkie Kellerman and Roxanna Nyiri for their input, patience and many hours assisting in editing, compiling, checking, commenting on and redrafting parts of this book.

Dr Daniel N Erasmus
Colorado, 2025

EDITOR

PALESA SANOLE

TRANSFER PRICING & PILLAR 2 ADVISOR

Palesa Sansole (a fellow Zimbabwean, with heritage from Lesotho) has over 20 years of experience, providing deep expertise in transfer pricing and international tax. She has most recently worked on a Pillar 2 project, providing legal advice on the interpretation of the OECD Administrative Guidance and GloBE rules. Her extensive understanding of multinational enterprises enables her to offer clients Pillar 2 impact assessments, modelling for Safe Harbours, and interpretation of the application of Pillar 2 rules.

Her broad industry experience includes working in financial services, medical devices, and the software industry, with a keen interest in artificial intelligence (AI).

Her in-house experience at GE Capital & Global Foundries (semi-conductor MNE), combined with her tenure at Deloitte & KPMG allows her to adopt a client-focused approach, optimizing tax strategies to align with corporate goals.

Additionally, Palesa has reviewed transfer pricing software provided by niche boutique providers and the Big 4. She has conducted cost-benefit analyses for procuring transfer pricing software and understands how to support a business case for automation to senior internal stakeholders.

Palesa has trained in-house teams on new tax topics and has been accredited with an ability to explain complex tax concepts in a simple way to a multi-functional audience.

She has experience in tax controversy, working with African and European tax authorities to resolve tax issues, including participation in Mutual Agreement Procedure discussions. Her global experience is further enriched by having lived and worked in Africa, the UK, and the US, giving her a unique perspective on international tax matters.

EDUCATION

LL.M, European, International & Comparative Law, University of Keele, UK

LL.M, Taxation, Cape Town University, SA

LL.B, (Hons) Politics and Law, Buckingham University, UK

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GLOSSARY

OF TERMS

ADMISSIBILITY OF EVIDENCE

Admissibility of evidence refers to whether a particular piece of evidence is allowed to be presented and considered in a legal proceeding, such as a trial. It's a determination of whether the evidence meets specific legal standards and rules that govern what can be used in a court of law. Essentially, if evidence is deemed admissible, it can be used to help prove a case; if it's not, it cannot.

AFRICAN TAX ADMINISTRATION FORUM

The African Tax Administration Forum offers tax expertise and support to its member countries in the form of training, short courses, technical assistance, country programmes and rapid response initiatives. Their numerous policy briefs, suggested approaches and publications provide evidence-based tax data and statistics which are invaluable to tax administrations.

APPEAL

An appeal is a formal request made by a party who lost a court case to a higher court, asking that court to review the lower court's decision and potentially reverse it. The appealing party believes the lower court made a legal error, and the appellate court will typically examine the record and legal arguments from the original trial, rather than re-trying the case or admitting new evidence.

ARM'S LENGTH

Is an expression commonly used to refer to transactions in which two or more unrelated and unaffiliated parties agree to do business, acting independently and in their self-interest.

BALANCE OF PROBABILITIES

Refers to the standard of proof used in civil cases. It means that the party bearing the burden of proof must convince the court that their version of events is more likely to be true than not.

BASE EROSION AND PROFIT SHIFTING (BEPS)

Refers to corporate tax avoidance strategies used by multinationals to "shift" profits from higher-tax jurisdictions to lower-tax jurisdictions or no-tax locations where there is little or no economic activity, thus "eroding" the "tax-base" of the higher-tax jurisdictions using deductible payments such as interest or royalties.

BEST EVIDENCE RULE¹

The Best Evidence Rule requires the original document, recording, or photograph to prove its content in court. The rules of evidence provide that the “original writing, recording, or photograph must be provided to prove its content unless the original is lost, destroyed, or otherwise unobtainable.”

This undergirding principle of evidentiary law is called the **Best Evidence Rule**, also referred to as the **original writing rule**. The foundation of the Best Evidence Rule is that the original writing, recording or photograph is the ‘best’ way to prove the actual content of the evidence. This is because requiring best evidence ensures that litigants provide evidence that will best facilitate a court’s task of accurately resolving disputed issues of fact. Other evidence of the writing, recording, or photograph will be admissible only if the original document is not available.

A photocopy is generally considered the same as the original unless there is a genuine concern that the photocopy is not genuine. The original documents rule serves to exclude documents that paraphrase or re-state the original.

Exceptions to the Best Evidence Rule exist. The original writing, recording or photographic evidence is not required when:

1. All the originals are lost or destroyed and not by the party offering the evidence acting in bad faith;
2. The original cannot be obtained by any available judicial process;
3. The party who the original document would be offered against had control of the original, was put on notice that the original would be a subject of proof at the trial or hearing, and fails to produce it; or
4. The writing, recording or photograph is not closely related to a controlling issue in the case.

Once a party shows that one of these four exceptions is applicable, the content of the writing, recording or photographic evidence can be shown through secondary evidence.

The Federal Rules of Evidence contain three further rules that are not necessarily exceptions to the rule but provide clarification on non-applicability of the rule to some categories of evidence.

A party does not need to introduce an original public record into evidence because removing the original of a public record is simply not practical and could be an inconvenience. Public records can be proven with a copy of an official record, or of a document that was recorded or filed in a public office, when:

1. The record or document is otherwise admissible; and
2. The copy is certified as correct; or a party who has compared the copy to the original testifies that the copy is correct.

Large or voluminous writings, recordings or photographic evidence are also treated differently because reviewing the originals would be inconvenient to the court. For this type of evidence, the party offering it may provide a summary, chart or calculation to prove its content. The party offering the summary, chart or calculation must make the original or a duplicate available for examination. Thus, a party may provide a summary of a large book to the court, while providing notice that the original book is available, and any party can examine it.

¹ <https://www.lawshelf.com/shortvideoscontentview/best-evidence-original-documents-rule> (last accessed 7 February 2024). This explanation references the United States codified Federal Rules of Evidence which provides good general guidance of the applicable evidence principles.

Finally, a party may use the testimony, deposition, or written statement of an opposing party to prove the content of a separate writing, recording or piece of photograph evidence when that evidence is being offered against that party.

BUSINESS RECORDS EXCEPTION

Is a statutory exception to the rule against hearsay evidence. The exception allows parties to enter regularly compiled records within an organization that meet a certain level of trustworthiness, and this exception often plays an important role in business litigation. While called the business records exception, the exception actually applies to records of organizations broadly, including non-profits like churches and hospitals.

CERTIORARI

Means a writ or order by which a higher court reviews a case tried in a lower court.

CLOSING ARGUMENTS

Also known as closing statements, are the final speeches made by attorneys to the jury (or judge in a bench trial) at the end of a trial. These arguments summarize the case, highlighting key evidence and legal principles, and persuade the fact-finder to rule in their client's favor. Attorneys cannot introduce new evidence during closing arguments; they can only discuss evidence presented during the trial.

Closing arguments are a crucial opportunity for attorneys to synthesize the evidence, explain its significance, and persuade the jury to interpret it in a way that supports their client's position.

COST PLUS METHOD

Is a pricing strategy where a selling price is determined by adding a predetermined percentage markup (the "plus") to the total cost of producing a product or service. This ensures that all costs are covered, a profit margin is achieved, and the final price reflects what an independent party would charge for a similar transaction, especially in transfer pricing contexts.

CROSS-BORDER TRANSACTIONS

Are financial transactions where the payer and recipient are located in different countries. These transactions involve the transfer of funds across international borders, often using different currencies and payment systems. They are essential for facilitating international trade, investments, and personal remittances.

CROSS-EXAMINATION

Is the process in a trial or hearing where a lawyer questions a witness who has already testified for the opposing side, typically to challenge their testimony, uncover inconsistencies, discredit their credibility, or elicit information that supports their own case. This interrogation, which usually occurs after the witness's initial "direct examination" by their own side's attorney, is limited to matters brought up in the direct examination and often involves leading questions.

CUP METHOD

Or Comparable Uncontrolled Price method, is a transfer pricing technique for determining arm's-length prices for transactions between related entities by comparing them to the prices in similar transactions between independent parties. This traditional transaction method is considered a cornerstone of transfer pricing and is highly reliable when sufficient, comparable data can be found, as it directly aligns internal prices with market standards and helps prevent tax disputes and profit shifting.

DEMONSTRATIVE EVIDENCE

Demonstrative evidence can be objects, pictures, models, displays, or other devices used in a trial or hearing to support facts that the party is trying to prove.

DEMPE

Is Development, Enhancement, Maintenance, Protection, and Exploitation. It's a framework used in transfer pricing to analyze how multinational enterprises (MNEs) create value through intangible assets and allocate profits accordingly. It focuses on identifying which entities within a group perform these key functions and how their contributions should be rewarded.

DISCOVERY

To begin preparing for trial, both sides engage in discovery. This is the formal process of exchanging information between the parties about the documentary evidence they will present at trial relevant to the tax dispute. The parties are expected to discover all relevant documents, and failure to do so can elicit a court order compelling them to do so. If one party suspects the other party has certain relevant documentary evidence relevant to the tax dispute, they can give notice for that documentary evidence to be produced. Discovery enables the parties to know before the trial begins what evidence may be presented. It is designed to prevent "trial by ambush," where one side does not learn of the other side's evidence or witnesses until the trial, when there is no time to obtain answering evidence. Discovery gives each party the opportunity to review (oftentimes extensive documents) documentary evidence from the other side in preparing for trial. This is sometimes where the "smoking gun" can be uncovered!

DOCUMENTARY EVIDENCE

Means documentary evidence is evidence that contains a record of some kind. Documents may be admitted as evidence in court, but there are rules in place to determine their admissibility, and to help the court to decide what the documents prove.

DOMESTIC LEGISLATION

Refers to laws and regulations created and enforced within a specific country's national or local jurisdiction. It encompasses the entire body of laws that govern the conduct of individuals, organizations, and entities within that nation's borders. Unlike international law, which governs relations between countries, domestic legislation provides the legal framework for how a society is structured and how its people interact.

DOMESTIC TRANSACTIONS

Are financial exchanges that occur entirely within the borders of a single country, involving local banks, currencies, and payment systems. These transactions can include everyday purchases, fund transfers, bill payments, and cash withdrawals, and are typically faster and cheaper than cross-border transactions because they don't require currency exchange or complex international regulations.

DOUBLE TAX TREATY OR DOUBLE TAX AGREEMENT ("DTA")

Is an agreement between two countries to avoid or mitigate double taxation. Such treaties may cover a range of taxes including income taxes, inheritance taxes, value added taxes, or other taxes.[2] Besides bilateral treaties, multilateral treaties are also in place. For example, European Union (EU) countries are parties to a multilateral agreement with respect to value added taxes under auspices of the EU, while a joint treaty on mutual administrative assistance of the Council of Europe and the Organisation for Economic Co-operation

and Development (OECD) is open to all countries. Tax treaties tend to reduce taxes of one treaty country for residents of the other treaty country to reduce double taxation of the same income.

EXPERT EVIDENCE

Is an opinion given by a witness with specialized knowledge or skills (an expert witness) on a matter outside the typical experience of a judge or jury. Its purpose is to help the court understand complex issues by providing information and drawing inferences that a layperson could not. For this evidence to be admissible, it must be relevant to the case and based on established facts or assumptions, with the expert acting as an independent, unbiased source of assistance to the court.

EXPERT REPORT

Is a written document created by a qualified expert to provide impartial opinions and detailed findings on a subject relevant to a legal dispute. The report includes the expert's qualifications, the facts reviewed, the methods used, their conclusions, and the reasoning behind them, with the goal of assisting the court or decision-makers in understanding complex technical issues.

EXPERT WITNESS

Means an expert witness is a person with specialized knowledge, skills, education, or experience in a particular field who is called upon to provide their expertise in legal proceedings to assist the court with understanding complex technical or scientific issues. Each party selects their own expert witness, and those experts are usually paid a fee for their consultation and their testimony. A person who is designated as an expert witness must be qualified on the subject of their testimony.

FACTUAL WITNESS

Means a person with knowledge about the relevant facts in a particular case who appears before an arbitral tribunal, through a witness statement and potentially in person, to provide testimony pertaining to the facts.

FUNCTIONAL ANALYSIS

The functional analysis is used for transfer pricing purposes. It analyzes the functions performed (taking into account assets used and risks assumed) by associated enterprises in a transaction. In order to determine arm's length transfer pricing, multinational enterprises (MNEs) must identify, by means of a functional analysis, which members of the MNE group perform or exercise control over functions, provide assets and assume risks associated with the transaction. The functional analysis is a way of structuring and organizing factual information about the functions and roles of the related parties in a transaction, providing an understanding of the functional profiles of the parties to the transaction.

The functional analysis is important as it provides an overview of value creation within the supply chain in general and the related party transaction in particular. It provides an understanding of the relative contributions of the parties to the transaction and their roles in overall value creation.

HABIT EVIDENCE

Is a term used in the law of evidence in the United States to describe any evidence submitted for the purpose of proving that a person acted in a particular way on a particular occasion based on that person's tendency to reflexively respond to a particular situation in a particular way. Habit evidence must be distinguished from character evidence, which seeks to show that a person behaved in a particular way on a particular occasion based on that person's prior bad acts, or based on the opinion of a witness, or based on that person's reputation in the community. Such character evidence is generally inadmissible.

HEARSAY EVIDENCE

Is an out-of-court statement offered to prove the truth of whatever it asserts. Hearsay evidence is often inadmissible at trial. However, many exclusions and exceptions exist. For something to be hearsay, it does not matter whether the statement was oral or written.

“Hearsay evidence exceptions” some key hearsay exceptions in U.S. law, which are similar in many common law jurisdictions, including the U.S. Federal Rules of Evidence, South Africa and England:

- **Present Sense Impression:** A statement describing or explaining an event or condition made while the declarant was perceiving the event or immediately thereafter.
- **Excited Utterance:** A statement relating to a startling event or condition made while the declarant was under the stress of excitement caused by the event or condition.
- **Then-Existing Mental, Emotional, or Physical Condition:** A statement of the declarant’s then-existing state of mind, emotion, sensation, or physical condition (such as intent, plan, motive, design, mental feeling, pain, or bodily health).
- **Statements for Medical Diagnosis or Treatment:** Statements made for purposes of medical diagnosis or treatment describing medical history, or past or present symptoms, pain, or sensations, or the inception or general character of the cause or external source thereof, insofar as reasonably pertinent to diagnosis or treatment.
- **Recorded Recollection:** A record that is on a matter the witness once knew about but now cannot recall well enough to testify fully and accurately, made or adopted by the witness when the matter was fresh in the witness’s memory and accurately reflects the witness’s knowledge.
- **Records of a Regularly Conducted Activity (Business Records):** Records of acts, events, conditions, opinions, or diagnoses made at or near the time by—or from information transmitted by—someone with knowledge, kept in the course of a regularly conducted activity of a business, organization, occupation, or calling, whether or not for profit.
- **Absence of a Record of a Regularly Conducted Activity:** Evidence that a matter is not included in records kept in accordance with the business records exception if the evidence is admitted to prove the matter did not occur or exist.
- **Public Records:** Records, reports, statements, or data compilations, in any form, of public offices or agencies, setting forth the activities of the office or agency, matters observed pursuant to duty imposed by law as to which matters there was a duty to report, or factual findings resulting from an investigation made pursuant to authority granted by law.
- **Public Records of Vital Statistics:** Records or data compilations in any form of births, foetal deaths, deaths, or marriages, if the report thereof was made to a public office pursuant to requirements of law.
- **Absence of Public Record:** Evidence that a matter is not included in public records, reports, statements, or data compilations, in any form, if the evidence is admitted to prove that the matter did not occur or exist.
- **Ancient Documents:** Statements in a document that was prepared before January 1, 1998, and whose authenticity is established.
- **Market Reports and Commercial Publications:** Market quotations, lists, directories, or other compilations generally used and relied upon by the public or by persons in particular occupations.
- **Statements in Learned Treatises, Periodicals, or Pamphlets:** Statements in a treatise, periodical, or pamphlet if the statement is established as a reliable authority by the testimony or admission of an expert witness or by judicial notice.
- **Reputation Concerning Personal or Family History:** A reputation among a person’s family by blood, adoption, or marriage—or among a person’s associates or in the community—concerning the person’s birth, adoption, marriage, divorce, death, legitimacy, relationship by blood, adoption, or marriage, ancestry, or other similar fact of personal or family history.
- **Reputation Concerning Boundaries or General History:** A reputation in a community—arising before the controversy—concerning boundaries of land in the community or customs that affect the land, or concerning general historical events important to that community, state, or nation.
- **Reputation as to Character:** A reputation among a person’s associates or in the community

concerning the person's character.

- **Judgment of a Previous Conviction:** Evidence of a final judgment of conviction if the judgment was entered after a trial or guilty plea, the conviction was for a crime punishable by death or by imprisonment for more than a year, the evidence is admitted to prove any fact essential to the judgment, and when offered by the prosecutor in a criminal case for a purpose other than impeachment, the judgment was against the defendant.
- **Judgment as to Personal, Family, or General History, or Boundaries:** A judgment that is admitted to prove a matter of personal, family, or general history, or boundaries, if the matter was essential to the judgment and could be proved by evidence of reputation.
- In South African and English law, the hearsay rule and its exceptions are governed by similar principles but are codified differently.

South African Law: Under the Law of Evidence Amendment Act 45 of 1988:

- Hearsay evidence may be admitted if the court is of the opinion that it should be admitted in the interests of justice, considering the nature of the proceedings, the nature of the evidence, the purpose for which the evidence is tendered, the probative value of the evidence, the reason the evidence is not given by the person upon whose credibility the probative value depends, any prejudice to a party which the admission of such evidence might entail, and any other factor which should be taken into account.

English Law: Under the Civil Evidence Act 1995 and Criminal Justice Act 2003:

- Hearsay evidence is generally admissible in civil proceedings if it is relevant, and in criminal proceedings under certain conditions such as if the maker of the statement is unavailable, the statement is in a document, or the statement is made in circumstances which would make it reliable.

In all these legal systems, the underlying principle is to balance the need for reliable evidence with the practicalities of litigation, ensuring that justice is served through fair and consistent application of the rules. "Interpretation" involves scrutinizing legal texts such as the texts of statutes, constitutions, contracts, and wills.

IN LIMINE APPLICATION

Means a pretrial motion that seeks the exclusion of specific evidence or arguments from being presented during a trial. A motion *in limine* is a strategic legal tool used to manage and control the evidence presented in court, to address and resolve evidentiary and procedural issues before the trial, ensuring a fair and efficient judicial process.

Examples:

- Challenging the admissibility of evidence obtained unlawfully.
- Raising objections to the jurisdiction of the court.
- Addressing issues related to procedural fairness.

INTERPRETATION

Involves scrutinizing legal texts such as the texts of statutes, constitutions, contracts, and wills.

INTERPRETATION NOTES

Refers to the juridical understanding of legislation and case law, rules and principles used to construct its meaning for judicial purposes. Broadly speaking there are three means by which and through which to construe statutory law: linguistics or semantics, common law and jurisprudence. Although statutory interpretation usually involves a personal predisposition to the text, the goal is generally to "concretise" it: to harmonise text and purpose. This is the final step in the interpretative process. Statutory interpretation is broadly teleological, comprising as it does first the evaluation and then the application of enacted law.

INTERQUARTILE RANGE

Means In transfer pricing, the interquartile range (IQR) is a statistical tool used to narrow down a range of comparable data points to enhance the reliability of an analysis. It represents the middle 50% of a dataset, specifically the range between the first quartile (25th percentile) and the third quartile (75th percentile).

JUDICIAL REVIEW

Means the power of the courts of a country to examine the actions of the legislative, executive, and administrative arms of the government and to determine whether such actions are consistent with the constitution.

JURISDICTIONAL FACTS

These are facts which must objectively exist before a statutory power can be exercised by a decision-maker. They are created by and operate in the context of government authority produced by a statute and are linked to the legal concept of jurisdiction.

LAW OF EVIDENCE AMENDMENT ACT 45

Is a South African statute that primarily amended the rules of evidence by allowing for judicial notice of foreign and indigenous law and for the admissibility of hearsay evidence under certain conditions, including if it's in the interest of justice. It also provides specific rules for applying indigenous law and taking judicial notice of it in court.

LEGITIMATE EXPECTATION

in public or administrative law, a legitimate expectation is a clear, unambiguous and unqualified assurance, understood by those to whom it is given that a particular course of action will be taken or a particular procedure will be followed. If a failure to do so would be unfair or an abuse of power, it may be susceptible to judicial review. Broadly, a legitimate expectation may be either procedural or substantive.

LETTER OF ENGAGEMENT

Is a formal, legally binding written agreement between a professional service provider and a client that outlines the scope of services, terms, conditions, fees, and expectations for their business relationship. It defines the legal and professional relationship, provides clarity on responsibilities for both parties.

LETTER OF FINDINGS

Means a letter or document setting forth the determination to be made by a Revenue authority at the conclusion of a tax audits with proper reasons for the proposed determination (or decision to issue revised/ amended tax assessments).

INTERQUARTILE RANGE

Means In transfer pricing, the interquartile range (IQR) is a statistical tool used to narrow down a range of comparable data points to enhance the reliability of an analysis. It represents the middle 50% of a dataset, specifically the range between the first quartile (25th percentile) and the third quartile (75th percentile).

OECD MODEL TAX CONVENTION

A draft model double taxation convention, including commentary on each article of the convention, first published by the Organisation for Economic Co-operation and Development (OECD). The model convention is intended to provide a basis for double taxation agreements (DTAs) between OECD member countries and many DTAs follow the articles in the model convention quite substantially. HMRC and the UK courts may, in certain circumstances, use the guidance in the commentary to the model convention as an aid to interpretation of a DTA.

OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” provides guidance on the application of the “arm’s length principle”, which is the international consensus on transfer pricing, i.e. on the valuation for tax purposes of cross-border transactions between associated enterprises. In a global economy where multinational enterprises (MNEs) play a prominent role, transfer pricing continues to be high on the agenda of tax administrations and taxpayers alike. Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic double taxation that may result from a dispute between two countries on the determination of the arm’s length remuneration for their cross-border transactions with associated enterprises.

PAROL EVIDENCE RULE

Prevents the introduction of evidence of prior or contemporaneous negotiations and agreements that contradict, modify or vary the contractual terms of a written contract when the written contract is intended to be a complete and final express of the parties’ agreement. Even if parties later agree that they had a conversation creating, for example, a “side agreement” that was not included in the original written contract, and the side agreement contradicts the written contract (e.g. by changing the delivery date or price of a purchase), the additional or different terms included in the side agreement may not be enforced by the court. There are two exceptions to the parol evidence rule: the collateral contract exception and the ambiguity exception.

PERMANENT ESTABLISHMENTS

Is a fixed place of business that generally gives rise to income or value-added tax liability in a particular jurisdiction. The term is defined in many income tax treaties and in most European Union Value Added Tax systems.

PROFIT SPLIT METHOD (‘PSM’)

Is a transfer pricing approach where the combined profits or losses of related companies from a controlled transaction are divided between them based on their relative contributions and risks, following the arm’s length principle. It is used for highly integrated transactions, such as joint ventures developing unique intellectual property, where the contributions are intertwined and cannot be evaluated separately. The method ensures each entity receives a fair profit share commensurate with its functions, assets, and risks.

PROPER DOCUMENTATION

Consists of records that are complete, accurate, clear, timely, and suitable for their intended purpose, providing evidence or proof of something while ensuring consistency and adherence to regulations or guidelines. Key characteristics include being comprehensive, understandable, and well-organized, with information recorded contemporaneously and kept up-to-date. In professional settings, like healthcare or

law, it supports quality care, ensures compliance, and protects against liability, while in other fields, it serves to inform, track progress, and provide a clear audit trail.

REAL EVIDENCE

Also known as physical evidence, is a tangible object presented in court to prove or disprove a fact in a case. It's any physical item that has a direct connection to the event or issue being litigated.

"Residual exception" - is a legal rule of evidence, primarily found in Federal Rule of Evidence 807 (FRE 807), that allows a court to admit hearsay—an out-of-court statement offered for its truth—even if it doesn't fit into any of the established hearsay exceptions. This "catch-all" provision is a last resort for highly reliable and necessary statements that serve the interests of justice, requiring a case-by-case determination of trustworthiness, materiality, probative value, and proper notice to the opposing party.

RULES OF EVIDENCE

Are a set of laws and legal principles that determine what facts can be presented in a court of law and how they are presented, aiming to ensure fairness and accuracy in judicial proceedings. These rules dictate the relevance, reliability, and admissibility of information, with specific rules governing topics such as hearsay, expert testimony, the authentication of documents, and the privilege of certain communications. The specific rules can vary significantly by jurisdiction.

SARS INTERNAL AUDIT MANUAL

Describes the underlying principles, standards and code of ethics for the professional practice of internal auditing, and describes SARS's audit management process from planning and preparation to the performance of the audit, reporting of results and follow-up of recommendations.

SECONDARY EVIDENCE

This is any form of evidence that is not the original document or object itself but is introduced to establish the contents or existence of the original when the original cannot be produced. It includes copies, summaries, oral testimony, or reconstructions. For example, a photocopy of a document or photograph would be considered secondary evidence.

It becomes admissible only when primary evidence (e.g., the original document or recording) is shown to be lost, destroyed, or otherwise unobtainable without bad faith by the party offering the evidence. Secondary evidence is not inherently inadmissible—but it requires justification.

- It must be reliable and introduced only when primary evidence cannot be produced for valid reasons.
- Courts evaluate the credibility, accuracy, and necessity of secondary evidence before admitting it.

TAX ADMINISTRATION LEGISLATION

Is the body of law that governs the actions and powers of public authorities and government agencies. It defines how these bodies should be organized, what functions they perform, and how they exercise their powers, ensuring they act efficiently, fairly, and without abuse. Key aspects include the creation of regulations, the enforcement of laws, and the process for making decisions that affect the public.

TESTIMONIAL EVIDENCE

Is statements made under oath by a witness in a legal proceeding to prove a fact in a case. This evidence is based on a witness's personal knowledge, meaning they directly perceived the event or fact through their senses, and is presented in court through their testimony. This can include ordinary witnesses or expert

witnesses who offer opinions based on their specialized knowledge to help the court understand complex matters.

TRANSACTIONAL NET MARGIN METHOD ('TNMM')

The transactional net margin method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled transaction (or transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12). Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods.

TRANSFER PRICING LEGISLATION

Means in country legislation promulgated to implement transfer pricing provisions usually allowing the revenue authority to impute “fictitious” income where the offending taxpayer has failed to properly account for an “arm’s length” price or amount to be attached to a transaction ascribing the “arm’s length” price or amount to that offending taxpayer.

TRANSFER PRICING METHODOLOGY

Is used to calculate or test the arm’s length nature of prices or profits. Transfer pricing methods are ways of establishing arm’s length prices or profits from transactions between associated enterprises.

TRANSFER PRICING STUDY

Examines the pricing of transactions between related two or more associates. By applying and documenting various test methods, it is determined whether the transactions are conducted under market conditions and survive the scrutiny of tax authorities.

TRANSFER PRICING TAX AUDIT

An examination conducted by tax authorities to ensure that transactions between related entities of a multinational enterprise (MNE) comply with the arm’s length principle.

ULTRA VIRES ACTION

Is a Latin phrase meaning “beyond the powers,” and it refers to an action taken by an organization or public authority that exceeds the legal or authorized limits of its power. Such actions are considered unlawful and may be declared void or unenforceable because they were taken without proper legal authority, violating corporate charters, bylaws, or statutes. This doctrine acts as a safeguard to ensure that entities and officials stay within the scope of their legal authority and do not overstep their bounds.

UN TRANSFER PRICING GUIDELINES

Provides guidance from the United Nations on the application of the “arm’s length principle”, in line with the “OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations”.

CHAPTER 1

INTRODUCTION

Having prepared for and argued at numerous transfer pricing trials, I thought it a good idea to commit my experiences to paper. As sort of a guide to others about to travel this path in a tumultuous world where revenue authorities are looking to maximize their tax collections.

The aim of this book is to increase awareness about the critical importance of preparing comprehensive documentation for transfer pricing trials. It emphasizes that transfer pricing practitioners must go beyond merely preparing a transfer pricing study, local file, or master file. They must also ensure that all supporting documentation, such as surveys and interviews, is accessible and available. The taxpayer should leverage their intimate knowledge of the facts, as the tax authority relies on the information provided by them. It's crucial to ensure that these facts are accurate and consistently presented in a manner that strengthens the taxpayer's case. The opportunity to leverage these facts may diminish by the appeal stage, so it's essential to maximize this advantage during the documentation, audit, and initial trial phases. This strategic approach can significantly impact the outcome, making thorough and precise documentation a key element in the taxpayer's defence.

The necessity for robust supporting documentation, such as interviews and surveys, is driven by a need to comply with the rules of evidence, which are crucial for determining what documentation must be prepared. The book guides readers through a chronological process, from considering the requisite documentation and answering initial tax authority questions to preparing for audits. It offers practical recommendations to avoid or mitigate the likelihood of progressing from audit to trial. If a trial is inevitable, the book outlines the necessary preparatory steps, emphasizing the importance of understanding the laws of evidence, constitutional, and administrative law. It underscores that an experienced attorney should ensure the laws of evidence are applied favourably to the taxpayer's case and that tax authorities conduct themselves lawfully. In the event of an unfavourable trial outcome, the book advises on conducting a cost-benefit analysis to decide on an appeal. It provides practical advice on the appeal process, the limitations of constitutional and administrative law in appeals, judicial review, and lessons from other cases. The rules of evidence remain relevant but appeals focus more on legal interpretation than new facts. Additionally, the book discusses messaging and managing reputational risks associated with trials or appeals.

In the field of taxation, going to tax court (if you have not been successful with an objection) is an appeal. What then is a further appeal? In a typical tax case that has gone the litigation route, if the objection is unsuccessful, the first tax appeal is the tax trial. This is where the evidence (including expert evidence) is tested in court between the taxpayer appellant and the revenue authority respondent. Your typical TP trial will take at least 3 weeks in the tax court to work through the evidence. The taxpayer appellant will start. Their evidence will be cross-examined and challenged by the revenue authority legal team in the tax court. Then it's the revenue authority respondent's turn. The taxpayer appellant then has the opportunity to cross-examine the evidence presented by the revenue authority. Usually this consists of the expert evidence presented by their experts, challenging the taxpayer's the arm's length price (ALP) and supporting evidence. Both parties then have the opportunity to present closing arguments. Then there is the trial judgment. An example is the first major TP case in South Africa, ABD Ltd v CSARS, case 1403 of 2024 (ABD Case or ABD) - see **Appendix N**

for a copy of the judgment).

Much of this book is related to this trial and its preparation, so I urge you to read the judgment. What you will find, is that despite 3 weeks of trial and much time spent defending the taxpayer's ALP and supporting evidence on the profit-split method (PSM), the court did not comment much on that, but rather deferred to the supporting internal CUP used to support the ALP. The court also critiqued the revenue authority's proposed methodology advanced by their latest (out of a string of previous experts) expert witness.

After the tax trial, the losing (or winning party if dissatisfied with a portion of the tax court judgment) can appeal the tax court judgment to a higher court. Oftentimes that is a High Court. However, application must be made to the tax court for approval that the judgment go on appeal. This is usually granted by the judge who presided over the tax trial. Sometimes the appeal can be made directly to the highest court, the Appellate Division (in South Africa the Supreme Court of Appeal – "SCA"). In the ABD case SARS appealed as the appellant to the SCA. The tax trial judge approved of the appeal application for the matter to go on appeal to the SCA. SARS were dissatisfied with the acceptance of the internal CUP as support for the taxpayer's ALP, and the fact that the court did not accept their latest expert's PSM methodology over that of the taxpayer in support of their ALP. The trial judge would have accepted that these are complex principles at play and acknowledged that justice would be best served if an appeal court reviewed the evidence presented in the case to check if they agree with his judgment. The outcome may be a full agreement, a partial agreement with some amendments, or a overturning of the judgment replaced with a new one. However since then SARS has withdrawn the SCA appeal, meaning ABD Ltd has won.

In rare occasions (such as in South Africa, there is the Constitutional Court) a tax case, after going the appellate division route to the SCA, can be referred to the Constitutional Court to pass judgment on a constitutional issue or one that is in the public interest.

What would be a constitutional question or public issue interest? In the ABD case, a technical issue was that the DTA provision on finalising the MAP process first was argued. It was argued that before a revised assessment can be executed the MAP process with other States had to be finalised, as that agreement overrides any revised assessment (and judgment) in South Africa. If the SCA were to find against the taxpayer and ignore the MAP principle, then an application could be made to the Constitutional Court stating that the overriding principles in an international treaty have been ignored by the SCA, in contravention of the Constitution.

The tax world changed substantially in the BEPS era of the early 2020's where much focus was placed on profit shifting within multi-national entities or MNE's. In all the countries I have worked in the field of transfer pricing or TP, revenue authorities have bolstered their legislation with transfer pricing provisions. In some countries they have extended the interpretation¹ and influence of their longstanding general anti-avoidance provisions² to extend to TP adjustments – fictitious tax income is deemed to be actual income shifted in a tax-saving series of transactions. The effect is the application of TP adjustments preceding the new TP provisions in the legislation, with manipulated judgments to boot. The development into this arena has become increasingly popular with many tax authorities.³

¹ See Glossary of Terms.

² In Zimbabwe, the Special Court for Income Tax Appeals, concluded that section 98 of the Income Tax Act [Chapter 23:06], which is an anti-avoidance provision, could be used to effect transfer pricing adjustments, thereby applying the provision to tax fictional income. See SDC Ltd (2) v Zimra (21-HH-338) in this regard.

³ In the Zimbabwean judgment of Commissioner of Taxes v Ferera 1976 (2) SA 653 (RAD) Macdonald JP at 659A said "It is equally absurd to suggest that the Legislature could possibly have intended, as has sometimes been suggested, that taxpayers would not be subjected to those powers if the means or the manner employed to avoid, postpone or reduce tax was a means or manner normally employed for this purpose." The court went further to say that "I endorse the opinion expressed that the avoidance of tax is an evil. Not only does it mean that a taxpayer escapes the obligation of making his proper contribution to the fiscus, but the effect must necessarily be to cast an additional burden on taxpayers who, imbued with a greater sense of civic responsibility, make no attempt to escape or, lacking the financial means to obtain the advice and set up the necessary tax avoidance machinery, fail to do so. Moreover, the nefarious practice of tax avoidance arms opponents of our capitalistic society with potent arguments that it is only the rich, the astute and the ingenious who prosper in it and that 'good citizens' will always fare badly. While undoubtedly the short term effects of the practice are serious, the long term effects could be even more so."

At the time of writing, I am and have been involved in transfer pricing related disputes in South Africa, Zimbabwe, Zambia, Malawi, Tanzania, Nigeria, Ghana, and Uganda. All emerging African economies. All these jurisdictions have sought the OECD Transfer Pricing Guidelines⁴ as guidance. But in certain circumstances they have sought to argue that the OECD Transfer Pricing Guidelines are not applicable to justify their recalculation of taxpayers' transfer pricing related income in raising additional assessments.⁵

This book is aimed at transfer pricing (TP) specialists that have the requisite knowledge and experience in TP but have not necessarily been exposed to litigation. However, the appendices are there to supplement the reading material where the reader lacks the requisite knowledge.

When tax disputes go to trial oftentimes the advocates hired to represent their clients are not specialists in this international tax arena, albeit they are good lawyers. Thus, the approach tends to be quite myopic around what the legislated provision states, and in particular the meaning of an "arm's length price" or ALP. It is reduced to simply what an independent supplier is prepared to charge to an independent buyer. And there are many ways to make that determination in interpreting the basic words of the legislation. Thus, when the argument is presented, it is not necessarily dictated to by the OECD Transfer Pricing Guidelines, or the UN Transfer Pricing Guidelines.⁶ Why are there guidelines better than any other number of processes to determine an ALP? Such as those used in competition law disputes around areas such as the "willingness to pay" or the "price premium". All of which are totally acceptable valuation models used in other areas of law.

Lawyers (including judges) tend to focus on those areas of law they are comfortable with when analyzing facts and applying the principles of law, developed by the interpretations of words and phrases they are used to applying.

The OECD and UN Transfer Pricing Guidelines⁷ provide a framework for ensuring that transfer pricing practices are consistent with international standards, helping to prevent tax evasion and double taxation.

The judges that face the taxpayer and revenue authorities to reason out who is right are mostly inexperienced and unknowledgeable in the field of transfer pricing.⁸ The pride of these lawyers is aptly overcome with: "Well, transfer pricing as a specialized field is no different to other areas of specialization we adjudicate upon, such as engineering and medicine. We do not have to be specialists in those fields to judge. We have expert witnesses⁹ to assist us in this regard."

There is truth in this statement, but as transfer pricing legislation¹⁰ and the OECD and UN Transfer Pricing Guidelines are written specifically to guide transfer pricing related tax disputes, it places transfer pricing on a different footing. This will become apparent in this book and part of the reason why I decided to write it.

This book is not supposed to be a technical piece of writing that analyses the OECD and UN TPGs and the tomes of articles available to research and analyze. It is a simple treatise to give practical guidelines on how to go about preparing for and conducting a TP trial, incorporating research that I have done over the years in gathering the technical expertise to proceed with TP trials. In the process the book takes an unusual format in that I cross-reference to many Appendices, some of which are detailed explanations of areas of law (with examples) that are relevant to that step in the overall process. I have also incorporated some case studies to give examples in the overall process.

The book is primarily published in electronic format, as I expect many areas will change frequently and

4 See Glossary of Terms.

5 Tanzania Revenue authority and Zimbabwe Revenue authority.

6 See Glossary of Terms.

7 See OECD TPG 2022, Chapter I, paras 1.6 – 1.11 – Rationale: These explain the framework and intent of the OECD Guidelines

8 NEWS ANALYSIS Reviewing Transfer Pricing's Standard Of Review After Coca-Cola by Ryan Finley at page 861: *Tax Court judges generally have no particular expertise in economic theory or valuation principles, and vesting them with unchecked discretion to dictate the best transfer pricing method is questionable policy.* TAX NOTES INTERNATIONAL, VOLUME 106, MAY 16, 2022.

9 See Glossary of Terms.

10 See Glossary of Terms.

extensively. It is also hoped that revising the book annually will elicit comments from interested readers to improve the content and its practical value.

CHAPTER 2

THE TRANSFER PRICING STUDY STARTING POINT

SETTING THE BACKGROUND TO THIS BOOK AND THE LEGAL LANDSCAPE

What is the starting point?

If you are new to TP, then it is essential that you master the OECD Transfer Pricing Guidelines (TPGs)¹ and align them with legislation, regulations, and rules of the countries you are involved with. The scope of this book does not cover these basics but there is an introductory course available through the Academy of Tax Law (www.academyoftaxlaw.com).

There are various Appendices to this book aimed at giving more insights to the reader about fundamental principles underpinning TP. The Appendices draw from research I have conducted in my TP trial preparation and oftentimes are extracts or quotes from sources I researched. I make the raw research available to you to assist you in your endeavors to master this journey.

There are many Appendices dedicated to tax risk management and tax audits. These should be reviewed by all. All multi-nationals should have the requisite tax risk steering committee written about. This will prepare them properly for any ensuing tax audits. See **Appendices D to L**.

Then there are several Appendices dealing with evidence. Evidence required at a tax trial. The quality of this evidence is very different to what TP experts are accustomed to dealing with. There is much more detail. See **Appendices C1 to C4** and read these through in addition to what I write in the book. Focus on hearsay evidence and any exceptions, secondary evidence, and the parole evidence rule.

This book was inspired by my participation in various TP trials, culminating in ABD Ltd v CSARS, case 1403 of 2024 (ABD Case or ABD). See **Appendix N** for a copy of the judgment.

You would do well to read the interviews of the 2 advocates employed in this case at Appendices A and B, together with the transcripts of the expert witnesses giving evidence at **Appendices N1 to N5**. These transcripts will illustrate in practice how difficult evidence is in a TP trial, and how it is tested.

Lastly, the case studies at the end of the book are some of the more difficult TP trials I was involved in. The judgments and notes set out the challenges faced, and lessons learned.

WHAT DOES TRANSFER PRICING TYPICALLY APPLY TO?

You will find that the most legislation where transfer pricing provisions exists in country apply only to cross border transactions. However, in some instances, such as the European Union, Nigeria and Zimbabwe, the

¹ See OECD Transfer Pricing Guidelines 2022, Preface paras 1-6; Chapter I, para 1.6. Rationale: These paragraphs introduce the purpose and role of the Guidelines. These paragraphs introduce the purpose and role of the Guidelines.

TP provisions also apply to in-country transactions between associated persons. And then there will be instances around the world where not only are cross border transactions impacted by transfer pricing, but in country domestic transactions may also be impacted.

What cross-border transactions or domestic transactions would typically be impacted by transfer pricing legislation?

The next step is to determine whether the transactions are taking place between associated enterprises or connected persons. The term of art used internationally is associated enterprises but often you will find that the domestic legislation refers to connected persons. The two concepts are one and the same and this would typically include relationships between head office and branches, head office and permanent establishments and obviously head office and subsidiaries. It is obvious that a lot of subsidiaries if they fall within the purview of associated enterprise or connected person would automatically fall within the scope of transfer pricing.

You are going to look for what cross-border transactions and domestic transactions are impacted by the transfer pricing legislation and then you must determine whether your transacting parties fall within associated enterprise definitions or connected persons definitions and be very sensitive to head office transactions with branches. A branch is just an extension of the head office or company. The primary company or the primary company or head office or permanent establishment, which is like a branch scenario. Permanent Establishment as you should now should be a business place that is situated typically in another country where the head office situated let us say in the USA is actually transacting business on an ongoing basis, let us say in Lithuania, as an example, and the Lithuanian business transaction being driven out of the United States, would be considered depending on the domestic legislation and also depending on the existing of any Double Tax Treaties between those two countries would typically be a permanent establishment and those entities would be impacted by the transfer pricing legislation as well.

Therefore, it is not just two separate legal entities such as the head office and parent company and a subsidiary company that would be impacted by transfer pricing, it would also be a parent company and head office that may conduct a branch activity in another country. That branch may for all intense purposes be considered from an artificial point of view to be a separate entity and thus transfer pricing provisions would apply to any transactions between those. And then you would have the head office or parent company and the permanent establishment where same thing applies. The permanent establishment is just an extension of the parent company in the United States extended into Lithuania, however, because the permanent establishment is regarded artificially as a separate entity for tax purposes transfer pricing provisions would be applied to transactions between those two entities.

It is very important to understand what the associated enterprise or connected persons definition means being a domestic legislation.

Then if those two requirements are met typically the legislation will say that the arm's length tax standard or test will then be applied to the transactions that take place between my example of a parent company in the United States and a subsidiary or branch or permanent establishment in Lithuania.

What is "arm's length"? "Arm's length" is typically not defined in any of the legislation. There may be exceptions. The interpretation would depend on the approach of the domestic courts to what those words mean. And that in turn is influenced by the underlying legal system that applies to that country.

The legal system of Lithuania would be different to the underlying legal system of the United States of America and that it is going to determine the approach to interpretation. For instance, the United States typically is a common law country, and the term "arm's length" would be determined by looking not only at case law but in America much of the interpretation given to provisions of the interim revenue code is driven by Treasury Regulations that are promulgated and so the courts defer to what those Treasury Regulations say. The

United States Internal Revenue Code section 482 of contains about a four- or five-line provision for transfer pricing. That provision is then expanded and explained in hundreds of pages in transfer pricing regulations that were promulgated as Treasury Regulations under regulation 482. The regulations will go at great lengths to give examples and explain what arm's length means from an American perspective you would typically have to take into consideration. However, it may be very different in Lithuania because Lithuania's legal system falls under civil law, not common law and the subset of civil law it falls under would be what they call or term transition and post conflict countries, like what you would see in Russia, the Ukraine and other Eastern European countries.

Now, when you look at the application of the "arm's length" principle, what you need to also consider is whether the legislation drafted in such a way that an obligation is placed on the taxpayer to ensure that cross-border or domestic transactions between associated enterprises are arm's length. If the wording of the legislation is such that an obligation is placed upon you in country, let us say in this case the parent in United States, then if you are challenged by the revenue authority the onus of proof rests with you to show that the transactions you have entered into which your Lithuanian subsidiary, Lithuanian branch, Lithuanian permanent establishment that your subsidiary or branch or permanent establishment that you have done so in accordance with the arm's length principle. The onus is on you to prove that. However, in some legislation the commissioner of taxes is given a discretion in instances to determine whether or not an arm's length principle has been applied in the transactions between these associated enterprises. Now if it is a discretion, being exercised by the commissioner of taxes, as opposed to an obligation being imposed on the taxpayer where it is discretion being exercised in applying the transfer pricing provisions the argument goes that then the onus should prove that you the taxpayer have not transacted at arm's length. The onus then is on the commissioner of taxes. And that plays a very important role if the matter is ever challenged in a dispute scenario because it is then the commissioner of taxes that must show that what you have done is not arm's length, as opposed to in the former instance where the onus of proof is on you to show that what you have done is arm's length.

Now, as I said to you it is important for several reasons to understand the background legal system. There is a lot of useful information in the book "Comparative Tax Law: by Victor Thuronyi".² Typically the commonwealth family is one legal system that applies to many countries. The American family, the French family, the Latin/American family, the transition and post conflict countries family, the Northern European family, the Southern European, the Japanese/Korean family. That gives you a broad overview and it flows to page 43, which then actually specifically sets out in a listing an overview of where different countries fit into different legal systems. Under commonwealth, would typically be all the Caribbean Islands, in Africa it would be most of Southern Africa as well as some of West Africa and most of East Africa, so countries such as Kenya, Nigeria, Tanzania, Ghana, Zimbabwe, Zambia, South Africa etc. Of course, the American common law family would typically be United States, Liberia which is a West African country, the Martial Islands, and the Philippines.

Those are categorized under the broad spectrum of common law families or common law jurisdictions and what those jurisdictions are driven very much by the precedent set by higher courts. You would oftentimes deflect to the higher court decisions in determining, for instance, what the meaning of arm's length is in those jurisdictions. Bearing in mind in the case of the United States there is an additional requirement that needs to be reflected upon and considered carefully and that is the Treasury Regulations. That deals with the common law sets of families.

Then you have civil law. Civil law will typically codify everything, they historically do not rely on case law as precedent although that is changing because of the influence of international law. Do not take it for granted that a particular case is not going to influence a future case. That is starting to develop in certain jurisdictions and your civil law jurisdictions is the French, a lot of West Africa. Civil jurisdictions because of the Latin influence, the Spanish influence. Latin American countries will typically be civil law.

2 Thuronyi V Comparative Law Kluwer Law International (2003) Great Britain, Page 23.

Your transition and post conflict country, the former Soviet Union. Countries such as the Czech Republic the People's Republic of China. Those typically are considered as transition and post conflict countries that fall under the broader definition of civil law jurisdictions. But again, if you go back to Victor Thuronyi's book you will get a good understanding of where those legal systems lie for the different countries that you may be working for. And as I said it is important to understand that because it is going to influence the way in which legislation in country, domestic legislation is interpreted. It is going to influence the way in which those countries accept foreign precedent as being persuasive. In transfer pricing you will find outside of India there are very few reported cases. There are several reported cases in the United States. The United States has its own set of regulations. They are similar as both follow the arm's length principle and recommend methods to use; namely, the Comparable Uncontrolled Price (CUP) method, Resale Price Method, Cost Plus Method, Comparable Profits Method (CPM), and the Profit Split Method. However, the US has the best method rule and specific penalties for non-compliance, which are not as explicitly detailed in the OECD Guidelines. One must be careful using United States precedents in other jurisdictions. Be that as it may, United States has several important transfer pricing cases. So does Canada. Canada is part of the commonwealth group of countries under common law.

And then you have a variety of cases around the world. But the country that has by far the most reported cases in transfer pricing, more than any other country but together, is India and there you must be careful relying on that case precedent because many of the judgments that have been reported are by lower tribunals. Pay attention to the High Court and the Supreme Court decisions in India, but not the lower tribunals. The lower tribunal cases are not binding on each other. You will find many conflicting decisions and it becomes confusing.

The Starting Point

The starting point of a transfer pricing analysis is to identify the controlled transactions (i.e. the transactions between the related parties) and to conduct a functional analysis. The latter describes the functions/activities performed by each party, the assets they employ to conduct those functions and the risks assumed as part of the performance of those functions. The purpose is to understand the roles performed by each related party and to compare them to similar functions which would be conducted by unrelated parties in a similar transaction. This exercise determines the economic contributions of the parties and facilitates the process to determine how profits should be allocated and the ALP. These are the recommended steps prior to the event of a trial.

1. Begin with the annual preparation of the MNE's transfer pricing study.
 - a. The price setting process will have already taken place where the controlled transactions have been identified, a functional analysis conducted, and the appropriate transfer pricing method chosen. The transfer pricing study (often referred to as a local file) will document this information and will be part of your defense documentation.
2. Ensure compliance with local transfer pricing legislation.
3. Subject to the local legislation confirm how OECD and UN Transfer Pricing Guidelines are incorporated into the local transfer pricing rules.
4. Justify the supply of goods and services to associated entities at an arm's length price ("ALP"). The TP study should compare the controlled transactions (between associated entities) with uncontrolled transactions (between independent entities) under similar circumstances. It should factor the characteristics of the goods or services, contractual terms, economic conditions, and business strategies.

Sometimes the transfer pricing study appears to be a work of "cut and paste" of relevant terms and principles, where the real value appears from a proper detailed assessment of key variables to arrive at an ALP.³ Tax authorities are increasingly scrutinizing the actual conduct of the parties to ensure that it aligns

³ The OECD Transfer Pricing Guidelines, 2022, states at paragraph 1.13 that "...transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer."

with representations made in the transfer pricing study.⁴

Let us unpack those variables. Remember the goal is to determine the ALP at that point in time. In the absence of an ALP definition, we seek guidelines to interpret what ALP means, but in the context of what?

First, examine the activities being performed and the corresponding charges (or lack thereof) for goods and services exchanged within the MNE. The enquiry should look specifically at the parties or entities to the tested transaction (the ones being looked at to determine the ALP), and the subject matter of the transaction. The related party transaction could be, inter alia, the sale of goods or services, a financial transaction, or the use of intellectual property.

If the transaction is a license for the “use of a brand” between the supplier/licensor (brand owner) and the buyer/licensee (the brand user) pay particular attention to the following, as examples:

1. What is the brand? Determine the brand as the unique identifier the company associates with its products. It may include the name, design, tagline, reputation or way of doing things. The brand is a specific part of the entity’s intellectual property and is usually defined in the license agreement to include images that are trademarked with unique phraseology to describe the brand with particular colours and fonts, collectively representing the aesthetic “look and feel” of the brand. In addition, the factor in how the brand is represented contractually and

economically. This will determine what you will compare the transaction to and ultimately the ALP.

2. Is the use of a brand (not the sale of a brand) during a specific time period?
3. If you are not looking at a supply of a product that includes in its offering the use of the brand, then the use of the brand is not isolated in the supply of that product. A transaction offering a product with the brand is not the same as a transaction offering the mere use of the brand
4. Between which entities is the transaction? It is often a parent company supplying goods or services to an associated entity. It can also be associated entities with common ownership transaction with each other. It is not an associated entity supplying goods or services to an end consumer of a branded product. There are other elements in the latter transaction that are different to the tested transaction, eliminating the quality of comparison required in determining the ALP.

By looking at and analyzing the basic starting point of the transfer pricing study, and what it is addressing, in very specific terms, the alignment with the most appropriate OECD and UN TPGs that should apply, becomes obvious. These guidelines produce specific axioms defined as: “*a statement or proposition which is regarded as being established, accepted, or self-evidently true.*”⁵ The clear intention is that the TPG axioms exist through decades of building consensus attained by participating revenue authorities from around the globe to establish specific rules to be followed (as soft law) to standardize the process of establishing an ALP. If a revenue authority and taxpayer enter their relationship based on the OECD and UN TPGs, these established axioms in the guidelines are rules to be followed. If not, an extensive motivation by the entity breaching the rules must be provided. This only happens where there are extreme limitations in the availability of comparability factors in the process of establishing an ALP.⁶

4 “Transfer Pricing and Anti-Abuse Rules: Key Lessons from Recent Judicial Rulings” Prof. Dr. Daniel N. Erasmus, <https://www.taxriskmanagement.com>, 18 September 2024.

And “**Lessons on ALP, Economic Substance, Documentation, and Comparability Challenges - Prof. Dr. Daniel N. Erasmus**, <https://www.taxriskmanagement.com>, 28 November 2024.

5 <https://axiomdigitalpromotions.com/2022/10/11/axiom-defined/> (accessed 25 March 2025).

6 In this regard, paragraph 3.38 of the OECD TPG, 2022 states the following at paragraph 3.38: “For instance, independent transactions may be scarce in certain markets and industries. A pragmatic solution may need to be found, on a case-by-case basis, such as broadening the search and using information on uncontrolled transactions taking place in the same industry and a comparable geographical market, but performed by third parties that may have different business strategies, business models or other slightly different economic circumstances; information on uncontrolled transactions taking place in the same industry but in other geographical markets; or information on uncontrolled transactions taking place in the same geographical market but in other industries. The choice among these various options will depend on the facts and circumstances of the case, and in particular on the significance of the expected effects of comparability defects on the reliability of the analysis.”

By returning to the key starting point of a transfer pricing study and what it is supposed to represent, you become aware of the fundamentals. The fundamental facts, process, and principles.

For instance, when determining the ALP for the use of a brand, it is a specific transaction, between specific parties, for something very specific. Identify these fundamental elements as it becomes clear what must ultimately be defended and proved in court:

- The brand – what is this? A name (trademark) and/or a ‘look and feel’ (the aesthetic appearance).
- The transaction – what is this? For example, is it an agreement to use the brand (not a sale)?
- The parties – who are the parties? A supplier of the use of the brand to a buyer of the use of the brand, both are operating businesses, looking to exploit the best profits out of their bargain, on an ongoing basis. Confirm that it is not a sale requiring the valuation of an asset to determine what that sale price should be.

These basic steps are then expanded upon to determine what the OECD and UN TPGs require you to do. But with the fundamentals understood, an attempt by the revenue authority to manipulate the determination of an ALP to justify their end – an additional assessment of tax – can be thwarted.

Importance of Accurate Characterisation and Subsequent Comparables

The accurate characterization of a transaction is critical as it determines the applicable legal and tax implications, ensuring compliance and ultimately the justifiable ALP. When conducting a TP trial, one of the first hurdles is often the mischaracterisation of the transaction.

In the case of a specific brand, ABC, the supplier makes ABC available to the buyer.⁷ Say then, the revenue authority erroneously proffers an ALP determination process by valuing the brand using a ‘prime premium’ method. How does this fundamental analysis assist? In basic terms, the determination of a ‘price premium’ of a product or service looks to taking a product, comparing it to similar products in the same market, proposing a fictitious ‘no name’ product in that same market to represent the extreme price point of difference between the ABC example of product brand and the ‘no name’ product.

Then, if the ABC branded product gave rise to a US\$100 sale, this price point is taken and in a survey of consumers of the ABC product, they are asked at what price point will they switch from the ABC product to the ‘no name’ product. Let us say at US\$50, the largest price difference in that market is US\$50. So, theoretically the ABC product has a price premium of US\$50. The same exercise is conducted with the other branded products in that market. Those results should inference the final price premium result of the ABC product. Let us say the result is US\$40. The conclusion is drawn that the ABC product has a ‘price premium’ of US\$40. The conclusion is drawn that the ABC product has a ‘price premium’ of US\$40 per product in that market. This US\$40 is then used to determine the value of the brand in that market.⁸ This is then converted to a percentage that is supposed to represent what the ABC brand influence and thus value is in that market.⁹

The revenue authority will typically take the gross market revenue generated by the ABC product (i.e., its sales), excluding other revenue streams from interest and other areas where it is not the branded product giving rise to the revenue.

For example, let us say there is no other revenue stream in our market. Thus 100% of the revenue stream is generated by the ABC branded product. In applying the 40% price premium obtained from a survey between an operating business and its end consumers, 40% of the revenue is said to be driven by the ABC brand, on the product.

Thus, the royalty charge by the owner of the ABC brand should be based on 40% of branded revenue for the

7 I use basic terminology, not licensor or licensee to illustrate the fundamental analysis.

8 $\text{Price premium} = (\text{PBRAND.A} / \text{PBRAND.B}) - 1$.

9 $\text{Price premium} / (\text{price premium} + 1)$.

use of the ABC brand. The revenue authority may argue the ALP price for the use of the ABC brand by a third party using the ABC brand to sell ABC branded products can charge the equivalent of 40% for the use of the ABC brand. Therefore, the ALP price between the supplier of the ABC brand (the legal owner) and the buyer (an associated subsidiary) in that market should be a 40% royalty for the use of the ABC brand.

I now ask you to deconstruct the comparison royalty rate of the revenue authority against what the fundamentals tell us. The transfer pricing pundits at this point will justifiably be going crazy with a list of criticisms, all jumbled together, such as:

- What about economic ownership?
- This does not align with OECD methodologies!
- The comparables used are incorrect.

But I say, keep all those defenses and criticisms in abeyance. You should have identified that the use of the prime premium to determine the ALP in the above example does not align with OECD methodologies and is not defensible. We need to look at the fundamentals:

- The brand is ABC, whereas the revenue authority process considers an ABC branded product. The ABC branded product is, for instance, a cell phone linked to a cell phone network owned or operated by the seller. The network is extensive and established and was the owner of 4 licenses to be granted by the government in that market. Before the ABC brand could be introduced, the license had to be purchased at great expense, and the network had to be built. The ABC branded product is represented by the cell phone, with an ABC branded sim card, with access to the network (all of which could not occur without one of four licenses and the building of the network). The price for the ABC branded product also includes the actual sale of the cell phone itself, whether it is an Apple iPhone or Samsung or another cell phone. The ABC branded product and its price included variables that stand independently from the ABC brand. What are those and how does this affect the 'price premium'? Once one of the four licenses was obtained and the network was created, the ABC brand would have had to be marketed to the potential customers against the competition of the 3 other license holders in that market. Usually, those expenses of the marketing campaign (TV, radio, billboards, person-to-person campaigns and the like) are funded by the subsidiary in that market. That funding is an investment made by the subsidiary and a contribution to the economic value of the brand. This is where the OECD and UN TPGs around economic ownership come into play. The original owner of the ABC brand, in the transfer pricing universe, gives way to the concept of joint economic ownership between the supplier/licensor and the buyer/licensee (the subsidiary in our example). But for the purposes of looking at what is being supplied in the real transaction, compared to the revenue authority comparison, the real transaction is the supply of the ABC brand. The revenue authority's erroneous characterization is a transaction for the supply of an ABC branded product. It should now be obvious that there are significant differences, which any expert in the field will expose. But fundamentally our real transaction is for the use of the ABC brand and not the sale of an ABC branded product that is bundled with variables extraneous to just the ABC brand. In addressing the question of the subject matter of the transaction and the comparison used to determine an ALP, the version put up by the revenue authority fails. The revenue authority is not comparing the ABC brand to another brand of a similar nature, in the same market. They have compared the brand to branded products with other bundled influences of the brand price premium. As I said, your experts will expand on this with specific points to be made. However, as a starting place you have identified a major defect in the revenue authority's comparison.

CONCLUSION

First and foremost, make sure your initial transfer pricing study accurately determines the key product or service for ALP purposes. If possible, you should have prepared contemporaneous documentation as this will strengthen your case and, in some jurisdictions, provide penalty protection. It will also be important to understand how the tax authority is characterizing the transaction. In my example, the ABC brand, which

is then incorporated into various elements to generate the revenue stream, is also encapsulating other intellectual property not specific to the brand, e.g. licenses, software and copyrights. Other intangibles including the network coverage, the one of four licenses, the accessibility to the network, must be stripped away to expose just the ABC brand. That is what must be compared to establish an ALP.

It should now also be obvious that ‘the transaction’ in my ABC example, and the revenue authority’s comparison process assesses the wrong parties to the transaction. The revenue authority assessed a transaction between the subsidiary and end consumers. Our transaction is concerned with a transaction between the supplier of the use of the ABC brand only, and the buyer of that use. Also, different to the revenue authority’s assessment, our transaction is not concerned with the supply of an ABC branded product. Our transaction is the supply of the “use of the brand” by the subsidiaries. Here the experts will have a field day with the influence of the OECD and UN TPGs. The quality of comparison is paramount.¹⁰ You must compare the same product or service, in the same type of transaction, between the same type of parties. Or, at least, as close as you can get, making various adjustments to simulate a product/service, transaction, and parties as the real one. Obviously, the comparison principles of the OECD and UN TPGs should be followed as closely as possible. The basic guideline principles are:

- The OECD Transfer Pricing Guidelines provide two key aspects when it comes to the application of the ALP which is based on a comparison of the conditions in a controlled transaction with the conditions that would have been made had the parties been independent and undertaking a comparable transaction under comparable circumstances.¹¹ The first aspect is to identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated.¹² The second aspect is to compare the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically relevant circumstances of comparable transactions between independent enterprises.¹³
- The typical process of identifying the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations requires a broad-based understanding of the industry sector in which the MNE group operates and of the factors affecting the performance of any business operating in that sector.¹⁴ A detailed industry analysis should form part of the transfer study and support the transfer pricing conclusion.
- The process then narrows to identify how each entity within that MNE group operates, and provides an analysis of what each entity does and identifies its commercial or financial relations with associated enterprises as expressed in transactions between them.¹⁵ The accurate delineation of the actual transaction or transactions between the associated enterprises requires analysis of the economically relevant characteristics of the transaction.¹⁶ The economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations are categorized as follows:¹⁷
 1. The contractual terms of the transaction;
 2. The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices;
 3. The characteristics of property transferred or services provided;
 4. The economic circumstances of the parties and of the market in which the parties operate;
 5. The business strategies pursued by the parties.

In my ABC example, the revenue authority has failed to compare like with like. In your transfer pricing study,

10 OECD Transfer Pricing Guidelines and UN Transfer Pricing Guidelines.

11 OECD Transfer Pricing Guidelines, 2022, paragraph 1.33.

12 OECD Transfer Pricing Guidelines, 2022, paragraph 1.33.

13 OECD Transfer Pricing Guidelines, 2022, paragraph 1.33.

14 OECD Transfer Pricing Guidelines, 2022, paragraph 1.34.

15 OECD Transfer Pricing Guidelines, 2022, paragraph 1.35.

16 OECD Transfer Pricing Guidelines, 2022, paragraph 1.35.

17 OECD Transfer Pricing Guidelines, 2022, paragraph 1.36.

make sure you compare like with like within the parameters of the OECD and UN TPGs. Where you deviate, explain why. Para 2.9 of the OECD TPGs states that MNE groups retain the freedom to apply methods not described in the guidelines provided they satisfy the arm's length principle. Other methods should not be used in substitution for OECD recognized methods where the latter is more appropriate:

“2.9. Moreover, MNE groups retain the freedom to apply methods not described in these Guidelines (hereafter “other methods”) to establish prices provided those prices satisfy the arm’s length principle in accordance with these Guidelines. Such other methods should however not be used in substitution for OECD-recognised methods where the latter are more appropriate to the facts and circumstances of the case. In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or nonworkable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution. A taxpayer should maintain and be prepared to provide documentation regarding how its transfer prices were established.”

Any deviation will be met with explanations by the revenue authority why they also deviate. Thus, your deviation must align with the OECD and UN TPGs core principles. Ultimately, evidence will have to be given by an expert who is qualified to testify to the deviation from the OECD and UN TPGs methodology, or to the compliance with that methodology where the following legal principles of evidence are of paramount importance.

The starting point is the Daubert standard in the USA, which prefers well-trodden expert scientific evidence to support an expert opinion expressed by a transfer pricing specialist. I refer you to my section on evidence below where careful note should be taken of the Daubert standard and the ensuing references. This is especially relevant where your transfer pricing study may have deviated from the OECD and UN TPGs and the well-trodden pathway created by the 5 acceptable methodologies.

Lastly, the fundamental question of who the parties to the transaction are, exposes the obvious mistake made by the revenue authorities in my ABC brand example. They may compare the supplier of an ABC branded product to the end consumers. In our real transaction we are concerned with establishing the ALP between a supplier of the ABC brand's use (not bundled in a product offering) to the buyer of the use of the ABC brand, later to be bundled into the sale of an ABC branded product. The revenue authority's comparison looks at the wrong parties and the wrong transaction. As simple as that. Once again, your experts should expand on this, with your guidance on why it is important.

In the transfer pricing study, the parties to the transaction should be clearly defined, and where they stand in the typical supply chain, highlighting the unique elements of the parties in the supply chain. The supplier of the ABC brand allows and expects the buyer to use the ABC brand in a specified manner, for a specific period. The buyer is expected to take the ABC brand's use and commercialize this in its offering to the end consumer. This entails functions (DEMPE)¹⁸ performed in respect of the ABC brand. No such relationship exists between this buyer and the end consumer. It simply is not comparable.

The transfer pricing study, as the starting point, is not the beginning and the end of the revenue authority enquiry and a potential ensuing tax dispute. It will not present a convincing defense to an attack by a revenue authority in the absence of:

- Showing bona fides by the accounting or consulting firm preparing the transfer pricing study;
- a written explanatory memorandum by the in-house tax manager at the time explaining exactly what was done in preparing the transfer pricing study;
- supported by all the relevant background source information; and
- further supported by an independent unbiased and objective expert report.

18 DEMPE is Development, Exploitation, Maintenance, Protection and Exploitation.

Please read the transcripts in Appendices A and B¹⁹ carefully, referencing the importance of the bona fide's in preparing the initial transfer pricing study (and subsequent revisions). The transfer pricing study's background information is potential evidence, with a written explanatory memorandum by the in-house tax manager at the time. The importance of the bona fide's is also the way in which the transfer pricing study, with its background evidence, is presented by an independent expert that is unbiased, objective and able to venture an opinion that is open to criticism in an arena where the arm's length price is not an exact science.²⁰

The interviews detail the difficulties presented when having to defend a transfer pricing study where the original tax manager has moved on from the multi-national entity or group ("MNE") and the challenges in dealing with old hearsay evidence presented by a new factual witness explaining the background of the transfer pricing study to the court.

Much of what is dealt with in these interviews is unpacked in the later chapters of this book.

19 Interviews conducted in January 2024 with Adv W Trengove SC and Adv R Mastenbroek who were both briefed by the author on behalf of a corporate client in a transfer pricing dispute that proceeded to trial in the tax court. The interviews give practical insights into the preparation process to be followed in defending a transfer pricing study at a tax trial. Practical insights are given into what steps should be taken to prepare and preserve key evidence, how it should be presented, how witnesses should be prepared and what experts should do and not do. The practical insights in these interviews point decidedly to the importance of preserving the original source evidence backing-up the initial transfer pricing study with a written signed memorandum by the responsible in-house tax manager explaining the process.

20 The OECD Transfer Pricing Guidelines, 2022, states at paragraph 1.13 that "...*transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer.*"

CHAPTER 3

CONTEMPORANEOUS DOCUMENTATION FOR AUDIT AND TRIAL EVIDENCE

In the section of “The transfer pricing study starting point” I pointed out to various basic elements that should be looked at to ensure the transfer pricing study holds up to scrutiny in a revenue authority audit tackling the ALP charged.

By way of example, assume the revenue authority TP audit takes place in 2024 looking at information in 2018, the following will take place. When this happens, start your checklist of what you see emerging as points of defense.

	INVESTIGATE	COLLECT/COLLATE	ANALYZE
Audit Team	Who will be the team to respond to the revenue authority queries?		
Key employees	Who would be key and potential witnesses?		Professional consultants, operational employees
Transfer Pricing Study		Calculations and data supporting 2018	
		Minutes of meetings relevant from the past (e.g. if a subsidiary was taken over, existing royalty rate license agreements may have been altered, by tacit agreement)	
Tax Risk Steering Committee	Was there a committee in 2018 or any other similar type of committee	2018 Minutes of Meetings	
	Who were the members (typically the CFO, group tax manager, tax attorney, tax accountant)		
2018 Legislation	How did the transfer pricing provision read in 2018?		Why were these changes made?
	Are there any material changes in the practice notes?		
	Are there any changes in interpretation notices?		
	Are there changes in the legislation?		

	Is there possible prescription, i.e. the period for the revenue authority to amend assessments has lapsed?		Did we disclose all relevant information? (check the legislation for the meaning 'non-disclosure')
OECD and UN Transfer Pricing Guidelines (NB: TPG's are not legislation, and the most recent version is used in interpreting the guidelines at that time)	Are there more current guidelines?		The OECD and UN TPGs are ambulatory in nature

The OECD TPGs state the following in respect of contemporaneity:

“3.68. In principle, information relating to the conditions of comparable uncontrolled transactions undertaken or carried out during the same period of time as the controlled transaction (“contemporaneous uncontrolled transactions”) is expected to be the most reliable information to use in a comparability analysis, because it reflects how independent parties have behaved in an economic environment that is the same as the economic environment of the taxpayer’s-controlled transaction. Availability of information on contemporaneous uncontrolled transactions may however be limited in practice, depending on the timing of collection.”

“5.7...Moreover, contemporaneous documentation requirements will help to ensure the integrity of the taxpayers’ positions and restrain taxpayers from developing justifications for their positions after the fact.”

“5.8. This compliance objective may be supported in two important ways. First, tax administrations can require that transfer pricing documentation requirements be satisfied on a contemporaneous basis. This would mean that the documentation would be prepared at the time of the transaction, or in any event, no later than the time of completing and filing the tax return for the fiscal year in which the transaction takes place.” [my emphasis]

The UN TPGs state:

“3.5.2.31 Information derived from external comparables should reflect the economic environment at the time the controlled transaction was undertaken. In principle, information from external comparables contemporaneous with the controlled transaction might be expected to reflect the same economic environment, but there can be practical difficulties in obtaining contemporaneous information given the time required for such information to be prepared, reported, and uploaded on to databases. For a discussion on timing issues, see section 3.6.2.”

“3.6.2.2 Timing of origin of the transactions needs to be considered. In principle, information relating to the conditions of comparable uncontrolled transactions undertaken or carried out during the same period of time as the controlled transaction (“contemporaneous uncontrolled transactions”) is expected to be the most reliable information to use in a comparability analysis, because it reflects how independent parties have behaved in an economic environment that is the same as the economic environment of the taxpayer’s controlled transaction.”

“3.6.2.8 Data from years following the year of the transaction may also sometimes be relevant to the analysis of transfer prices, but care must be taken to avoid the use of hindsight, perceiving the significance of facts and events with the benefit of knowledge accruing after they have occurred.” [my emphasis]

In my example, the transfer pricing audit is for 2018, some 6 years before 2024 when the transfer pricing audit commenced. My suggestion is that the following process be followed. It will require a significant amount of work and you may ask why? Why make all this effort now, and we do not know the revenue authority will pursue the matter as a tax dispute all the way to a tax trial?

Firstly, any transfer pricing audit will potentially go to trial if not addressed properly. The revenue authority is under pressure to collect more taxes, and transfer pricing is low hanging fruit. They will pursue the matter. So, you might as well do your homework properly, because if you do not do it now, you will have to in the future. Procrastination in transfer pricing results in major problems down the line! What I mean is that the typical transfer pricing audit will take at least 2 years to complete to a point where additional assessments are raised. Even if the revenue authority issues hasty additional assessments to avoid prescription, there will still be a significant effort on providing transfer pricing related information. If the transfer pricing audit takes place in 2024 and is in respect of the 2018 year of assessment, then already 6 years have passed, and it will be 8 years later when the audit is completed. It will then take at least another 2 years to go to tax trial. That is 10 years after 2018. In any MNE, 10 years is a long time. It is most likely that the supporting data required to corroborate what was done in the 2018 transfer pricing study is not easily available. The information will be scattered. Groups change their structures, change accounting systems, redesign, and remodel administrative divisions, promote, or lose employees. Transfer pricing audits involve multiple countries outside the jurisdiction of the revenue authority where the record-keeping processes are not very reliable, and potential witnesses to corroborate what was done both inside and outside the MNE may no longer be available. And the problem list goes on. 10 years after the fact! In those 10 years you will have lost much of what you want to rely upon to corroborate your transfer pricing study.

And worst of all, most jurisdictions require you, the taxpayer, to prove your ALP charges and prove that any version put up by the revenue authority is wrong. Thus, you need the back-up evidence. Time slippage will adversely affect that.

The commencement of the 2018 transfer pricing audit, or preferably during 2018 or shortly after the year end, is the proper opportunity to collect and collate as much of that evidence, before it all slips away.

My periods above are very conservative. In my experience most audits and tax disputes involving additional assessments, objections and the ensuing appeals take much longer to go to trial. In a recent transfer pricing matter the period between the first transfer pricing audit year and the date of the trial was 13 years.

Do I need to motivate more?

You should collect as much data as possible, now at the commencement of the transfer pricing audit. Not just the reams of information the revenue authority will require from you. But also, any broader data that will prove and corroborate your ALP charges.

CRUCIAL ROLE OF EVIDENCE & ITS COMPLEXITY

A key problem is that the tax manager responsible for attending to the audit, will most likely not be a lawyer with a specialized qualification in the law of evidence. In fact, most lawyers are not specialists in evidence. And evidence is one of the most difficult areas of the law.

At trial you are expected to prove your ALP position on a ‘balance of probabilities’ which means:

“It must carry a reasonable degree of probability, but not so high as is required in a criminal case. If the evidence is such that the tribunal can say: ‘We think it more probable than not’, the burden is discharged.”¹

1

Lord Denning in *Miller v Minister of Pensions* 1947 2 All ER 372 373 – 374.

Simplistically, I see it as: Is my version of an ALP charge more probable than the revenue authority's version. Do the scales of justice tilt a little more in my favour? And what must I rely upon to tilt the scale a little more in my favour? The weight of my evidence: the material source data, the material supporting data, the testimony of the supporting witnesses.

At tax trial you are supposed to produce the 'best evidence'. This means:

*"...no evidence is ordinarily admissible to prove the contents of a document except the original document itself."*²

In a transfer pricing audit, that would be the original signed agreements you rely upon showing the royalty rate for the use of a brand, the invoices generated and paid for, and the bank statements showing the flow of money. Usually, MNEs only produce copies. But are these certified copies? Where are the originals? Be aware of the hearsay evidence and business records exceptions.³ In the absence of the originals, if they cannot be produced, copies will usually suffice.

Then the agreements stating the terms and conditions of the supply of product, goods or services must be corroborated with the actual invoices and proof of payments. In our 2018 transfer pricing audit, 6 years later, where are those invoices? Where is the proof of payment? Do the invoices delineate what is stated as the charge in the agreements? If it is a composite sum made up of various components not specified, where is the proof that the various components were in fact paid for? Where are the accounting entries? Where and how was it disclosed in the tax returns?

The element of contemporaneity (outside of what the OECD and UN Transfer Pricing Guidelines (TPGs) require becomes important. I will explain.

In the absence of providing the actual material source documents to prove the ALP charges in an original agreement supported by original invoices, there is an exception to the inadmissibility of 'hearsay evidence' in most jurisdictions.

Firstly, what is 'hearsay evidence'?⁴

In South Africa, it is defined in section 3(4) of the Law of Evidence Amendment Act 45 of 1988 as:⁵

"... evidence, whether oral or in writing, the probative value of which depends upon the credibility of any person other than the person giving such evidence."

The basic rule is that 'hearsay evidence' is not admissible. Different jurisdictions will have exceptions to this basic rule. In Zimbabwe, for example, section 14(2) and (3) of the Civil Evidence Act [Chapter 08:01] raises "business records" as an exception. The said section reads as follows:

2. A statement contained in a document shall be admissible as evidence of any fact stated therein of which direct oral evidence would be admissible if—
 - a. the document is or forms part of the records appertaining to or kept by or for a business or at any time formed part of such records; and
 - b. the statement in the document was made, or may reasonably be supposed to have been made, in the ordinary course of or for the normal purposes of the business—

2 Zeffert DT *Essential Evidence* (2020) Lexis Nexis, p 134.

3 See Glossary of Terms.

4 See Glossary of Terms.

5 See Glossary of Terms.

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- i. by a person who had or may reasonably be supposed to have had personal knowledge of the fact concerned; or
 - ii. on the basis of information supplied directly or indirectly by a person who had or might reasonably be supposed to have had personal knowledge of the fact concerned.
 3. A document which is admissible under this section may be produced in evidence by any person who for the time being has custody of the document or is responsible for managing the business for which the document was produced.

The effect of this is that if contemporaneous business records can be produced to prove the ALP charges and payments by way of an accounting system report (and the process of explaining how the report is produced from the accounting system) these business records will be admissible. The weight attached to these business records (and other evidence that is not original) and other hearsay evidence is explained as follows:

- The Zimbabwean case of *H Ltd v Commissioner of Taxes*⁶ sets the tone of how a taxpayer discharges the burden of proof. Goldin J held that when it comes to determining those balance of probabilities there are two main lines of approach, which are not mutually exclusive, namely, credibility and probability.⁷ In determining whether a witness is to be believed or not, the court must have regard to the probability of his story. But there may be cases where probability will have to yield to credibility; for a court may believe a witness, despite improbabilities in his evidence and where it does so, it may find that any burden of proof resting on him has been discharged.⁸ Where the probabilities are evenly balanced, a finding of credibility might well be the determining factor.⁹
- Furthermore, when it comes to weighing up probabilities, it must be remembered that a trial judge is not concerned with what is or is not probable when dealing with abstract businessmen or normal men, but he is concerned with what is probable and what is not probable as regards the particular individual situated in the particular circumstances in which they were.

The rules of evidence in other common law? jurisdictions will not be far different from the Zimbabwean example given. Do the research. Understand the legal landscape you are working in. Know the fundamentals.

UNDERSTANDING TRANSFER PRICING, LEGISLATION & GUIDELINES

Refer to Chapter 2: The Transfer Pricing Study Point: *Setting the legal landscape*, which is a transcript of the introductory lecture I give every year to new transfer pricing students. As supplementary reading to this, please read **Appendix C5: Admissibility of Hearsay Evidence by an Expert Witness** and **Appendix C6: Supporting Arguments to Evidence** – this is an application to tax court for the admissibility of hearsay evidence by an expert in a management fee deductibility tax dispute, and the written argument provided in the same case on the admissibility of other hearsay evidence by various factual witnesses. Reading these appendices will assist you in understanding the various principles of evidence to consider overcoming any objection by a revenue authority opponent to your hearsay evidence.

The typical Transactional Net Margin Method (TNMM) transfer pricing study report will be supported by extracts from the commercial database relied upon to generate the transfer pricing study. This will be further supported by the financial statements. Other supporting data will be required to support the companies chosen to compare to. If the methodology is the cost plus or the profit split method (PSM), or other methodologies, other supporting data will be necessary.

As a starting point (and this applies to the TNMM as well) a thorough functional analysis of the tested party¹⁰ vs its counter party will be required. It is not simply the summary set out in the transfer pricing study. Who performed the functional analysis? Where is the source data? Where are the notes of any interviews? Was

6 34 SATC 57 1925 TPD.

7 34 SATC 57 1925 TPD at 60.

8 34 SATC 57 1925 TPD at 60.

9 34 SATC 57 1925 TPD at 60.

10 See OECD TPG 2022, Chapter III, paras 3.18 – 3.23. Rationale: These provide the OECD's rationale for tested party selection

a survey conducted? Where is the data from the survey? Were core statistical and economic principles adhered to in any survey conducted? These are all variables that may ultimately be tested at trial to show that the process followed to prove an ALP price is flawed.

Then, why was that transfer pricing methodology applied? Were there no internal or external CUPS? Where the ALP charge methodology is based on ‘profits’, how were these determined? Is the determination of the profits in line with the OECD and UN TPG’s? For instance, in applying the combined PSM method, Step 1 requires the determination of the combined profits of the transaction to be split. In determining the joint profit, why are certain amounts excluded / included?

Step 2 requires an allocation key to determine the split in the PSM and should be substantiated with supporting evidence. The reason why the allocation key was considered appropriate in the circumstances should be recorded, who made the decisions and supporting data and calculations should be available.

If (as in the case with an ALP for the “use of a brand”) there is joint economic ownership of the brand i.e., the supplier and buyer both contribute to the value of the brand, the supplier and owner of the “use of the brand” cannot take all the profits generated using the brand. The determination of economic ownership should be recorded. Is there economic ownership? If so, what is the split? This is a factual enquiry and all supporting evidence to determine the extent to which economic ownership is shared should be preserved. Then, quite apart from this, what does the agreement between the parties say? How is the “use of the brand” defined in the agreement? Oftentimes this includes the trademarks and similar intangible property. It will usually not include goodwill and other attributes that are linked to the product attached to the use of the brand. This highlights the fundamental difference between the “legal definition” of the brand, versus the “economic definition” of the brand. The lawyers will constantly defer to the “legal definition” as is obvious from the agreement between the parties. That includes the judge. However, the experts and economists will constantly defer to the OECD and UN TPGs. There is a wide gap between the two. Remember that in a trial the judge will apply the law in that jurisdiction. The OECD and UN TPGs are guidelines, and usually not the law. In American TP case law detailed references are made to the guidelines, but it must be remembered that in section 482 of the Internal Revenue Code extensive reference is made to the methodologies in the OECD TPGs, with various adaptations. This is quite different to other jurisdictions, where the TP legislation is supported by much shorter regulations that simply defer to the OECD and UN TPGs. As stated, the referenced guidelines are not legislation. In the case of the United States:¹¹

“Under Section 482 of the Internal Revenue Code the Commissioner has been given broad power to allocate income and deductions

between related taxpayers. Until recently Section 482 has been a comparatively dormant weapon in the Commissioner’s arsenal for use in preventing the evasion of taxes and the distortion of taxable income. The section has mainly been invoked where commonly controlled foreign and domestic taxpayers are involved.

In the spring of 1965 proposed regulations were published which give the clear impression that the Service intends to enforce Section 482 more vigorously in the future, especially where the taxpayers involved are all domestic entities. It also appears from these regulations, however, that the Commissioner has been given power to create income where none was earned and also to allocate income and deductions regardless of the materiality of the distortion of income. In order for the Commissioner to invoke Section 482 no intent to evade taxes need be shown under these new regulations.”

What does the OECD TPG’s state in this regard? Paragraph 4 of the Preface states:

¹¹ New Importance for Section 482 of the Internal Revenue Code, Robert N. Lent, William & Mary Law Review, May 1966, Volume 7 (1966), Issue 2, Article 12.

“In the case of tax administrations, specific problems arise at both policy and practical levels. At the policy level, jurisdictions need to reconcile their legitimate right to tax the profits of a taxpayer

based upon income and expenses that can reasonably be considered to arise within their territory with the need to avoid the taxation of the same item of income by more than one tax jurisdiction. Such double or multiple taxation can create an impediment to cross-border transactions in goods and services and the movement of capital. At a practical level, a jurisdiction’s determination of such income and expense allocation may be impeded by difficulties in obtaining pertinent data located outside its own jurisdiction.” [my emphasis]

This should be read with Article 9 of the OECD Model Double Taxation Agreement, which relates to the taxation of the profits and associated enterprises, and applies the arm’s length principle.¹² A corresponding adjustment would by agreement between the two jurisdictions be required otherwise the MNE group will be taxed twice on this part of profits (i.e. economic double taxation - that has been subjected to a transfer pricing adjustment).

Profit is as defined in the OECD TPG’s, but its ordinary grammatical meaning is the difference between the amount earned and the amount spent buying, operating, or producing something.

Paragraph 17 of the OECD TPG’s preface states:

“These Guidelines are also intended primarily to govern the resolution of transfer pricing cases in mutual agreement proceedings between OECD member countries and, where appropriate, arbitration proceedings. They further provide guidance when a corresponding adjustment request has been made. The Commentary on paragraph 2 of Article 9 of the OECD Model Tax Convention makes clear that the State from which a corresponding adjustment is requested should comply with the request only if that State “considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm’s length”. This means that in competent authority proceedings the State that has proposed the primary adjustment bears the burden of demonstrating to the other State that the adjustment “is justified both in principle and as regards the amount.” Both competent authorities are expected to take a co-operative approach in resolving mutual agreement cases.”

Lastly, does the transfer pricing study cover all transactions? One thing I have noticed is that despite a focus by revenue authorities on intellectual property, large MNE’s with well-known names, or brands, omit concluding license agreements for the use of their name-known brands.

For instance, the MNE Group known as ABC, trades as ABC in various countries, but then produces different products that may not be supplied under the ABC label. But ABC as a reputable company in various countries becomes known as a stable and reliable entity that produces reliable brands, all bearing the ABC company name linked to the brand. It may be that the ABC name was unknown when the company started, and that it is known as a household name because of the efforts of the local company. Nevertheless, it warrants ensuring that the ABC name that originated in country X, owned by X, is not an intangible asset for transfer pricing purposes that requires an ALP to be charged for the use of the ABC name. There are many examples of brand names.¹³ Undocumented transfer pricing areas (or which are not properly documented)

may trigger revenue authority audits. These potential problem areas should be addressed in a tax risk management process within the MNE via a Tax Risk Management (TRM) tax steering committee that reports confidentially to the audit committee. It is beyond the scope of this work to segue into the TRM tax steering committee.

¹² Article 9(2), *Klaus Vogel on Double Taxation Conventions*, 5th Edition (2021), Article 9(2) at 216 (page 786) to 233 (page 796).

¹³ Examples Of Good Brand Names: Successful Brand Names (<https://fabrikbrands.com/>) or TOP 10 - Most Valuable Brands in 2025 - World’s Best Brands | FXSSI - Forex Sentiment Board.

But for more information about this process access these links for more information:

- Amazon: Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies;¹⁴ and
- The Academy of Tax Law - www.academyoftaxlaw.com

Refer to **Appendix D: Extract from the textbook – “TAX INTELLIGENCE: The 7 Habitual Tax Mistakes Made by Companies”**.

Because this is a transfer pricing dispute, the tax team must be expanded to include a transfer pricing specialist to participate in preparations. This is not the person who will ultimately appear as a transfer pricing expert witness in a trial, or the consultant who drafted the transfer pricing study. This person must be able to participate objectively, and under the guidance of the specialist tax attorney, will be able to objectively critique the transfer pricing study, and participate without bias in addressing the revenue authority in the audit.

All this person’s work, together with the other tax team members, will be under the direction of a skilled specialist tax attorney, with deep tax litigation experience. I will refer to this person as “the attorney chairperson”. The attorney chairperson of the tax team will direct the roles and participation of the tax team members.

The CFO and tax manager will collate all the data required by the revenue authority, in the best evidentiary format. This means the actual transfer pricing study, the signed transfer pricing related agreements, certified copies of minutes of meetings, the data and calculations informing the transfer pricing study.

The accountant member, usually from the tax advisory accounting firm that provided the transfer pricing study, will collate all the data supporting the transfer pricing study: financial statements, transfer pricing reports from popular databases, any survey material relied upon in the transfer pricing study, data making up the functional analysis, backup spreadsheets interpreting financial statements to extract and adjust the annual financial data to tie in with the OECD and UN transfer pricing method relied upon (e.g., the comparable uncontrolled price (CUP) method, the resale price method (RPM), the cost plus method (CPLM), the transactional net margin method (TNMM) or, the profit split method (PSM)).

The transfer pricing specialist will review the transfer pricing study and compile an analysis of the transfer pricing study, pointing out its strengths and weaknesses.

The legal team will analyze the legislation relied upon by the revenue authority to ensure all jurisdictional facts¹⁵ are met. This requires a careful analysis of the Income Tax and Tax Administration legislation with the Constitution and the principles of Administrative Law.¹⁶

14 Email the author at daniel.n.erasmus@me.com for a free PDF copy of the post 2022 edition.

15 See the Glossary of terms.

16 The author published his PhD on the South African Constitutional and Administrative legal principle applicable to tax audits.

CHAPTER 4

THE INITIAL TAX AUDIT

INTRODUCTION

A transfer pricing audit will most likely start with the request for information; a lot of information to substantiate what was stated in the MNE or subsidiary's tax return and transfer pricing study.

I set out below the prudent and most effective response.

- Instead of reacting immediately, rather reflect.
- What are you lawfully required to produce and show?
 - That depends upon the wording of the revenue authority's empowering legislation.
- What have you provided previously?
- What is their main concern?
 - Do not guess and ask them in writing so that you can focus on that, instead of a broad-based fishing expedition response.
- Engage your broader tax team to consider all these questions and plan a careful response knowing where you are headed.

If you can, attempt to set up a meeting with the revenue authority to present your facts in answer to their specific concerns. Oftentimes, such a well-prepared meeting, with a comprehensive memorandum supported by the facts will cause the termination of the audit. That is the best solution. Failing such an early termination will result in a protracted audit, resulting in the possibility of a tax dispute going to trial.

But an early audit termination will require significant input by the tax team. It is not a quick fix. Most MNEs' are not prepared to spend the time, money, and effort to do this. They hope by just giving reams of evidence in response to a revenue authority query will make the tax audit go away. It will not. The revenue authority knows that a significant additional assessment sits behind any transfer pricing tax audit. They just need to invest time over a protracted period, as they learn more about the business and transactions, making mistakes over a long period of time, and being allowed to correct those mistakes.

WORKING TOWARDS A RESPONSE

A solid and fully-fledged response, giving all relevant information in a well-structured manner, as if presenting evidence at a trial, with convincing and supporting arguments and submissions, will force the revenue authority's hand to terminate the transfer pricing audit, or alternatively, to continue with it, but with rational and reasonable reasons. If they are presented with the complete case, and if they do not terminate the audit, they will have to provide solid reasons why they want to proceed. That means pulling their team together quickly to properly consider everything they have and then motivating why they want to continue. This is different to them pulling at straws and asking for more information as they buy more time to reflect, learn and prod a little more, to see if any mistakes emerge. With a full-frontal response, will all the facts, explanations, and reasoning, very little is left to prod and probe at.

If in your thorough preparation you discover an obvious mistake, that can be rectified now. Why draw it out thinking that an evasive approach may hide the mistake. Experience shows by admitting cap in hand, the penalties and interest will be reduced substantially, as you would have exposed the mistake, through self-disclosure, without the revenue authority requiring more effort. Plus, you would have saved the expense of defending your position. Your mistake is divulged, dealt with and you move on.

Much can be said about a TRM steering committee of your tax team conducting a self-disclosure exercise before any tax audit. Most MNEs' have historical tax issues in the closet. But that is a topic for another day. It is also dealt with in detail in my book: *Tax Intelligence*.¹ I quote from the executive summary:

“Empowering the tax team with the support and the easy flow of communication within the business is vital. The tax team must become a vital cog of the business and be made up of people empowered with knowledge, not only of the laws, but the knowledge of what exactly is going on within the business through the implementation of an effective and efficient TRM process. An efficient communication process must also be implemented in the business.”

Refer to **Appendix E: Example of being Audited or Selected for Verification**.

For a more detailed description of the rules of engagement at the commencement of a tax audit, applicable to all tax audits in all jurisdictions, refer to **Appendix F: Rules of Engagement at Commencement of the Tax Audit**, setting out the detailed steps that should be considered and taken.

In summary, an initial transfer pricing audit requires:

- an experienced tax team;
- access to all relevant background data supporting the transfer pricing study;
- an analysis of the revenue authority's empowering legislation, including the Constitution and Administrative law, clarifying the revenue authority's powers of audit;
- the arrangement of a formal revenue authority meeting with the aim of convincing the revenue authority to cease the transfer pricing audit, based on an undertaking of full disclosure, within the ambit of the law (including an analysis of the legislation on full disclosure, any penalty and interest leniency, any amnesty provisions, any prescriptions (or time bias provisions));²
- researching and drafting a transfer pricing audit presentation to the revenue authority, with the intention of presenting it in person with members of the tax team present.

A complete appreciation and understanding of the legal provisions, knowing what the revenue authority is entitled to do, and what the potential defenses of the taxpayer are, is the foundation to a successful revenue authority presentation, to convince them not to proceed with the transfer pricing audit, and ultimately the necessity to proceed to a tax dispute process. As previously stated, if an obvious mistake has been made, confront it.

With the legal foundation in place, the presentation is completed with full reference and support of the OECD and UN TPG's and all the relevant data supporting the transfer pricing study.

Remember, the aim is to give the revenue authority such precise information that, in the event they decide not to terminate the transfer pricing audit, they are obliged to agree to what precisely is their issue in wanting to advance the transfer pricing audit.

In certain jurisdictions, for instance Tanzania, all evidence to be relied upon during the trial must be submitted during the audit phase.

¹ *Tax Intelligence: The Seven Habitual Tax Mistakes made by Companies 2010*, Chapter 2 pages 21 to 32. The book is available at Amazon. com. *op cit*, page 21.

² This must not be construed that I am suggesting any fault on the part of the taxpayer. But understanding the complete 'legal universe' is very important in a convincing approach taken in any revenue authority presentation.

IMPORTANCE OF ACCURATE & DETAILED LETTER OF FINDINGS

In most jurisdictions, if a transfer pricing audit is pursued the revenue authority must give a detailed “letter of findings”³ on conclusion of the transfer pricing audit setting out their detailed conclusions of what they propose doing in an additional assessment to be raised. This requires a reasoned conclusion stating what legislation they rely upon, as supported by the facts, to raise the additional assessments. The importance of this cannot be underestimated. The tax team must be able to elicit specific reasons from the revenue authority.

In one of the transfer pricing cases I was involved with for a period of thirteen years, the revenue authority changed their stance three times. The last change took place a few weeks before the trial was meant to commence, and that caused the trial to be postponed for another two years. How was this possible? The courts tend to indulge the change of pleadings (in this case the stance of the revenue authority) if they are prepared to pay the wasted costs. That seems reasonable. But, in fact, it is not. The ‘wasted costs’ are at the ‘party and party’ scale in most jurisdictions. That is not the actual costs incurred. And then what is ‘wasted costs’ becomes an issue and will trigger a new dispute. In the case I am referring to the revenue authority had decided upon a PSM OECD transfer pricing method as calculated by the taxpayer, with a change in one of the variables required to calculate the combined profits to be split. This was evident from a careful process followed with the “letter of findings” where the revenue authority was convinced to abandon their methodology. By the time the revenue authority decided to make the third pleading change, they knew they could not change the original reason for exercising their decision some seven years before, which was based on the PSM of the taxpayer with the one variable changing. Instead, they noted the basis of their decision had not changed, but that they merely recalculated the arm’s length royalties. This was an attempt to be surreptitious, so they simply pleaded that the royalty rates were being recalculated as per an annexed formula. The formula, on closer scrutiny, reflected a complete alteration of their original decision based on the taxpayer’s PSM.

Had the process from the “letter of findings” not been documented carefully, showing precisely what was presented to the revenue authority in the audit, with the data the revenue authority required, and their acceptance of the taxpayer’s PSM calculation, a court simply looking at the third version proposed by the revenue authority in the pleadings before the court (without the important history) may have placed the taxpayer in a difficult position to prove that their PSM⁴ was correct, as opposed to the methodology proposed by the revenue authority now. Refer to ‘Proper records of the dispute’.

In the matter before the court, the taxpayer was able to show that the revenue authority’s decision was based on the taxpayers’ PSM, with one changed variable in the calculation, as opposed to the new methodology the revenue authority now proposed in the third version. In this way, the taxpayer was able to show that in effect the revenue authority was changing their decision some seven years ago (which administrative law principles do not allow them to do) and argue that the revenue authority had novated the methodology presented by an entirely new formula.

Therefore, it is important that the initial transfer pricing audit presentation to the revenue authority is strategically planned to either terminate the transfer pricing audit or have the revenue authority commit to specific issues or decisions regarding ALP.

PROVIDING INFORMATION VIA A DOUBLE TAX TREATY

Sometimes a taxpayer is asked via a double tax treaty to provide information about their activities and

connections with a “Named Company” in the country seeking the information. The following example letter illustrates the significance of analysing the underlying empowering legislation to ensure proper compliance

³ See Glossary of Terms.

⁴ The onus of proof usually rests with the taxpayer.

with that legislation is adhered to comply with the requirements of the revenue authority.

Refer to **Appendix G: Typical Request for Information under a Typical Section of an Income Tax Act**. The taxpayer is placed in a low tax jurisdiction (Mauritius) and because it does business with another taxpayer in Uganda, the Uganda Revenue Authority (“URA”) seeks information about the Mauritian taxpayer from the Mauritius Revenue Authority (“MRA”) which is extensive, prodding potentially confidential areas of the taxpayer in Mauritius. A suggested response is set out in **Appendix H**.

The information sought by the URA may very well be put to the Ugandan taxpayer which will expose the very valuable client base of the Mauritian taxpayer. Currently the Mauritian taxpayer buys much of the mined product from the Ugandan taxpayer to supply to its own customers at a profit. Supplying this information may end up providing the Ugandan taxpayer with a lucrative client list thus enabling the Ugandan taxpayer to approach those clients directly, eliminating the Mauritian taxpayer from participating in any of that business. If the Ugandan and Mauritian taxpayers are in fact associated enterprises, that is exactly what the URA wants to achieve so that all the profits can be taxed in Uganda. But, if they are not associated enterprises, the consequences for the arm’s length Mauritian taxpayer may be catastrophic in that its ability to conduct business with its proprietary customer list could be closed down if the Ugandan taxpayer, with the details of its customers, approaches those clients directly to sell their mined product. That must be avoided.

Unless the URA in the example can show that they are in fact associated enterprises, and there is some alleged fraud, the information requested does not have to be provided on a close analysis of the Mauritius Income Tax Act.

What the URA should have done is to limit their enquiry to the ownership of the Mauritian taxpayer to establish whether or not they are associated enterprises. As the URA letter stands, by a careful analysis of the legislated provisions and the clauses in the DTA between Uganda and Mauritius, the Mauritian taxpayer needs only to provide limited information. Refer to **Appendix H: Template** where the MNE can ask the revenue authority to justify why it is asking for information in cases where the MNE is an international entity and not a taxpayer in-country for a well-structured response to the revenue authority.

A WORD ABOUT TAX INSPECTORS WITHOUT BORDERS & EXTERNAL ADVISORS

Details on “Tax Inspectors Without Borders” can be found at un.org. The description is as follows:

“The OECD and UNDP are pleased to announce the worldwide launch of the Tax Inspectors Without Borders program. Tax Inspectors Without Borders (“TIWB”) is a joint initiative of the OECD and UNDP designed to support developing countries to build tax audit capacity. TIWB facilitates well-targeted, specialized tax audit assistance in developing countries around the world. Under TIWB tax audit experts work alongside local officials of developing country tax administrations on tax audit and tax audit related issues. TIWB aims to transfer technical know-how and skills to developing countries tax auditors, as well as shared general audit practices. The host administrations of developing countries are the lead partners in TIWB programs, clearly specifying their needs and scope of work. A dedicated central unit (TIWB Secretariat) jointly managed by OECD and UNDP operates as a clearing house to match the demand for auditing assistance with appropriate expertise. TIWB is a capacity-building program.”

The one country in Africa, being a developing nation that has used Tax Inspectors Without Borders is Kenya. In my experience, I have not had to deal with any of the so-called expert auditing officials that assist the Kenyan Revenue Authorities, but I do know that there has been much participation in planning and executing audits in the transfer pricing arena.

What must be taken into account, is that any outside expertise employed by a revenue authority in any of the developing countries are individuals that are not authorized in terms of the typical tax legislation that

governs these tax audits to access and comment on taxpayers' secret information. These individuals would have to be seconded into the revenue authority and given the special powers by the Treasury or by the Commissioner, depending on the wording of the legislation, to enable them to legitimately participate in any tax audit. Thus, in any complex tax audit in a foreign country where it is suspected that Tax Inspectors Without Borders is participating, it is my recommendation that in the initial engagement letter taken up with the revenue authority in question, it be specifically asked whether or not the Tax Inspectors Without Borders program or any other external advisors are being utilized in the tax audit. In this regard, it should also be requested that the letters of authority of all participating individuals be provided to the taxpayer so that the taxpayer can verify that everyone involved in the tax audit does have the special powers to participate in that tax audit as set out in the governing tax legislation. Should any person participate that has not been given these special powers of authority, then their participation is unlawful. That would then mean that the tax audit in question is potentially unlawful. That in turn would mean that the taxpayer does not have to participate in any of the tax auditing investigations that are being undertaken by the revenue authority in question.

From a practical point of view, one needs to establish what is the advantage to the taxpayer in doing this. Any tax audit, particularly in the transfer pricing arena, is a very complex one. With the very extensive powers given to the revenue authority, the opportunity for them to ask open-ended questions and demand open-ended information placing the taxpayer in a very difficult position when it comes to accessing that information, the time to be spent on the audit and the like, gives the taxpayer the opportunity to really focus on narrowing down the issues being investigated. In this regard if Tax Inspectors Without Borders are participating with the assistance of outside tax expertise from one of the developing countries, in the process of establishing their proper authorization, the opportunity arises for the taxpayer to also question the scope and extent of the tax audit so that the issues can be narrowed down.

In my experience, at the commencement of an audit the opportunity arises to place them on a back foot and reconsider the legitimacy of their conduct. The revenue authority then tend to be prepared to provide more information about exactly what they are auditing, giving the taxpayer an opportunity to focus on specific audit issues. Otherwise, the tax audit tends to be open-ended and broad-based that would require an extensive amount of resources, not only internally (which are oftentimes not available), but also in having to contract outside expertise to handle the responses to the revenue authority.

In conclusion, the external tax auditors brought into the fray by virtue of Tax Inspectors Without Borders does not open the powers of the revenue authority in question to simply introduce anybody into the tax audit arena. Those persons, as stated, must be properly authorized by the Treasury or by the Commissioner, as the case may be.

For instance, in the case of the African Tax Administration Forum (ATAF) an individual who was with the OECD and prior to that was with a European revenue authority, sometimes participates in African tax audits in order to assist the revenue authority in executing their powers. As stated, the question arises whether this individual, in fact, has been legally authorized by the relevant revenue authority, to access confidential taxpayer information. If he has not, then his participation in that tax audit is unlawful and potentially so is the entire tax audit.

As previously stated, in the case of the Kenya revenue authority, I know that Tax Inspectors Without Borders have assisted the revenue authority in various international tax related audits. I have not had any direct dealings with those individuals, but I do know that they have been working behind the scenes with the Kenyan revenue authority for many years. All the potential unlawful impediments that I have mentioned above are equally applicable in those instances, and the taxpayers in question would be well within their rights to ask for the letters of authority for the participation of those individuals. As I have already stated, tax information is secret and can only be shared amongst properly authorized revenue authority officials and not anyone on the outside.

In investigating the relevant legislation of the developing country, for instance in Africa, one would need to look at either the Income Tax, VAT Act, or other tax legislation and/or the appropriate tax administration legislation to identify those sections that deal with the secrecy of taxpayer information. There is generally a universal provision in the tax legislation emanating from the original English tax laws that were initially applied in many of the African states that formed part of the former British colonies. Most of that legislation will contain secrecy provisions and will also contain provisions stating that the information can only be shared with other tax officials that have been properly authorized to deal with the tax audit. There may not be a specific section that speaks to letters of authority, but the inference can be drawn that some form of letter of authority should exist to prove that that individual that is involved in fact is legitimately involved in terms of overcoming the secrecy provisions in the tax legislation.

What would be useful is a summary table that looks into the legislation of various developing countries in Africa to identify those sections that deal with secrecy provisions, and those sections that deal with letters of authority or some indication that flowing from the secrecy provisions, that one is entitled to request the appropriate letter of authority authorizing whatever individual is involved in the tax audit that that person is involved and is entitled to participate.

In doing so, it may be necessary to look at the Constitution of the country referred to, but this would have to be done on a case-by-case basis.

By way of example, I refer to the following extract from a paper presented by an Australian law firm⁵ to their clients on tax audits and the governing Australian legal principles:

“A word about Tax Inspectors without Border

Situations may arise where information obtained by the Commissioner under his access powers is detailed and complex. In such a case the Commissioner may seek to enlist the help of outside experts to interpret and analyze the information supplied. The circumstances where this is considered appropriate, and the rights of the affected taxpayer were considered in Consolidated Press Holdings v Federal Commissioner of Taxation.⁶ There the Commissioner passed information to a private practicing accountant for assistance in interpretation and analysis. In that case the taxpayer argued:

- *the appointment of the outside expert was a contravention of section 16;*
- *the taxpayer had a legitimate and reasonable expectation that the information would not be communicated outside of the revenue authority without the taxpayer being consulted.*

Although interlocutory relief was granted, the Federal Court held that the appointment of the expert did not contravene section 16. At page 4236 Lockhart J said:

“A point of vital importance is that s.16 is a constraining, not an empowering, provision. Section 16 is not a source of the Commissioner’s power to engage people to perform services at all. It says nothing about that question. It is confined to prohibiting the divulging of information concerning the affairs of taxpayers and others when acquired by officers in the course of their duties. The Commissioner’s powers to engage people to perform services are found elsewhere in the Assessment Act and the Taxation Administration Act 1953: see s.8 of the Act and s.3A of the Taxation Administration Act.”

“For the Commissioner to engage persons outside the revenue authority to perform services to enable the Commissioner to perform better his or her functions requires considerable care, both in the process of selecting those persons and preserving the need to maintain the secrecy of

5 Corrs, Chambers, Westworth Lawyers, with information from Stewart J Grieve *“The Exercise by the Commissioner of Taxation of Statutory Investigatory Powers and the Individual’s Right to Privacy”* 1997 LLM thesis Monash University.

6 95 ATC 4231.

taxpayer's affairs. It is important that the confidence of taxpayers is maintained in the taxation system and its integrity.

In my opinion the Commissioner was empowered to instruct the AGS and Mr Walker to examine the implications of the requests by the taxpayers under ss.206 and 207, with the result that they and other persons employed by them (also Mr Walker's partners) performed services for the Commonwealth and therefore were all subject to the prohibition against divulging information imposed by s.16(2)."

At page 4237 his Honour concluded the point with:

"The attack made by the applicants upon the Commissioner's appointment of the AGS and Mr Walker therefore fails so far as the construction of s.16 is concerned."

However, his Honour also found that the taxpayer did have a legitimate and reasonable expectation that the information would not be communicated outside of the revenue authority without the taxpayer being consulted. As a result, at page 4239 he said:

"In the long run the duty of the Commissioner to accord procedural fairness to the applicants is directly referable to the proper administration of the Act because it is not conducive to the confidence of taxpayers if highly sensitive and important information about their finances and affairs may be revealed to persons or bodies outside the revenue authority, in particular chartered accountants who may act for competitors of the taxpayers themselves, without taxpayers having some say on the five points to which earlier reference has been made."

In my opinion the power of reference to Mr. Walker was not properly exercised by the Commissioner in accordance with the rules of natural justice.

No doubt this case will be carefully examined by the Commissioner to ensure that the rules of natural justice are observed in the future. Plainly, there was no willful or intentional breach of them. The revenue authority is a responsible authority, and it will doubtless ensure that in the future its procedures are designed to ensure that legitimate expectations⁷ of taxpayers of the kind which have arisen in this case are fulfilled."

In this regard the Federal Court followed the decision of the High Court in *Johns v Australian Securities Commission* where the Australian Securities Commission released confidential information to a Royal Commission holding a public hearing. At page 480 Brennan J said:

*"An exercise of the authority conferred by s.127(4)(b) is apt to affect adversely the interests of an examinee who is prima facie entitled to have the confidentiality of the transcript of the examination observed. Accordingly, there is an obligation on a person proposing to exercise that authority to observe the rules of natural justice *Kioa v. West* (1985) 159 C.L.R. 550. Of course, there would be some situations in which natural justice would not require notice to be given to an examinee of an intention to make transcripts of the examination available to a State agency: for example, where an investigation by a State law enforcement agency might be frustrated by informing the examinee that information disclosed in a s.19 examination was in the hands of the agency. But where no such consideration countervails against a person's right to be heard before a decision prejudicial to his or her interests is taken, the ASC should give that person an opportunity to oppose."*

In *Consolidated Press Lockhart J* expressly stated that the Judgment was not a bar on appointing an outside expert but that such appointment should be preceded by appropriate discussions to ensure that natural justice is observed. At page 4240 he said:

7 See Glossary of Terms.

“The judgment of the Court is not a bar to the Commissioner appointing chartered accountants in the future to examine the applications of the applicant under Sections 206 and 207; indeed, not a bar to the appointment of Mr Walker. But, if any such further appointment is to be made it should be preceded by appropriate discussions between the revenue authority and the applicants to ensure that the requirements of natural justice are observed.

What I have said is not to be taken as an expression of a general view that whenever the Commissioner proposed to engage outside experts (whether chartered accountants or others) he must necessarily first consult with the relevant taxpayer. There may be occasions when appointments of this kind do not require prior consultation with or notice to taxpayers. My judgment is based squarely on the facts of this case.”

In response to the Australian decision in Consolidated Press the Commissioner released guidelines for obtaining assistance from external advisors. These guidelines confirm that the Commissioner in Australia is empowered to engage external experts under section 8 of the Act and section 3A of the Taxation Administration Act 1953. They also confirm that such an engagement does not contravene section 16.

The guidelines then outline the revenue authority’s understanding of the doctrine of legitimate expectation.”

In summary, these are salient steps to consider in preparation for the initial audit.

1. It is prudent to draft contemporaneous documentation. It will be more credible and easier to draft while corporate memory is fresh.
2. Assemble the resources you need, orchestrating the transfer pricing and tax expertise you need and whether you need external advisors;
3. Clarify what the tax authority’s concern is and investigate whether a well prepared meeting can address the concern. The aim of the meeting would be to conclude the audit or address specific issues;
4. Analyse the tax authority’s empowering legislation, including the Constitutional and Administrative law, to understand whether the tax authority is conducting the audit within its legal authority. This includes how they engage external advisors.
5. Only provide the documentation that is lawfully permitted and sourced within the correct procedural and legal means. Ensure you have a clear record of documentation previously provided.
6. Obtain a letter of findings to memorialize what has been concluded and prevent the tax authority from changing its arguments later.
7. Expect that the audit may be lengthy stretching to many years. Ensure there is a plan for tracking documentation provided, progress and the step plan.

CHAPTER 5

THE AUDIT FINDINGS

The previous section ended with “The Initial Revenue Authority Audit” with an extract¹ that stated: “What can I expect when the audit is finalized?” Of importance is that the revenue authority must “issue an audit findings letter indicating the grounds for the proposed assessment.” The full presentation by the taxpayer to the revenue authority should result in the issue of a “letter of audit findings” or an equivalent.

Either the letter will state that the revenue authority is satisfied with the explanations and terminates the transfer pricing audit, or they will indicate the grounds for the proposed additional assessment. If the transfer pricing audit is not terminated at this point, the letter should include “the grounds for the proposed assessment”. What are these? The grounds can be divided into “the facts” and “the relevant tax legislation”.

THE FACTS & THE RELEVANT TAX LEGISLATION

The truth will set you free.² A “fact” is a thing that is known or proved to be true. That truth is derived from the evidence you present as physical evidence and by the first-hand account of witnesses. In a MNE first-hand accounts may be difficult to obtain because the extensive structure of the MNE with its many employees attending to many functions is complex and oftentimes scattered. Certainly, this is the case if there is no planned structure and process. Things don’t end wrong, they start wrong.

Getting to the facts means exposing the truth and that is achieved in law by following the rules of evidence. This encompasses the rules and legal principles that govern the proof of facts in a legal proceeding. These rules determine what evidence must or must not be considered by the “trier of fact” starting with the revenue authority through to the tax court judge and assessors. The

law of evidence is concerned with the quantum (amount), quality, and type of proof needed to prevail in a tax trial.

ADMISSIBILITY OF EVIDENCE

Important rules govern the admissibility of the evidence:

- Hearsay;
- Authentication;
- Relevance;
- Privilege; and
- Expert opinions.

In the Chapter below on “Giving Evidence” I provide more detail about what elements are required for

¹ From the SARS.gov.za website (5 September 2022): “Being audited or selected for verification”.

² John 83:32. *Veritas liberat vos.*

the admissibility of evidence and what constitutes admissible hearsay. Evidence can be divided into the following categories:

*Real evidence:*³

- “In evidence law, physical evidence (also called real evidence or material evidence) is any material object that plays some role in the matter that gave rise to the litigation, introduced as evidence in a judicial proceeding (such as a trial) to prove a fact in issue based on the object’s physical characteristics.

Documentary evidence:

- Documentary evidence is any evidence that is, or can be, introduced at a trial in the form of documents, as distinguished from oral testimony. Documentary evidence is most widely understood to refer to writings on paper (such as an invoice, a contract or a will), but the term can also apply to any media by which information can be preserved, such as photographs; a medium that needs a mechanical device to be viewed, such as a tape recording or film; and a printed form of digital evidence, such as emails or spreadsheets.
- Normally, before documentary evidence is admissible as evidence, it must be proved by other evidence from a witness that the document is genuine, called “laying a foundation.”

Testimonial evidence:

- The evidence given by witnesses in court.

Demonstrative evidence:

- “Demonstrative evidence is evidence in the form of a representation of an object. This is, as opposed to, real evidence, testimony, or other forms of evidence used at trial.”

BALANCE OF PROBABILITIES

The rules of evidence all play into the “burden of proof” which usually lies with the MNE based on the “balance of probabilities”.

What does the “balance of probabilities” mean?⁴ In one case (Miller v Minister of Pensions [1947] 2 All ER 372) Denning J said:

“If the evidence is such that the tribunal can say ‘we think it more probable than not’ the burden is discharged, but if the probabilities are equal it is not.”

Expressing that in percentage terms, if a judge concludes that it is 50% likely that the claimant’s case is right, then the claimant will lose. By contrast, if the judge concludes that it is 51% likely that the claimant’s case is right then the claimant will win. One may well ask how the judge is expected to measure the probabilities of a case to 1%!

POST AUDIT COMMUNICATION & ENGAGEMENT LETTER

Refer to **Appendix I: Tax Risk Management (“TRM”) Tax Risk Review Project Template by the Group Tax Risk Steering Committee**. This sets out an example of the typical risk review process engagement by a multinational corporation to determine all tax risks that might give rise to disputes with a revenue authority. This process should commence well before an audit by a revenue authority so as to plan for potential outcomes and possibilities for settlement and resolution.

An example of the documented tax risk management process (TRM process) in response to a tax audit is set out in a table in **Appendix J: TRM Tax Steering Committee Risk Review Template**. This shows the typical layout of a strategy by a tax risk steering committee under the attorney/client privilege to identify and manage

³ https://en.wikipedia.org/wiki/Real_evidence (accessed 16 September 2022).

⁴ Thomson Reuters, Practical Law, Proof on the balance of probabilities: What this means in practice. Accessed 15 September 2022.

all tax risks in an MNE. In time this strategy will eliminate going to a tax trial in many instances. This process is commenced well before any tax audit is initiated by a revenue authority. It is in effect a self-tax audit.

During the process, it will be advisable to consider whether or not to communicate with the revenue authority advising them potential areas for discussion, namely tax risks that they may identify in a tax audit that expose the MNE. Going to them first may eliminate interest and penalties under any self-disclosure programs. This is done without sharing the full “attorney and client privileged” documentation being worked upon.

The TRM process should have taken place long before the tax audit. But if by necessity it only commences with a specific tax audit, I suggest a letter of engagement be concluded with the revenue authority to agree to timelines.

The letter of engagement from the revenue authority would typically take the following form in country X:

“For the purposes of administration of the Acts administered by the Commissioner for the NAMED revenue authority audits are conducted on taxpayers and traders to verify compliance with legislation under its control. As a result, taxpayers and traders are selected for audit through various means and processes.

NAMED revenue authority has publicly committed itself to a certain standard of service as contained in the Named Service Charter. This Charter sets standards for the levels of service expected of NAMED revenue authority officials, and what NAMED revenue authority in turn expects of taxpayers.

In terms of Section 73A of the Income Tax Act No. 58 of 1962 (“the Act”) and Section 55 of the Value-added Tax Act No. 89 of 1991 (“the VAT Act”), a taxpayer/vendor is obliged to retain records of information for a period of five years from the date of receipt by the Commissioner of the returns due for each year of assessment. You are reminded that failure to supply any information/documentation requested could result in the taxpayer becoming liable for prosecution.

This letter serves to inform you that, in terms of the Acts administered by the NAMED revenue authority, an audit of Income Tax, VAT, Stamp Duties, and Securities Transfer Tax will be conducted on your company for the above-mentioned periods.

The audit will be conducted by the following auditors:

- 1. Auditor 1*
- 2. Auditor 2*
- 3. Auditor 3*

In terms of Section 74B of the Act, the Commissioner, or his authorised officer, may for the purpose of administration of the Act require that any taxpayer or other person with reasonable prior notice, furnish produce or make available any information, documents or things he may require to inspect, audit, examine or obtain. As part of the audit procedures adopted we will be carrying out an inspection of certain books, documents, and other statutory information held at the registered offices of the company on DATE commencing at TIME. Accordingly, you are requested to have the following documents, information and statutory records available for inspection at the registered offices of the company from TIME on DATE:

- 1. Company Share Registers including, the register of allotment of shares, and the register of members setting out details of each and every beneficial shareholder and legal owner of all shares issued and allotted by the company, in the manner required by the Companies Act No 61 of 1973.*

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2. *In respect of all shares issued by the company, proof of duties and transfer taxes paid.*
 3. *Original or certified copies of the share certificates for all investments held by the company.*
 4. *Directors and shareholders minute books and attendance registers.*
 5. *Directors register of interests in contracts.*
 6. *Books of original entry including, but not limited to, cash book, journals, and general ledger. Where any of the above records are contained in an electronic format, such electronic record must be made available to the NAMED revenue authority on the day and time of inspection.*
 7. *Copies of all rulings or opinions obtained from the Named revenue authority.*
 8. *Copies of all loan or advance arrangements/agreements, entered into by the company, with third parties, group companies and entities, including connected parties to the company, the rate of interest payable on unpaid balances, the terms of each loan or advance, the terms of repayment, and any security arrangements or guarantees issued to or provided for and on behalf of the company or related party in respect of such loan or advance agreements.*
 9. *A copy of the company's Memorandum and Articles of Association.*

Following a scrutiny of the above-mentioned records together with the audited financial statements and annual returns of income the scope of the audit may be extended. This will necessitate and result in further requests for information/documentation, being issued in terms of sections 74 and 74A of the Act and may include data stored electronically by means of a computer.”

The response letter to this would be the letter of engagement. Refer to **Appendix K: Letter of Engagement**, explaining with notes the relevance of the various paragraphs. The importance of the letter of engagement is to take control of the tax audit process and understand the exact nature of the tax audit. Before simply providing information and details, establish precisely what the revenue authority is after. If it's a basic verification audit to check the expenses claimed, then provide the relevant source documents. If it's more than that, interrogate what they want. Be precise. Remind them that before they act on the information and explanations provided by you that they are duty bound to provide a letter of findings which you are entitled to respond to.

CHALLENGING A REVENUE AUTHORITY'S PROCEDURES

In one case, my client agreed with the revenue authority precisely what was being audited, what information was expected by the revenue authority, and that the revenue authority would respond with a detailed letter of findings before issuing revised assessments. The revenue authority ran out of time as the prescription date for the tax years in question approached. They issued a general letter of findings response, acting outside the scope of what was agreed. I launched an urgent application for the client against the revenue authority setting aside the general letter of findings and requesting an interdict against the revenue authority from issuing quick revised assessments. An agreed court order ensued setting aside the general letter of findings where the revenue authority agreed not to raise revised assessments. The next day the tax years prescribed and thus the tax audit ended with no result. The revenue authority was thwarted in raising an estimated US\$350 million revised assessment. See **Case Study 1**.

Do not underestimate the significance of proper engagement terms with a revenue authority.

The provision of tax audit information is the starting point of the evidence that will be discovered in a trial. What is discovery?⁵ It will typically include many documents and excel spreadsheets. These are factors to consider. If including an excel spreadsheet summarizing financial information, create a covering TAB in the spreadsheet that contains the following information:

- Where are you going to save this information to give to your legal team down the line?

5 See Glossary of Terms. This is an important part of preparing for a tax trial.

- How are you going to present the spreadsheets? Actual and PDF copies?
- What will the PDF copies look like? Large spreadsheets may be difficult to print.
- Are the formulas hard coded? Can you see and understand the formulae giving the results?
- Who are the authors of the excel spreadsheets?

Did they work under the direction of another manager? Who?

- Where did the source information come from?
- Is it a central data system available to all financial managers in the MNE?
- What is the integrity of the information?
- The date the documentation was created?
- Who provided all the information?
- Who interpreted the information as it is transcribed in the spreadsheet?
- What was the precise method of transcription?
- Are the source documents providing the information available? Where are the documents?
- Can the source documents be discovered for the purposes of the trial?
- Is the spreadsheet something that was created contemporaneously when the source information was created/obtained?
- Is the spreadsheet a typical MNE record?

The first case study was referred to above on a US\$350 million tax dispute, challenging a revenue authority in sub-Saharan Africa in issuing a defective letter of findings contrary to the terms of the initial letter of engagement for a tax audit. See **Case Study 1**, in the *Appendices*.

Case Study 2 is a draft court application brought against the revenue authority eager to issue assessments without following principles of administrative and constitutional law.

Applications are brought by way of affidavit, with supporting documents and confirmatory affidavits by third parties. Much of the content will be hearsay, so pay special attention to the rules of evidence on hearsay and hearsay exceptions.

The revenue authority will simply deny the facts you rely upon and the taxpayer will have the burden of proof.

The Respondent's (revenue authority's) version is the one followed by the courts when making a court application against a revenue authority (Plascon Evans Rule)

The principles in the South African case of Plascon Evans⁶ may apply where the final relief was based on the applicant's facts admitted by the respondent taken together with respondent's allegations. Albeit that it is a South African case; the principles may apply in similar situations around the world. See further below for summaries from other jurisdictions.

Read the case and any commentaries to fully understand its importance:

"...our courts have followed and applied the Plascon-Evans Rule in all instances where there are material disputes of fact on the papers and where there is no request for the hearing of oral evidence by the parties. The general rule is that final relief may only be granted if those facts as stated by the respondent, together with those facts stated by the applicant that are admitted by the respondent, justify the granting of an order. Simply stated, the court will consider –

- *what facts have been alleged by the respondent in its answering affidavit; against*
- *the facts and/or version of the applicant which have been admitted by the respondent.*

On a quick analysis, what this approach effectively does is to establish which facts are common

⁶ *Plascon-Evans Paint Ltd v Van Riebeeck Paints (Pty) Ltd* [1984] 2 All SA 366 (A), a South African Appellate Division case that is binding in South Africa and arguably persuasive in other jurisdictions.

cause between both applicant and respondent; and thereafter consider which facts that are denied by the respondent are, genuine and bona fide, a dispute of fact. In this regard, where there is indeed a real, genuine and bona fide dispute of fact, a respondent may, as it is entitled to do in

terms of the Uniform Rules of Court, refer such dispute to the hearing of oral evidence. Plascon-Evans Rule is not rigid in this sense. If however the respondent fails to do so, the respondent's case will stand and fall on the facts averred in its answering affidavit.”⁷

PLASCON-EVANS PRINCIPLES IN OTHER JURISDICTIONS

United Kingdom (Plascon-Evans principles)

R v Inland Revenue Commissioners, ex parte Rossminster Ltd [1980] AC 952 (HL) – Similar to Plascon-Evans, UK courts generally follow the principle that where evidence conflicts in judicial review or affidavit-based proceedings, the respondent's version is generally preferred unless it is inherently improbable.

American Cyanamid Co v Ethicon Ltd [1975] AC 396 (HL) – In interlocutory matters (such as injunctions), courts are reluctant to resolve factual disputes without cross-examination or oral evidence unless the dispute is clearly incapable of resolution.

United States (Plascon-Evans principles)

Anderson v Liberty Lobby, Inc., 477 U.S. 242 (1986) – While addressing summary judgment, the U.S. Supreme Court emphasized that where factual disputes exist, the non-moving party's evidence must be believed, and all reasonable inferences must be drawn in their favour. This mirrors the Plascon-Evans standard of giving the benefit of the doubt to the respondent.

Celotex Corp. v. Catrett, 477 U.S. 317 (1986) – Also highlights the requirement that factual disputes must be resolved in favour of the non-moving party unless the opposing party's evidence is insufficient or incredible.

Canada (Plascon-Evans principles)

Rule 20 of the Ontario Rules of Civil Procedure (Summary Judgment Test) – Courts in Canada apply a similar test where summary judgment or other motion proceedings are concerned, emphasizing that disputes of fact should not be resolved without a trial unless the responding party's position is manifestly without merit.

Sattva Capital Corp v Creston Moly Corp, 2014 SCC 53 – Canadian courts apply the principle that factual findings should be deferred to unless they are unreasonable or implausible.

New Zealand (Plascon-Evans principles)

R J Davidson Family Trust v Marlborough District Council [2018] NZSC 26 – Similar principles are applied in judicial review or interlocutory matters where courts are reluctant to resolve disputes of fact without a full trial unless the opposing version is demonstrably implausible.

Waller v Hider [1998] 1 NZLR 412 (CA) – Echoes the rule that affidavit evidence should be assessed by giving weight to the respondent's version unless it is demonstrably without foundation.

COMMON FEATURES IN VARIOUS JURISDICTIONS

Despite the existence of different procedural rules and ways to settle tax disputes, there are several

important common features that contribute to taxpayers' best interests, which are stressed by the majority of authors. A useful guide on preparing for a transfer pricing trial and the evidence, see Tax Controversy 2023 – Chambers Global Practice Guides,⁸ highlighting important points to consider and execute:

“These include:

- the importance of being prepared before an audit has even started and of being assisted by a legal adviser from the first hour;*
- the need to be fully conversant with all the relevant facts around the potential controversy and to evaluate the risks and associated contingencies in order to minimise them;*
- supporting the facts and bolstering the substance of the case, disclosing documentation and engaging expert assistance, or any other necessary support;*
- verifying if the dispute may be narrowed, by either settling or abandoning any of the issues, but making wise use of all procedural and material rights; and*
- the importance of an awareness of previous case law, even in civil law jurisdictions where precedent does not have the same strength as in common law systems – this importance increases with the need to know international jurisprudence from the ECJ or the ECHR and to be aware of comparative jurisprudence or doctrine.”*

Naturally, in-depth analysis of a case, its facts and the applicable rules of law is crucial to mastering tailor-made strategies for individual cases, as this Guide repeatedly emphasises. The reader will certainly understand that, in spite of globalisation and similar concepts/substantive tax issues (such as transfer pricing matters, hybrid mismatches, recharacterisation issues or cross-border disputes after BEPS) or procedural rules and principles, the way disputes may best be settled in each country is still part of the expertise and art of practitioners in the respective jurisdictions.

Difficult areas of producing relevant and convincing evidence are illustrated in the redacted Zimbabwe Tax Court judgment handed down on 20 January 2022, **Case Study 3**. The main issue before the judge and his two assessors was proving that actual management services were rendered. Surprisingly, despite three weeks of leading evidence from individuals actually involved in rendering the services, the taxpayer lost:

“The Finance Director for appellant testified and his testimony remarkably contradicted that of the Group Finance Director of XX on the fundamental premise upon which the notices in issue were raised. He contended that the invoices were issued on the basis of services portion of the period concerned, the contradiction the Group Finance Director had testified that the rendering of a service was not a prerequisite for the charge which XX raised on a monthly basis to the appellant. The evidence of these witnesses was therefore, mutually destructive. The appellant’s Finance Director stated that the yearly fees were registered and agreed upon the commencement of the year. He, however, had no documents as proof of such negotiations on the fees. He did not provide

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<https://practiceguides.chambers.com/practice-guides/tax-controversy-2023>: (accessed 16 November 2023):

Despite the existence of absolutely different procedural rules and ways to settle tax disputes, there are several important common features that contribute to taxpayers' best interests, which are stressed by the majority of authors. These include: the importance of being prepared before an audit has even started and of being assisted by a legal adviser from the first hour; the need to be fully conversant with all the relevant facts around the potential controversy and to evaluate the risks and associated contingencies in order to minimise them; supporting the facts and bolstering the substance of the case, disclosing documentation and engaging expert assistance, or any other necessary support; verifying if the dispute may be narrowed, by either settling or abandoning any of the issues, but making wise use of all procedural and material rights; and the importance of an awareness of previous case law, even in civil law jurisdictions where precedent does not have the same strength as in common law systems – this importance increases with the need to know international jurisprudence from the ECJ or the ECHR and to be aware of comparative jurisprudence or doctrine. Naturally, in-depth analysis of a case, its facts and the applicable rules of law is crucial to mastering tailor-made strategies for individual cases, as this Guide repeatedly emphasises. The reader will certainly understand that, in spite of globalisation and similar concepts/substantive tax issues (such as transfer pricing matters, hybrid mismatches, recharacterisation issues or cross-border disputes after BEPS) or procedural rules and principles, the way disputes may best be settled in each country is still part of the expertise and art of practitioners in the respective jurisdictions.

any rational basis for the charge which was raised by XX to the appellant. He also admitted XX exists for its own purposes and does not exist to provide service to the subsidiary only. It was therefore, necessary to separate the functions of the employees, directors and shareholders of XX in pursuant of the interests of XX as against the interests of the appellant as a subsidiary. He conceded that the invoices were not itemizing the services rendered. The acceptance of an

irregular invoice by the respondent does not make the appellant compliant with the law... From these authorities it is trite that "one should be taxed by laws, and not untaxed by commissions" or errors of revenue officers."

This illustrates the difficulty between the probability of the evidence and the credibility of the witnesses. Without the court saying so, albeit that the rendering of the management fees was more probable than not, it appears that the contradiction expressed between the two Finance Directors challenged the credibility of that probable evidence. Thus, the court opined that the onus of the Taxpayer had not been discharged.

The matter is on appeal to the Supreme Court. Please read **Case Study 3**.

In summary, the taxpayer should request a letter of audit findings if the tax authority has not already issued one. Ensure that all facts are aligned and supported by evidence. The discovery process will involve numerous documents, which should substantiate the facts you aim to prove. It's crucial to have the right legal advice from professionals who are aware of precedents and fully conversant with all relevant facts surrounding the potential controversy. They should also evaluate the risks and associated contingencies to minimize them effectively.

CHAPTER 6

GIVING EVIDENCE

INTRODUCTION

This chapter deals with an essential part in preparing a TP trial. In reading this chapter, it is essential that you also review **Appendix C1**, which contains fundamental basics on the rules of evidence. The law of evidence is a highly complex area of law and simply relying upon a TP study, with supporting documentation, will not be enough. Not by a long shot. It is essential that you understand basic definitions and concepts, such as hearsay evidence, the best evidence rule, the business records exception, discovery, documentary evidence, the expert witness, the factual witness, habit evidence, hearsay evidence exceptions, the parol evidence rule, and secondary evidence.

These definitions and concepts are set out in the glossary of terms of this book. Please pay careful attention to this information, otherwise you may get lost in trying to understand the rules of evidence. By the time you have mastered the basics, you will know why your TP study falls horribly short of the standard of evidence required in court to discharge the onus of proof that rests upon you as taxpayer.

Also review **Appendices C2 to C6** and read **Case Study 3** in conjunction with these Appendices. That will give you a solid understanding of the rules of evidence and their complexity in TP trials.

UNDERSTANDING THE RULES OF EVIDENCE TO MITIGATE TAX RISK

Let me explain. When the tax authority issues revised assessments, the onus of proof that they are wrong and you are right, rests squarely upon the shoulders of the taxpayer. It is thus incumbent upon you to present the best possible evidence of the ALP that applies to your facts. The say so of your TP advisor, in a TP study, is not enough. Once you have studied this chapter and the related areas in this book, you will know why. A TP study is merely an opinion. What matters is how did you use the TP study and what supporting original evidence is available to back up that TP study.

- Where are the original surveys and affidavits from the participants that you interviewed?
- Which reputable business conducted the survey and have they documented in detail the steps taken by them to ensure there is no bias and the information is relevant and untainted with variables that impact the veracity of that information?
- Where are the transcripts of interviews conducted between the TP advisor who wrote the TP study and the business representatives who provided the relevant background facts?
- Are the transcripts in the form of affidavits?
- Where are those business representatives. Is the TP advisor available?
- Is the conductor of the surveys available?

This is all in addition to the obvious contractual and other documentary evidence to explain the pricing and ALP relevant to the TP study.

If you don't understand the basis rules of evidence, you are going to get this part of your essential preparation wrong and your ability to conduct a successful trial will be thwarted.

By way of example, the tax authority has audited you and requesting information about your ALP and your TP process. Tax representatives in the company will refer to the TP study, local file and master file, thinking that will suffice. If the tax authority is inclined to challenge you, they will require must more convincing evidence. If you now supply them with TP study/local file and master file, and all of the background original evidence, they will be inclined not to further the audit, unless something is blatantly wrong.

If something is blatantly wrong, you have the opportunity to fix it. If there are no obvious problems with the evidence provided by you, it will result in the conclusion of the audit without going through the painful process of preparing for a TP trial. In addition to this, I would strongly advise that you enlist a TP expert witness at this stage, to write a preliminary expert opinion based on the evidence discussed and presented by you that supports your TP study. It will be very difficult for the tax authority to raise a lawful revised assessment against you. Thus, you eliminate the TP trial process.

The problem is that most corporations are not willing to spend time, effort and cost into detailed audit responses, as I have suggested. It takes effort and will cost more than the usual half baked response. However, the potential results are compelling. In essence, you better understanding of the rules of evidence will eliminate any revised assessments.

I would go one important step further. Please study my book on Tax Intelligence and the necessity to form a Tax Risk Management Steering Committee, which meets quarterly to identify and manage any emerging tax risk. This process will empower the taxpayer to anticipate potential audit exposures and to dispense with those risks. The result - no or limited tax audits and trials.

What happens in practice is once you have given the tax authority the level of detail expected with the expert opinion; it will be difficult for them to raise a lawful revised assessment without detailed counter expert opinion. The taxpayer has an opportunity very early on in the process to block the tax authority from pursuing the revised assessments with a variety of technical reasons based on constitutional and administrative law, which have nothing to do with tax law, but which apply to all government institutions including the tax authority.

For this reason, it is imperative that you understand the constitutional and administrative law defences available to the taxpayer where a government institution acts unlawfully. This body of law runs parallel with process of objections and appeals. My experience is that most tax specialists are not well versed in the constitutional and administrative law. You need a tax attorney that is a constitutional and administrative lawyer.

Obtaining and giving evidence in a transfer pricing case is the most difficult part of the dispute resolution exercise. At the end of the day you want all the relevant and admissible evidence to be presented and conveyed in a truthful and unambiguous manner that the judge and assessors will believe and accept.

In considering the practicalities of evidence for a trial, I am reminded by a very recent conversation with a senior associate preparing the statement of case (pleadings) to advance a tax dispute in a tax dispute forum. The pleadings required any relevant evidence to be filed with the pleadings. In that case the dispute required evidence of interest paid on borrowed monies used to advance the business, and to prove the write off (wear and tear) on assets utilized to advance the business as well.

What are the required documents? Invoices, purchase contracts, evidence from individuals involved in purchasing and spending the funds and advancing the business. In that case, as oftentimes, the individuals who originally produced the documentation were not present, having left the company. Thus, the original drafters were not available to give evidence. It followed that the individual allocated to give evidence was the

most recent group tax manager, tasked with reviewing all relevant documents and other business records to enable him to give the required evidence. Some invoices evidencing the assets were lost or destroyed (outside the document retention period). However, audited financial statements were available reflecting what sums were spent on assets.

When the best evidence is not available hearsay or secondary evidence¹ is required.

The starting point is to review the rules of evidence of that jurisdiction, to obtain guidance what evidence is admissible, and to what extent hearsay evidence is admissible. That requires an analysis of the rules of evidence for that jurisdiction.

ADMISSIBILITY, RELEVANCE AND OTHER CONSIDERATIONS

Added to this are other overriding considerations that impact the admissibility and relevance of that evidence, and various philosophical and ethical considerations. These nuanced aspects should not drive the process but will help you in your general approach. By way of introduction to this theme, as general guidance please look at **The SA Law of Evidence** published by LexisNexis South Africa,² “**Chapter 2 The South African evidentiary system and theories of proof**” starting at page 31:

An evidentiary system contains legal rules relating to ‘evidence’, as that concept happens to be defined in a particular system. However, and as much as this statement may be true, it is not the whole truth. Legal rules are not, for a start, absolute and unchecked in a constitutional system such as ours. They do not, furthermore, operate in a vacuum, since they crystallise out of a legal mind-set that, depending on its expansiveness or receptiveness to the influence of cognate disciplines and ideas, defines the relationship between the rules of evidence and the science of proof itself. The rules, moreover, may be made to resonate to the rhythms of a dominant theme – a particular philosophy of proof that may be employed to set the tone for many of the difficult problems of proof that arise in such areas as the onus of proof, relevance, circumstantial evidence, inferential reasoning, and the proof of intermediate facts. This observation alerts us to a question that holds the possibility of both a deeper truth and a higher responsibility: is it possible, or even necessary, to select a mode of thought, necessarily lying outside the rules of evidence themselves, to lend coherence to that system and to justify the emergence of rules that may be consistent with one such approach, yet in conflict with another? And this, finally, leads us to consider the nature of the relationship between the rules of evidence and those rules that make up the logical system that we select to inform the evidentiary rules and to give them their scope and character, but that, at the same time, lies outside of the ‘evidentiary rules’ in the narrow sense of that term. In the light of

these observations, it is both necessary and useful to consider the nature and ambit of the ‘evidentiary system’ that underpins our formal evidentiary rules in South Africa. To this end, four questions are examined:

1. *What is the impact of the Constitution on our approach to evidence?*
2. *How has the ‘rationalist tradition’ of Anglo-American evidence scholarship influenced our law of evidence?*
3. *Is it necessary to select a philosophy of proof and, if so, how must we do so?*
4. *If we are to identify and select a dominant logical system or mode of thought to apply to our rules of evidence, what is the nature of the relationship between the rules of logic of that system and the formal rules of evidence themselves?...*

A cursory inspection of the cases dealing with the onus of proof in civil cases, for instance, would

¹ See Glossary of Terms.

² Zeffertt and Paizes, **The SA Law of Evidence** 3rd Ed. LexisNexis, South Africa: <https://store.lexisnexis.co.za/products/the-south-african-law-of-evidence-3rd-ed-skuZASKUPG5701>

reveal a strong Pascalian inclination, with clear and apparently unequivocal support being given to the standard formulated by Denning J in *Miller v Minister of Pensions*: ... 'If the evidence is such that the tribunal can say "we think it more probable than not," the burden is discharged, but if the probabilities are equal it is not.' Such an approach would seem to exclude the possibility of finding for an onus-bearing party whose case, while it may be more probable than that of his opponent, is not 'more probable than not'.... At the same time, however, a long line of cases can be found where the adaptation to a civil trial of the rules of inferential reasoning, set out within a criminal context in *R v Blom*,... would permit of the drawing of an inference, even for the purpose of establishing an issue attracting the onus of proof, where that inference was the 'most natural and plausible inference'.... It is at once apparent that inference A may be more 'natural and plausible' than inferences B, C or D without being, at the same time, more likely than 'not A'. As a result, the civil standard may, in cases where this reasoning is invoked, easily collapse – in the absence of a vigilant eye – into the kind of balancing of probabilities that would allow a party to win where his or her case is more probable than that of his or her adversary even if it is not more probable than not. There may, in other words, be a strong (albeit unconscious) Baconian overlay to a test formulated in clear Pascalian language, leading to a situation where one might be unable, in certain circumstances, to predict which of these approaches would prevail.

SECONDARY EVIDENCE – HEARSAY AND THE EXCEPTIONS

Unfortunately, tax professionals have a habit of “messing up” this part of the preparation of a tax dispute case. Experts differ drastically in their views. The OECD TPG’s are not always clear. Key witnesses are lost. Records are lost. The latter two problems usually exist because the revenue authority takes so long to complete the audit and bring the tax dispute before a court.

In a trial in Zimbabwe (a jurisdiction based on English law) reliance was placed on the hearsay and secondary evidence to be given by the expert witness. Refer to **Appendix C5: Admissibility of Hearsay Evidence** by an Expert witness setting out the application prepared for submission in court for the admissibility of the expert witnesses’ evidence. Read this together with **Appendix C6: Supporting Arguments to Evidence** in respect of such type of evidence generally.

HEARSAY EVIDENCE

Take a look at Chapter 13 of *The SA Law of Evidence* published by LexisNexis, South Africa.³ The following extract from that chapter is typical of what applies in many jurisdictions:

“The common law of hearsay, as mentioned above, no longer applies in South Africa now that section 3 of the Law of Evidence Amendment Act 45 of 1988 has come into operation. It lays down:

- (1) Subject to the provisions of any other law, hearsay evidence shall not be admitted as evidence at criminal or civil proceedings, unless –
 - a. each party against whom the evidence is to be adduced agrees to the admission thereof as evidence at such proceedings;
 - b. the person upon whose credibility the probative value of such evidence depends, himself testifies at such proceedings; or
 - c. the court, having regard to –
 - i. (i) the nature of the proceedings;
 - ii. (ii) the nature of the evidence;
 - iii. (iii) the purpose for which the evidence is tendered;
 - iv. (iv) the probative value of the evidence;

³ Zeffertt and Paizes, *The SA Law of Evidence* 3rd Ed. LexisNexis, South Africa: <https://store.lexisnexis.co.za/products/the-south-african-law-of-evidence-3rd-ed-skuZASKUPG5701>.

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- v. (v) the reason why the evidence is not given by the person upon whose credibility the probative value of such evidence depends;
 - vi. (vi) any prejudice to a party which the admission of such evidence might entail; and
 - vii. (vii) any other factor which should in the opinion of the court be taken into account, is of the opinion that such evidence should be admitted in the interests of justice.
- (2) The provisions of subsection (1) shall not render admissible any evidence which is inadmissible on any ground other than that such evidence is hearsay evidence.
 - (3) Hearsay evidence may be provisionally admitted in terms of subsection (1) (b) if the court is informed that the person upon whose credibility the probative value of such evidence depends, will himself testify in such proceedings: Provided that if such person does not later testify in such proceedings, the hearsay evidence shall be left out of account unless the hearsay evidence is admitted in terms of paragraph (a) of subsection (1) or is admitted by the court in terms of paragraph (c) of that subsection.
 - (4) For the purposes of this section – “hearsay evidence” means evidence, whether oral or in writing, the probative value of which depends upon the credibility of any person other than the person giving such evidence; “party” means the accused or party against whom hearsay evidence is to be adduced, including the prosecution.”

In the USA the rules of evidence are codified, making it easier to establish and understand the hearsay exceptions. These codified exceptions will help inform any hearsay application brought in terms of in-country legislation. The US federal rules of evidence as set out in **Appendix C1**.

FEDERAL RULES OF EVIDENCE

This section deals with the Federal Rules of evidence. It is heavy reading and is included because it is a great piece of work, codifying the basic rules of evidence that apply worldwide. I am not saying that the Federal Rules of evidence are applicable in every jurisdiction. It is a great summary of all the difficult concepts in the law of evidence, found in legislation of the countries you may deal with. I would recommend using the FRE as the starting point and then look for the specific local rules of evidence of the country you are dealing with. In that country the rules of evidence will most likely be set out in various pieces of evidence dealing with evidence; e.g. civil evidence. You will also find rules of evidence in the tax legislation, rules or regulations. If these rules of evidence that you find in the FRE are not codified, you will most likely find developed principles of evidence in the case law of that country. The FRE helps you identify those rules of evidence. In today's world, ChatGPT is a very useful tool to seek out the rules of evidence in your country. However, do not wholly rely on its summaries because sometimes they are wrong. It is useful in listing where to find the rules and how to access them. You must then go and read those sources and extract the relevant detail using the FRE as a guideline.

USA FEDERAL RULES OF EVIDENCE HEARSAY EXCEPTIONS

“Rule 801 – Definitions That Apply to This Article: Exclusions from Hearsay

The following definitions apply under this article:

- (a) Statement. “Statement” means a person’s oral assertion, written assertion, or nonverbal conduct, if the person intended it as an assertion.
- (b) Declarant. “Declarant” means the person who made the statement.
- (c) Hearsay. “Hearsay” means a statement that:
 - (1) the declarant does not make while testifying at the current trial or hearing; and
 - (2) a party offers in evidence to prove the truth of the matter asserted in the statement.
- (d) Statements That Are Not Hearsay. A statement that meets the following conditions is not hearsay:
 - (1) A Declarant-Witness’s Prior Statement. The declarant testifies and is subject to

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- cross-examination about a prior statement, and the statement:
- (A) is inconsistent with the declarant's testimony and was given under penalty of perjury at trial, hearing, or other proceeding or in a deposition;
 - (B) is consistent with the declarant's testimony and is offered;
 - (i) to rebut an express or implied charge that the declarant recently fabricated it or acted from a recent improper influence or motive in so testifying; or
 - (ii) to rehabilitate the declarant's credibility as a witness when attacked on another ground; or
 - (C) identifies a person as someone the declarant perceived earlier.
- (2) An Opposing Party's Statement. The statement is offered against an opposing party and:
- (A) was made by the party in an individual or representative capacity;
 - (B) is one of the party manifested that it adopted or believed to be true;
 - (C) was made by a person whom the party authorized to make a statement on the subject;
 - (D) was made by the party's agent or employee on a matter within the scope of that relationship and while it existed; or
 - (E) was made by the party's co-conspirator during and in furtherance of the conspiracy.

The statement must be considered but does not by itself establish the declarant's authority under (C); the existence or scope of the relationship under (D); or the existence of the conspiracy or participation in it under (E)."

"Rule 802 – The Rule Against Hearsay

Hearsay is not admissible unless any of the following provides otherwise:

- a federal statute;
- these rules; or
- other rules prescribed by the Supreme Court."

"Rule 803 – Exceptions to the Rule Against Hearsay – Regardless of Whether the Declarant is Available as a Witness

The following are not excluded by the rule against hearsay, regardless of whether the declarant is available as a witness:

- (1) Present Tense? Impression. A statement describing or explaining an event or condition, made while or immediately after the declarant perceived it.
- (2) Excited Utterance. A statement relating to a startling event or condition, made while the declarant was under stress of excitement that it caused.
- (3) Then-Existing Mental, Emotional, or Physical Condition. A statement of the declarant's then-existing state of mind (such as motive, intent, or plan) or emotional, sensory, or physical condition (such as mental feeling, pain, or bodily health), but not including a statement of memory or belief prove to the fact remembered or believed unless it relates to the validity or terms of the declarant's will.
- (4) Statement made for Medical Diagnosis or Treatment. A statement that:
 - (A) is made for – and is reasonably pertinent to – medical diagnosis or treatment; and
 - (B) describes medical history; past or present symptom or sensations; their inception, or their general cause.

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- (5) Recorded Recollection: A record that:
- (A) is on a matter the witness once knew about but now cannot recall well enough to testify fully and accurately;
 - (B) was made or adopted by the witness when the matter was fresh in the witness's memory; and
 - (C) accurately reflects the witness's knowledge. If admitted, the record may be read into evidence but may be received as an exhibit if only offered by an adverse party.
- (6) Records of a Regularly Conducted Activity. A record of an act, event, condition, opinion, or diagnosis if:
- (A) the record was made at or near the time by – or from information transmitted by – someone with knowledge;
 - (B) the record was kept in the course of a regularly conducted activity of a business, organization, occupation or calling, whether or not for profit;
 - (C) making the record was a regular practice of that activity;
 - (D) all these conditions are shown by the testimony of the custodian or another qualified witness, or by a certification that complies with Rule 902(11) or (12) or with a statute permitting certification; and
 - (E) the opponent does not show that the source of information or the method or circumstances of preparation indicate a lack of trustworthiness.
- (7) Absence of a Record of a Regularly Conducted Activity. Evidence that a matter is not included in a record described in paragraph (6) if:
- (A) the evidence is admitted to prove that the matter did not occur or exist;
 - (B) a record was regularly kept for a matter of that kind; and
 - (C) the opponent does not show that the possible source of information or other circumstances indicate a lack of trustworthiness.
- (8) Public Records. A record or statement of a public office if:
- (A) it sets out:
 - (i) the office's activities;
 - (ii) a matter observed while under a legal duty to report, but not including, in a criminal case, a matter observed by law-enforcement personnel; or
 - (iii) in a civil case or against the government in a criminal case, factual findings from a legally authorized investigation; and
 - (B) the opponent does not show that the source of information or other information or other circumstances indicate a lack of trustworthiness.
- (9) Public Records of Vital Statistics. A record of a birth, death, or marriage, if reported to a public office in accordance with a legal duty.
- (10) Absence of a Public Record. Testimony – or a certification under Rule 902 – that a diligent search failed to disclose a public record or statement if:
- (A) the testimony or certification is admitted to prove that
 - (i) the record or statement does not exist; or
 - (ii) a matter did not occur or exist, if a public office regularly kept a record or statement for a matter of that kind; and
 - (B) in a criminal case, a prosecutor who intends to offer a certification provides written notice of that intent at least 14 days before trial, and the defendant does not object in writing within 7 days of receiving the notice – unless the court sets a different time for the notice or the objection.
- (11) Records of Religious Organizations Concerning Personal or Family History. A statement of birth, legitimacy, ancestry, marriage, divorce, death, relationship by blood or marriage, or similar facts of personal or family history, contained in a regularly kept record of a religious organization.
- (12) Certificates of Marriage, Baptism, and Similar Ceremonies. A statement of fact contained in a certificate:
- (A) made by a person who is authorized by a religious organization or by law to perform

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- the act certified;
- (B) attesting that the person performed a marriage or similar ceremony or administered a sacrament; and
- (C) purporting to have been issued at the time of the act or within a reasonable time after it.
- (13) Family Records. A statement of fact about personal or family history contained in a family record, such as a Bible, genealogy, chart, engraving on a ring, inscription on a portrait, or engraving on an urn or burial marker.
- (14) Records of Documents that Affect an Interest in Property. The record of a document that purports to establish or affect an interest in property if:
- (A) the record is admitted to prove the content of the original recorded document, along with its signing and its delivery by each person who purports to have signed it;
- (B) the record is kept in a public office; and
- (C) a statute authorizes recording documents of that kind in that office.
- (15) Statements in Documents that Affect an interest in Property. A statement contained in a document that purports to establish or affect an interest in property if the matter stated was relevant to the document's purpose – unless later dealings with the property are inconsistent with the truth of the statement or the purport of the document.
- (16) Statements in Ancient Documents. A statement in a document that was prepared before January 1, 1998 and whose authenticity is established.
- (17) Market Reports and Similar Commercial Publications. Market quotations, lists, directories, or other compilations that are generally relied on by the public or by persons in particular occupations.
- (18) Statements in Learned Treatises, Periodicals, or Pamphlets. A statement contained in a treatise, periodical, or pamphlet if:
- (A) the statement is called to the attention of an expert witness on cross-examination or relied on by the expert on direct examination; and
- (B) the publication is established as a reliable authority by the expert's admission or testimony, by another expert's testimony, or by judicial notice. If admitted, the statement may be read into evidence but not received as an exhibit.
- (19) Reputation concerning Personal or Family History. A reputation among a person's family by blood, adoption, or marriage – or among a person's associates or in the community – concerning the person's birth, adoption, legitimacy, ancestry, marriage, divorce, death, relationship by blood, adoption, or marriage, or similar facts of personal or family history.
- (20) Reputation Concerning Boundaries or General History. A reputation in a community – arising before the controversy – concerning boundaries of land in the community or customs that affect the land, or concerning general historical events important to that community, state, or nation.
- (21) Reputation Concerning Character. A reputation among a person's associates or in the community concerning the person's character.
- (22) Judgment of a Previous Conviction. Evidence of a final judgment of conviction if:
- (A) the judgment was entered after a trial or guilty plea, but not a nolo contendere plea;
- (B) the conviction was for a crime punishable by death or by imprisonment for more than a year;
- (C) the evidence is admitted to prove any fact essential to the judgment; and
- (D) when offered by the prosecutor in a criminal case for a purpose other than impeachment, the judgment was against the defendant. The pendency of an appeal may be shown but does not affect admissibility.
- (23) Judgements Involving Personal, Family, or General History or a Boundary. A judgment that is admitted to prove a matter of personal, family, or general history, or boundaries, if the matter:

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- (A) was essential to the judgment; and
 - (B) could be proved by evidence of reputation.”

“Rule 804 – Exceptions to the Rule Against Hearsay – When the Declarant is Unavailable as a Witness

- (a) Criteria for Being Unavailable. A declarant is considered to be unavailable as a witness if the declarant:
 - (1) is exempted from testifying about the subject matter of the declarant’s statement because the court rules that a privilege applies;
 - (2) refuses to testify about the subject matter despite a court order to do so;
 - (3) testifies to not remembering the subject matter;
 - (4) cannot be present or testify at the trial or hearing because of death of a then-existing infirmity, physical illness, or mental illness; or
 - (5) is absent from the trial or hearing and the statement’s proponent has not been able, by process or other reasonable means, to procure:
 - (A) the declarant’s attendance, in the case of a hearsay exception under Rule 804(b)(1) or (6); or
 - (B) the declarant’s attendance or testimony, in the case of a hearsay exception under Rule 804(b)(2), (3), or (4). But this subdivision (a) does not apply if the statement’s proponent procured or wrongfully caused the declarant’s unavailability as a witness in order to prevent the declarant from attending or testifying.
- (b) The Exceptions. The following are not excluded by the rule against hearsay if the declarant is unavailable as a witness:
 - (1) Former Testimony. Testimony that:
 - (A) was given as a witness at a trial, hearing, or lawful deposition, whether given during the current proceeding or a different one; and
 - (B) is now offered against a party who had – or, in a civil case, whose predecessor in interest had – an opportunity and similar motive to develop it by direct, cross-, or redirect examination.
 - (2) Statement Under the Belief of Imminent Death. In a prosecution for homicide or in a civil case, a statement that the declarant, while believing the declarant’s death to be imminent, made about its cause or circumstances.
 - (3) Statement Against Interest. A statement that:
 - (A) a reasonable person in the declarant’s position would have made only if the person believed it to be true because, when made, it was so contrary to the declarant’s proprietary or pecuniary interest or had so great a tendency to invalidate the declarant’s claim against someone else or to expose the declarant to civil or criminal liability; and
 - (B) is supported by corroborating circumstances that clearly indicate its trustworthiness, if it is offered in a criminal case as one that tends to expose the declarant to criminal liability.
 - (4) Statement of Personal or Family History. A statement about:
 - (A) the declarant’s own birth, adoption, legitimacy, ancestry, marriage, divorce, relationship by blood, adoption or marriage, or similar facts of personal or family history, even though the declarant had no way of acquiring personal knowledge about that fact; or
 - (B) another person concerning any of these facts, as well as death, if the declarant was related to the person by blood, adoption, or marriage or was so intimately associated with the person’s family that the declarant’s information is likely to be accurate.
 - (5) [Other Exceptions.] [Transferred to Rule 807.]

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- (6) Statement Offered Against a Party That Wrongfully Caused the Declarant's Unavailability. A statement offered against a party that wrongfully caused – or acquiesced in wrongfully causing – the declarant's unavailability as a witness, and did so intending that result."

"Rule 805 – Hearsay Within Hearsay"

Hearsay within hearsay is not excluded by the rule against hearsay if each part of the combined statements conforms with an exception to the rule."

"Rule 806 - Attacking and Supporting the Declarant's Credibility"

When a hearsay statement – or a statement described in Rule 801(d)(2)(C), (D), or (E) – has been admitted in evidence, the declarant's credibility may be attacked, and then supported, by any evidence that would be admissible for those purposes if the declarant had testified as a witness. The court may admit evidence of the declarant's inconsistent statement or conduct, regardless of when it occurred or whether the declarant had the opportunity to explain or deny it. If the party against whom the statement was admitted calls the declarant as a witness, the party may examine the declarant on the statement as if on cross-examination."

"Rule 807 – Residual Exception"

- (a) In General. Under the following conditions, a hearsay statement is not excluded by the rule against hearsay even if the statement is not admissible under a hearsay exception in Rule 803 or 804:
- (1) the statement is supported by sufficient guarantees of trustworthiness – after considering the totality of circumstances under which it was made and evidence, if any, corroborating the statement; and
 - (2) it is more probative on the point for which it is offered than any other evidence that the proponent can obtain through reasonable efforts.
- (b) Notice. The statement is admissible only if the proponent gives an adverse party reasonable notice of the intent to offer the statement – including its substance and the declarant's name – so that the party has a fair opportunity to meet it. The notice must be provided in writing before the trial or hearing – or in any form during the trial or hearing if the court, for good cause, excuses a lack of earlier notice."

BUSINESS RECORDS

Refer to **Appendix C1: Questions and Answers to Federal Rules of Evidence**.

In the SA textbook *Principles of Evidence* it states at:

- "15.3.4 *Admissibility of certain trade or business records*
Certain trade or business records will be admitted into evidence as proof of their contents in terms of s 221 of the CPA if (a) they were compiled in the course of trade or business from information supplied by persons having personal knowledge of the matters dealt with in the document; and (b) the person who supplied the information is dead, out of the country, physically or mentally unfit to attend as a witness, cannot be identified or found, or cannot reasonably be expected to recollect the matters dealt with in the document. In determining the weight of the evidence, the court will have regard to the reliability of the statement, in particular the contemporaneity of the statement with facts contained in the

document and the impartiality of the person who supplied the information. Subsection (4) specifies that the section shall not prejudice the admissibility of any evidence which would be admissible apart from the provisions of s 221.”

“15.3.6 *Accounting records and documentation of banks*

Accounting records and documents in the possession of a bank shall be admissible in evidence in terms of s 236(1) of the CPA provided they are accompanied by an affidavit by a person stating that (a) they are in the service of the bank (b) they are ordinary records and documents of the bank; (c) the entries have been made and the documents compiled, printed or obtained in the usual and ordinary course of the business of the bank; (d) the records or documents are in the custody or under the control of the bank. An entry, record or documents will constitute proof of its contents if accompanied by an affidavit in which the deponent states that: she is in the service of the bank, that she has examined the entry or record and that the attached copy is a correct copy. The person against whom such records and documents are admitted, may inspect the record or document. A bank can only be compelled to produce such records and documents by an order of court. Proof of entries in accounting records and documentation of banks in countries outside the Republic are similarly regulated by s 236A of the CPA.”

The business records exception to hearsay evidence applies in many jurisdictions.

PAROL EVIDENCE AND THE VIEW OF ECONOMISTS

There is a dichotomy between the understanding of lawyers of established legal rights and what economists refer to as value assets. For instance, the typical license agreement will license the “use of certain intellectual property” defined as trademarks and copyrights as represented by an image and a particular “get up”. The economist sees a “brand” and will want to value “the brand”.

However, “the brand” is not defined in the license agreement. When questioning an economist of what the license agreement supplies, the economist will typically not rely specifically on the license agreement’s definition of the intellectual property licensed for use. The economist will see the intellectual property as defined but with a “goodwill” attached to those defined rights. The lawyer will point out that the “goodwill” does not form part of what is licensed to use. The economist will answer that for transfer pricing valuation purposes that “goodwill” will typically affect the valuation.

Obviously, the value of the use of the trademarks and the copyright will be much less than what the economist sees as “the brand’s value, i.e., the trademarks and the copyright with the “goodwill” towards the entity licensing the intellectual property.

In the English law based legal systems, the parol evidence rule⁴ is applicable. This is pitched against the Transfer Pricing Guidelines, which must be remembered are guidelines, and not law.

The parol evidence rule states in *Republic v Commissioner of Income Tax; Ex Parte Maatschappij De Fijnhouthandel N.V. (Fynhout)* [1971] 1 GLR 213 at paragraph (3) of the Headnote:

“It is settled law that where a finding is not supported by evidence, it then becomes a question of law and certiorari⁵ will lie to quash the finding. The question whether a company is carrying on trade or business in Ghana is a question of fact which must be supported by evidence. Since the Commissioner has not shown by his affidavit the evidence on which he relied for the assessment, certiorari lay to quash the assessments. Judgment of Coussey J. digested in (1970) C.C. 28 revised.”

The parol evidence rule provides that “where a jurat act is incorporated in a document, it is not generally

⁴ See Glossary of terms.

⁵ See Glossary of terms.

permissible to adduce extrinsic evidence of its terms.” “Extrinsic” refers to evidence other than, or extraneous of, the document itself. Closely connected with the parol evidence rule is the “extrinsic evidence rule” that no evidence may be given to alter the clear and unambiguous meaning of a contract, whether written or oral. The rule is one of substantive law.⁶

How does one reconcile the legal principles of evidence, and override the terms and conditions of the agreements between the parties? The key to that lies in the application of the ALP to the affected transaction between the associated parties. If the revenue authority is successful in its decision that the transaction was not conducted at an ALP, the terms and conditions pertaining to price can be overridden with the results of an economic analysis. However, can more be read into what in fact is being supplied? For instance, is it merely as described in the agreement as intellectual property consisting of trademarks and copyright, or should that be read to mean something more? Such as the inclusion of all the attributes related to a branded product being supplied?

In the USA in the Treasury regulations issued for section 482 (the transfer pricing section in the Federal Income Tax Act) the following definition is applicable where there is no written agreement:

1.482-1(d)(3)(ii)(B)(2) No written agreement.

In the absence of a written agreement, the district director may impute a contractual agreement between the controlled taxpayers consistent with the economic substance of the transaction. In determining the economic substance of the transaction, greatest weight will be given to the actual conduct of the parties and their respective legal rights (see, for example, § 1.482-4(f)(3) (Ownership of intangible property)).

In all countries applying transfer pricing adjustments, the revenue authority will attempt to ascribe the ‘fictitious income’ determined by them after a TP analysis, to justify the application of ALP. Does the legislation specifically allow for this, or is this an act that is *ultra vires*⁷ their legislated powers. The USA Treasury regulation is an example of the type of provision that should be promulgated as part of the law. Otherwise. The parol evidence rule in English common law would apply, and extrinsic evidence to the written agreements should not be applicable. Revenue Authorities may attempt to segue into the ALP with the guidance of an expert economist valuing the transaction. But, does the actual legislation (the wording of the anti-avoidance provision) actually allow for this?

For instance, in Zimbabwe the anti-avoidance provision reads:

“98 Tax avoidance generally

Where any transaction, operation or scheme (including a transaction, operation or scheme involving the alienation of property) has been entered into or carried out, which has the effect of avoiding or postponing liability for any tax or of reducing the amount of such liability, and which in the opinion of the Commissioner, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out-

- (a) as entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or*
- (b) Has created rights or obligations which would not normally be created between persons dealing at arm’s length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and the Commissioner is of the opinion that the avoidance or postponement of such liability or the reduction of the amount of such liability was the sole purpose or one of the main purposes of the transaction, operation or scheme. The Commissioner shall determine the liability for any tax and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case*

⁶ Schwikkard and Van Der Merwe, Principles of Evidence, 4th ed., Juta’s at page 40, para 4.6.1. Footnotes are omitted.

⁷ See Glossary of Terms – *ultra vires* action.

he considers appropriate for the prevention or diminution of such avoidance, postponement or reduction.” (my emphasis)

JUDICIAL INFERENCE OF THE PAROL EVIDENCE PRINCIPLE IN TRANSFER PRICING CASES

Although courts in transfer pricing disputes do not typically invoke the Parol Evidence Rule by name, a coherent body of judicial authority demonstrates its functional application. In these cases, courts have consistently preferred contemporaneous contracts, documented conduct, and observable economic facts over ex post narrative explanations, hindsight-based economic reconstructions, or retrospective assertions of commercial intent.

The effect of this jurisprudence is that economic and expert evidence is admitted only to the extent that it explains contemporaneous arrangements, not where it seeks to rewrite or rehabilitate them.

United States

In *Veritas Software Corp v Commissioner* (133 T.C. 297)⁸, the United States Tax Court rejected the Commissioner’s valuation approach on the basis that it relied impermissibly on hindsight assumptions about future profitability and synergies. The court emphasised that arm’s length pricing must be evaluated using information available to the parties at the time of the transaction, and not through retrospective economic reasoning developed during litigation.

The significance of *Veritas* lies not merely in valuation methodology, but in its evidentiary stance: economic models cannot be used to contradict or replace the contemporaneous commercial record.⁹

A similar evidentiary discipline is evident in *Amazon.com Inc v Commissioner* (148 T.C. 108; *aff’d* 934 F.3d 976 (9th Cir. 2019))¹⁰. The Tax Court rejected the Internal Revenue Service’s attempt to recharacterise the transaction by attributing additional value to intangibles based on subsequent business success. The court grounded its analysis in the contractual allocation of rights and risks and the parties’ contemporaneous conduct, declining to accept economic evidence that depended on assumptions not reflected in the agreements as executed¹¹.

In *Coca-Cola Co v Commissioner* (155 T.C. 10)¹², the court further reinforced this approach by holding that assertions of “control” over marketing intangibles must be demonstrated through actual decision-making authority and risk assumption, supported by evidence, rather than inferred from group affiliation or later profitability. The court declined to give decisive weight to expert testimony that was not anchored in contemporaneous proof of DEMPE functions¹³.

Canada

The Supreme Court of Canada in GlaxoSmithKline Inc v The Queen (2012 SCC 52)¹⁴ held that transfer

8 *Veritas Software Corp v Commissioner* 133 T.C. 297 (2009). See in particular the Tax Court’s rejection of valuation assumptions based on hindsight and post-transaction developments, emphasising that arm’s length pricing must be assessed using information reasonably available at the time the transaction was entered into.

9 OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2022), paras 1.33–1.36 (accurate delineation of the transaction); para 1.34 (importance of contemporaneous conduct over ex post assertions).

10 *Amazon.com Inc v Commissioner* 148 T.C. 108 (2017), *aff’d* 934 F.3d 976 (9th Cir. 2019). The court declined to accept an approach that attributed additional value to intangibles based on subsequent business success rather than the contractual allocation of rights and risks as documented and implemented at the time.

11 See also R. Finley, “Transfer Pricing and the Use of Hindsight after Amazon and Veritas”, *Tax Notes International* (2019), noting the increasing judicial resistance to retrospective economic reconstruction in transfer pricing litigation.

12 *Coca-Cola Co v Commissioner* 155 T.C. 10 (2020). The Tax Court required proof of actual control over risks and DEMPE functions through contemporaneous decision-making authority and conduct, and gave limited weight to expert opinion unsupported by such evidence.

13 OECD, *Transfer Pricing Guidelines* (2022), paras 6.32–6.59 (DEMPE functions), emphasising that legal ownership alone is insufficient absent demonstrable control over economically significant risks.

14 *GlaxoSmithKline Inc v The Queen* 2012 SCC 52. The Supreme Court of Canada held that arm’s length pricing must be assessed in light of the full commercial and contractual context, rejecting an approach that isolated price from the surrounding contemporaneous arrangements.

pricing analysis must reflect the full commercial and contractual context in which transactions occurred. The Court rejected a narrow approach that isolated pricing from the surrounding contractual arrangements, emphasising that arm's length conditions must be assessed by reference to what independent parties actually agreed.

Although not framed in evidentiary terms, the decision reinforces the principle that economic analysis cannot disregard or override the contemporaneous contractual framework.

In *Cameco Corporation v The Queen (2018 TCC 195)*¹⁵, the Tax Court rejected the Canada Revenue Agency's reliance on hindsight to attack pricing arrangements that later proved highly profitable. The court focused on the commercial risks and expectations at the time the contracts were entered into, and declined to allow retrospective reasoning to invalidate arrangements that were commercially rational when made.

United Kingdom

In *GE Financial Investments Ltd v HMRC ([2018] UKSC 20)*¹⁶, the Supreme Court confirmed that the arm's length condition requires an assessment of risks actually assumed under the contractual arrangements, rather than a reconstruction based on later events or outcomes. The court rejected approaches that effectively substituted hindsight-driven economic logic for the parties' documented allocation of risk¹⁷.

Synthesis

Across these jurisdictions, courts have demonstrated a consistent reluctance to permit after-the-fact narrative explanations to displace contemporaneous contractual terms, documented conduct, or objective economic evidence. While the Parol Evidence Rule is not expressly cited, the practical result is analogous: extrinsic explanations that contradict or supplement the contemporaneous record are given little or no weight.

This judicial approach closely aligns with the OECD Transfer Pricing Guidelines¹⁸ emphasis on accurate delineation, FAR analysis, and DEMPE functions grounded in observable, verifiable facts. Expert economic evidence remains relevant, but only insofar as it elucidates the contemporaneous economic reality of the transaction, rather than reconstructing it through hindsight.

EXPERT EVIDENCE

For a general overview of the principles affecting expert evidence, see Schwikkard and Van Der Merwe, Principles of Evidence, 4th ed., Juta's at page 54 on relevance and the extract from Toohy v Metropolitan Police Commissioner 1965 1 All ER 506.

In the cross-examination of transfer pricing experts, especially those involved in drafting the transfer pricing studies relied upon by the MNE, that expert will be giving mostly hearsay evidence by definition. One example is the establishment of ALP royalty rates for the use of a brand. In such a case, various third parties would have been contracted and sub-contracted to determine the ALP.

A market research agency would design the research project in consultation with the MNE's marketing department to determine relevant attributes to a brand that must be tested in that country. Survey agencies, employing a number of interviewers, will conduct interviews with thousands of respondents to obtain statistically relevant data. The data will ultimately be analysed by data analysts and interpreted by valuation

15 *Cameco Corporation v The Queen* 2018 TCC 195. The Tax Court rejected hindsight-based arguments derived from later profitability and focused instead on the commercial risks and expectations existing at the time the relevant contracts were concluded.

16 *GE Financial Investments Ltd v HMRC* [2018] UKSC 20. The Supreme Court confirmed that the arm's length condition requires an evaluation of risks actually assumed under the contractual framework, rather than a reconstruction influenced by subsequent events.

17 See J. Schön, "Evidence, Proof and Persuasion in Transfer Pricing Litigation", *World Tax Journal* (2018), observing that courts increasingly treat contemporaneous documentation and observable conduct as the primary evidentiary anchor in transfer pricing disputes.

18 OECD, *Transfer Pricing Guidelines* (2022), para 1.122, noting that tax administrations should not disregard the actual transaction or substitute alternative arrangements based solely on hindsight.

experts to establish the value of the brand, which in turn will inform an arm's length principle royalty rate. There are several detailed steps.

But let's break it down to the starting point.

Mr. X or Mrs. Y will be the expert that was involved in possibly reviewing and/or overseeing the transfer pricing study. That person may not have drafted the transfer pricing study. They may only have reviewed it in preparation of giving expert evidence. In that situation he/she may be given access to the marketing agency's excel spreadsheets containing the raw respondent data together with the questions from the marketing surveys.

He/she may be given access to the data analysts' excel spreadsheets analysing the raw data to arrive at a %, which represents the proportion of earnings attributable to the brand. That % is applied to the MNE's internal financial data to determine the profit derived from the brand in the MNE. Thus, they would have had access to the annual financial statements, compiled by the MNE's auditors, as well.

The first problem facing this expert is that he/she will not have personal knowledge of the actual source data. They will be asked if they have personal knowledge of the questions asked, and answers given. Did they verify the raw data? On what basis are they relying upon the analysis done. They will not have compiled the analysis, tables or information. They may have checked it and understand the logic behind it but they will have relied upon the work and integrity of others. This will require additional and careful auditing and analysis by that expert with respect to the key source information.

It is guaranteed that the revenue authority will challenge the credibility of the information relied upon by the expert to testify to what was done in terms of the OECD TPG's to determine the ALP. The questioning in cross-examination will drill into very specific source data related questions. For instance, "affinity" serves as a proxy for purchase intent, an emotional driver of the brand, that will ultimately contribute to determining the ALP of the royalty rate.¹⁹ If the expert is questioned on how "affinity" drives purchase intent, not being a marketer specialist or survey specialist, they will have difficulty answering this.

As an expert they will be asked to give best assurances to the court that all the facts obtained via third party entities are accurate and reliable. Here they will rely on the integrity of those third parties. At best, they will testify that they accepted the data presented to them as accurate and reliable from reputable third parties. That expert cannot be expected to have reviewed all the source data and analyses. But in the absence of this, doubt as to the reliability and accuracy of that information will be created. That then undermines the credibility of the expert opinion given by the expert. That detail is very important.

How should this be addressed?

All the data points, excel spreadsheets, analyses leading up to the final ALP calculation should be available in an accessible database in the MNE. This should be supported by a detailed factual memoranda explaining the "chain of evidence" from the survey design stage and collection of the data to the final calculation.

Affidavits by the marketing employees and the agency employees involved in the design of the study and affidavits by the interviewees, annexing the questionnaires and the data collected should be filed. These affidavits must confirm precisely each party's responsibilities and why certain decisions were made. An affidavit of the manager overseeing the data collection process should also be on file. Then affidavits of the

¹⁹ How were these different drivers of the brand valued? Were the expenses incurred in doing so considered? Who in the relationship was the owner of that driver? For instance, a brand from South Africa is made available under license to various new African subsidiaries that are responsible for developing that brand in those countries. The goodwill attached to the brand is a brand value driver. Any goodwill attached to the brand in each country will in some cases not belong to the owner/licensor of the brand in South Africa, as the African subsidiary was responsible for creating the goodwill of that brand in that country, through its efforts in that country. Thus, the goodwill built in the African subsidiaries are not part of the brand value from the perspective of the South African brand owner and licensor as a driver of the value of that brand from the South African perspective in determining an ALP for the license fees charged to the African subsidiaries.

data analysts, the valuation experts and the specialist firm running the process, explaining what was done and referencing the other affidavits referred to, are necessary.

Where the data (as explained by the affidavits) informs the transfer pricing study, the professional firm drafting the transfer pricing study should produce an affidavit explaining how that data and information was used in the transfer pricing study.

All this preparation will make a response to a revenue authority at tax audit stage very effective, and most likely be the beginning and end of the enquiry, unless clearly wrong! But should it not end, the problem of calling factual witnesses²⁰ from all the third-party agencies is rendered mostly unnecessary. Many of those factual witnesses will most likely not be available. Many would have left the firms they worked for.

In the absence of the suggested TRM strategy supporting the transfer pricing study, the factual evidence verifying the veracity of the data relied upon by the expert will have to be led. The MNE would have to try and call the individual participants many years later. Good luck with that!

Thus, the quarterly TRM tax risk steering committee explained in my book “Tax Intelligence”²¹ is key to ensuring the typical evidentiary problems referred to here, is avoided. If you want to experience the painful cross-examination process that will ensue in a transfer pricing trial, refer to **Appendix C2: Cross Examination Extract from a TP Case with an Expert Giving Advice** (a redacted transcript).

The expert witness can expect something along the following lines when they are positioned in the witness box.

The counsel acting for the MNE will ask them some background questions about their experience, position and involvement in the TP study.

Counsel will ask them to explain exactly what they did, and if and how they checked the accuracy of the data provided to them. If they did not check, why not? Presumably because they were receiving it from an established and reliable source of the MNE. This will require some elaboration as this aspect will be drilled upon by the revenue authority’s counsel in cross-examination. They will ‘pound the hearsay drum’ consistently trying to show the unreliability of the TP expert’s evidence in the form of explanations, and ultimately the TP study relied upon by the MNE in the tax dispute.

In the explanations, the expert will be expected to explain what they did with the data or information they received in compiling or reviewing the TP study, explaining any subjective judgment applied by the original drafter and reviewed by them in achieving any result set out in the TP study. Oftentimes there are subjective judgment calls driven by objectively obtained data and information. If the data or information relied upon is shown to be unreliable, the opinion of the expert based on that data and information will equally be regarded as unreliable and inadmissible. The explanations of the TP specialist must be made with reference to the OECD/UN TPGs.

If there were deviations, those must be carefully explained and why the precise guidelines were not followed. Remember they are guidelines where some judgment calls are required, but these must be explained. For instance, sometimes the guidelines refer to ‘relevant profits’²² when investigating a transaction and determining the profits to be split. From an accounting perspective, that may be regarded as ‘operating profits’. But is that correct? What is meant by ‘relevant profits’? It is not defined in the guidelines. At para 2.162 of the guidelines, it is stated that the most common relevant profits to be split are the operating profits.²³

20 See Glossary of Terms – “factual witness”.

21 Refer to **Appendix B**.

22 Para 2.154.

23 “A company’s operating profit is its total earnings from its core business functions for a given period, excluding the deduction of interest and taxes. It also excludes any profits earned from ancillary investments... Operating profit is also (wrongfully) referred to as earnings before interest and tax (EBIT), as interest and taxes are non-operating expenses... Operating profit does not include non-operating income, but EBIT does.” https://www.investopedia.com/terms/o/operating_profit.asp (last accessed 29 October 2022).

That is a known accounting term and can be determined from the MNEs financial statements.

If any proprietary models are relied upon by the expert, they will be required to explain the model. Is their use of the model merely a ‘plug and play’, with number results produced? Or, does the expert understand what is taking place in the proprietary model to produce the resultant numbers?

Once the evidence in chief is completed, the revenue authority’s counsel will commence cross-examination. From this point the expert may not confer with the MNE or its legal team. The cross-examination may be conducted by a cantankerous and condescending counsel. This is done to unnerve and unsettle the expert, so that the expert starts doubting the evidence just given. The revenue authority counsel’s task is to try and discredit the evidence given by the expert as being unreliable.

The counsel is a lawyer and not a TP specialist. The expert is the specialist. Thus, the expert should stand on that fact and with confidence, and ignore any snarky remarks made by that counsel in answering the questions. Any answers given in cross-examination should be short and exactly to the point. Counsel for the revenue authority will oftentimes try to have the expert say simply ‘yes’ or ‘no’ to the questions asked. In that way the counsel will try to corner the expert to make submissions on what they testified on previously in an attempt to form the impression that the previous testimony is not accurate, contradicted, hearsay, or unchecked and therefore unreliable and inadmissible.

It must be remembered that hearsay is generally inadmissible evidence, i.e., testifying to what others did, as opposed to what the expert personally did. But there are many exceptions. The keeping of business records is one of them. If one is working with business records and business information of any kind, produced contemporaneously, as part of a systematic information gathering and record keeping process, the information and records are admissible, even though it is strictly speaking hearsay evidence. The keeping of business records exception applies. Much of the data relied upon by the expert is most likely records or information provided in the ordinary course of the MNEs business, contemporaneous in nature, and provided from a trusted and reliable source, for the expert to perform their professional work – to consider, draft and review the TP study.

When it comes to the expert evidence given, especially from TP specialists, the starting point is the Daubert standard. This standard prefers expert scientific evidence which is based on well-trodden principles. If the TP study on which the expert is testifying deviates in any way from the 5 acceptable OECD/UN TPG methodologies, the evidence given by the expert may become unreliable and inadmissible. Consider the following legal principles:

“The Daubert standard is the standard used by a trial judge to assess whether an expert witness’s scientific testimony is based on scientifically valid reasoning which can properly be applied to the facts at issue. The standard is applied after a Daubert motion to strike, a motion in limine, is filed before or during trial to exclude the presentation of unqualified evidence to the jury. It must also be noted that the courts have held that the Daubert standard governing admissibility of expert testimony is procedural and, thus, applies retroactively.

Overview

This standard comes from the Supreme Court case, Daubert v. Merrell Dow Pharmaceuticals Inc., 509 U.S. 579 (1993).

Under the Daubert standard, the factors that may be considered in determining whether the methodology is valid are: (1) whether the theory or technique in question can be and has been tested; (2) whether it has been subjected to peer review and publication; (3) its known or potential error rate; (4) the existence and maintenance of standards controlling its operation; and (5) whether it has attracted widespread acceptance within a relevant scientific community.

...

In General Electric Co. v. Joiner, 522 U.S. 136 (1997), the Supreme Court clarified Daubert, holding that an appellate court may still review a trial court's decision to admit or exclude expert testimony. The standard of review for this inquiry is the abuse of discretion standard.

Kumho v. Carmichael

In Kumho Tire Co. v. Carmichael 526 U.S. 137 (1999), the Supreme Court further clarified that the Daubert factors may apply to non-scientific testimony, meaning "the testimony of engineers and other experts who are not scientists."²⁴

In South Africa, in SMD Telecommunications CC v Mutual & Federal Insurance Company Ltd [2009] JOL 24577 (WCC) from para 57, Davis J states:

"[57] Much was made by Mr Dane, and experts Dr Du Toit and Dr Mabin, that, were the court to uphold the Tyrell hypothesis, it would run counter to prevailing medical evidence. In this regard, it is helpful to refer to the approach of the US Supreme Court in dealing with expert scientific evidence. In the seminal case of Daubert v Merrell Dow Pharmaceuticals Inc 509 US 579 at 485 Blackmun J said:

"It is true that open debate is an essential part of both legal and scientific analyses. Yet there are important differences between the quest for truth in the courtroom and the quest for truth in the laboratory. Scientific conclusions are subject to perpetual revision. Law, on the other hand, must resolve disputes finally and quickly. The scientific project is advanced by broad and wide-ranging consideration of a multitude of hypotheses, for those that are incorrect will eventually be shown to be so, and that in itself is an advance. Conjectures that are probably wrong are of little use, however, in the project of reaching a quick, final, and binding legal judgment – often of great consequence – about a particular set of events in the past. We recognise that in practice, a gatekeeping role for the judge, no matter how flexible, inevitably on occasion will prevent the jury from learning of authentic insights and innovations. That, nevertheless, is the balance that is struck by Rules of Evidence designed not for the exhaustive search for cosmic understanding but for the particularised resolution of legal disputes."

[58] However at footnote 13 to Justice Blackmun's judgment, the following appears:

"This is not to say that judicial interpretation, as opposed to adjudicative fact finding, does not share basic characteristics of the scientific endeavor: 'The work of a judge is in one case enduring and in another ephemeral . . . In the endless process of testing and retesting, there is a constant rejection of the dross and a constant retention of whatever is pure and sound and fine.' B Cardozo, the Nature of the Judicial Process 178–179 (1921)."

[59] This dictum from Daubert needs, of course, to be seen within the context of the US Supreme Court's development of four factors for admissibility of expert evidence:

- 1. The process of arriving at some propositional hypothesis about a set or group of events which can be tested;*
- 2. The known or potential rate of error associated with using the particular scientific techniques adopted in (1);*
- 3. Peer review and publication; that is whether the theory or technique has been subjected to peer review and publication; and*

-
4. General acceptance, that is a measurement of the extent to which the experts' methods produce information that qualifies the scientific knowledge's recognised within the relevant scientific community."

And in **Bee v Road Accident Fund** [2018] JOL 40197 (SCA) the Supreme Court of Appeal stated at para (25):

[25] In *Daubert v Merrell Dow Pharmaceuticals Inc* 509 US 579; 113 S. Ct 2786 (1992), which concerned scientific testimony, the Supreme Court of the United States dealt with, inter alia, the admissibility of expert opinion in terms of the Federal Rules of Evidence and particularly rule 702. In its summary at 507 the court said:

"... but the Rules of Evidence especially Rule 702 do assign to the trial judge the task of ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand."

[26] In the European Union and United States Antitrust Arbitration cases expert evidence is utilised. The tribunal, if it deems fit, can appoint an expert to prepare a report and lead evidence before the tribunal. The expert evidence is not binding on the tribunal even if the evidence is led by the tribunal-appointed expert. The tribunal is required to give reasons, if it rejects the evidence of an expert witness. The evidence of an expert witness, even if such expert witness is appointed by the tribunal, is not binding on the tribunal unless the tribunal is satisfied that such evidence is reliable (see GBP Landolt and W Kluwen (eds) *EU and US Antitrust Arbitration* (2011) Volume 1 at 284; and JF Poudret and S Besson *Comparative Law of International Arbitration* (2 ed) (2007)).

[27] The England and Wales Court of Appeal (Civil Division), in *Huntley* (also known as *Joseph Paul Hopkins*), a Protected Party by his Litigation Friend, *Alison Jane McClure v Simmons* [2010] EWCA Civ 54, dealt with expert opinion and the joint statement of two neuropsychologists. One of the parties made the point that the judge was bound by the joint statement as to the conclusion that the judge should reach. The judge rejected this submission, holding that the joint statement was only part of the evidence before the court. The Court of Appeal, Civil Division agreed with the view of the trial judge.

[28] In *Moloi v The State* 1995 BLR 439 (CA), the Court of Appeal dealt with the admissibility of expert witnesses. The court said that such witnesses must speak in detail to the facts upon which their opinions and conclusions are based. The court went further and quoted with approval the statement of Ramsbottom J in *R v Jacobs* 1940 TPD 142 at 147 where he said:

"Expert witnesses are witnesses who are allowed to speak as to their opinion, but they are not the judges of the fact in relation to which they express an opinion, the court... is the judge of the fact... In cases of this sort it is of the greatest importance that the value of the opinion should be capable of being tested, and unless the expert witness states the grounds upon which he bases his opinion it is not possible to test its correctness, so as to form a proper judgment upon it."

[29] In *The State v Thomas* (CC 19/2015) [2016] NAHCMD 320 (19 October 2016), the mental condition of the accused, which was in question, was enquired into by two psychiatrists and they produced reports. In respect of the experts' reports, the court at paragraph [29] said:

"When dealing with expert evidence the court is guided by the expert witness when deciding issues falling outside the knowledge of the court but within the expert's field of expertise; information the court otherwise does not have access to. It is however of great importance that the value of the expert opinion should be capable of being tested. This would only be possible when the grounds on which the opinion is based is stated. It remains ultimately the decision of the court and, although it would pay high regard to the views and opinion of the expert, the court must, by considering all the evidence and circumstances in the particular case, still decide whether the

expert opinion is correct and reliable” (see also *State v Apadile* 2011 1 BLR HC).

[30] *In my view, these pronouncements indicate that if an expert witness cannot convince the court of the reliability of the opinion, and his report the opinion will not be admitted. The joint report of experts is a document which encapsulates the opinions of the experts and it does not lose the characteristic of expert opinion. The joint report must therefore be treated as expert opinion. The fact that it is signed by two or more experts does not alter its characteristic of expert opinion. The principles applicable to expert evidence or reports are also applicable to a joint report. The joint report before the court is consequently part of evidential material which the court must consider in order to arrive at a just decision. The court, in such instance, will be entitled to test the reliability of the joint opinion, and if the court finds the joint opinion to be unreliable, the court will be entitled to reject the joint opinion. The court is entitled to reject the joint report or agreed opinion if the court is of the view that the joint report or opinion is based on incorrect facts, incorrect assumptions or is unconvincing.*

[31] *The court cannot base its decision on unreliable evidence.”*

The importance of the **Daubert** principle is to ensure that any theory proposed by an expert is not ‘left field’ and outside the ambit of the OECD Transfer Pricing Guidelines, without a fully motivated justification. At the end of the evidence, in consider a judgment, an experienced judge will follow common sense in reaching a decision. The legal team can assist to assure that common-sense approach follows the well-trodden guidelines.

In the US Tax Court judgment of the *Coca-Cola Company & Subsidiaries v. Commissioner of International Revenue* 155 T.C. No. 10,²⁵ the tax court stated the following in relation to expert witnesses:

“Each party relies on expert testimony to establish an arm’s-length price for the transfer of petitioner’s intangibles. Expert testimony is admissible where it assists the Court to understand the evidence or to determine a fact in issue. See Fed. R. Evid. 702; ASAT, Inc. v. Commissioner, 108 T.C. 147, 168 (1997). The Court has broad discretion to evaluate the cogency of an expert’s analysis. See Gibson & Assocs., Inc. v. Commissioner, 136 T.C. 195, 229-230 (2011). We are not bound by any particular expert’s opinion, and we will reject expert testimony to the extent it is contrary to the judgment we form on the basis of our understanding of the record as a whole. See id. At 230.”

The taxpayer called 15 expert witnesses. The IRS called 10 expert witnesses, and the US Tax Court only accepted the evidence of one expert witness for the IRS.

CONCLUSION

Evidence is complex. As stated at the commencement of this book:

“The quality of this evidence is very different to what TP experts are accustomed to dealing with. There is much more detail. See Appendices C1 to C4 and read these through in addition to what I write in the book. Focus on hearsay evidence and any exceptions, secondary evidence, and the parol evidence rule.”

If you have learnt anything from reading this book, it will be focus on more evidence collected from the starting point of your tax risk steering committee.

- Can the source documents be discovered for the purposes of the trial?
- Prepare proper defence files for high tax risk areas such as TP.

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-
- Record the processes.
 - Take signed statements and affidavits where possible explaining the ALP process.
 - How did you get to your methodology?
 - Back the TP study up with all background interviews expressing the *bona fides* of the process in not pursuing tax avoidance.
 - Identify your potential expert witnesses, who will not be the entity producing the TP study.
 - Pay careful attention to the parol evidence rule and the agreements that record the transactions behind the ALP. If there is no tax avoidance, those agreements are your main convincing evidence. That means, the agreements reflect the ALP.

If you require secondary evidence to corroborate your ALP, then make sure you comply with the rules of law requiring you to motivate the veracity, quality and necessity for that evidence.

If it is hearsay evidence, take note of the exceptions such as business records. On this note, oftentimes in preparing for a trial, an expert will compile a spreadsheet summarizing other evidence to explain the taxpayer's position. If this spreadsheet is relied upon in the trial, its source, veracity and accuracy will come under scrutiny. It will be regarded as secondary evidence, and if its existence is not properly justified, it will be ignored by the court as being unreliable. See **Case Study 3** where extensive hearsay evidence was led to explain the incurring of management fees supported by a spreadsheet explaining the process. The court ignored this evidence. Albeit it incorrectly, had the taxpayer motivated this evidence with a hearsay and secondary evidence admission application, the outcome may have been different. See **Appendices C2 and C3**.

In preparing evidence for a possible TP trial, it is essential that the MNE have an experienced TP tax trial attorney on retainer to assist in the process. As previously stated, this should commence at the tax risk steering committee where that attorney would be a member of the committee, and most likely the chairperson, ensuring the meetings are all subject to attorney/client privilege. This is important to prevent revenue authorities accessing the meeting minutes and content. Imagine if revenue authorities could peer into tax risk steering committee meetings? They would have a bird's eye view of all the MNEs tax risks and could cherry pick what tax audits to pursue. This is eliminated with the attorney/client privilege via the chairpersonship of a tax litigation lawyer overseeing and guiding what could be potential litigation against revenue authorities. Review the Appendices on tax risk management, namely **Appendices D to L**. These are essential introductory materials that will help reduce tax exposures in tax audits.

Pay careful attention to the next **Chapter 7 Expert Reports at Trial**. Then read **Appendices C1 to C6 with Case Study 3**.

CHAPTER 7

EXPERT REPORTS AT TRIAL

INTRODUCTION

Any transfer pricing expert will be expected to compile a written expert report. This is part of the court pleadings and will be available to the revenue authority's counsel in court that will cross-examine the MNE's expert. At the time that the expert commences giving evidence, she will be required to confirm the accuracy of the expert report and given the opportunity to change anything in that report. This is important.

The cross-examiner will interrogate the written expert report and test what has been stated therein together with the information or documents relied upon. If there is information or documents that were considered and not included in the list of documents considered, the expert will be asked why not?

She will then be asked ***"What else is not shared with the court in the written expert report that may be important?"*** This line of questioning is designed to undermine the credibility of the witness. Every mistake pointed out will add up in undermining the credibility of the expert witness. Many witnesses will start to doubt themselves in answering questions about their expertise and come across as lacking confidence in their subject matter.

Questions will then be put to the expert witness in a ridiculed tone, e.g., ***"Do you really think that what you stated before is correct when I show you para 1.36 of the OECD Transfer Pricing Guidelines which requires a functional analysis to be conducted? You said a functional analysis was not necessary in a CUP analysis?"***

If the expert witness has just been corrected for not stating something accurately in their written expert report, their confidence levels may be negatively impacted. Thus, confidence in answering a subsequent question may be impacted, showing uncertainty and insecurity.

Thus, the expert report must be prepared with meticulous input, and sufficient consideration must be given to anticipated cross-examination questions.

When an expert is preparing to give evidence, it may be good to remember that several experts may be giving evidence. It is not really a good idea that an expert review any of the other experts' reports. The reason for this is that in cross-examination an expert will be asked to comment on the opinion of another expert. In the process of doing this, some of what the second expert witness has written may contradict what the first expert witness is testifying about. Oftentimes the contradiction is pointed out by the cross examiner out of context and unless the first expert is thorough with the other expert's opinion and understands in what context the answer should be given to avoid a potential contradiction in the second opinion, either the first or second expert may be shown up as not knowing what they are talking about.

It is also possible that the expert has, during the development of the dispute, given an opinion to the taxpayer in the same or a slightly different context. You can expect that the expert will be cross-examined on any contradictions that may appear between the previous opinion and the expert report. The experts should also make sure that they are well prepared on any of their own published literary work as the cross examiner

will certainly look for any contradictions to be pointed out.

Consider the choice of your experts carefully. Transfer pricing is a unique field where a large amount of data in the form of factual information and financial information is put together in a model to produce a certain result. A lot of judgement calls are required. Where the model used is one of the standard methods prescribed by the OECD TPG's, it will be easier for the expert to substantiate his approach. However, where the model is a novel one, and not one of the recognized methods, it may be a good idea not to use the deviser of that model as your expert. They will be too passionate and will struggle to be objective to defend their own creation.

The preparation of expert evidence and the preparation of expert evidence reports for the submission to the court is a process that requires very careful preparation.

In any complex tax litigation, particularly where transfer pricing is involved, the expert witness plays a pivotal role. Their primary function is to assist the court in navigating issues that require specialist knowledge, offering technical clarity in a field where precision and credibility can determine the outcome.

SELECTING THE RIGHT EXPERT

Choosing an expert is a strategic decision that can significantly influence the strength of the taxpayer's case. Since the onus typically lies on the taxpayer, presenting a compelling and authoritative expert witness is crucial. The first consideration should be the expert's availability and level of commitment. Many expert witnesses have full-time employment elsewhere, so it's essential to ensure they can dedicate sufficient time to thoroughly review the case, prepare a detailed report, and attend court sessions—especially in the event of postponements.

Beyond availability, the expert must possess strong credentials. Academic qualifications are helpful, but without practical experience they may not carry much weight. Likewise, experience without formal training can be limiting. Because transfer pricing encompasses a broad array of disciplines—economics, law, finance, and international standards—the expert should have specific competence in the subject matter at the heart of the dispute.

It is also advantageous to select an expert who has testified in court before. The ability to remain composed under cross-examination and to engage with the legal process comes more naturally to those familiar with the courtroom environment. However, beyond professional background, the expert must be impartial. The court expects neutrality, and any sense of bias or advocacy will undermine the witness's credibility. For this reason, avoid relying on someone who has developed a novel methodology that they are eager to defend; their attachment to their theory may cloud their objectivity.

Equally important are communication skills. Transfer pricing is inherently technical, and the expert must be able to present complex concepts in a manner that is clear and understandable. They must also respond adeptly to the subtleties of cross-examination, picking up on shifts in tone, implication, and strategy. Their ability to translate jargon into plain language and to maintain the court's attention is invaluable.

Legal admissibility cannot be overlooked. Some jurisdictions impose specific rules on who may testify as an expert. Ensure your chosen witness meets those standards. Additionally, it's essential to work with someone who can collaborate effectively with the legal team and establish a rapport that supports seamless preparation and trial performance.

PRESENTING EXPERT ADVICE

During the trial, particular attention must be given to how expert evidence is introduced. Evidence in chief may be presented through traditional question-and-answer sessions or, alternatively, through structured

visual presentations. This latter approach can be especially effective for technical evidence, allowing the expert to walk the court through charts, graphs, and diagrams. When using visual aids, ensure that they are consistent with the existing body of evidence and contribute to clarity rather than distraction.

The factual foundation of the expert's opinion must be established early. Experts should only base their conclusions on information they have thoroughly reviewed. If their conclusions rest on incomplete or incorrect facts, opposing counsel will exploit this vulnerability during cross-examination. The appropriateness of the method used by the expert should also be highlighted. There must be a clear and logical connection between the factual foundation, the method employed, and the relevant transfer pricing guidelines. This helps the court understand not just the what, but the why and how of the expert's reasoning.

Transparency is critical. Experts should openly acknowledge any limitations in their opinion. If assumptions were made or if certain data were unavailable, these limitations must be disclosed up front. Failure to do so risks the expert appearing evasive or unreliable when such facts inevitably surface during cross-examination. Throughout the process, clarity and brevity should be the guiding principles. Long-winded explanations or overuse of technical terminology can dilute the impact of the testimony.

PREPARING FOR CROSS-EXAMINATION

Perhaps the most important phase of expert preparation is readiness for cross-examination. A well-prepared expert is not only familiar with their own report but is also aware of potential weaknesses and prepared to defend their methodology and conclusions. Working collaboratively, the legal team and expert should identify likely areas of attack and rehearse thoughtful responses. The expert must be ready to concede points when appropriate. Phrases like "It is possible but highly improbable" carry more weight than stubborn denials and can bolster the expert's credibility.

Cross-examiners often attempt to identify errors in the assumptions underlying the expert's opinion. Once an error is found, they will probe its significance. The expert should be prepared to discuss how any such error affects—or doesn't affect—the overall outcome of their analysis. Another common tactic is to challenge the justification for inferences drawn by the expert. A seasoned witness will be able to acknowledge that reasonable people may draw different conclusions while persuasively explaining why their conclusion is the more probable or correct one.

Cross-examination can also involve subtle distortions of prior testimony. Experts should be trained to identify and resist such mischaracterisations. They should never agree to a rephrased proposition unless it accurately reflects their position. The aim of such distortions is to create contradictions and erode credibility.

Maintaining composure is vital. A calm and respectful demeanour, even under pressure, goes a long way with the court. Defensive or argumentative responses should be avoided. Experts should listen carefully to each question, request clarification if needed, and answer only once the question is fully understood. Their answers should be concise and limited to the question asked. Rambling responses can open the door to lines of inquiry that go beyond the scope of the original issue.

Speculation or guessing is to be avoided at all costs. If the expert does not know the answer, they should say so clearly. If documents or exhibits are referenced in their testimony, they must review them beforehand. Likewise, if the expert has previously published opinions or articles on related issues, they should be refreshed on those views to ensure consistency.

Depending on the case, it may be necessary for your expert to review the reports of other experts. If so, ensure they are thoroughly familiar with the contents and prepared to comment on them under cross-examination. Consider also whether your expert should be present in court to hear the testimony of others. This will depend on whether hearing such evidence will strengthen or weaken your case.

To prepare thoroughly, conduct mock cross-examinations. Role-playing these scenarios helps the expert become comfortable with courtroom dynamics and sharpens their ability to stay on message under pressure. These simulations also provide an opportunity to practice courtroom etiquette, including proper address to the judge and maintaining a respectful posture.

Preparing for trial with your expert witness is not just a matter of filing reports and showing up in court. It is a disciplined process that combines legal strategy, technical precision, and persuasive communication. With the right expert, properly prepared, you stand a far better chance of persuading the court and prevailing in your case.

For a concise summary of the principles discussed above, refer to ***Appendix C4: How to Prepare for a Trial with Your Experts.***

CHAPTER 8

THE TRANSFER PRICING TRIAL

INTRODUCTION

Conducting a TP trial is the culmination of meticulous preparation, strategic planning, and expert engagement. This chapter provides a comprehensive short guide on how to effectively conduct a TP trial, drawing insights from the preceding chapters on preparation, procedural law, and audit processes. Thus, a thorough knowledge of the preceding chapters and supporting Appendices is required. The summaries set out below will “pop” if you know the content of the preceding chapters and supporting Appendices.

PRE-TRIAL PREPARATION

Assemble the Legal and Expert Team

Legal Counsel: Engage experienced legal counsel specializing in TP and tax litigation. This includes both trial lawyers and subject matter experts. Review the **Appendices I and L** on tax risk management and the tax risk steering committee.

Expert Witnesses: Identify and brief expert witnesses who can provide authoritative testimony on TP methodologies, economic principles, and industry practices. Ensure they are well-prepared to withstand cross-examination. For example, see **Appendix C4** on preparing expert witnesses. Consider the expert evidence transcripts in **Appendices N1 to N4**.

Review Documentation

Transfer Pricing Study (TP Study): Ensure the TP study is comprehensive, well-documented, and aligns with OECD TPGs. Review all underlying data, assumptions, and methodologies.

Supporting Evidence: Gather all supporting documentation, including contracts, financial statements, invoices, and contemporaneous records. Ensure all documents are organized and easily accessible. Carefully review the Glossary of Terms, the chapters on evidence and the **Appendices C1 to C6** on evidence.

Develop a Trial Strategy

Case Theory: Develop a clear and compelling case theory that explains why the taxpayer’s TP practices are at arm’s length. This should be based on solid economic rationale and supported by evidence. This is developed in the consultations between your legal team and your experts, with the participation of the TP study entity. Again, the tax risk steering committee is the starting point.

Key Arguments: Identify key arguments and counterarguments. Prepare to address weaknesses in the taxpayer’s case and anticipate the revenue authority’s challenges.

Mock Trials and Rehearsals

Mock Trials: Conduct mock trials to simulate the court environment. This helps in refining arguments, improving witness performance, and identifying potential issues.

Rehearsals: Rehearse opening statements, direct examinations, and cross-examinations. Ensure all team members are familiar with their roles and responsibilities.

OPENING STATEMENTS (HEADS OF ARGUMENT)

Structure and Content

Introduction: Introduce the case and outline the key issues. Provide a roadmap of what the court can expect during the trial. This is developed by the counsel arguing the case with input from the tax team supporting the process.

Overview of Arguments: Summarize the main arguments and evidence that will be presented. Highlight the strengths of the taxpayer's position and the weaknesses of the revenue authority's case.

Clarity and Persuasion

Clarity: Ensure the opening statement is clear, concise, and easy to understand. Avoid technical jargon and focus on the main points.

Persuasion: Use persuasive language to engage the court. Emphasize the fairness and reasonableness of the taxpayer's TP practices. Look at **Appendices A and B**, the interviews with 2 advocates that argued the ABD case.

PRESENTATION OF EVIDENCE

Direct Examination of Witnesses

Expert Witnesses: Begin with the expert witnesses. Allow them to explain the TP methodologies, the economic rationale behind the pricing, and how it complies with OECD TPGs.

Factual Witnesses: Present factual witnesses who can provide context and support the expert testimony. This includes company executives and financial officers.

Use of Documents and Exhibits

Key Documents: Introduce key documents and exhibits during the direct examination. Ensure each document is authenticated and its relevance is clearly explained.

Visual Aids: Use visual aids such as charts, graphs, and summaries to illustrate complex points. This helps in making the evidence more accessible and understandable.

CROSS-EXAMINATION

Preparation and Strategy

Anticipate Challenges: Prepare for revenue authority's cross-examination by anticipating their challenges and questions. Have rebuttal evidence and arguments ready. Look at **Appendix N4** as an example of a

transcript of a cross-examination of an expert witness.

Control the Narrative: Use cross-examination to control the narrative and highlight inconsistencies or weaknesses in the revenue authority's case.

Techniques

Focused Questions: Ask focused and precise questions that lead the witness to the desired point. Avoid open-ended questions that give the witness room to manoeuvre.

Impeachment: If necessary, impeach the credibility of the revenue authority's witnesses by highlighting inconsistencies, biases, or lack of expertise.

CLOSING ARGUMENTS (HEADS OF ARGUMENT)

Summarize Key Points

Recap Evidence: Summarize the key evidence presented during the trial. Highlight how the evidence supports the taxpayer's position and aligns with the arm's length principle.

Reinforce Arguments: Reinforce the main arguments and address any points raised by the revenue authority.

Persuasion and Impact

Persuasive Language: Use persuasive language to leave a strong impression on the court. Emphasize fairness, reasonableness, and compliance with international standards.

Emotional Appeal: Where appropriate, make an emotional appeal to fairness and justice. This can help in swaying the court's opinion.

POST-TRIAL ACTIONS

Review and Feedback

Debrief: Conduct a debriefing session with the legal and expert team to review the trial process. Identify what worked well and what could be improved.

Feedback: Seek feedback from all team members and, if possible, from observers or advisors who attended the trial.

Preparation for Appeal

Anticipate Outcomes: Be prepared for the possibility of an appeal. Ensure all trial materials and evidence are well-documented and organized for potential future use.

Legal Analysis: Conduct a thorough legal analysis of the trial's outcome and the court's decision. Identify any grounds for appeal and prepare accordingly. ***See Chapter 9 on appeals.***

CONCLUSION

Conducting a TP trial requires meticulous preparation, strategic planning, and effective execution. By following the guidelines outlined in this chapter, taxpayers can navigate the complexities of TP disputes and present a compelling case in court. The key to success lies in thorough preparation, clear and persuasive arguments, and the strategic use of expert testimony and evidence.

The case before the tax court on which much of this book was based on as a practical example of a longstanding TP dispute was concluded with the following judgment: ***Appendix N: The ABD vs Commissioner for South African Revenue Service judgment.***

The court based its decision on the testimonies of various expert witnesses. Extracts of their transcripts are set out in ***Appendices N1, N2, N3, N4 and N5.*** The extracts illustrate challenges in the expert witnesses giving evidence. That is why careful preparation of all witnesses is essential, supported by the best documentary evidence available.

The ABD vs Commissioner for South African Revenue Service case was going on appeal in August 2025 to the Supreme Court of Appeal. SARS has withdrawn the case, meaning ABD has won.

CHAPTER 9

THE TRANSFER PRICING APPEAL

TO APPEAL OR NOT TO APPEAL, THAT IS THE QUESTION

I will attempt to provide practical advice about whether to appeal or not.

Oftentimes it will be the losing party that appeals a case to a higher court. In my typical situation, that is the revenue authority. However, the winning party can also appeal, or cross-appeal to the losing party's appeal. Usually this is on a point of law that the appellant believes a higher court should reconsider. If you are the winning party, there will most likely be no need to appeal. A win is a win.

However, the losing party will want a higher court to review the recorded evidence and the findings of the tax court. It is thus very important that all the evidence has been placed on record.

A revenue authority might appeal a transfer pricing (TP) tax trial judgment to a higher court—even after losing at the lower court—for several strategic, legal, and policy-driven reasons. TP cases often turn on complex interpretations of law and OECD guidelines.

An appeal by a revenue authority may also occur to clarify or establish legal precedent for future cases. If the lower court's decision introduces a legal interpretation that the authority believes is flawed or too taxpayer-friendly, an appeal could aim to overturn or narrow its application. This helps maintain consistency and predictability in the tax system.

Transfer pricing affects cross-border profit allocation. A ruling against the authority could open the door for other taxpayers to adopt similar arrangements, potentially eroding the domestic tax base. The purpose of the appeal may be to limit broader fiscal risk by challenging a ruling that may otherwise encourage aggressive profit shifting.

If the decision undermines a key enforcement policy or contradicts long-standing administrative practice, the authority may appeal to defend that policy and avoid setting an undesirable precedent.

In some cases, revenue authorities test the limits of transfer pricing interpretations to gradually develop jurisprudence.

By way of an example, a revenue authority might have lost due to insufficient evidence but believes stronger presentation in a higher court or different judicial interpretation could lead to success.

The appeal might not be about the TP methodology per se, but:

- Errors in legal reasoning;
- Misapplication of the arm's length principle;
- Exclusion of critical evidence; and

-
- Procedural irregularities (e.g., bias, improper burden of proof)

Even if the case is fact-specific, a successful appeal can strengthen the authority's negotiating position in ongoing or future TP disputes by signaling resolve and clarifying the legal boundaries.

Revenue authorities are often under pressure to maximize collections or demonstrate effective enforcement—especially in high-profile or high-value cases. Appealing a loss isn't just about winning the current case—it's about protecting future tax revenue, influencing how courts interpret the law, and preserving institutional credibility.

Appeal to a higher court after the tax trial

After a decision by a first-instance tax tribunal or tax court in a tax trial, a party (e.g., the revenue authority or the taxpayer) may appeal to a higher court — but only on specific grounds.

Typical Grounds for Appeal can be summarised as follows:

- Error of law – The trial court misapplied or misinterpreted the law (e.g., misinterpreted the Income Tax Act or Transfer Pricing Regulations);
- Misapplication of legal tests – E.g., incorrect application of the arm's length principle;
- Procedural irregularities – Important procedural safeguards were breached, e.g., right to be heard;
- Unreasonable or irrational decision – The findings are not supported by evidence or are arbitrary; and
- Violation of constitutional or statutory rights – If the decision infringes fundamental rights or exceeds jurisdiction.

Grounds that are not for appeal would include:

- Mere disagreement with the findings of fact (e.g., comparability analysis) unless they are clearly wrong or irrational – appeal courts tend to accept the trial court's assessment of the evidence as the trial judge actually heard the evidence. However, that is why it is important to have a detailed record of the evidence in case anything needs to be reviewed and challenged;
- Dissatisfaction with the trial judgment without a legal basis.

Why a Revenue Authority May Appeal a Lost TP Case

When a revenue authority loses a transfer pricing tax trial, the decision to appeal to a higher court is not automatic. It involves careful evaluation of multiple economic, strategic, and policy-related factors. After taking into account whether or not the outcome of the tax trial satisfies the appealability criteria set out above, the following assessments play a role as well.

Potential Recoverable Revenue vs. Cost of Litigation

High Financial Stakes: Transfer pricing disputes often involve large multinationals and billions in adjusted taxable income. If the potential tax revenue (including interest and penalties) far exceeds the expected cost of legal proceedings, an appeal becomes financially justifiable.

Legal Costs: Litigation in higher courts is expensive, requiring specialized legal counsel, expert witnesses, and internal resource allocation. The appellant must weigh whether the potential upside of a win is worth these costs.

Time to Resolution: Long-Term View vs. Immediate Resource Use

Years to Finality: Appeals can take 3–7 years or more, especially if they reach a Supreme Court equivalent.

This delay can strain internal capacity and delay finality.

Opportunity Cost: Key personnel in a revenue authority may be diverted from ongoing enforcement or policy development to focus on prolonged litigation.

Counterpoint – Long-Term Payoff: If the appeal has the potential to establish precedent that strengthens future audits or improves compliance across the taxpayer population, the time investment may be seen as worthwhile. The same applies to taxpayers where a positive outcome creates certainty for the taxpayer on its future TP studies.

Reputational Risk and Institutional Credibility

Protecting the Tax Base: A lost case against the revenue authority, if left unchallenged, might be interpreted by other multinationals as a green light to adopt aggressive TP positions. An appeal signals that the tax authority stands firm on enforcing the law and defending the tax base.

Policy Signaling: Appeals can reaffirm the tax authority's commitment to combating base erosion and profit shifting (BEPS). This is particularly important for countries that want to maintain a strong international reputation on tax compliance and transparency.

Reputational Risk if Lost Again: Repeated losses on appeal could damage the tax authority's credibility, potentially emboldening taxpayers and weakening future enforcement positions.

Legal and Policy Clarification

Precedent-Setting Value: An appeal to a higher court may clarify key legal principles surrounding TP—such as the acceptable method for allocating profits between related parties or the burden of proof.

Unresolved Legal Questions: If the lower court's ruling is seen as legally flawed, inconsistent with international guidance (e.g., OECD TP Guidelines), or lacking clarity, an appeal may be justified to obtain authoritative legal interpretation.

Political and Public Interest Considerations

Public Expectation: Taxpayers may expect the government to pursue large corporations seen to be avoiding taxes. Appealing may align with political or societal demands for fairness.

Risk of Settlement Backlash: Opting not to appeal and instead pursuing settlement may be viewed as “letting corporations off the hook,” especially if the case has received public attention.

Strategic Appeal as a Tax Governance Tool

The decision to appeal a transfer pricing loss is not just a legal question—it's a strategic governance call. Revenue authorities weigh:

- Monetary recovery potential;
- Litigation cost and complexity;
- Duration and internal capacity strain;
- Reputational implications; and
- Precedent-setting value.

If the expected benefits, both financial and strategic, outweigh the costs and risks, the appeal proceeds—not just to recover tax, but to protect the integrity of the system and send a clear message to the market.

Appealing a Transfer Pricing Judgment: Strength of the Trial Case and Lessons Learned

When a revenue authority loses a TP case at trial, the decision to appeal is not simply about dissatisfaction with the outcome. See the beginning of the chapter that deals with what is appealable. It is a strategic choice, informed by the strength of the original case, the appellate prospects, and the practical lessons drawn from the trial process itself.

Strength of the Original Case: Foundation of an Appeal

A central consideration is the substantive strength of the original case. Before launching an appeal, the revenue authority must assess certain variables.

Merits of the legal and factual arguments: Were the core TP positions—e.g., functional analysis, comparability, or method selection—robustly presented? If the underlying principles were sound but misunderstood or misapplied by the trial court, this may justify an appeal.

Clarity of legal questions: Appeals are most viable when they hinge on legal interpretations, not disputed facts. If the trial court erred in interpreting statutes, applying the OECD TP Guidelines, or misjudging the burden of proof, those issues are prime candidates for appeal.

Consistency with precedent: If the lower court's judgment is inconsistent with prior rulings or introduces uncertainty, this can be a compelling reason to seek appellate clarification.

Lessons from the First Trial: A Crucial Learning Opportunity

Every trial—win or lose—offers a wealth of insight. A revenue authority should conduct a post-mortem analysis to understand what worked, what didn't, and how the appellate court might view the case. These are some of the factors that come into consideration:

Evaluate the expert evidence: Were the experts persuasive? Did they effectively explain complex economic models or financial transactions to the court? If not, expert strategy may need revision before appeal.

Understand judicial perception: How did the judge view the case theory? If skepticism arose due to lack of clarity or overreach, an appeal brief must confront those impressions directly and reframe the argument persuasively.

Assess factual presentation: Did the facts come through clearly? Were there gaps or inconsistencies the taxpayer exploited? If so, appellate strategy must address those weak points or avoid leaning heavily on them.

Witness performance: Did the witnesses hold up under cross-examination? Weak testimony at trial may not be curable on appeal, but recognizing these issues informs how much weight to place on certain evidence in appellate filings.

Courtroom style and engagement: Was the approach of the parties overly technical, failing to connect with the judge on first principles? A second chance offers an opportunity to reframe the case with a clearer narrative.

Sharpening the Appeal Based on Trial Insights

Drawing on the trial experience, the appellant must develop a refined appellate strategy. Key areas include:

Clarifying complex TP issues: Simplify and distill the technical elements that were misunderstood or poorly

received.

Reinforcing the record: Highlight the strongest portions of the trial record and discredit findings based on flawed logic or misapplication of law.

Revisiting legal framework: Anchor arguments more firmly in statutory language and established legal principles, especially if the trial judgment appeared overly fact-dependent or ad hoc.

Using the First Loss as a Springboard

An appeal, if grounded in reflection and learning, can be more than a second shot—it can be a strategic reset. For instance, the revenue authority now better understands the taxpayer’s strategy, the court’s expectations, and the evidentiary hurdles.

In a broader sense, the trial experience might also inform policy reform at the revenue authority. If the loss revealed statutory ambiguities or practical enforcement difficulties, the revenue authority might consider regulatory or legislative changes alongside the appeal.

An appeal is not simply about overturning an adverse decision—it’s an opportunity to refine the legal narrative, improve evidentiary presentation, and strengthen the revenue authority’s overall TP enforcement strategy. The strength of the trial case and the lessons learned from defeat must guide this decision. With the right analysis, a loss at trial can lay the foundation for a meaningful victory on appeal—and in future litigation.

What precedents may support the appeal?

Here are some basic examples of precedents that may support a TP appeal, followed by key case examples from global jurisdictions (which are often persuasive even in domestic settings, especially where TP law draws from OECD Guidelines).

Burden of Proof and Role of the Revenue Authority

If the taxpayer’s evidence is weak or unsupported, the Commissioner’s assessment must stand.

Commissioner for Inland Revenue v Louw 1983 (3) SA 551 (A); 45 SATC 113 – South Africa: Held that the taxpayer bears the burden to show that an assessment is wrong. If the taxpayer fails, the original assessment must stand.

Pillay v Krishna 1946 AD 946 – South Africa: Classic precedent on the burden of proof: he who alleges must prove. Often cited to argue that the taxpayer’s evidence did not meet the balance of probabilities.

Requirement for Actual Services Rendered (Management Fees)

A TP deduction in the case of management fees is only valid if services were actually rendered and not just contracted. Ensure that proper documentation and proof is at hand. **See Case Study 3.**

CF (Pvt) Ltd v Zimbabwe Revenue Authority HH 99-18; [2018] ZWHHC 99 – Zimbabwe: Held that contractual arrangements are not enough; taxpayers must prove services were rendered and that expenses were actually incurred.

Edward Collins & Sons Ltd v Commissioners of Inland Revenue [1924] 12 TC 773 - (UK): Confirmed that deductible expenses must be incurred and connected with the income-producing activities.

Methodology and TP Documentation

The revenue authority will argue that the taxpayer failed to demonstrate that its transfer pricing method was the most appropriate or aligned with OECD Guidelines.

Commissioner for the South African Revenue Service v Sasol Chevron Holdings Limited (Case no 1044/2020) [2022] ZASCA 56 – South Africa: The court emphasized the need for robust TP documentation and use of the most appropriate TP method under OECD guidelines.

Canada v GlaxoSmithKline Inc., 2012 SCC 52; [2012] 3 SCR 3 – Canadian Federal Court: The court rejected the taxpayer's cost-plus pricing where there was insufficient evidence that the chosen method reflected arm's length pricing.

OECD Guidelines as Authoritative

Where the local law is silent or ambiguous, use prior cases to establish the OECD Guidelines as persuasive authority.

Zimbabwe Revenue Authority v Astra Holdings (Pvt) Ltd SC 27/03; 2003 (1) ZLR 417 (S) – Zimbabwe Supreme Court: The court accepted OECD principles as guiding tools in the absence of detailed local TP legislation.

Penalty and Intent

Argue that penalties should only be upheld if there was intention to evade tax, not just errors.

ITC No. 1725, 64 SATC 223 – South Africa: The court held that penalties must be based on intent to evade tax, not mere misjudgment or technical error.

Appeals Based on Judicial Error or Misinterpretation of Law

Argue that the lower court misapplied the law, misunderstood TP principles, or used incorrect tests (e.g., ignored factual evidence of services rendered).

CIR v King 14 SATC 184 – South Africa: Appeal succeeded where the trial court misapplied the legal principles governing tax deductions.

CONSTITUTIONAL AND ADMINISTRATIVE PROCEDURE

Introduction

In transfer pricing appeals, constitutional and administrative procedural issues can play a critical role, especially when challenging how a tax authority exercised its powers or applied the law. These issues can be independently appealable or arise as grounds to overturn a substantive TP decision. These challenges most likely proceed any tax trial and would be launched by way of application to the court to set aside the wrongful conduct of the tax authority.

However, this could also form part of the objection and appeal process. The advantage of going the application route is that the dispute could be disposed of quickly. The challenge is that many tax laws require all tax disputes to travel the objection and appeal route. There are exceptions, but they are narrow and must be carefully researched to ensure the court application is not lost on a technicality – exhausting the objection and appeal process.

Right to a Fair Hearing (Audi Alteram Partem)

A constitutional principle is that taxpayers are entitled to be heard before any administrative action is

taken that prejudices them. The appealable issue is that if the revenue authority made a TP adjustment or assessment without giving the taxpayer an opportunity to respond or ignoring key evidence or arguments, this can be grounds for appeal. An example is the failure to disclose the basis of the TP adjustment or not providing sufficient time to respond to a letter of findings. This may be subject to a direct challenge to the court by way of an application outside the objection and appeal process. But beware of any provisions requiring the taxpayer to exhaust the objection and appeal process.

This legal principle could form part of the appeal to the higher court.

Legality and Ultra Vires Action

An administrative law principle is that tax authorities must act within the bounds of their legal authority (ultra vires doctrine). The Appealable issue is that if the tax authority applied powers it didn't have, or relied on irrelevant considerations, a higher court can intervene. An example is using general anti-avoidance powers to bypass specific TP rules improperly. This may be subject to a direct challenge to the court by way of an application outside the objection and appeal process. But beware of any provisions requiring the taxpayer to exhaust the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Legitimate Expectation

Taxpayers may have a legitimate expectation of consistent treatment based on prior conduct, rulings, or agreements. The appealable issue is that if the authority suddenly reverses a previously agreed position, without giving the taxpayer a chance to respond, this may violate administrative fairness. An example is reneging on an advance pricing agreement (APA) or ignoring a long-standing TP methodology. This would typically form part of the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Reasonableness and Rationality

In terms of Constitutional and Administrative law principles, public bodies must make rational and reasonable decisions. An appealable issue is that if the TP assessment is arbitrary, irrational or lacks evidentiary support, it may be challenged on the basis of unreasonableness. An example is applying a TP method that is inappropriate for the transaction or ignoring OECD Guidelines without justification. This would typically form part of the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Bias and Lack of Independence

Taxpayers are entitled to an impartial adjudication. An appealable issue is that if the decision-maker showed actual or perceived bias, or where the tribunal or tax committee isn't independent or impartial, this raises constitutional questions. An example is if revenue authority officials who raised the audit also sat on the objection committee. This would typically form part of the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Violation of Due Process in Audit and Assessment

Procedures for audits and assessments must be transparent and lawful. An appealable issue would be if TP documentation deadlines were unreasonably shortened, or audits extended beyond statutory periods, a taxpayer can challenge the assessment on procedural grounds. This may be subject to a direct challenge to the court by way of an application outside the objection and appeal process. But beware of any provisions requiring the taxpayer to exhaust the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Access to Information and Reasons

Taxpayers are entitled to reasons for adverse decisions and access to documentation used against them. If the authority refuses to disclose documents, benchmark data, or reasoning behind a TP adjustment, that violates fair process and is appealable. For example, if the revenue authority uses secret comparables or benchmarks and refuses to share them. This usually forms part of the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Delay (Unreasonable Delay Doctrine)

It terms of administrative fairness undue delay in concluding TP audits or appeals may violate the taxpayer's rights. A TP case that drags for years without resolution may be challenged as a violation of the right to administrative justice without delay. For example: A 10-year unresolved audit with no updates or decision issued. This may be subject to a direct challenge to the court by way of an application outside the objection and appeal process. But beware of any provisions requiring the taxpayer to exhaust the objection and appeal process. This legal principle could form part of the appeal to the higher court.

Separation of Powers / Judicial Overreach

Tax authorities should not act as both investigator and judge. If the tax authority refuses to refer matters to the courts when required or imposes penalties without judicial oversight, this may breach separation of powers. This usually forms part of the objection and appeal process. This legal principle could form part of the appeal to the higher court.

WHERE TO APPEAL TO? AN ADMINISTRATIVE REVIEW, A TAX TRIBUNAL, OR A JUDICIAL REVIEW?

Administrative Review (Objection Process within Revenue Authority)

This is the first line of appeal after receiving an assessment or TP adjustment. It typically involves filing an objection with the same tax authority (e.g., ZIMRA Commissioner General). The purpose is to allow the authority to reconsider its own decision before proceeding to external litigation.

Pros:

- Usually faster and less expensive.
- Opportunity to correct misunderstandings or provide additional documentation.
- Limitations:
- Lacks independence — the same tax authority that raised the assessment reviews the objection.
- Not suitable for constitutional or serious procedural challenges.

Tax Tribunal / Tax Court

This applies after administrative remedies are exhausted. It is the best forum for appealing substantive TP issues, such as:

- Whether a TP method was correctly applied;
- Whether the taxpayer met documentation requirements; and
- Whether a deduction (e.g. for management fees) is valid.

Jurisdiction is usually empowered by statute to hear disputes of fact and law under the tax code.

Pros:

-
- Judges or panel often have tax expertise;
 - Can determine complex factual disputes.
 - Limitations:
 - May not deal with broader constitutional issues (e.g., right to fair hearing, delay, bias);
 - Often limited to issues of tax law only.

Judicial Review (High Court / Constitutional Court)

When procedural fairness, administrative justice, or constitutional rights are in question. This is NOT typically used to review the merits of the TP assessment itself (e.g., choice of comparables), but rather how the decision was made.

Although these grounds can be dealt with in a direct court application outside the objection and appeal process (provided the tax laws do not limit the taxpayer to deal with all dispute issues through the objection and appeal process), they can form part of the objection and appeal process.

Suitable Grounds:

- No fair hearing / bias
- Delay / unreasonable conduct
- Ultra vires actions
- Breach of legitimate expectations
- Refusal to disclose information
- Violation of right to access courts

Pros:

- Focuses on process and legality;
- Independent, higher-level court.
- Limitations:
- May not overturn a TP decision on substantive grounds (e.g., arm's length pricing);
- Cannot substitute its own TP assessment.

As previously stated, these grounds are very useful to pursue where the revenue authority has failed to follow constitutional and administrative law principles. For example, a failure to adhere to the letter of findings process would entitle the taxpayer to review the wrongful conduct of the revenue authority. As stated, this is outside the objection and appeal process as you are reviewing wrongful conduct and not application of a tax law. That separates it from most restrictions that the tax dispute must travel the objection and appeal process. But beware of different country court procedures.

For instance, in Tanzania the high court registrar will refuse to issue a court application against the Commissioner on whatever basis if not via the objection and appeal process. Make sure you have an in-country tax lawyer who specialises in TP litigation to help steer the dispute.

Lessons from other appeal cases

Transfer pricing (TP) disputes have been at the forefront of international tax litigation, offering critical insights into the complexities of intercompany transactions and the application of the arm's length principle. Analyzing prominent TP cases provides valuable lessons for multinational enterprises (MNEs) aiming to ensure compliance and mitigate risks. Below are key takeaways from notable TP tax trial appeals:

The Coca-Cola Company v. Commissioner of Internal Revenue (U.S.)

Background: The IRS challenged Coca-Cola's allocation of profits among its foreign affiliates, asserting that the company's transfer pricing methods did not reflect arm's length standards, leading to a tax deficiency of approximately \$3.3 billion for the years 2007-2009.

Outcome: The U.S. Tax Court ruled in favor of the IRS, concluding that Coca-Cola's pricing arrangements resulted in an inappropriate allocation of income to low-tax jurisdictions.

Lessons Learned:

- **Consistency with Prior Agreements:** MNEs should ensure that their transfer pricing policies are consistent with prior agreements and settlements with tax authorities.
- **Economic Substance:** It's imperative that intercompany transactions have economic substance and reflect the functions performed, assets utilized, and risks assumed by each entity.
- **Documentation and Justification:** Robust documentation supporting the rationale behind transfer pricing methodologies is crucial to withstand scrutiny.

Canada v. GlaxoSmithKline Inc. (Canada)

Background: The Canada Revenue Agency contested the prices paid by GlaxoSmithKline's Canadian subsidiary for the purchase of ranitidine (an active pharmaceutical ingredient) from a related Swiss entity, arguing that the prices exceeded arm's length amounts.

Outcome: The Supreme Court of Canada held that in determining arm's length prices, it is appropriate to consider the surrounding circumstances, including the rights and benefits conferred by related agreements. The case was remitted to the Tax Court for reassessment.

Lessons Learned:

- **Holistic Evaluation:** Courts may consider the totality of intercompany agreements and the context in which transactions occur, rather than assessing transactions in isolation.
- **Comparable Uncontrolled Price (CUP) Method Application:** When applying the CUP method, adjustments may be necessary to account for differences in contractual terms and economic circumstances.

Cameco Corporation v. The Queen (Canada)

Background: Cameco faced allegations of shifting profits to a Swiss subsidiary through intercompany contracts, purportedly to exploit lower tax rates.

Outcome: The Tax Court of Canada ruled in favor of Cameco, stating that the transactions were commercially rational and did not violate transfer pricing rules. Subsequent appeals by the Canada Revenue Agency were unsuccessful.

Lessons Learned:

- **Commercial Rationality:** Demonstrating that intercompany transactions have a sound business rationale can be pivotal in defending against transfer pricing challenges.
- **Respect for Legal Form:** Courts may uphold the legal form of transactions if they reflect economic reality and are not solely tax-motivated.

Apple Inc. v. European Commission (European Union)

Background: The European Commission determined that Ireland granted undue tax benefits to Apple, allowing the company to pay substantially less tax than other businesses, which was deemed illegal state aid.

Outcome: The General Court of the European Union annulled the Commission's decision, stating that there was insufficient evidence to prove that Apple had been granted a selective economic advantage.

Lessons Learned:

- **State Aid Considerations:** MNEs must be cautious of arrangements that could be perceived as receiving preferential treatment from governments, as these may be subject to state aid investigations.
- **Transparency:** Clear and transparent tax arrangements with governments can mitigate the risk of disputes related to alleged preferential treatment.

RR Donnelley Czech s.r.o. v. Czech Tax Authority (Czech Republic)

Background: The Czech tax authority challenged the transfer pricing practices of RR Donnelley, focusing on the pricing of intercompany transactions.

Outcome: The Supreme Administrative Court ruled in favor of RR Donnelley, emphasizing the necessity for tax authorities to provide substantial justification for transfer pricing adjustments.

Lessons Learned:

- **Burden of Proof:** Tax authorities bear the burden of providing robust evidence when proposing adjustments to a taxpayer's transfer pricing.
- **Taxpayer's Documentation:** Maintaining comprehensive and contemporaneous documentation can effectively counteract tax authority claims.

These cases underscore the importance for MNEs to establish and document transfer pricing policies that are economically justified, consistent with international guidelines, and reflective of genuine business activities. Proactive compliance and thorough documentation are essential to navigate the complexities of transfer pricing and to defend against potential disputes.

THE FINANCIAL IMPACT

Finally, the ongoing appeal and TP dispute has ongoing financial implications that must be managed with the participation of the executives of the MNE.

Messaging to Your CFO, CEO, and Board: Strategic Clarity During an Ongoing TP Appeal

As the business enters a prolonged phase of legal uncertainty due to the TP dispute, clear, proactive, and transparent communication with your executive team and board is critical. CFOs, CEOs, and board members are not only concerned with financial exposure, but also with reputational risk, compliance integrity, and the broader strategic implications of sustained litigation with a revenue authority. Thus, continued communication with them is key.

If you followed my principles in **Appendix L** on tax risk management with a tax steering committee, this process will already be in place.

I emphasize some key areas to consider and implement:

Demonstrate Financial Control Amid Legal Uncertainty

Frame the TP adjustment as a **non-cash contingent liability** at this stage:

- Accounting Entry (IFRS-aligned):
 - **Dr.** TP Adjustment Expense (Income Statement)
 - **Cr.** Contingent Liability for TP Adjustment (Balance Sheet)
- This treatment reflects prudence without prematurely conceding tax liability.

Highlight Confidence in the Arm's Length Position

- Reaffirm that the **intercompany transactions are supported by robust contemporaneous documentation**, in line with OECD/UN guidelines.
- Emphasize the independent validation of the TP method used, including **economic rationale and expert support**.

Control the Narrative: “A Dispute of Methodology, Not of Malpractice”

- Make clear that this is a **technical dispute**, not evidence of tax evasion or bad faith.
- Reinforce the organization's long-standing commitment to ethical tax compliance and full cooperation with authorities.

Explain the Timeline and Appeal Strategy

- The appeal process is likely to extend over **several years**, but:
 - It is being managed by **seasoned litigation counsel and specialist transfer pricing advisors**.
 - The litigation posture is supported by favorable precedents and case law.

Mitigate Stakeholder Concerns

- Investors, auditors, and regulators will expect transparency. Confirm that the liability is:
 - **Disclosed appropriately** in the notes to the financial statements;
 - **Monitored actively** through a Tax Steering Committee;
 - Subject to **ongoing legal and financial review**.

Final Recommendations to the Board

- **Maintain a litigation reserve** sufficient to cover the potential exposure, reviewed quarterly.
- **Strengthen documentation** for all future intercompany transactions, especially in high-risk jurisdictions.
- **Continue stakeholder briefings** with legal and tax updates to avoid surprises during earnings cycles.

CHAPTER 10

RECENT CASE LAW IMPACTING TRANSFER PRICING

WHY NON-TP CASES NOW MATTER FOR TRANSFER PRICING

Transfer pricing disputes no longer operate in isolation from broader developments in tax jurisprudence. Recent case law, particularly in relation to treaty residence, GAAR, economic substance, and the binding effect of administrative guidance, has begun to influence how courts and revenue authorities approach profit attribution, DEMPE analyses, and the evaluation of transfer pricing evidence.

Although many of these cases are not, strictly speaking, transfer pricing cases, their reasoning has direct spill-over effects. Courts are increasingly willing to look beyond formal legal entitlements and contemporaneous documentation where they conclude that a structure lacks commercial substance or economic reality. This development materially alters the risk landscape for transfer pricing adjustments, especially in structures involving SPVs, holding companies, IP owners, and financing entities located in low-tax or treaty-favoured jurisdictions.

This chapter examines the emerging jurisprudence and analyses its implications for transfer pricing litigation and audits.

THE TIGER GLOBAL / MAURITIUS GAAR DECISION: A STRUCTURAL TURNING POINT

Core holding

In *Tiger Global International Holdings v Union of India*¹, the Delhi High Court held that entities within the Tiger Global group were not entitled to treaty benefits under the India–Mauritius tax treaty, notwithstanding the existence of valid Mauritian Tax Residency Certificates (TRCs). Applying India’s General Anti-Avoidance Rule (GAAR), the Court concluded that the arrangements lacked commercial substance and were primarily designed to obtain tax benefits.

The Court further held that:

- GAAR may apply to income arising after 1 April 2017 even where investments were made prior to that date, if such investments formed part of an “arrangement”;
- Circular No. 789 (2000), which had historically provided certainty regarding Mauritius treaty benefits, is binding only within the legal framework that existed when it was issued;
- For treaty relief to apply, the taxpayer must demonstrate that the relevant income is taxable in its state of residence.

¹ The Authority for Advance Rulings vs. Tiger Global International II Holdings, CIVIL APPEAL NO. 262 OF 2026

INTERACTION WITH ESTABLISHED TREATY JURISPRUDENCE

The Tiger Global ruling sits in tension with earlier Supreme Court authority, most notably *Union of India v Azadi Bachao Andolan*². In *Azadi Bachao*, the Supreme Court held that:

- A Tax Residency Certificate constitutes sufficient evidence of residence for treaty purposes; and
- The correct test is whether the taxpayer is liable to tax, not whether tax is actually paid in the residence jurisdiction.

By requiring proof of actual taxability and by discounting the evidentiary weight of TRCs, the Tiger Global decision signals a more sceptical judicial posture toward formal treaty gateways. This shift has important consequences for transfer pricing, where residence, entitlement, and functional allocation are often treated as settled starting points.

IMPLICATIONS FOR TRANSFER PRICING: CONCEPTUAL SPILL-OVER

Residence and entitlement are no longer safe assumptions

In transfer pricing disputes, the residence of the tested party or profit-earning entity has traditionally been accepted as a given once treaty residence is established. Post-Tiger Global, revenue authorities may be emboldened to argue that:

- An entity that is not accepted as a “true” treaty resident lacks the economic justification to earn residual or non-routine returns;
- Residence and entitlement must be supported by demonstrable people, control, and decision-making functions.

This directly affects:

- IP holding companies,
- Principal structures,
- Mauritius, Singapore, Netherlands, and similar SPV-based models.

GAAR as a back-door transfer pricing tool

Although GAAR and transfer pricing are doctrinally distinct, Tiger Global illustrates how GAAR can be used to override formal pricing and allocation outcomes. Once an arrangement is characterised as lacking commercial substance, pricing outcomes may be treated as unreliable or artificial.

This mirrors approaches taken in other jurisdictions, where courts have rejected hindsight-driven recharacterisation but nevertheless insisted on substance-based profit attribution, including:

- ***Veritas Software Corp v Commissioner***³ – rejection of valuation based on hindsight assumptions;
- *Amazon.com Inc v Commissioner*, *aff’d 9th Cir.*⁴ – insistence on contemporaneous contractual allocation of rights and risks;
- *Coca-Cola Co v Commissioner*⁵ – DEMPE control must be proven by actual decision-making, not inferred from group outcomes.

The Indian GAAR jurisprudence risks enabling outcome-driven TP adjustments, rather than method-driven

2 Union Of India And Anr vs Azadi Bachao Andolan And Anr on 7 October, 2003: CASENO.: Appeal (civil) 8161-8162 of 2003

3 *Veritas Software Corp v Commissioner* 133 T.C. 297 (2009)

4 *Amazon.com Inc v Commissioner* 148 T.C. 108 (2017), *aff’d* 934 F.3d 976 (9th Cir. 2019)

5 *Coca-Cola Co v Commissioner* 155 T.C. 10 (2020)

analysis grounded in OECD principles.

DEMPE, SUBSTANCE, AND THE RE-ALLOCATION OF RETURNS

The Tiger Global decision reinforces a judicial preference for economic substance over legal form, a theme also evident in international transfer pricing cases such as:

- *Cameco Corporation v The Queen*⁶ – rejection of hindsight attacks on commercially rational structures;
- *GE Financial Investments Ltd v HMRC*⁷ – emphasis on risks actually assumed under the contractual framework.

For transfer pricing, this increases pressure on taxpayers to demonstrate that entities claiming DEMPE-based returns:

- Employ personnel with authority;
- Control economically significant risks;
- Make and implement key decisions.

Absent such evidence, revenue authorities may rely on Tiger Global-style reasoning to justify profit re-allocation, even where formal pricing methodologies appear compliant.

Erosion of Administrative Certainty and Its TP Consequences

By narrowing the binding effect of Circular 789, the Court has weakened reliance on administrative guidance and historical acceptance. In transfer pricing terms, this undermines arguments that:

- Prior audits,
- Advance rulings,
- Historical acceptance of pricing models should constrain future adjustments.

This is particularly relevant where:

- BEPS-era substance expectations were not previously applied;
- Legacy APAs or benchmarks are relied upon without refresh.

PRACTICAL IMPACT ON TP AUDITS AND LITIGATION STRATEGY

Following Tiger Global, multinational groups operating in or through India should expect:

- Greater scrutiny of holding and SPV structures in TP audits;
- Challenges to tested party selection based on substance, not residence alone;
- DEMPE-focused recharacterisation, supported by GAAR reasoning;
- Increased emphasis on actual tax outcomes to question entitlement to returns.

Taxpayers will need to respond with:

- Updated FAR and DEMPE analyses;
- Evidence of decision-making and control;
- Clear separation between GAAR arguments and OECD-compliant TP methodology.

CONCLUSION

⁶ *Cameco Corporation v The Queen* 2018 TCC 195
⁷ *GE Financial Investments Ltd v HMRC* [2018] UKSC 20

The Tiger Global decision represents a significant development in Indian tax jurisprudence with consequences extending beyond treaty eligibility and capital gains taxation. Its reasoning strengthens a broader judicial trend toward substance-based analysis, reduced reliance on formal documentation, and scepticism toward structures perceived as tax-driven.

For transfer pricing, this creates heightened risk. While OECD principles continue to require methodical, evidence-based pricing analysis, revenue authorities may increasingly rely on GAAR-inflected reasoning to challenge profit allocation, DEMPE attribution, and the legitimacy of SPV-based models.

Practitioners conducting or defending transfer pricing trials must therefore integrate treaty, GAAR, and substance jurisprudence into their evidentiary and strategic framework. Transfer pricing disputes are no longer confined to pricing alone; they are now litigated within a broader contest over economic reality and good-faith treaty application.

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CHAPTER 11

THE FINAL CHAPTER

This book should illustrate the difficulties in going to a TP trial. The most complex area is preparing the evidence that will be accepted by the trial court. That means having the right best evidence documentation supported by the hearsay testimony of various factual and expert witnesses. Knowing the rules of evidence and the hearsay exceptions such as business records. As a TP specialist you are most likely not schooled or experienced in these areas of law – so get the help you need.

In addition, overlay the complexities of constitutional and procedural law that affects the tax audit process. Again, as a TP specialist you are most likely not schooled or experienced in these areas of law - again, get the help you need.

When? Start with the tax risk steering committee under the attorney/client privilege. That will help you identify tax risks, help prepare for tax audits and the correct evidence you need to gather. More importantly you will know what to do on time before it is too late. Many rights that exist in favour of an MNE are lost if not used in time.

For the rest, I have nothing further to add, other than to repeat the lessons learned taken from the case studies at the end of this book:

LESSONS LEARNED FROM CASE STUDY 3

Burden of Proof Rests on the Taxpayer

The taxpayer bears the onus of proof to demonstrate that a tax authority's assessment was incorrect. Taxpayers must provide substantial, detailed, and reliable evidence to support their claims, especially when claiming deductions, exemptions, or adjustments. Mere assertions, assumptions, or incomplete documentation will not suffice to discharge this burden.

Importance of Proper Documentation for Deductions

For deductions, the taxpayer must prove that expenses were incurred for the purposes of trade or income production. Taxpayers should maintain accurate and comprehensive records to substantiate:

- Actual services rendered;
- Cost build-up of fees; and
- Evidence that claimed expenses are directly related to income production.

Invoices and Service Level Agreements must meet statutory requirements. Failure to comply can result in disallowed deductions.

Mere Existence of a Contract Does Not Prove Services Were Rendered

In line with the substance-over-form doctrine, the signing of a contract does not automatically create a legal obligation for tax deduction. A taxpayer must show that services were actually rendered and that the fees claimed are commensurate with the services provided. Pre-determined or subscription-based fees (like a monthly DSTV subscription) are not deductible without proof that actual services were provided. Payments made without evidence of services rendered will not be deductible.

Valid Invoices Are Mandatory for Deductions

For VAT Act purposes, tax invoices must contain key information such as:

- Description of goods or services.
- Quantity or volume of goods or services supplied.

Non-compliance with invoice requirements renders the claim invalid, and erroneous acceptance of invalid invoices by ZIMRA officials does not validate them. Taxpayers should ensure that all invoices meet legal standards to avoid disallowance of claims.

Penalties Are Linked to Intent and Compliance

Penalties under tax laws are imposed based on intent and degree of non-compliance. Good faith mistakes may result in a reduction of penalties. However, taxpayers with professional expertise should take extra precautions to comply with legal requirements, as ignorance of the law is not a defence.

Revenue Authorities Cannot Dictate Business Decisions

Revenue authorities are not able to dictate business decisions or impose hindsight judgments about what is reasonable for a business. Courts will uphold the taxpayer's decisions where they are made in the ordinary course of business and not for the purpose of avoiding tax. Taxpayers have discretion to choose their business strategies, and authorities should not substitute their own views.

Application of OECD Transfer Pricing Guidelines

Transfer pricing adjustments should follow OECD Transfer Pricing Guidelines when determining the arm's length nature of intercompany transactions. Multinational companies must ensure that intercompany transactions meet the arm's length standard and are properly documented. Inconsistent or arbitrary application of transfer pricing methods can be challenged.

Consistency in Evidence and Witness Testimony

Contradictory witness testimonies weaken a taxpayer's case. Witnesses must be consistent and demonstrate first-hand knowledge of the facts. Inconsistent testimonies can lead to adverse findings.

LESSONS LEARNED FROM CASE STUDY 4

Substance Over Form

Courts look beyond legal structuring to the economic substance and control of functions, assets, and risks. Simply transferring operations to a subsidiary doesn't absolve the parent of tax obligations if it still performs core functions.

Inconsistent or Incomplete Documentation Harms Credibility

The appellant's failure to maintain consistent employment records, misleading emails, and withholding of agreements undermined its case.

OECD TPGs Must Be Legislated to Be Binding

Unless explicitly incorporated into local law¹, international guidelines like the OECD TPGs do not override domestic tax provisions.

Expert Evidence Must Be Unbiased and Thorough

The court was critical of the appellant's expert, calling her testimony biased and noting flaws in her analysis, such as selective data use and failure to account for relevant legal distinctions. This finding was disputed in the draft appeal.

The Burden of Proof Lies with the Taxpayer

Since the appellant challenged ZIMRA's assessments, it bore the burden of proving them incorrect.

FINAL ADVICE

You will note the importance of evidence in the lessons learned from the case studies. That is going to be the most difficult part of the preparation for your TP trial.

I am available to assist at daniel.n.erasmus@me.com.

Don't leave it too late!

¹ OECD and UN Guidelines are not law unless legislated

APPENDIX A

INTERVIEW WITH ADVOCATE W TRENGOVE SC, JANUARY 2024, CONDUCTED AFTER THE *ABD LTD VS THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICE* (UNREPORTED) TAX COURT TRIAL

Dr Erasmus:

Most of the students in this course come from an accounting background and most likely have never seen the inside of a courtroom and more particularly not the inside of a courtroom dealing with defending a transfer pricing study.

How would you suggest corporate transfer pricing specialists should prepare generally for anticipated audits and a potential trial that may emerge in the future in defending a transfer pricing study?

Advocate Trengove SC:

Well, I would suggest that probably the most important combination of skills that need to go into such a defence would be both expert knowledge and objectivity because it is a field which ultimately turns on the determination of an arm's length price. It is an area in which there is room for lots of legitimate differences of opinion but also open to biased manipulation so that the important features would be a combination of expert knowledge and objectivity. Lack either is fatal to the evidence relied upon.

Dr Erasmus:

All of these transfer pricing disputes emanate ultimately from a transfer pricing study that has been prepared by an accounting or consulting firm. It is done on an annual basis. They prepare the transfer pricing study to reflect the arm's length price of a transaction, a brand name as an example. If we drill down to practicalities, what do you suggest these transfer pricing specialists should be doing to ultimately achieve what you have just suggested in your previous response?

Advocate Trengove SC:

Well, I suppose there are two parts to such an exercise. The one is to determine the number i.e. the transfer price to be applied in a particular case. The other would be to defend the legitimate accuracy and legitimacy of that number. Now

if I may take them one by one firstly to determine the number i.e. the notional arm's length price between connected parties. As you know, the method for that determination depends very much on the circumstances of the case. There are a range of methods by which transfer prices, notional arm's length prices may be determined and the OECD Guidelines are an authoritative and weighty authority on the legitimacy of various methods. But then even those methods are open to application in different ways, often involving a great deal of judgment of the expert applying the method. And that is where objectivity comes in. In those areas of judgment if the expert is in-house, then the exercise of judgment just carries so much less weight than it would if the expert is external and objective. And then it's of course also important for the expert to demonstrate the objectivity and the manner in which they go about determining the price. A factor, which I think is important in interrogating the legitimacy of a price, is to determine whether there is a motive for manipulation between the parties to the transaction. Now there quite often is, typically transfer price would be challenged or would be a transfer price between say for instance a parent company in one jurisdiction and a subsidiary in another. There may sometimes be strong commercial reasons for transfer pricing. Let me give two examples.

The parent might be in a high corporate tax rate jurisdiction and the subsidiary in a low corporate tax rate jurisdiction. It would then in those circumstances be in the best interest of both for any profits to be maximized in the subsidiary where it is subject to little tax and the profit then distributed to the parent by tax free dividend. So, in those circumstances where the corporate tax rates differ markedly, there is inevitably a motive for transfer pricing, but it can also work the other way around. Assume for the moment that in the subsidiary there are significant minority shareholdings, then it would be to the advantage of the controlling parent, the holding company, to maximize profits in the holding company and not in the subsidiary because in the subsidiary those profits have to be shared with the minority shareholders. So in those circumstances that the motive would operate the other way around and one would look out for the possibility of maximizing profit in the holding company. But absent motive to shift profit, I think that it would be important merely to demonstrate that the exercise was done in good faith, but in the absence of a motive to distort courts should be slow to infer good faith, but inadvertent transfer pricing manipulation.

Dr Erasmus:

What typically happens is a transfer pricing study is completed that forms the core basis for the arm's length price. The team of professionals in the outside advisory firm that prepare the transfer pricing study do not end up being the ultimate expert that you would call to defend that transfer pricing study. What problems have you encountered or do you foresee here?

Advocate Trengove SC:

No, I think it is often very useful to not merely defend an accusation of price manipulation, but to be able to point to a study that was done at the time the price was fixed and demonstrate that that study was done in a good faith effort to determine an arm's length price. But that is not invariably the significance of a study done at the outset. And let me explain why I think one comes back to my issue of motive. If there is no motive to manipulate and the only motive at the time of the determination of the price is to determine an appropriate price, then the external determination would be very weighty because it would be judged to have been a good faith effort, a best effort to arrive at an arm's length price. But if there is a strong motive to manipulate prices, then such a study would often be subject to some suspicion that it was merely a device employed in anticipation of a challenge in order to justify the price charged. So yes, contemporaneous study is important. Yes, it is probably always worth doing it to determine the price, but its weight depends I think on the question whether there is motive to manipulate or not. And of course the study if done by an independent party is far more credible than an in-house study, but even then we know that professional service providers often want to impress and serve their clients' best interests by accommodating their commercial needs. So yes, it is a good idea to have an independent expert, but it is not always fool proof.

Dr Erasmus:

So in defending what was done by the external advisory firm, if you now look forward and consider there might be an extensive audit followed by a transfer pricing trial, what type of evidence should the corporation have its hands on as soon as possible in the process to assist in defending that transfer pricing position?

Advocate Trengove SC:

Well, if there is a challenge, it is always useful to bring in fresh expertise. The experts who determined the price at the outset by way of, in other words the authors of the original study are useful witnesses because they would testify to the good faith of the effort they made. But it is probably also always a good idea to bring in fresh expertise to support the original experts with an opinion that not only was there a determination done in good faith, but also that it was appropriately done. There is always a measure of a limitation on the credibility of the original study because being responsible for the original determination of the price, the expert would tend to want to defend their own work. So, it is a good idea to bring in fresh expertise, fresh eyes to support the original study.

Dr Erasmus:

Based on experience, one of the challenges that the corporation faces is that when these fresh experts are introduced, they are reliant upon the original information procured by the outside advisory firm. We have encountered severe challenges on that approach in particular that the new expert is challenged as introducing hearsay evidence and evidence that has also not been first-hand obtained by them in defending or putting forward their independent viewpoint. What do you suggest in response to that?

Advocate Trengove SC:

Well, let me say the particular problem that you described was in a rather unusual case where the tax authorities challenged the transfer pricing long, long, long after the event and due to various combination of circumstances, the trial took place a decade or more after the years in question. But it is always important to preserve the evidence on which the transfer pricing assessment is made and therefore it would be a wise precaution, whenever the transfer pricing report is done in the first place, for all of the gathered information and evidence to be preserved because to protect against the risk that you mentioned that when the time comes the evidence might no longer be readily available. So the recordal and then preservation of the supporting evidence is crucial. And you will see that the OECD also makes the point that it is important that contemporaneous formation be preserved for purposes of a later reassessment of transfer pricing.

Dr Erasmus:

Can I ask you to give a few examples of what you believe should be preserved? For example, let us assume a use of a brand is being defended by a corporate group in a transfer pricing study. What evidence do you believe should be preserved from the inception of that first transfer pricing study and subsequent updates?

Advocate Trengove SC:

Well, generally speaking, what should be preserved is the information on which the original study was based because that would generally be an expert selection of evidence germane to the particular method by which the transfer pricing is determined. And in the example you mentioned, one is talking about the arm's length price between a willing buyer and a willing seller of the use of a brand so that any evidence of the value of the brand and prices likely to be paid for it, would be crucial and that would be contemporaneous prices of the use of the brand in the marketing of the product and then also the benefit derived by it.

For instance, if a subsidiary is acquired and is rebranded, what difference did it make to its commercial success to its turnover and its profit by the rebranding and the like. So, any evidence of value of the brand, but particularly the evidence gathered and used in the original transfer pricing study would be critical and should be preserved. Having said that, one cannot always predict what evidence might ultimately turn out to be relevant because the experts might appropriately employ one method for the determination of price at the outset and it may then later turn out that a different method is more appropriate, in which event you will simply not have retained the evidence. But that is the exception and not the rule.

Dr Erasmus:

So just expanding a little on the example that I put forward, in my experience in doing the initial value of the use of that brand, there are certain key steps that are taken by various specialists that would give their input. For instance, a survey would be done in the different regions where the brand is now being used as made available by the headquarter or the parent company. And so studies of the approach to that brand by the general public may in fact be relied upon in doing the ultimate valuation calculation. By way of example, would you give us your suggestions as to how deep that retention of evidence should be and what that would comprise?

Advocate Trengove SC:

Well survey evidence, public survey evidence, sometimes present tricky issues in court because survey evidence invariably constitutes hearsay evidence. Your survey is ultimately based on the answers consumers gave to a set of questions put to them. So, if one were to want to preserve all of the evidence, it would have to go down right to the bottom to those people who did the surveys and who received the answers from the public to testify not only about the answers they received but also the method in which they went about asking the questions and recording the answers. There would then after the original survey be one or more levels of synthesis and analysis of the information so gathered. So, ideally one should preserve all of the documents generated at all three levels of that exercise. The more of it the better. Ultimately with the appropriate expertise, one should be able to avoid having to call as witnesses the underlying foot soldiers who did the street surveys and asked the questions. But to have the fruits of their labor available is very important and should be preserved if one can.

Dr Erasmus:

My experience is that this sort of deep dive into the gathering of evidence typically does not happen and this seems to be something that should be addressed by all these corporations facing these potential challenges. What your experience?

Advocate Trengove SC:

Let me say, as adversarial litigation one's opponent normally does not take such a technical point unless they sense that you are vulnerable to it. So, the better your evidence preservation of evidence has been, the less the likelihood that there will be a challenge because your adversity would normally recognize that nothing much can be gained from it. So yes, challenges of that kind of very technical are not often made or very seldom succeed, but you become vulnerable to the risk and the risk is enhanced if you do not have your ducks in a row.

Dr Erasmus:

So, moving on specifically to the typical tax audit that would take place and that connects to what we have just discussed, what would you suggest the general approach of a corporation should be in a revenue authority now wanting to investigate a transfer pricing study?

Advocate Trengove SC:

Well, I postulate a study done in good faith by appropriate expertise and in such a case I would suggest that the taxpayer should be forthcoming in giving the tax authority not only what they ask for, but also to engage with them, to persuade them of the legitimacy of the transfer pricing and the studies that underpinned it. So, I am all for active engagement and cooperation if one has no guilty conscience about your transfer pricing.

Dr Erasmus:

So what typically happens is, as you would have seen, there is a general inquiry, specific information is looked for and expected to be delivered to the revenue authority and ultimately there is silence for a long period of time and then an audit response is made available by the revenue authority giving the taxpayer a final opportunity to make whatever

representations it wants to make. If one looks at that period, what would you suggest the corporate taxpayer do?

Advocate Trengove SC:

Well, there is usually an opportunity to persuade rather than to fight. And the opportunity for persuasion diminishes over time as the revenue authorities position gets formulated and hardened. So, by the time the revenue authority produces the outcome of its audit, opinions will have very significantly solidified and very little room remains then for persuasion. The only kind of persuasion that then still works is to point to palpable errors in the revenue authorities assessment, but short of probable mistake, room for debate and discussion and persuasion in areas of discretionary calculation are pretty much closed down by that stage. And that is why I suggest an earlier engagement with the revenue authorities at a time when the prospects of persuasion are still better before they have taken a position and hardened in it.

Dr Erasmus:

The taxpayer should reach out to the revenue authority and in addition to the responses to their questions and the information provided, the taxpayer would engage with the revenue authority in discussion so that they can explain how they operate and explain the study that has been presented. Would you align with that?

Advocate Trengove SC:

Yes, exactly. And that means not only the taxpayer but also the taxpayer's expert advisor should be made available to the tax authorities to explain, to persuade them of its position because that potential for persuasion diminishes over time.

Dr Erasmus:

Then at what point should someone of your specialization be briefed as lead counsel, bearing in mind it is difficult to determine whether a matter is going to become litigious? What is the best time to engage a person like you as lead counsel, because oftentimes clients leave it too late?

Advocate Trengove SC:

In our jurisdiction, as you know, as also in the UK we have a split bar. So, the client's first port of call would be a solicitor or a firm of attorneys and only if the matter is litigious is it necessary to engage advocates or barristers. But these cases often turn firstly on pivotal issues of law and secondly on equally pivotal issues of strategy. And so for that reason, I think it is a good idea for the whole team to be constituted at an early stage, but as soon as it becomes clear that one is heading for a dispute to assemble a team to get early consensus on the approach to be taken and the positions to be taken on the legal issues in the case.

Advocate Trengove SC:

Developing that theme, many large corporations typically align themselves with large law firms to represent them in any matter of litigation. And in my experience, the large firms have well developed litigation teams who have been involved in a variety of different commercial litigation disputes, but oftentimes do not have a specialist in-house in their team that is very sensitive to and well-heeled in the issues of transfer pricing. What problems do you foresee, if any, in that situation and what would you suggest should be done about it?

Advocate Trengove SC:

Well of course some firms have transfer pricing experts within the firm, others do not. Those who do not, I would suggest, should sooner than otherwise seek expert input from the barristers who have transfer pricing expertise. So, I would suggest that to fill the gap within the firm of attorneys or solicitors, it sometimes is necessary for them to resort to consultation with litigation experts in transfer pricing at an earlier stage.

Dr Erasmus:

You are well known as being an advocate or lead counsel in administrative law and constitutional issues and you have over your career argued some very interesting and ground-breaking cases. And if I align that with what we are dealing with here on defending a transfer pricing study, oftentimes revenue authorities make mistakes in key procedural steps.

And I give you examples. For instance, they do not align themselves with proper time periods and one that we have encountered recently is their failure to either give proper reasons at the time that their final letter prior to the assessment is issued, and more particularly in cases where they have made up their minds and given reasons and then decide later on in the process to change the basis of their assessment. For instance, instead of following one particular methodology all of a sudden abandon their experts and then switch into another methodology. I know that is a bit of a hodgepodge of different contraventions, but what would your advice be in monitoring these procedural steps and what would you suggest? What steps should be taken and when?

Advocate Trengove SC:

Well, let me say I can speak of our jurisdiction where the courts are pretty indulgent with revenue authorities in correcting mistakes of the past and sometimes in delivering late pleadings and other documents. So, it is often counterproductive to fight the revenue authority at every turn on every misstep that they commit. But what is important is firstly to look out for those missteps that might be fatal, but also to consider to what extent those missteps, for instance, a shift in the basis upon which the cases is advanced changes because it might help to discredit the new version if it can be demonstrated that the new version was merely a last resort after the initial position had been shown to be flawed or inapplicable. So, I do not think that one can generalize on a response to missteps from the other side, depends on the nature of the misstep provided. It is also always important to be alert to see the significance of what is happening.

Dr Erasmus:

Yes, those procedural missteps are typically areas of law that a well-heeled litigation lawyer would be alive to that has dealt with similar problems. It is typically not something in my experience that is recognized by experts who do not have a litigation background. What is your experience?

Advocate Trengove SC:

Yes, and it actually cuts both ways, but the people who are less experienced will sometimes not spot a flaw if there is one, but also people of less will sometimes seek to make a big stand on something which a more experienced practitioner will know the court will condone or overlook. So, it is a question of expertise helping in recognizing the flaw but also in determining whether to make a song and dance about it or not.

Dr Erasmus:

Let us say a revenue authority does not generate a thorough letter of reasons or letter of assessment typically prior to issuing an assessment. They have taken shortcuts. Is that something you suggest should be dealt with sooner than later, or would that be thrown into the mix of issues that would ultimately go to trial?

Advocate Trengove SC:

There are different schools of thought on that score. Many of my colleagues would take a point if they see one. My policy is different, because I think that quite often the taking of a point serves merely to educate your opponent on the flaws in the case. And so I believe that it is wise to take a point and make a stand on a flaw of that kind only if it is incurable. In other words, only if the revenue authorities concur the flaw by amendment or supplement. Because if they can, then all you will have achieved by your objection is to educate them on the flaws in their case. In cases where the flaw is curable, and in our jurisdiction it often is, I think it is better to let it stand so that the revenue authority discover the flaw in their case only at the end of the case when it is too late for them to fix it.

Dr Erasmus:

That is a very fair point and I have certainly seen the different approaches. Again, just furthering that example a little more apart from being an incurable misstep by the revenue authority, timing would also play an important role. And I have seen an instance where the revenue authority failed to give a proper letter of findings and they were challenged on that, but literally two or three days before the time period for reassessing the taxpayer was about to expire and it was highly unlikely that they would be able to remedy that letter of findings within the two or three day period. And it so happened that the revenue authority realized that and backed off with an appropriate consent order made by the court.

Advocate Trengove SC:

That is a good example where you take the point because you know it is incurable and that is a legitimate time to do it. On the other hand, if it is one of those cases where they can simply issue another letter and cure their flaw, your objection will not have achieved anything.

Dr Erasmus:

In receiving a brief from instructing attorneys requiring a client's transfer pricing study to be defended, at that point what would you expect to receive in your brief?

Advocate Trengove SC:

Well, it depends on the stage at which I receive the brief stage of the litigation or stage of the dispute. I would obviously expect if the litigations are already pending, all the formal documents in the litigation, the pleadings and the like, but then also the crucial documents leading up to the litigation, the letter of findings, the letter of objection, the revenues, dismissal of the objection and so on. But what is really essential in any brief at whatever stage the brief is received, is an explanation, the attorney's explanation of the facts and issues in the case. A five-page memo which describes the case and the issues is hugely useful because it avoids hours of work to get to an understanding of the case. And at the same time, I would not suggest that at that stage it is appropriate to give counsel all the relevant documents in the case that might run into thousands of pages and it is just pointless at an earlier stage. So, key documents plus an explanatory note I would suggest is most useful.

Dr Erasmus:

This really connects back to your earlier point. It is important to assemble the appropriate team of specialists as early on as possible because in preparing such a memorandum of instructions in a brief, it would require a careful consideration by the instructing attorney of the written facts and issues to help have you focus on the key issues. Is that what you mean.

Advocate Trengove SC:

Yes, exactly.

Dr Erasmus:

And assuming you were briefed quite early on in the process where the corporation and the instructing attorneys acknowledged they do not have someone on the team that is an experienced transfer pricing litigant, how would your brief change?

Advocate Trengove SC:

Well, it would mean that they would require input from counsel at a for more extensive level that would for instance require that a more junior advocate be employed in the team because there would be more routine drafting and running to be done where the senior advocate does not necessarily have the time or capacity to attend to it. So, the more the

case depends on counsel's input, the bigger the team of counsel would be required because the job of the leader of the team is not really to draft documents but merely to guide the case.

Dr Erasmus:

So hence the core team should typically, as soon as possible, have an experienced transfer pricing lawyer or attorney for that matter as part of that process to synthesize all of this information and allow you to then do your job effectively.

Advocate Trengove SC:

Sure. And if that expertise is not resonant in the firm of attorneys, then it is necessary that an advocate be briefed to bring that expertise to the team.

Dr Erasmus:

Moving on to witnesses, so much of what ultimately is dealt with in court is going to be driven by key evidence that needs to be advanced in order to convince the court that the arm's length price is just that. Can you give me your views on the approach to that evidence and in particular the approach to witnesses?

Advocate Trengove SC:

Well, I suppose one could broadly differentiate between witnesses of fact and witnesses to expert opinion. Witnesses who give evidence of merely factual evidence in cases of this kind, invariably based their evidence on a massive documentation. And there is very little room for a witness to give any evidence of any consequence which is not consistent with and supported by a body of documentation. So, for those witnesses it is crucial for the witness and the lawyers including the advocate to understand all the underlying documents because the documents have to support the witness and if they do not, the witness's evidence will be discredited. So, that is quite a crucial exercise to synthesize and understand the documents for both the lawyer and the attorney and the witness.

And let me just emphasize that it is not good enough for the lawyer to understand the documents if the witness does not have a proper insight into the documents, it also does not help. I have seen how witnesses that I have cross-examined often give their evidence even honestly in good faith, but if they do not know the documents, their evidence becomes very tentative because they never know when they answer a question, whether there might be a document lurking somewhere that contradicts the answer they give. So they become insecure and tentative and tend to give weak evidence. Whereas the witness who really knows and understands the documents can usually give so, not only accurately, but with a great deal of confidence. So much for the lay witnesses to fact. But then as far as the experts are concerned, probably the most important requirement is for the expert, well I suppose like I said earlier, has to satisfy two criteria. Firstly, a level of expertise, the higher the better, but then importantly also a level of independence. An expert witness who merely comes across as a piper for the cause of the client carries very little credibility. So, a smart witness who makes a point of not only being objective but demonstrating objectivity usually achieves a lot more than one who is simply a fighter for a cause.

Dr Erasmus:

So, on the factual witness there are an array of different possibilities and if we look at the typical corporation, there usually is a senior individual head of international tax or head of tax, who has oversight over all of these different issues, and may also be a new person to that role. We see a lot of movement in these corporations where people either leave or are promoted and so, ultimately the key individual in-house at the time that the important transfer pricing study was done to determine the arm's length price in the first place is no longer around. And then of course you have your accounting or consulting firm that sits on the outside and has prepared the original transfer pricing study and the revisions of that every year. And with that sort of panel of potential factual witnesses, what would your recommendations be?

Advocate Trengove SC:

Well, the lay witnesses within the corporation, in the circumstances in which you described, would still be able to give evidence of general history, general company policy, and would still be able to give evidence of the documentary evidence available within the corporation. So, they can often give enough of the kind of general evidence that is required for transfer pricing purposes. But if there are specific incidents or facts, historical incidents or facts of which the particular new executives do not have personal knowledge, then it is sometimes necessary to go out and to search and find the former employees to bring back those with personal knowledge. So, it depends very much on the nature of the issues in the case. Tax cases of this kind usually turn on general policy issues and general issues of fact, but sometimes particular facts become controversial and then it is necessary to call the people who were there when they happened.

Dr Erasmus:

So going back to the preparation stage, I have at instances suggested through a tax risk steering committee, which oversees many different tax issues in the corporation, if there is a type of unique criteria to a transfer pricing study, I have in the past suggested that that should be recorded by way of some form of memorandum and possibly signed off by the employee concerned and then kept with the body of evidence so that if down the line it is very difficult to track that person, that particular step and criteria has been placed on record. What would your view be on that type of process?

Advocate Trengove SC:

It is a sensible idea and valuable precaution. It does not necessarily always solve the problem because remember the statement by the employee involved, I now postulate your facts where you have a statement 10 years old by an employee who was involved in the transaction but has since left the statement remains hearsay evidence. It is not first-hand evidence because you cannot cross examine the author, but our law permits hearsay evidence if there is good reason for its admission. Now in your scenario, the scheme would suggest very good reason for the admission of hearsay evidence if the witness is no longer readily at hand because it would be hearsay evidence of a most reliable kind so that a court would be quite readily persuaded to admit evidence of that kind for the slightest reason. On other occasions, when one seeks admission of less reliable hearsay evidence, a more compelling case has to be made for its admission. But your precaution is a wise one, because it would mean that if a witness is unavailable at all, the hearsay evidence could be admitted and it would carry significant weight.

Dr Erasmus:

So in practical terms, you would now have this key new individual in the corporation provide evidence of the background describing the transaction and then segueing into key elements that might have special criteria attached to them. And then that witness having read all the paperwork and the statements would be able to testify, once again on a hearsay basis, as to what the written statement contains and then the written statement would in effect be used to corroborate that evidence. If one is to assume the original witness cannot be found or is in a jurisdiction that they cannot be called.

Advocate Trengove SC:

Yes, the witness, the current executive would say this is company policy, this is generally how we approach these things. This is our methodology. And look, here is a statement from my predecessor who was party to the transaction 10 years ago, who describes the way in which it happened and he is either now dead or immigrated or too old and could not be bothered and therefore I asked for the admission of his statement. Such a statement would be readily admissible.

Dr Erasmus:

Let focus on your experience in problems with expert witnesses. What are the things you do not want from an expert witness, which is important to help our corporate taxpayers in preparing for such a defence? What do you not want to see in an expert witness?

Advocate Trengove SC:

Well, the first and most important flaw would be bias. If the witness comes across as a fighter for a cause, these opinions lose all weight. So, it is important that a witness does not come across as being biased. The second is that the witness must demonstrate a thorough grasp of not only the principles involved in the case, but also the underlying facts. It does not help to propound clever transfer pricing theory if it turns out that the witness is ignorant of the underlying facts.

In fact, there is a well-known, highly regarded, highly skilled expert witness here in Johannesburg whom I cross examined 20 years ago and I demonstrated that although he had very clever opinions, he did not know the facts of the case. So, that I ultimately put to him and said, "Mr. X, I put to you that your opinion is clearly a function of your ignorance of the facts." And the guy conceded that that was so and it was that answer that won the case. Let me say he is a friend of mine, I will not tell you who it is, but it is fatal to a witness not to know the underlying facts if his opinion is dependent on those facts.

Dr Erasmus:

Final question, any suggestions not covered in this interview? I am sure there are many, but the principle ones that come to mind that you would suggest to corporations that they should attend to in ultimately preparing to defend a transfer pricing study down the line in court?

Advocate Trengove SC:

A principle of transfer pricing that I think is a valuable ground of attack and of defence, is the recognition that a transfer price, an arm's length price, is hugely a line and not a point. And it is a principle recognized by the OECD, which one can use in both attack and defence. In defence on the basis that yes, there might be this view different from mine, but it does not mean that my arm's length price is incorrect because the determination of an arm's length price leaves room for difference of opinion between honest and skilful experts. So, an opinion on a transfer price can be defended on the basis that there is legitimate room for difference of opinion. It can also be used as a means of attack because some experts are arrogant and adamant that only they are right and everybody else is wrong. And that is also a foolish position to take because its manifest is incorrect.

Dr Erasmus:

Thank you very much.

Advocate Trengove SC:

Great pleasure.

APPENDIX B

INTERVIEW WITH ADVOCATE R MASTENBROEK, JANUARY 2024, CONDUCTED AFTER *THE ABD LTD VS THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICE* (UNREPORTED) TAX COURT TRIAL

Dr Erasmus:

As a general starting question, how would you suggest corporate transfer pricing specialists should prepare generally for anticipated audits and a potential trial that may emerge in the future in defending their typical transfer pricing study to prove or demonstrate the arm's length pricing in whatever transaction is at stake.

Advocate Mastenbroek:

That is a very broad question, but I will respond broadly by saying if there is a possibility not only of an audit by the relevant revenue authority, but more particularly if there is a possibility of litigation ensuing such an audit, then what I would suggest to be of utmost importance is for transfer pricing practitioners to keep in mind that in general what is going to happen when you get to litigation is that you will be obliged to make discovery and to produce and to be transparent as regards basically everything that happened within your corporate, or within your client, concerning the subject matter of the dispute. So, what this means is that one has to be cognizant of the possibility that your opponent and more particularly their lawyers are going to be scrutinizing your emails, your correspondence, even your drafts. That is the first thing that springs to mind in answer to your question.

Dr. Erasmus:

To help you focus in a little more detail because it is a very broad question. What you have seen is that typically there is a transfer pricing study that was done at a particular point in time to analyse, and let us use the use of a brand name as a set example so that it is not too general. So a brand name is now introduced by the parent company into various other countries and their subsidiaries to expand the use of that brand name. The parent company as well as the subsidiaries have to conduct transfer pricing studies in country to demonstrate that in the case of the parent company, what they are receiving is an arm's length price for the use of that brand and in the subsidiary country to demonstrate that the amount being paid for the use of that brand in that country is also arm's length.

So we have the determination of a transfer pricing study, which is typically done by a accounting or consulting firm. What would your practical advice be as to what the corporations should have within their records to defend their position many years down the line?

Advocate Mastenbroek:

Again, I am going to keep it general. The anticipation of litigation ought to instil a discipline within a corporation. It is a discipline that needs to and that will drive transfer pricing specialists and the lawyers and the operations around the transfer pricing team to keep in mind that the information provided to whatever external outfit does the transfer pricing study that that information is good, is authentic to keep records of it so, that you do not cut any corners. That you verify for yourself the work that is done by the external party. In advising the corporate of the transfer pricing study, you must be satisfied yourself that that process is a decent process and that it will withstand scrutiny. And again, that is what I am saying is that the anticipation of litigation and of the possibility of litigation downstream is what must instil that discipline, because as you pointed out, the last iota of information that is contained in that transfer pricing study is going to become the subject of intense scrutiny and in litigation there is no space to hide, which is why we need to, when we lay the foundations of that house, we must make sure that it is done properly because that is precisely what it is. As you know from the OECD Transfer Pricing Guidelines, it is not an exact science, it does not need to be done in a manner that will lead to an exact agreement downstream.

What is important is that the process is done authentically. It is done with bona fides, it is done properly, that no corners are cut. And if the corporation then decides in consultation with its service provider that X is the arm's length price, then you stand by that and we defend that. But what is important from a litigation point of view is that you are not caught 3, 4, 5, 8 years downstream to say how did we do that? To then start to ask questions to say what happened there again? Where did we get this document? Why did we say that? That is why record keeping is so important. That is why keeping a proper audit trail of how the decision made is so important because it is the minutiae. It is the devil that lies in the detail that is going to trip you up and only one mistake could cost you very, very dearly. So that would be my advice that there is no corners that you can cut. It has got to be decent and a thorough and an honest process and it has got to be documented. It has got to be supported by a portfolio of evidence and keep that stuff.

Dr. Erasmus:

Let us talk specifically about what types of evidence in this process. What type of evidence are you talking about that you would like to see when you defend a transfer pricing study?

Advocate Mastenbroek:

Well that depends as in a legal dispute it depends on the facts. So if you are talking about a brand, talking about intellectual property, you are obviously going to be talking about a fair amount of financial information and the information that we are going to rely on that goes into the transfer pricing study and that is going to become the subject of scrutiny that will have to be done properly. So keep those audited financial statements, keep the management accounts that went into the audit financial statements, keep the source documents that are the subject of little asterisks in the audited financial statements. If you are talking about non-financial information that goes into the determination for example of a transactional profit split method. If you are referring for example to specific functions that are performed or risks that are assumed, what is required is proper information, is proper documentation that will support and corroborate the conclusions that are going to be reached by the transfer pricing experts upon which the corporation is going to rely to say that. As an example, if you talk about the transactional profit split method, if the contention is made that party A performs X functions and party Y performs Y functions to be clear, have a very clear description of those functions that are performed.

And again, going back to what I said earlier on, keeping in mind the discipline of the possibility of future litigation, what is Samuel Johnson's saying? Nothing focuses the mind and the thought more than that you are going to be hanged in the morning. That is the discipline. Keep in mind that in a transfer pricing dispute that becomes litigious where real life lawyers are involved in scrutinizing the source documentation that went into the determination of the arm's length

price. Be ready with the corroborative evidence if you say X functions are that, corporate X performed these particular functions. Have the exact documents ready. Again, I said do not cut corners. It is perfectly fine for a transfer pricing expert to form an expert opinion and to say, in my opinion, on basis of the following functions that have been performed on basis of the following risks that have been assumed, it is my considered opinion the following, an arm's length price for whatever that is that is being priced. But be sure to keep the necessary records to make sure that if that opinion is scrutinized downstream by a lawyer who is well trained in cross-examination, that the underlying documentation is handy and that that opinion is defensible.

Dr. Erasmus:

So just drilling a little deeper into an important part of any transfer pricing study is an analysis of the functions and risks. How would you see those functions and risks being documented as a source document for evidentiary purposes? So instead of just reading this out of the transfer pricing report, one would want to be able to drill into the source of what those functions and risks are and where it came from. Any suggestions you would make?

Advocate Mastenbroek:

Again, I would say that it depends on the facts, number 1. Number 2, I would say use your common sense. This is not an arcane lens. Think with the end in mind and think of the courtroom that your corporates transfer pricing dispute might end up in that courtroom. You are going to find a legally trained presiding officer in the form of a judge or more than one judge. That judge is not necessarily a transfer pricing expert and they are not going to be swayed by fancy jargon or long words only that are provincial. And there are particular to transfer pricing experts and that they glean from years of falling through OECD documents. What is important is to just keep your common sense hat on and to think of the need to persuade that presiding officer, that judge whose job it is to listen to the evidence to determine what were the facts to keep in mind. What the law is and then to make a determination. Simply keep in mind what would be necessary to convince such a person of the weight of your corporate's case and let that be your guiding light.

So do not have your transfer pricing expert make a wild statement, if you cannot understand it yourself, and if you do not understand it yourself and if you cannot explain the logic to yourself in plain English, and if you cannot back it up with the necessary documentation that you will know what is necessary, then do not go there. So that is what I am saying, keep it simple, keep it in plain English and keep your common sense hat on regardless of precisely what the subject of your transfer pricing study is. You will know with your common sense hat on what documents would be necessary to corroborate the opinion that you are concluding on what is necessary for you to keep. And, again, keeping in mind that that dispute may become the subject of intense scrutiny years down the line.

Dr. Erasmus:

So a common problem in corporations is that there is a change of guard on an ongoing basis. The parties involved in documenting and giving input on the original arm's length transfer may no longer be available in later years down the line as they may have left the corporation, may have taken up other positions, but oftentimes left the corporation and the person who is now regarded as the in-house witness to give the factual background history and describe the transaction and what has happened in creating the transfer pricing study, which is updated every year. But let us go back to the starting point. At someplace there would have been an initial transfer pricing study looking at that transaction and then moving forwards. Would you think it a good idea that whoever was involved in briefing the accounting or consulting firm on the facts, the functions, the risks, and any other information that the firm requires to create the transfer pricing study, that that should in some way be recorded in the form of a written statement in as much detail as possible and signed off by the individual so that if that individual is no longer available down the line to testify that this information can be relied upon?

Advocate Mastenbroek:

I think that is very prudent and it is specifically prudent in the context of revenue authorities, specifically in the developing world being on a growth curve if you like, in their capacitation and their interest in conducting transfer

pricing audits and embarking on transfer pricing litigation. I would think that it is not only important but that it is going to become increasingly important for corporates that do business across national boundary lines to do precisely what you say. They need to be cognizant of the need to, if you like to have a snapshot that captures insufficient detail, the reality at a given moment in time to keep in mind the fact that specifically in developing countries such audits are going to, might be conducted many years after the taking of that snapshot. Keeping in mind as you said, that there is a natural turnover within corporates. People do not hang around, there is a continuous turnover of staff. It is quite simply in my view, responsible corporate governance for that corporate to be in a position to say if the relevant moment where a transfer pricing audit might be focusing on is X on a timeline, is my responsibility as a corporate to have such a snapshot that captures the necessary information that can defend that corporate's view on whatever they were charging for their transfer price at that moment to defend that.

And so we can decide and we can discuss what is to go into that snapshot. But what is important is what you suggest that the corroboration and the evidence, the portfolio of evidence is not dependent on the warm bodies that occupy the head offices and the tax offices of big corporations, but that the body of evidence, the portfolio of evidence is capable of speaking for itself regardless of whether the tax manager moves on or gets ridden over by a bus or joins the opposition or joins the revenue authority or is no longer there. So that body of evidence needs to be there. That to my mind, seems not only what the OECD requires of the corporates to do, but it makes simple sense. That makes good corporate governance principles. So as for the format of that snapshot, that depends again on the corporate involved and the goods or the service that is being priced, but that a body of evidence is required to be retained in a format that is not dependent on the warm bodies that are there at that moment. That is absolutely critical.

I have got no doubt that that is the case. And again, it brings you to the transfer pricing report that we were talking about earlier on and the documentation that needs to go into it, maybe the operative word is documents. You need to document what happens. The corporate needs to document the decision-making process in order for a person downstream in the course of possible litigation to be able to have reference to those documents and to say, I was not there myself, but I can testify to the fact that this was found in our corporate archives. This is the process that we went through. This was not sucked out our thumb. This was in corroboration of the final conclusion that was reached by person A at that time. I found the following 5 or 6 or 25 or 56 documents. And as you can see there is a logic to it. This is not a random or arbitrary or irrational process. There is a clear methodology. There is a clear logic to it. But indeed I would think that the keyword is documentation and to document that process in order to have that snapshot be there as your security because you do not know what is going to happen.

Dr. Erasmus:

So in a perfect scenario, if I can sketch this picture, you would have the key in-house tax expert or in-house advisor who is given the task of initiating the initial transfer pricing study and then subsequent revisions of that, that person would document the process that is being followed and not simply show instruction to an accounting firm to do a transfer pricing study. And in that document would explain the different criteria and different issues that have been addressed and in the same document, cross-reference to key documentation that is and will be retained in support of what was done. What type of supporting documentation would you see that needs to be attached to this general statement made by that original in-house tax advisor?

Advocate Mastenbroek:

I would answer it by saying go on the side of caution. If, for example, the ultimate conclusion on a transfer price is to be corroborated by among others survey evidence. With reference to the recent dispute that we were involved in, it would have been very useful to have such a comprehensive and a contemporaneously made documentation of the different survey evidence that was conducted. That was one of the inputs into the calculation of the transfer price we would have. A lot of efforts would have been spared had that process, had those vast and comprehensive processes been more scrupulously and more comprehensively documented.

And, of course when you are talking about survey evidence, you are talking about different layers, and you are talking about a vast amount of data. So, I am not suggesting that every single last piece of data that gets collected gets stored

somewhere. And of course the longer time that runs on, the more forgiving, if you like, a court is going to be of the fact that evidence does get lost, witnesses do move on. So, we keep that in mind as well. Again, what I said earlier, just use our common sense. We are not asking for the unreachable and for the impossible here, but if in a given tax period at a given moment in time, a particular transfer price was dependent on a particular input document that input properly. And these days with the cloud, we can save a lot, we can save a lot up there. It does not cost much, but the effort needs to go into collating that information properly and just having it ready and being in a position to defend it and to taking out that snapshot and to say, that is fine if you are interested in this, this is good, it is no problem. We are not defensive about this, we are not pressured about this. We did our work properly at that time, even though it is many years back. Here it is. Here is my portfolio ready, documented and collated. That is the key.

When there are holes in the evidence, it is when there are unexplained links in the chain, that the lawyers become interested and that become hard for witnesses to explain and they are invariably the ones that are having to sweat under oath. So again, it is what I am saying, keep in mind the possibility of litigation and let that be the disciplinary force when we on a regular basis keep our bookwork properly.

Dr. Erasmus:

Last question: Many years later the head of tax now is going to be the factual witness and the original parties are no longer available as witnesses and this individual must now prepare to be the factual witness in a trial. That witness is invariably going to face tremendous criticism from the cross examiner acting for the revenue authority to say, but X, you were not personally available, you were not personally involved. Everything you are telling us is hearsay and you are asking us to believe whatever was handed to you on a platter in the form of a statement that is many years old. How would you suggest our factual witness should prepare and meet such challenges in court, which we all know and those of us who have been there are quite invasive and can be very threatening and make the person feel very insecure. What would your suggestions be in that preparation?

Advocate Mastenbroek:

Again, it is what I said earlier on, a court is not un-understanding. The presiding officer is also a human being and they know that with the passage of time, our memories fade, the ink on documents become more faded, witnesses die, witnesses move on. A court is not unforgiving in that department. And there is also such a thing as the best evidence rule, namely that if under the circumstances the best that we have is whatever it is, then that is what it is. Of course, it is the responsibility of the legal team of that particular tax manager, who is now sweating in the witness box to protect them as well and to protect them from unreasonable harassment. And I would think that it is unreasonable to place a person under pressure who was not in that position many years ago, but who is capable of explaining, to say I was only recently appointed in this position, but by virtue of my responsibilities in this position, I was given access to the following archives and in the archives I found the following. I found a narrative essay that explains what this is, and I can see from the narrative essay that it was communicated by the then tax manager, this person is no longer in our employer, he's now currently the tax manager of a following corporate or he is passed on law, whatever. But underlying that narrative, there was the following documentation. So I wasn't there at the time, but I can tell you this makes sense to me. This has a certain logic of its own. I can understand how this opinion was derived at that. If that is all that we can do, then that is fine. That will be perfectly sufficient. I would say for a presiding officer who is busy adjudicating a transfer case that depends on facts that goes back many years in time.

But again, what the point is, is to say that there is a responsibility on the corporate to conduct its business in such a mind. Keeping in mind that by, in its very nature a transfer audit is something that only happens after the fact. That is something that can take an awfully long time. And when at the conclusion of that audit there is a disagreement between the taxpayer and the revenue authority, then litigation, it works. And in its nature, litigation is a lengthy and time consuming process as well. So the better your documentation is, the better you have recorded the inputs into and the nature of the decision-making process at the time and the conclusion that was reached, the better you are going to be in a position to defend the interest of your corporate when and if the time comes.

Dr. Erasmus:

So, just by way of a concluding remark on my side, such a tax manager should not worry too much about a hearsay objection being raised and being bantered about. The courts acknowledge and accept in large corporations that parties down the line will appear to represent the interests and the facts of that corporation. But if the underlying source documentation, so not only that old statement made by the original tax manager is available to be read, but the corroborating underlying source documentation is still at hand and looked at and also the way in which the corporation is currently conducting its activities and most likely still doing the same thing year in and year out. That person should not worry too much about being a so-called hearsay witness. That person is quite capable of helping present an acceptable, admissible, relevant set of facts to support the defence of that transfer pricing study in the arm's length transactions.

Advocate Mastenbroek:

Absolutely.

Dr. Erasmus:

Thank you very much.

APPENDIX C1

QUESTIONS AND ANSWERS TO THE US FEDERAL RULES OF EVIDENCE (“FRE”)

HABIT EVIDENCE¹

Habit evidence is testimony or documentation that shows a person’s regular practice or routine behavior in specific situations. This type of evidence is often used in legal contexts to demonstrate that a person acted in a particular way on a specific occasion because it aligns with their established habits.

When is habit evidence admissible under the Federal Rules of Evidence (FRE) and at common law?

Under FRE², habit evidence is freely admissible to prove that a person acted in conformity with his habit on a certain occasion.

COMMON LAW: Habit evidence is admissible provided there are not eyewitnesses, and the evidence can be corroborated.

NOTE: Habit is usually proved by witnesses who testify to specific instances of the habit. Alternatively, a habit might be proved by having a witness testify that in his opinion, the person had the habit.³

By way of example, what is Habit Evidence in a TP trial?

The taxpayer (company) introduces evidence showing that for the past 10 years, its internal finance department has consistently prepared and reviewed a detailed transfer pricing report for all intercompany sales between its U.S. entity and its foreign subsidiaries, following a standardized internal policy.

Specifically:

- Every year, prior to filing tax returns, the finance team conducts a comparability analysis using external databases

¹ See Glossary of Terms.

² Rule 406, Federal Rules of Evidence, referred to hereafter as FRE.

³ M&K §4.21 - C. Mueller and L. Kirkpatrick, ***Evidence***, 3rd Ed, 2004, Aspen.

(e.g., benchmarking comparable transactions).

- The finance team habitually obtains sign-off from senior management and the legal department before setting final intercompany prices.
- This habitual conduct is documented in internal control logs, emails, and meeting minutes across multiple years.

Why is this Habit Evidence?

- The company is showing that it has a routine practice or custom of following a structured and methodical process for setting transfer prices that comply with the arm's length standard.
- It is not just an isolated event; it is a regular practice, which could counter allegations that the transfer pricing decisions were arbitrary or solely tax-motivated.

Relevance of Habit Evidence in a TP Trial

- The court may accept this habit evidence under Rule 406 (U.S. Federal Rules of Evidence) or equivalent law, to show that on the occasion in question, the company likely followed the same routine.
- This could bolster the taxpayer's argument that its transfer pricing was consistent with sound business practices and regulatory compliance, not merely tax avoidance. This argument of not pursuing tax avoidance usually bodes well with a tax court.

Distinguish the treatment of habit evidence from the treatment of character evidence, under the FRE and the common law

Under FRE,⁴ habit evidence is admissible to prove that a person acted in conformity with that habit on a certain occasion. At common law, habit evidence is admissible to prove conduct in conformity, but only if there are no eyewitnesses and if the habit is corroborated.

By contrast, under both the FRE⁵ and the common law, character evidence is generally not admissible to prove conduct in conformity therewith on a certain occasion but is admissible when character is "in issue."⁶

May an organization's "routine practice" be admitted proving conduct in a particular circumstance under the FRE?

Yes, as an analogue to the admissibility of "habit" evidence. An individual's regular response to a repeated situation is called a habit; the same behaviour on the part of a group is designated "routine practice of an organization" by FRE⁷ (which allows it to be used to show that the organization acted in conformity with that practice on a particular occasion).

RATIONALE: All jurisdictions, even those that disallow or restrict habit evidence, freely allow evidence of the routine practice of an organization. This evidence is considered more reliable on the theory that businesses typically act with greater regularity than individuals.

What are the three main problem areas for the introduction of documentary evidence?

- Authentication (determines relevancy; if it is not authentic, it is not relevant);
- Best Evidence Rule⁸ (if the witness is testifying relying on a document OR the terms of a writing are being proven, the document itself must be introduced if available); and
- Hearsay (problem arises if the document repeats someone's out-of-court declaration).

4 FRE 406.

5 FRE 404(a).

6 M&K §§1.14.,4.11 - C. Mueller and L. Kirkpatrick, *Evidence*, 3rd Ed, 2004, Aspen.

7 FRE 406.

8 See Glossary of Terms.

What is the Best Evidence Rule?

It provides that when a party wants to prove the material terms of a writing, the “original writing” must be produced. (“Original” ordinarily includes a “duplicate”, such as a photocopy;)⁹ Imperfect copies and oral testimony concerning the writing’s contents are only permissible on a showing of the original’s unavailability that is not the result of proponent’s serious misconduct.¹⁰

FRE FORMULATION: The FRE’s Best Evidence Rule is Rule 1002: “To prove the content of a writing, recording or photograph, the original writing, recording, or photograph is required, except as otherwise provided in these rules or by Act of Congress.”

RATIONALE: Where the writing is available, errors or gaps in memory, as well as fraud, can be avoided by allowing the trier of fact to see the original document.

NOTE: The judge decides the threshold issue of whether the document is “unavailable”.

NOTE: The Best Evidence Rule may be waived if the opposing party does not timely object to admission of the secondary evidence.

In what situations does the Best Evidence Rule apply?

Only consider the Best Evidence Rule when:

1. The terms of a writing are being proven, or
2. The witness is relying on the writing for his testimony. If words of the document are not “legally operative” (e.g., words of will, contract or defamation), the writing must still satisfy the hearsay rule.

NOTE: Even if one of the two requirements above is satisfied, the document will not be covered by the Best Evidence Rule if it involves a “collateral matter” – that is, something not closely related to a controlling issue.¹¹

In a transfer pricing dispute, a taxpayer will often:

- Rely on a written TP study to justify intercompany pricing.
- Present witnesses (e.g., economists or financial officers) who refer to the TP study in their testimony.
- Use the TP report to support the arm’s length nature of their pricing and the conclusions of comparability analysis.

How the Best Evidence Rule Applies in a TP dispute:

1. **When the TP Study’s Terms Are Being Proven**

If the taxpayer is introducing the actual content of the TP study (e.g., comparable company selection, pricing methodology, margins), this clearly triggers the Best Evidence Rule.

Implication: The original TP study or a duly authenticated duplicate must be presented. Summaries or paraphrases aren’t sufficient if the document’s contents are directly in issue.

9 FRE 1003.

10 FRE 1002 – 1004.

11 FRE 1004(4).

2. When a Witness Relies on the TP Study

If a witness (e.g., transfer pricing advisor or company CFO) is testifying and relies substantially on the TP study:

- The study becomes a foundational document for the testimony.
- The original or a copy should be submitted to support the evidence.

Otherwise, the opposing party or tax authority could object on the basis of violating the Best Evidence Rule.

3. When the TP Study Is Merely a Collateral Matter

If the TP study is only background information or used to explain the process, but not the content, it may be considered collateral.

Example:

The witness mentions that “a TP study was done” to support compliance but does not introduce the actual data or rely on its terms.

In that case, the Best Evidence Rule does not apply.

Hearsay Consideration in respect of the TP study and Best Evidence Rule

Even if the original TP study is presented, it must also comply with hearsay rules:

- The TP study may be considered hearsay if introduced to prove the truth of its assertions (e.g., that X Co. is comparable).
- It could be admitted if:
 - o The report falls under a business records exception, or
 - o It's treated as an expert report supporting the expert's opinion.

Conclusion on the Best Evidence Rule

In a tax dispute:

- If the taxpayer relies on a TP study to prove pricing was arm's length, the Best Evidence Rule applies.
- The original TP study or an acceptable duplicate must be produced.
- If a witness's testimony is based on the TP study, it must be available and possibly disclosed to avoid objection.
- If the TP study is only tangential or background, it may be considered collateral and outside the scope of the rule.

Does the Best Evidence Rule require that a litigant must introduce the best evidence available on every issue?

No. The Best Evidence Rule¹² is triggered only when a party seeks to prove the terms of a writing.¹³ (Recordings and photographs are also covered where their contents are sought to be proved).

When a document is covered by the Best Evidence Rule, if the original is unavailable, is any evidence on the contents of the writing barred?

No, it is just that the original is preferable. If an original can't be produced, because it is lost, destroyed or otherwise legally unavailable, secondary evidence (e.g. non-duplicate copies, notes, or oral testimony) will be admissible.

NOTE: The rule allowing non-originals where the original is unavailable does not apply if the proponent

12 FRE 1004.

13 FRE 1002.

has lost or destroyed the originals in bad faith.¹⁴

Do the FRE recognize different degrees of secondary evidence under the Best Evidence Rule?

No. Under FRE,¹⁵ if an original is unavailable, written copies and oral testimony are treated equally.

COMMON LAW RULE: The common law rule (rejected by many states) observes “degrees” of secondary evidence: if the original is unavailable, the non-existence of written copies has to be proven before oral testimony is allowed.

What is the Parol Evidence Rule?

As stated previously, the Parol Evidence Rule is a rule of substantive contract law. Mainly, it provides that where there exists an unambiguous written agreement intended by the parties to embody the full and final expression of their agreement, NO prior arrangements, oral OR written, or contemporaneous oral agreements, will be admissible to contradict or supplement the terms of the writing.

The parol evidence rule can apply in a transfer pricing trial when a court or tribunal is asked to interpret intercompany contracts (also called intercompany agreements) between related entities of a multinational corporation.

How the Parol Evidence Rule Apply in a Transfer Pricing Context

As stated, the parol evidence rule generally states that if a written agreement is intended as the final and complete expression of the parties’ agreement, prior or contemporaneous oral statements or external writings cannot be introduced to vary, contradict, or add to its terms.

This rule applies to contract interpretation, including intercompany contracts.

Application of the Parol Evidence Rule in Transfer Pricing Trials

In a transfer pricing trial, the revenue authority may argue that the economic substance of intercompany transactions (e.g., services, licensing, sale of goods) differs from what is outlined in the written intercompany agreements.

Taxpayer’s Position Using Parol Evidence Rule

The taxpayer may argue that the written intercompany agreement governs the terms of the transaction and is the final expression of the parties’ intentions.

Therefore, under the parol evidence rule, external documents or oral testimony offered by the tax authority (e.g., employee emails, meeting notes, or verbal agreements) should not be admissible to alter the terms of the written agreement.

Example

Imagine a U.S. company and its foreign affiliate have a written licensing agreement that clearly states:

- A royalty rate of 5% of net sales.
- The foreign entity will have limited risk and routine functions.
- If the tax authority tries to introduce:
- Internal emails discussing plans to charge a lower or higher royalty,
- Or oral testimony stating that the foreign affiliate in practice took entrepreneurial risks inconsistent with the contract,

The taxpayer may invoke the parol evidence rule to block this external evidence, insisting that only the written contract should control the analysis.

14 FRE 1004.

15 FRE 1004.

Limitations of the Parol Evidence Rule in Transfer Pricing

- Economic Substance Over Form:
In transfer pricing, courts often apply the “substance over form” principle or OECD guidelines, meaning they will sometimes look beyond formal contracts to real-world conduct and economic relationships between entities.
- Regulatory Overrides:
The IRS Section 482 regulations or similar local rules in other countries allow tax authorities to adjust intercompany prices even if the written agreements appear compliant on their face.

Exceptions to Parol Evidence Rule

Evidence may still be admitted to:

- Show fraud or sham transactions,
- Prove that the contract was incomplete,
- Clarify ambiguous terms.

Conclusion

While the parol evidence rule can be a tool in a transfer pricing dispute to defend the integrity of written agreements, courts may still look at actual conduct and economic realities to determine whether the intercompany pricing complies with the arm’s length principle.

IMPORTANT: Prior written agreements are all covered, as well as oral ones!

NOTE: Subsequent agreements are not covered by the Parol Evidence Rule- only prior and contemporaneous ones.

What is the Reply Doctrine?

The Reply Doctrine is a means of authenticating writings by circumstantial evidence. Under the doctrine, a letter may be authenticated by the fact that its contents suggest that it is a reply to a previous communication concerning information known only to a few people (including, of course, the alleged author).¹⁶

Example: A letter purporting to be written by B to A says, “In response to your June 5th telegram, we’re making good progress preparing your order.” If it’s already been proven that A telegraphed to B on June 5 asking about the status of A’s order, then the letter is admissible without additional authentication. Thus, no supporting witness is needed to testify that the letter was written in response to the June 5th telegram or that it was written by A.

Objection overruled.

Under FRE,¹⁷ a photocopy of a document is called a “duplicate” of that document.

Under FRE,¹⁸ the duplicate is admissible to the same extent as the original, unless there’s a “genuine question” about the authenticity of the original or it would be “unfair” to admit the duplicate. Since what’s being offered here is a photocopy and there’s no question (so far as the facts tell us) about the authenticity of the original contract and no reason to believe use of the photocopy would be “unfair”, the copy should be admitted notwithstanding the Best Evidence Rule. By the way, only highly accurate mechanical/electronic reproductions of the original can be “duplicates”, under FRE 1001(4). In addition to photocopies, examples would include carbon copies, microfilm, copies of sound recordings, and other techniques not involving human interpretation. Inexact types of copies (e.g. handwritten transcriptions) are not “duplicates” and thus are not admissible unless it is shown that the original is unavailable, and its unavailability is not due to serious misconduct of the proponent.

16 FRE 901(b)(4); McC §225.

17 FRE 1001(4).

18 FRE 1003.

Only exact reproductions of an original (e.g., photocopies or carbons) are admissible as originals. (Under the FRE, these are “duplicates” and get essentially the same treatment as the original. See FRE 1001(4) and 1003. Other types of copies (e.g., Mrs.

Tolstoy’s handwritten ones) are not admissible unless it is shown that the original is unavailable, and the unavailability is not due to serious misconduct of the proponent.

RELATED ISSUE: Had the original been unavailable, the copy would be admissible as long as there was evidence of unavailability, and the unavailability was not due to serious misconduct by the proponent (Tolstoy).

NOTE: If an opponent doesn’t object to secondary evidence in a timely manner, she waives the benefits of the Best Evidence Rule.

Must a writing be authenticated at trial, or may it be authenticated in some other way?

Pretrial authentication is permissible via depositions, stipulations, and requests for admission of genuineness.

BUSINESS RECORDS

What evidence hearsay exceptions apply to excel spreadsheets summarizing business records?

Hearsay exceptions can be relevant when admitting excel spreadsheets summarizing business records as evidence in legal proceedings. The Federal Rules of Evidence and corresponding state rules provide several hearsay exceptions that may be applicable in this context.

The business records exception¹⁹ is perhaps the most directly relevant to excel spreadsheets summarizing business records. This exception allows for the admission of records of regularly conducted activity, including records of a business, if the record was made at or near the time by someone with knowledge, and if it was kept in the course of a regularly conducted business activity. The exception requires that the source of information or the method or circumstances of preparation indicate its trustworthiness.

If the excel spreadsheet qualifies as a business record under this exception, it may be admitted as evidence even if it contains hearsay, as long as certain foundational requirements are met. For example, the proponent of the evidence would need to establish the authenticity of the spreadsheet, show that it was created and maintained in the ordinary course of business, and demonstrate that the information it contains was based on firsthand knowledge and recorded at or near the time of the events or transactions it summarizes.

Another hearsay exception that may be relevant is the records of a regularly conducted activity.²⁰ This exception is similar to the federal business records exception and allows for the admission of records of regularly conducted activity as an exception to the hearsay rule.

Additionally, the residual exception²¹ might come into play if the information in the spreadsheet does not fit neatly into a specific hearsay exception but possesses circumstantial guarantees of trustworthiness. To use the residual exception, the proponent of the evidence must demonstrate that the statement has equivalent circumstantial guarantees of trustworthiness, it is offered as evidence of a material fact, it is more probative on the point for which it is offered than any other evidence that the proponent can obtain through reasonable efforts, and admitting it will best serve the purpose of the rules and the interests of justice.

It’s important to note that the admissibility of excel spreadsheets summarizing business records under these hearsay exceptions will depend on the specific facts and circumstances of the case, as well as the rules of evidence applicable in the jurisdiction where the legal proceedings are taking place. Therefore, it’s always advisable to consult with a qualified attorney familiar with the relevant laws and rules in the given jurisdiction to determine the admissibility of

19 FRE 803(6).

20 State Rule of Evidence 803(6)/804(5).

21 FRE 807 or similar state rules.

such evidence.

APPENDIX C2

EXAMPLE OF THE CROSS-EXAMINATION OF AN EXPERT WITNESS

Tax trials that have expert witnesses will become complex and drawn out. There will be painful and wasteful cross-examination techniques applied in an attempt to trip-up the expert witness. If the advocate acting for the taxpayer is too polite in objecting where required to questions being asked over and over again, then a lot of time will be wasted and your expert witness will start to get frustrated.

This is exactly what the cross-examiner wants. In a moment of frustration, an expert witness may end up saying something damaging to his expert opinion. Oftentimes this is done inadvertently, but the cross-examiner is waiting to pounce.

Careful note should be taken of the following comment by an experienced advocate who practices both in South Africa and in the United Kingdom. What he states about South Africa is also prevalent in other African jurisdictions, in my experience in Mauritius, Zimbabwe and Tanzania (tax courts where I have appeared as advocate for taxpayers).

CROSS EXAMINATION EXTRACT FROM A TP CASE WITH AN EXPERT GIVING ADVICE

Let me preface this extract with something Adv J Gauntlett QC SC an advocate in both South Africa and the United Kingdom said:

What do you feel the standard of advocacy in our¹ courts is like compared to that of the English courts at your level of practice?

“I think it’s far more disciplined and far more subtle. I give you one example. In the Supreme Court, a colleague returning to a point and Lord Neuberger presiding and saying very quietly “yes, I think we have that”. Immediately understood as “stop it, don’t repeat yourself”. It is that kind of level, which is a kind of glacial courtesy, that is very effective. I think it is also far more disciplined in terms of the

¹ The question was referencing South African courts as compared to English courts.

understanding of both oral and written argument. You have three different opportunities in argument, the one is in your skeleton (which truly must be a skeleton and not suffer from obesity), secondly, in your oral argument, which really has to be a focussed distillation and, of course finally, if you have the opportunity, in a reply. Each is unique. There is too much judicial indulgence, if you like, at times in South Africa in allowing people to start to tell the court at some considerable length at the beginning who the applicant is and who the respondent is and that there was a contract. That would be stopped very suddenly in England. No waffle from the Bench, or lack of preparation, either.”² (my emphasis)

My comment on the extract above in relation to the extract of the cross-examination below, is that the style followed by the cross-examining counsel is extremely convoluted, rude, blunt and oftentimes should have been curtailed. Nevertheless, the expert held up well, despite the painful process. After all, it was an expert called to assist the court in a complex series of principles emanating from the OECD TPGs. The style of cross-examination was very one dimensional showing a lack of understanding and proper preparation from the OECD TPGs, where interpretations were proffered in a one dimensional and simplistic manner without accounting for the following extract from the OECD TPGs:

“However, because transfer pricing is not an exact science, there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable. In these cases, differences in the figures that comprise the range may be caused by the fact that in general the application of the arm’s length principle only produces an approximation of conditions that would have been established between independent enterprises.”³

Cross examination extract commences below

MR NO: You were referred, please turn to page 07-810.

DR: Also, may I have your name... I would like to address you by name, please.

MR NO: My surname is NO.

DR: Can you say it again, please?

MR NO: NO.

DR: Go ahead, please.

MR NO: In paragraph 27 of your report, you reference OECD Transfer Pricing guideline 2.15, is that correct?

DR: Yes, of the 2017 edition.

MR NO: And you then quote from 22.15 the words “the most direct and reliable way to apply the arms-length principle”, is that correct?

DR: Yes.

MR NO: Is that an accurate reflection of paragraph 2.15?

DR: Also, if you think that I misquoted, I would appreciate if you tell me what is the proper quote. To my knowledge, I have accurately quoted paragraph 2.15 of the 2017 edition.

MR NO: May I ask you to look at the 2017 edition, paragraph 2.15, appearing at page 14-762? Is that visible to you, Dr ?

DR: It is visible, thank you.

MR NO: The part that you selected to quote, i.e. in the fourth last line towards the right hand margin where the words appear:

“The CUP method is the most direct and reliable way to apply the arms-length principle.”

Is that correct?

DR: That is how I read it.

MR NO: But there is an important qualification preceding those words that you did not consider necessary to quote for the reader, and that reads:

“Where it is possible to locate comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arms-length principle.”

Is there any particular reason why you omitted the first part of the sentence?

DR: There is no particular reason, and in my case I did find, I located the uncontrolled transaction. But I am not obligated to quote the full sentence, and the fraction of the sentence that I quoted, is accurate.

2 <https://gcbsa.co.za/law-journals/2017/april/2017-april-vol030-no1-pp24-26.pdf> (last accessed 7 November 2022).
3 OECD TPG 2022 para 3.55.

MR NO: Well, that is an important qualification, you would accept, the existence of a comparable uncontrolled transaction.

DR: The phrase, the CUP method that I quoted, the CUP method is the most direct and reliable way to apply the arms-length principle is true, it is a guidance. The question whether or not one finds or locates an uncontrolled transaction, goes to the application of the method. If one finds it, one applies the CUP method. If one does not find, one does not apply the CUP method. I am referring to a method that is regarded as the most reliable.

MR NO: Yes...(intervenes)

DR: Under the arms-length principle.

MR NO: My only point was that it is an important qualification.

DR: I accept your point.

MR NO: In the general statement that the CUP is the most direct (indistinct).

DR: I accept your point, because it is part of the sentence.

MR NO: Dr, there is no need to raise your voice up. I can hear you perfectly clear.

DR: That is uncalled for. I have not raised my voice. My voice is on the same tone that I have been speaking. I came closer to the screen and perhaps that is why you have understood it to – I can go farther from the screen, but to read, I have to come close to the screen. I will try to come closer to the screen and lower my tone.

NOTE: Here the expert witness does not allow himself to be intimidated by counsel cross-examining.

MR NO: Dr, in paragraph 2.15 there are two conditions that is required to be met for the CUP method to apply. The first one is that none of the differences, if any, between the transactions being compared or between the enterprise and the (indistinct) to those transactions, could materially affect the price in the open market. Is that also your understanding?

DR: Yes.

MR NO: And B, assuming that there are differences, that the reasonable accurate adjustments can be made to eliminate the material effects of such differences. Is that correct?

DR: That is what I am reading also.

MR NO: Dr, if I understand your evidence correctly, you concluded that there were no differences between the ABC agreement and the many opco agreements that could materially affect the price in the open market. Is that correct?

DR: Your conclusion is wrong, and I will give you – it is wrong, and I will give you first the principle, is that the difference must be measured, and the reason why it must be measured, is because an adjustment must be made. I recognise that for example the territories are different, each agreement applies to a single country, and I recognise that the duration among the (indistinct) agreements are different, and I recognise that the contractual terms regarding exclusivity are different. Some are exclusive, some are co-exclusive and some are sole agreements. So your conclusion is wrong.

NOTE: Oftentimes the counsel cross examining will attempt to rephrase the expert's testimony in such a way to elicit a response to her summary in an attempt to gain a concession from the expert witness. Here the expert witness did not allow that to happen. Counsel for the taxpayer should also have objected that the question has been asked and answered before.

MR NO: And you did not conclude – I am not sure I understand what you are saying, Dr. Are you saying that you did not conclude that there are no differences between the transactions being compared, and that is the ABC agreement compared to the many opco agreements that could materially affect the price in the open market. Yet you did not arrive to that conclusion.

DR: I recognise that there are differences which I have outlined between the ABC agreement which I am using as the CUP or the benchmark, and the individual OPCOS agreements. I believe that the differences cannot be measured, and I believe based on the statistical analysis that I have conducted of many samples of licence agreements, that the three contractual terms that I have listed, the list comes from the OECD Guidelines, meaning duration exclusivity and territory, do not have an effect on the royalty rate. They will have an effect on the value of the intangible, but not on the rate.

MR NO: Where you use royalty rate in this context as a proxy for price where it appears in 2.15.

DR: You mean as a proxy for what is called CUP. It is uncontrolled, in this case will be an uncontrolled royalty rate.

MR NO: I am asking you about the word price that appears in the seventh last line, the sentence starts with the word "affect" in the left hand margin, "affect the price in the open market." Are you using the word royalty rate as a proxy for the word "price" where it appears in paragraph 2.15?

DR: Yes, because the objective of analysis, the objective of SARS ordered in the object of MNE's defence, is what is the arms-length royalty rate, not price.

MR NO: I just want to understand in response of the context of what is stated in paragraph 2.15, Dr . Please forgive me for asking you again, but I need to make certain that I understand your response. If I understand the response correctly, you say that you had identified differences between the transactions, and you have identified three differences: the contractual terms, the duration and the, what was the third one I cannot read my handwriting now, the exclusivity. But what you are saying, is that those, the differences, do not materially affect, or could not materially affect the price in the open market.

DR: No, I am not saying that. I am saying that those effects cannot be measured. To the extent that I have measured the effects – am I speaking at a tone that is acceptable to you, Counsel?

MR NO: Yes thank you, Dr .

DR: Thank you. And I apologise if you think that I raised my voice. That was not my intention.

MR NO: No offence taken, Dr .

DR: But I hope that we remain friends, or as our counsel says, learned friends.

MR NO: I am a learning friend, you are a learned friend. Dr , you say that these differences cannot be measured. What does that mean?

DR: These differences cannot be measured when we have a single observation, a single contract as the CUP. I can show to you how we can measure it. I can show it to you orally, I will describe an equation if you wish. I can go on a board meeting that you can open a Word file and I will describe to you what I mean where it can be measured, because it is something that is very precise and cannot be subject to ambiguity.

MR NO: Is it possible ... (intervenes)

DR: So what do you prefer, Counsel?

MR NO: Can I perhaps just at the level of at least my logic try and understand, how does one conclude that differences would not materially affect the price in the open market if one is not able to measure the differences?

DR: My conclusion is based on a statistical analysis that I have done of royalty rates. And for us to have a better understanding, and we do not yet quite in a mud of ambiguity, because I want to be clear to the Court, this is a very important matter. I want us to imagine the following; and I want us to imagine an equation.

NOTE: The expert witness is there to assist the court with expert evidence and should always remain independent. The expert witness here demonstrates this by confronting the ambiguity counsel cross examining is trying to create by facing the potential ambiguity head-on with an abstract example to demonstrate the point she was making.

An equation has on the lefthand side the royalty rate. On the right hand side it has a constant, a number, for example 1 percent. And then it has some additional factors. So it has 1 percent that is the constant, and the question is, should we adjust this constant, this 1 percent royalty rate up or down. What we would do, is that we would plus, with the plus sign, as of now a unknown coefficient, call it b, small b, multiplied by a factor called duration. And we would add a third component. The first component is the 1 percent constant, the second component is a coefficient. We do not know the value of this coefficient yet, times duration.

The third component is a coefficient which we call a small c, times exclusivity, because exclusivity is a factor. And we have the final component, which is plus d, small d, is a coefficient, times a factor that equal territory. So I have the royalty rate that can be potentially adjusted by three factors. In order for us to determine if each of these three ex-factors, duration, exclusivity or territory, has a measurable effect on the royalty rate, the variable side, the variable on your left hand side, in other words if the one percent is going to be adjusted up or down, we need to analyse a set of agreements, and if you can further imagine a spreadsheet, and which we have in column A the ID, the identifier for the contract, for the licence agreement; in column B you have the royalty rate, and in column C you have the duration. And the next column, I think I am in D, you have the exclusivity. Exclusivity is, as you saw in the MNE contracts can be exclusive, yes, non-exclusive no, but it can be co-exclusive, and then you have the territory.

Except for duration, exclusivity and territory, must be what we call binary variable. So you assign a value of 001 to each of those values. So if you have a group of agreements, a reasonable group of agreement, a reasonable sample size of comparable agreements, you calculate the regression coefficients which, to this point, are unknown.

You calculate the b, the c and the d, and the calculation, the one would also be unknown, what is the intercept. And you will be able to tell by looking at the standard of the coefficients if it was significant. You would be able to tell by the sign preceding the coefficient if it is a plus or a minus if you adjust up or if you adjust down. And you would be able to tell by the what is called the R square, is the correlation coefficient square, if this equation is relevant to explain the placement or the adjustment to the royalty rate.

So when I say that it cannot be measured in the context of a single CUP, is that I do not have a set of comparable agreements for which I can compute coefficient b, c and d, and I can determine a, design of each coefficient, and I can determine b, the standard area of the coefficient. The standard area will tell us if the coefficient has merit, which can be disregarded, and I can tell c, if this equation that I have described, does not have to be linear, it can be not linear, can have an impact, a measurable effect on the royalty rate.

So this is very precise, but in the context of a single role, I cannot measure them. What I can do, is to rely on analysis as I have just described, not of comparables, because I did not do an analysis of, I did not submit an analysis for comparables, but I have made numerous analysis of data contained and the royalties database, because I am interested to know if we can adjust for duration, and I can tell you that the results are either not significant, or they are porous, meaning that as duration increase, the royalty rate decrease.

I have found that territory has no impact as an empirical matter, it is not a theoretical matter, and the samples that I have, they are random samples. They have no impact on the royalty rate, and likewise for exclusivity, so from this perspective, to me royalty rates are, unless one has a set of comparables to which this kind of measurement that I have described can be made, the royalty rate is a, you know, it is a stable number for which adjustments are very difficult to make.

MR NO: Are you finished, Dr, anything you want to add?

DR: For now I have illustrated the meaning of my summary statement that I could not measure.

MR NO: Your evidence is that these three differences that you identified, cannot be measured. Is that correct?

DR: They cannot be measured, not in the abstract, sir.

NOTE: When the material being cross examined is the OECD TPGs theses guidelines will be referred to in the abstract by counsel cross examining in an attempt to build ambiguities and concessions by the expert, or discredit the expert witness' testimony. Here the expert immediately points out that attempt and draws the attention of the court back to the realities of the facts of the case before the court so as not to postulate answers in the abstract.

They cannot be measured in the context of having a single CUP, but when I measure with random samples, I do not find them to, I do not find these three factors to – as empirical matters, I understand that as a matter of principle, they could have an effect, and I leave the question open that they could have an effect if we have the empirical data to show the effect.

In this particular case I use eristics to conclude that I – the eristic based on prior data that I have analysed, for example with territory, gives me comfort that we have all the countries, except for a few countries in the Middle East and Africa, and they are all classified by the World Bank and they are in the same group of income per capita. So it gives me comfort that the variation and the territory will not be significant.

MR NO: Dr, can I just perhaps summarise before the lunch adjournment? You identified three differences that cannot be measured. These differences you say could have a material effect on price, number two, and number three, you say you did not do a comparability analysis.

DR: You rephrase my statement incompletely, because I did not say cannot be measured in the abstract.

NOTE: This is another example of the counsel cross examining summarizing the expert testimony in an attempt to build ambiguities and concessions from the expert witness. Here the expert confronts that attempt to clarify what she said and meant. Again, remember the expert witness is in court to assist the

court as an independent to understand the subject-matter of their testimony.
I said they cannot be measured in the context of a single contract.

MR NO: So it cannot be measured through a single contract, and applying the CUP method.

DR: Yes.

MR NO: And secondly – well, is that the only qualification that you have to the three propositions that I am putting?

DR: Would you please repeat the other two, so that I am sure that I am responding to your precise questions?

MR NO: First one, simply identify the three differences. The second point that I made related to the measurement which you have affected, and the third one is recording your statement that you did not do a comparability analysis.

DR: So could you please give me more information about the third point?

MR NO: I am just repeating the statement that you made, Dr, where you said you did not do a comparability.

DR: Yes, initially I was looking for comparables. Once I found the CUP agreement, I thought that it would be confusing to look for comparables, because I found what I stated yesterday was a gift, you know, a golden nugget, and redundancy is not desirable, and that is why I did not pursue my initial thought for comparable licence agreements in this case.

MR NO: The other qualification, Dr ?

DR: I beg your pardon, could you please help me and tell me what...

MR NO: I just want to, I put three propositions to you. You have now commented on all three those propositions. I just want to know if there is anything that you want to add before the lunch adjournment.

DR: Yes, what I want to add, which you do not have in your list, is that I base my conclusion that, or my inference, if you wish, that the three factors that we have measured, duration, exclusivity and territory, I do not expect these differences to have an impact on the royalty rate, because I have done extensive work. Some of this work has been published, in which I do not find significant, a statistically significant effect of these factors on the royalty rates. I find porose effects, I find effects that when they are significant, the coefficient so many skill that it becomes immaterial.

So, that is substantial research. Some of them is published to support this inference that I make in a special case in which I cannot test the effect of the three factors on the royalty rate.

MR NO: But what we can conclude, Dr, is that your conclusion is not informed by a comparability analysis based on the CUP, is that correct?

DR: I have not submitted to the Court any analysis or looking for external comparables, because I have applied what is called Occam's razor, the principle of parsimony. Occam's razor, it is spelt O-c-c-a-m, he was an English friar that adopted a principle that when less is (indistinct) made more. It is called also the principle of parsimony, that if you have evidence that you consider to be reliable and important, you do not need to add to that evidence and create confusion, so I applied the principle of parsimony.

NOTE: This demonstrates the extensive knowledge of the expert witness. The counsel cross examining was applying an OECD TPG guideline to what the expert had not done as guided by the OECD TPGs. The expert explains in a plausible manner a principle that in effect overrides the guideline. Remember the OECD TPGs are guidelines, and if an overriding principle justifies strict non-compliance, that is perfectly acceptable.

My initial strategy was to look for comparable licence agreements, because I am in print; I have published papers showing that the determination of the split of profit between licensor and licensee using profit methods whether it is the DNNM or the profit split produce unreliable results, attributes income to the licensor that belongs to the licensee, especially when the licensee operates as an oligopoly. I have an extensive paper that I published on the CC case, in which I make this point. So my initial strategy was to look for comparable licence agreements, because I believe they are more reliable than profit methods, and if I find comparable licence agreements where there is sufficient sample size, I can make the adjustments, I can test the adjustment that I have described.

But once the CUP was provided for my review, I have made the determination that this document, this agreement between Low Tax Country and MNE, is the most reliable piece of information that I had to date. So there was an infraction point. I had to take an attitude before this important document. I had to pay attention to it, and as I paid attention to it and I considered these factors that we have discussed, that could potentially have an effect on it, I was comforted or reasonably assured by the prior research that I have done, that I have exposed to the public, that I have exposed to scrutiny and critique, and I was also reasonably assured, because the territory conveys countries with any single category of the World Bank and the United Nations group of low-income countries.

COURT: MR NO, I think let us take a...

MR NO: I am sorry, M'Lord...

COURT: ...break now.

MR NO: Can I just conclude on this topic?

COURT: Okay, all right.

MR NO: Dr, thank you for that explanation. It seems to me that you do agree with me that your ultimate conclusion in this matter is not based on a comparability analysis applying the CUP method, but based on what you referred to as the Occam's razor and parsimony approach, is that correct?

DR: No, it is wrong.

MR NO: All right, well, let us then make ...(intervenes)

DR: Because the CUP is a comparability analysis. I said that I have not pursued, I started, but did not pursue a comparability analysis of external comparables. I use an internal comparable, and I did not pursue an analysis of external comparables, because I applied the principle of parsimony. It is important, you know, that you read my statement as I state my statement.

NOTE: Again, the expert witness ensures that counsel cross examining does not deviate from her precise statement in making a summary and then posing questions based on that summary, which may create ambiguities and concessions.

MR NO: Thank you, Dr. M'Lord, is it convenient to take the lunch break?

COURT: Yes, let us take the lunch adjournment and we will return at 2 o'clock Africa time, I think that is 11 o'clock your time, Dr.

DR: Thank you. Judge, may I know how to spell, how to pronounce your name?

COURT: My name?

DR: Yes.

COURT: My name is MO, pronounced MO.

DR: MO?

COURT: Yes.

DR: Thank you.

COURT: Calling me Judge is absolutely fine.

DR: Thank you.

COURT: Okay, thank you. We adjourn for lunch, thank you.

COURT ADJOURNS

[13:06]

We quote some additional extracts below:

MR NO: I do not want to play with words. Can we accept that these requirements for the application of the Internal CUP?

DR: Well, Counsel, you want to rephrase what I say and you want me to agree to your rephrasing and I am not – I do not believe I am obligated to agree to your rephrasing. What I agree on this paragraph is that – or I can stipulate that I accept the text and I accept any accurate reading of the text. That I can stipulate or agree. I do not need rephrasing of a paragraph that is known to me that I am familiar with. I do not need rephrasing and I do not feel the obligation to agree to your rephrasing.

MR NO: Very well, Doctor. I was exploring your choice of words in paragraph 49 where you use the words requirements of the application of the Internal CUP Method and where we make the possible statement that the ABC Agreement fulfils those requirements. And what I am trying to establish is what those requirements are and whether you agree with me or not, we will argue that those requirements are the requirements set out in paragraph 215 at the very least, namely that, there must either be no differences between the transaction being compared which could materially affect the price or, if there are, that one is able to make reasonably accurate adjustments in order to eliminate those material differences. So, that is what we will argue and you are welcome to agree or disagree or comment as you wish.

DR: I do not wanted to argue. I just – the gist of my contention is that you have a formulism reading of the statement, and what I am saying to you is that, my response as an economist is that it is a – none of the differences. So, ...[indistinct – distortion] [00:22:17] you said the difference, for example, territory. Then you cannot claim to me that therefore it is not a CUP.

And I am saying, this manner of formulism is not realistic because the reasons why I, as an economist, can make a claim

that not any difference but a difference that can be measured. So, what I am – I am not objecting to the reading but I am objecting to your formalism because the formalism is out of context. If you apply transfer pricing using the actual data and you want to convey to the trial or fact intellectual honesty and you want to be transparent and not obscure, you are not going to admit, according to your professional standard, any adjustment.

You are going to admit adjustments that you can make a meaningful statement that this adjustment, for example duration as a positive with a negative effect, and that that adjustment is significant and you have to reduce the base rate or you increase it by such and such a magnitude. So, I do not want to, as I said, argue about a tactical reading but I want to put this paragraph in context and to say to you that there is a formalism and there is a reality.

MR NO: Doctor, can I ask you this? Did you conclude, when comparing the ABC Agreement with the many opco agreements, that there are no differences between these transactions that could materially affect the price, in this case the ...[indistinct] [00:24:28], in the open market?

DR: I did not conclude that. And I have repeat it, my inference several times, I do not know why you keep this refrain, you keep rephrasing a statement that I had not made. I have acknowledged differences and I have stated that the differences cannot be measured in the context of one agreement. And I have further stated that I made an inference they are not material based on statistical research that I have made. Now I can tell you why I drew this conclusion. Are you interested in that?

MR NO: Not at the moment, Doctor, I am more interested in your statement at the ABC CUP(?) [00:25:27] purports the requirements or the application of the Internal CUP Method. So, that really is what I am trying to understand is exactly how does the ABC CUP Agreement fulfil the requirements or the application of the Internal CUP Method, and it is for that reason that, as a starting point, I am trying to get clarity on what the requirements are for the application of the Internal CUP. So, if I understand your evidence correctly. You say that the first of the two conditions recorded in paragraph 2.15 were not met. Is that correct?

DR: No, I am not drawing that conclusion. And I would appreciate if you do not rephrase the opposite of what I am concluding. We have concluded – what I have concluded is that the differences that I have identified, these differences include differences in duration of the contract. Differences and exclusivity and difference and territory cannot be measured in the contracts of a single CUP. And I have further said, and this is an important supplement to my statement, I have further said that I was not satisfied with the – my inability to measure and I have the right on my extensive analysis of the effect of each of these factors on royalty rates when you combine the effect of these three factors that we have identified on royalty rates, and I have found – and I have published some of this result – either had no effect or perverse effect. When that is perverse, meaning the effect is contrary to expectations, the ...[indistinct] [00:27:48] is so tiny, so minuscule that they can – that it can be disregarded. So, this is my summary interpretation of paragraph 2.15 Condition A.

MR NO: Doctor, I am correct that the CUP Method contemplates an exercise in comparing a list of comparability factors or between the identified uncontrolled transaction with the comparable controlled transactions?

DR: You are correct.

MR NO: And those comparability factors are the ones that you identified in your – on – your ...[indistinct] [00:28:52] in paragraph 27 at page 07-810?

DR: [No audible reply]

MR NO: And that, of course, references paragraph 1.36 of the OECD Guidelines with which I am sure you are and perfectly au fait with. Is that correct?

DR: If I am familiar? Is your question if I am familiar with paragraph...?

MR NO: I assume that you are.

DR: So, that would be an assumption.

MR NO: I see. So, you missed six comparability factors, is that correct?

DR: Yes.

MR NO: And so then I would understand the process to involve is that you would take in this instance the ABC Agreement and you would compare having regard to each one of these comparability factors, the ABC Agreement with each one of the 14 agreements? Is that a correct interpretation?

DR: So, please be more specific.

MR NO: I am not sure that I can but let me try. It outlines in paragraph 1.36 identifies six comparability factors. The CUP Method seeks to compare an uncontrolled transaction, in this case the ABC Agreement, with 14 controlled transactions being the Licence Agreements concluded with each one of the many opco's. The CUP Method requires a comparison

between the ABC Agreement and the 13 Opco agreements with reference to the comparability factors listed from A to F in your document and which is a repetition of paragraph 1.36 of the OECD Guidelines. Is that correct?

DR: Yes, you are correct.

MR NO: Did you undertake such a comparison?

DR: Yes, I have, and the way in which I did is that among these factors that are listed herein, some of the factors are more important – they have a relevant importance to the CUP than other factors.

MR NO: Doctor, I do not want to interrupt you and I am sure and we will get to that point in the fullness of time. You are saying that you did do a comparison between the ABC Agreement and each one of the 13 opco's having regard to the comparability factors as they are listed in A to F?

DR: [No audible reply]

MR NO: Now can I just ask you? Let us perhaps work in the reverse. F is concerned with business strategies. Can you please show us where in your document you consider are they of comparison the business strategies of the ABC Opco in comparison to the business strategies pursuant on each one of the 13 opco's?

DR: This factor is irrelevant ...[intervenes]

MR NO: [Indistinct]

DR: ...to establish the – yes, question? Are you finished with your question?

MR NO: No, I did not ask you about the relevance. I asked you whether you as a fact interrogated these comparability factors where you did the comparison. You answered in the positive. Then I am asking you, Doctor, is to please show me where in your report is this so? We can debate the significance of the factors in the fullness of time, but for the moment, please just show me where in your report you did the comparison in relation to business strategies.

DR: Oh, so I am not interested in debating. I am interested in and *jubilating* in providing a reliable answer to your question to the best of my knowledge and ability. My response continues to be. I started, and I was interrupted, that business strategy is a factor that is irrelevant. Meaning, I do not have to consider it. It is irrelevant to the determination of a CUP. And I will tell you where this business strategy is relevant.

Business strategy is relevant when one applies a Profit Method because in applying a Profit Method and selecting where the profit to be applied is the operating profit before depreciation or after depreciation. The strategy of the business, of the comparable business is important because some businesses grow by natural growth, some businesses grow by artificial insemination, by measures and acquisition. The business that grows by measures and acquisitions typically acquire intangible property. The intangible property is recorded in a balance sheet and it is amortised in the amortisation of the acquired intangibles.

To be more precise. Some of the intangibles are amortisable, acquired intangible and some or not amortisable, they are subject to permit(?). Where they are being amortised or subject to impairment, it has an impact on the operating profit. So, business strategy is relevant – is irrelevant comparability factor when we are applying a Profit Method and a need to determine is the profit to be applied, is before or after depreciation.

If the comparable are constituted by companies that do not make acquisition, then it does not make much of a difference but if the comparable include companies that make acquisitions and companies that do not make acquisitions, the selection of the operating profit after depreciation must consider this, you know, this difference in strategy but this factor, unless you show me otherwise, is irrelevant for the determination of royalty rates.

MR NO: So, you say ...[intervenes]

DR: I do not need to - I am sorry to interrupt you, I need to draw my conclusion to my response. So, since it is irrelevant, I do not need to record on the – on my report unless you are fastidious reader that insists that I should make a statement. I considered the business strategy and found it to be irrelevant because depreciation resulting from applied intangibles is not relevant for the determination of royalty rates. So, if that is your reader, I apologise for my omission.

MR NO: Now can I accept then as far as you are concerned, business strategy is irrelevant to the CUP?

DR: Yes.

MR NO: And can I ask you in dealing with economic circumstances? The size of market, the extent of competition, the availability of substitute goods and services, the nature and extent of government regulation in the market, is that relevant or is that not relevant?

DR: Well, we have a geographical location which also surfaces in contractual terms. These factors are relevant to determine the value of the intangible asset. They are not relevant to determine the royalty rate ...[intervenes]

MR NO: [Indistinct]

COURT: Please let Doctor finish. Go on, Doctor .

DR: The difference is that when one establish the value of an intangible asset because the transaction in question is a sale, is an asset sale, which is not the case here, then the value is determined by a royalty rate times a projected sale and the, for example, the duration would have an impact because a contract that produces income for **three years** [00:09:08] has a different value than a project that produce income for ten years. So this is not what is happening here.

On the, for example, present value calculation, which gives us an *equal income method(?)* [00:09:28], you can give us the same royalty rate one year after the other because that is in reality of licence agreements in what changes and you use the same ...[indistinct] [00:09:39]. What changes are the annual future projections of the revenue generated by that intellectual property. So, these factors that are listed here have an effect on the value of the asset but we do not – they are not determined of the royalty rate.

MR NO: Doctor , can you recall the question that I asked you?

DR: Yes.

MR NO: What was the question?

DR: It was similar to the prior question from whether I have properly considered economic circumstances.

MR NO: But that was not the question, Doctor . The question was whether economic circumstances and we referred specifically the size of market, the extent of competition, the availability of substitute goods and services, the nature and extent of government regulation of the market is a relevant comparability factor to the CUP Method.

DR: Well, here there are several factors and I have conveyed that these factors are not relevant for the determination of royalty rates. They may be relevant for the determination of the asset value of the property but not the rate of the income.

MR NO: But Doctor , what – can you please – the question that I asked you and I asked the same question for the third time, and where it becomes obvious, Doctor , is that you are deliberately avoiding answering the question. The question I am asking you is whether the economic circumstances, and I am referring to specifically to the size of the markets, the extent of competition in the markets, the availability of substitute goods and services, and the nature and extent of government regulation of the market is a relevant comparability factor, it applies to the CUP Method.

DR: So, I have given a response and I wish to correct you that I have no objective to be evasive. My objective is to be clear and transparent. My objective is to persuade, not to evade.

MR NO: Can you be so kind as to answer the question?

DR: I have answered the question and I will repeat it, that there are multiple factors included in economic circumstances and except for geographic location which have – has also – which also service in contractual terms, these factors influence the value of the asset but not the royalty rate.

MR NO: So, it is not a relevant comparability factor in the application of the CUP Method. Is that your answer?

DR: You say factor in a singular but economic circumstances in the plural and it equals multiple factors and I am addressing the multiple factors and I am saying to you that if you are interested in the valuation of the asset then it will be relevant. They are not relevant to these factors, in the plural, are not relevant for the determination of royalty rates.

MR NO: But Doctor , I am not sure why you are referring to the determination of royalty rates. I am simply asking you about the application of the CUP Method and we have an agreement that the CUP Method requires a comparison between the uncontrolled transaction and the controlled transactions, 14 of them. There is a reference to a number of comparability factors. Is that correct?

DR: So, for the sake of proceeding, I am going to say yes.

MR NO: Thank you. You cite with reference to paragraph 1.36 of the OECD Guidelines a number of comparability factors in paragraph 27A to F of your report. Is that correct?

DR: Could you point me to the location of my statement, please?

MR NO: It is on the screen.

DR: Yes.

MR NO: Now you started with F Business Strategies and you say that:

“...business strategies is an irrelevant consideration in the application of the CUP Method. It is not a relevant comparable...”

Is that correct?

DR: That is what I said and I said also – unless you can show me otherwise. I am a scientist. I am willing, happy to consider evidence that you have to contradict my claim which is a ...[indistinct] claim. So, because it is a ...[indistinct]

[00:15:34] claim it is not true by definition, it can be true or false, facing the evidence. So unless you show me evidence to the contrary, my research and my understanding of royalty rates, which is substantial, leads to the conclusion that I have drawn.

MR NO: Doctor, I would have thought that the OECD Guidelines offers you sufficient evidence of the fact that this is a relevant comparability factor in the application of the CUP Method but you, obviously, hold a different view.

MRT SC: M'Lord, I wonder of my learned friend could be more specific in his question because he says are these factors relevant to the application of the CUP Method but then the questions and answers come between two different tenses. The first is, the application of the CUP generally, as the witness has explained, might sometimes mean to determine the value of an asset or does he mean the application of the CUP in this case in order to determine an arm's length royalty rate?

MR NO: M'Lord, I do not believe that there is room for confusion but Doctor let me be clear. I am talking about this matter and I am talking about the CUP Method and its application to transfer pricing. And to remove any room for misunderstanding, the origin of my question is your statement in paragraph 49 on page 07-816 and that is the statement that I am interrogating and will continue to interrogate until I indicate otherwise. The statement, for your benefit again, Doctor, is. The ABC Agreement refers the requirements for the application of the Internal CUP Method and is more reliable than any other methods under the OECD PPG.

DR: [No audible reply]

MR NO: Are you clear, Doctor, what we are busy debating?

DR: Yes, and I have – I am not interested in debating as I have said. I am interested in clarifying questions. I have offered to explain to you why I made that statement but you prefer to go through a list of factors and use a process of elimination and you are not accepting when I reply that a factor that you have mentioned, business strategy, is irrelevant for the determination of royalty rates. You can scratch my skin and it can bleed but you cannot compel me to give an answer that you want.

MR NO: Very well, Doctor. Let us see if we can make progress. So, let me explain to you what I am trying to understand is. I am trying to understand on your version which of the comparability factors that you have listed on page 07-810 and 07-811 are relevant comparability factors to a CUP analysis. Do you understand what I am trying to learn from you?

DR: Yes...[intervenes]

MRT SC: M'Lord, my learned friend again asks the question in the abstract. Does he mean the application of the CUP generally or does he mean the application of the CUP in this case to determine an arm's length royalty?

MR NO: This case, in this case.

DR: So, among the listed factors, which the OECD Guidelines, attempt to be comprehensive but for an economist it leaves some irrelevant volumes(?) of factors. Among the factors listed here, the primary factor that I considered is the characteristics of the property because the application of the CUP Method in the case of prices, as I have explained yesterday, in which revenue is it composed into price and quantity and they want to measure price, price must be associated with a specific product.

In the case of royalties, it is not the price of a product but a price of an asset, an intangible asset. So, the characteristics of the property is primary(?) [00:21:11] It is the telos, t-e-l-o-s, of the CUP in royalty rate. It the *cause of finale's*, it is a final cause, the final – the ultimate factor. So, that is the factor that, to me, determines in this case why the ABC Agreement is a CUP Agreement because when I look at the 14 licence agreements it is the same market intent that is conveyed.

[Indistinct] it may include one element with another element but I have no found evidence in which ...[indistinct – distortion] [00:21:58] or three rights, two or one property rights convey a different royalty rate than what we call a naked in which one right is conveyed.

So, this right, whether or not the contract around the many opco agreements contain a naked royalty rate or royalty rate separate from management fee or whether the royalty rate is embedded in the management fee. In my understanding that is 1% royalty rate. The characteristics of the property, namely marketing intangibles, is the same or very similar and that is the main reason why I concluded that we have a CUP.

There is another reason. When I looked, and it is a reason that is normally not looked at in the determination of a CUP, and that is the functions performed by the licensee. The functions performed by the licensee are the same. They are in the same industry. [Indistinct] [00:23:09] and Opco(?) may have a preferred or product or services that differ from

another but they are basically in the same industry, basic at performing the same functions. So, this factor, which I considered, also leaves me to conclude with confidence that we have a CUP Method.

Then we had factors that I had to consider and made a judgement and professional judgement is provided for and the OECD Guidelines because as long as one is not using arbitrary criteria. And my professional judgement is, do I believe that the differences in duration or the differences in exclusivity or the differences in territory given that these are all African countries with similar levels of per capita income, do I believe that these factors have – can impeach the CUP. And my position is that I could not measure the fact of these differences, but from research I can conclude with reasonable confidence that those factors cannot materially affect or displace or adjust the royalty rate from the uncontrolled agreement between MNE and Low Tax Country.

So, here I have given you the characteristics of the property, the terms performed and the contractual terms, and I have left out as irrelevant the ...[indistinct] [00:25:25] similar factors outside from geographic territory and the final(?) conditions.

MR NO: Doctor, perhaps – I am not sure what question you answered now but on the ...[indistinct – distortion] [00:25:43] simply a guess. Would you please – there is a list. We are not going to go through a list over and over again because it is there. It is your list, it is not my list. Perhaps, can you tell me, could you please identify those comparability factors that you consider relevant and I will then assume that you consider everything else to be irrelevant? So, maybe it is easier to just – can I make some progress. So, would you be so kind as, please, to list in your opinion what the relevant comparability factors are?

DR: Well, I was responding to your question and I have to repeat some of the statements that I have made because it is a response to the same question.

MR NO: Yes ...[intervenes]

DR: The factors are characteristics of property, functions performed in contractual terms, and I considered irrelevant the ...[intervenes]

MR NO: Sorry, will you please just allow me, please? You say the characteristics of the property, that is the first one. And the second one is?

DR: Functions performed by the licensee.

MR NO: Yes?

DR: And the contractual terms.

MR NO: And you consider these to be the only relevant comparability factors in the implementation of the CUP Method in this instance?

DR: I did not choose the verb only. I said these were the factors that I considered relevant.

MR NO: Is there anything that you want to add to the list, Doctor? We have got three items; characteristics of the property, functions performed of the licensee and the contractual terms.

DR: Yes, and the factor that the ...[indistinct] [00:27:56] independent.

MR NO: Is that a comparability factor?

DR: Well, let us just say if – it is because you need to consider contracts between uncontrolled entities.

MR NO: Which ...[intervenes]

DR: ...because, of course, I had to determine – I had to determine, initially, am I satisfied that the licensor and licensee are independent according to Article 9(1A) and (1B) and once I was satisfied upon reviewing the Licence Agreement, reviewed the Purchase of Shares, I was satisfied with that question. I proceeded to analyse the characteristics of the intangibles and the functions performed by the opco's and the contractual terms.

MR NO: The parties that are independent, is that a reference to the ABC Agreement, it is the ...[indistinct] [00:29:06]?

DR: [No audible reply]

MR NO: And you accept that the other 13 opco's that is all controlled transactions?

DR: I am having difficulties hearing you, Counsel, but I understood you to say that you accepted that the many opco's are controlled entities?

MR NO: Yes.

DR: Or something to that effect.

MR NO: It is correct.

DR: Yes. Yes, but here there is something interesting in the picture, that several of the opco's have minority on the ship.

Some of the minority on the ship can be substantial. And here we have a principle and corporate law that will respect an economic analysis, what is a principle of super minority rights. That one can argue, I am not making that argument, but one can make the argument based on a principle of super minority right that the ...[indistinct] individually, or as a group in large satisfy the condition for the evasion of tax, which is what motivates the tax authority to procure, or to test every transaction ...[indistinct] the fact that we have OPCOS in which MNE, the MNE group hold a minority, that is subject to super minority rights and I cannot under the super minority rights principle contemplate a scenario in which the OPCOS would engage in contracts that are not *bona fide*. So this is a factor that is important in this case that one could argue that certainly the OPCOS have mixed ownership and in some of the mixed ownership, the ...[indistinct] to the MNE group is substantial, which warns the tax authority of a motive of a tax evasion. Even the fact ...[indistinct] exhibit, I think on the joint statement, I do not recall precisely where this exhibit was showing that the tax rates ...[indistinct] the tax authority of a motive to assess MNE for underpayment. So these are factors that constitute a context in which ...[indistinct] that contract between 100% ownership underlying the CUP agreement and considering all these facts and circumstances, I made, I drew and continue to draw a conclusion, or two conclusions. One is that here we have an agreement that satisfies the conditions as I have spelled out of an internal CUP and that this agreement constitutes the most reliable, it is not a perfect match, but it is the most reliable document that we had in the record to determine the royalty rate between the licensor and the controlled OPCOS.

MR NO: Is there anything you want to add Dr ? You see I put to you something that is completely uncontroversial in this matter and that is that the many OpCos are all controlled transactions. But instead of simply answering that question, you once again take the opportunity to simply go on a rant of the run and offer information in relation to something that is completely uncontentious. And it seems to me Dr , that that is a constant feature of your answers to very simple questions. So can I ask you in the interest of time that you perhaps make an effort to answer questions and to confine yourself to the question that I have asked you. Nowhere in your expert report do you deal with the response that you have just offered and that again is a common feature of your evidence. The complete disconnect between your oral evidence in these proceedings and what is contained in your expert report. But what you have just discussed for the last almost 10 minutes is nowhere mentioned in your expert summary as anything of any moment.

DR: I believe that the word ...[indistinct] when it is unfriendly and inopportune and I believe that my response to your question contained important information and I understand that my testimony ...[indistinct] that is my understanding to a verbatim reading of my document. My understanding is that in my testimony I have the right to supplement, or to expand, or to qualify the statements that I have made, in particular to qualify and expand in my response to counsel's questions. I will for the benefit of the Court and to maintain a cordial relationship between question and answer try to respond to your questions as succinctly as I can.

MR NO: Thank you, you identified three relevant comparability factors in the characteristics of the property, the functions performed by the ...[indistinct] and the contractual perks. What was your conclusion in relation to those three comparability factors?

DR: [Indistinct]... and you are going to accuse me of rant, could you pass it and ask me one by one so that I can respond one by one?

MR NO: You identified three comparability factors, you are welcome to deal with them one by one. My question to you is whether having regard to these three comparability factors you are of the opinion that the CUP method as you employ it is complied with paragraph 2.15 of the OECD guidelines, that is the paragraph that imposes the two conditions for the application of the CUP method and I will be grateful if you can tell me whether it complies with, in each instance with the part A, or with the part B of the requirement?

DR: So one of the two conditions that we discussed refer to the contractual terms. Those conditions do not apply, or are relevant, one of those two conditions to the characteristics of property, or service. You cannot adjust the property of service. You cannot adjust the functions performed by the licensee, but you can adjust provided you have sufficient data, the contractual terms, especially as when we unfold the contractual terms we find that they consist of three factors that we have identified. And I have provided sufficient testimony about my opinion regarding duration, regarding exclusivity and regarding territory.

MR NO: Am I correct in a reading of paragraph 2.15, Dr , that an adjustment is only called for if there are differences that could materially affect the price?

DR: Yes and materially affect ...[intervenes]

MR NO: Sorry to interrupt you, I do not mean to interrupt you, is the answer yes?

DR: Yes. You did not ask me if it was yes, or no, so I was hoping to elaborate on my question, on your question.

MR NO: I am not suggest you cannot elaborate, I just want a yes, or a no, so that I know what informs the further

response, but do you agree that an adjustment is only a relevant consideration if there are differences that could materially affect the price in the open market?

DR: Yes, but material effect as me as an economist, or for anyone who has knowledge of statistics means in effect that can be A measured and two, shown to be statistically significant. It is very precise concept for me and the way in which it is ...[indistinct] is vague, I have to interpret it in a way that conforms to my training.

MR NO: Dr, were you able to conclude if any one of the three differences that you identified could materially affect the price in the open market. Were you able to draw a conclusion on that question, or is your answer that you could not draw a conclusion because you cannot measure the differences?

DR: Respectably counsel, I have responded to this question several times. I have said, I repeat now, that I could not measure in the context of a single contract, but I was not satisfied with the fact that I cannot measure and I recalled analysis that I have done in which I test the effect of each of the three factors that we have listed. For the purpose of clarity I will list them again, duration, exclusivity and territory and I have found either no significant effect, or to put in the language of the OECD guidelines, material effect, or I have found ...[indistinct] effect, or I have found that the effect was significant, but the ...[indistinct] that it did not displace the royalty rate. And I used this research, as I have said, some of it is published, subject to scrutiny to infer that these three factors do not have an effect on the CUP royalty rate of 1% and I have said further and prudence that unless I am shown data in this context that proves otherwise I am confident with my inference.

MR NO: This empirical analysis that you refer to, can you please show me where in the OECD guidelines that is indicated as a requirement for the application of the internal CUP?

DR: It is in paragraph 2.15 and it is the phrase NA, materially affect, or an economist, or a statistician, or anyone who has knowledge of economics and statistics, that phrase, that condition, that instruction means that one would have to measure the effect and ...[indistinct] if the fact conforms to expectation, if the sign is positive, or negative, depending on expectation and that the measurement produces a significant result. Without producing a significant result the fact of the adjustment factor is nullified.

MR NO: So are you saying that based on your empirical research, you concluded that the three comparability factors that you had identified did not materially affect the price, or does not materially affect the price?

DR: The royalty rate, the context is the royalty rate. So I draw your attention to an accounting, or a functional equation that I ...[indistinct] before lunch. In which the royalty rate was a function of the three factors. And suggested that the way to test material effect was to collect data from a reasonable size sample. And I even showed how one could construct a spreadsheet to collect the data and attest the ...[indistinct] of the coefficient, significance of the coefficient meaning that the ...[indistinct] of the coefficient is small compared to the coefficient ...[indistinct] and to determine if the R-squared of the relationship has ...[indistinct] but I can tell you that none of the multiple, of the many equations that I have tested using different industries with these contractual terms has the R-squared gone beyond 40% which means that when you examine these three factors in combination they explain at maxim 30% of the variation and the royalty rates. Typically the R-square is 5% which means that these three factors, however we anticipate them to influence the royalty rates, they are not determining factors of royalty rates. And this research that I am describing, it has been extensive because I am analysing my data frequently and I am as a scientist trying to learn what factors determine royalty rates and what I find that these three factors are not relevant, they are not significant, there are two factors that are significant, but these factors are not relevant for the agreement between the CUP and the OPCOS, because they have the same terms. So one factor that does influence the royalty rate is whether or not there are additional payments by the ...[indistinct] or upfront fees. So that displaces the royalty rate. The CUP does not have additional payments, or payments in addition to the royalty rates and none of the OPCOS agreements, with respect to royalty, I am not talking about management fees. I am talking about additional payments connected to the royalty rate. The other factor that displace the royalty rate is if the agreement contains a cleared royalty rate, or if the agreement contains moot royalty rates. None of these two attributes belongs to the Cyprus agreement, or to any of the OPCOS agreements. So as a matter of research ...[indistinct] trying to determine, trying to learn what explains behaviour of royalty rates. What explains the behaviour, or the difference of royalty rates amongst different industries. I have found that duration, that exclusivity, that territory do not have an influence, although when I do the test, I do not ...[indistinct] I do the test with two countries, or I do the test with which countries. And I have found that the factors that if the royalty rates, as I have said, additional payments ...[indistinct] and none of these factors are provided in the agreements between the CUP and used a benchmark for the OPCOS agreement. So there is substantial research to support my professional judgement regarding the contractual terms.

MR NO: Dr, is it then correct that in relation to the three comparability factors that you identified as relevant, you concluded that none of the differences between the transactions being compared, or between the enterprise and

...[indistinct] transactions could materially affect the price in the open market?

DR: No, I did not draw this conclusion.

MR NO: What conclusion did you draw?

DR: I am repeating I think the fourth time, the conclusion is that I could not measure effect of these three factors on the royalty rate, because I do not have data. And my intellect honesty does not allow me to draw a statement that it does, or it does not when I cannot measure. And absence of, or given my inability, the lack of data to do the test, I relied on substantial research to draw that inference that the contractual terms ...[indistinct] and three factors, I can ...[indistinct] but they do not increase or decrease the royalty rate of 1%.

MR NO: Is this the empirical research that you refer to?

DR: Yes, sir.

MR NO: Would you be so kind Dr, as to show us where in your report, I think you have probably spent the better part of 30, or 40 minutes, if not more referring ...[indistinct] analysis. But would you be so kind as to show us where in your report you deal with this analysis that you had undertaken and which informs your view that these three considerations are of no moment?

DR: That is a footnote, I do not recall the number, but you will find that I cite a paper that I published. It is a footnote which I cite a paper that I published about this statement that I am making.

MR NO: Paragraph 43 of your written statement, page 07-814. That is the statement without any particularity whatsoever.

DR: Can you go to my footnote please, that is what I am referring to.

MR NO: These are the characteristics of pharmaceutical patents. Is that correct? It is the pharmaceutical industry and relating to patents. Is that what you are referring to, not the empirical research that you referring to that informs your whole statement that these three considerations are irrelevant?

DR: I have said that I have made substantial research, some of it I published. This is not the only published paper that I have regarding this matter. But I have to, I believe that, well in this publication they do not allow citations, they do not allow footnotes, but if you go to the royalties website ...[intervenes]

MR NO: The question was directed at your report, your report is what foreshadows your evidence in these proceedings and we all prepare based on your report. And so my question was directed at your report. Because I see a lot of things in your report and there is certain things that I do not see at all. And you have spent a lot of time in these proceedings referring loosely to research that you had done and your database and the like. I asked you to who me where in your report you deal with this topic that I would have thought is of absolute critical importance to your conclusion is now appears, but all we find is statement of opinion in paragraph 43 without any particularity and then the only evidence that you offer in support of this bold statement is an article pertaining to written value dealing with the characteristics of pharmaceutical patterned royalty rates ...[indistinct] from brand in the telecommunications industry.

DR: I do have a reference and I have stated that I have done substantial analysis on many industries. I am sorry that I could not predict your obsession and I do not have a citation to one published research, but what I am saying to you is that I have done substantial research testing the fact of duration, exclusivity and territory on royalty rates. Some of the research I have published and here I have cited. One, I did not say that I published in the telecom industry. But I have been engaged in at least three cases in the telecom industry representing, one representing the government and two representing the ...[indistinct] in which I needed to determine royalty rates in which this kind of exercise was done. But the difference between that research and this case is that in that research I did not have an internal CUP. And I had to resort to an analysis of external CUP and the reason why I looked for this adjustment is because when you look for royalty rates from external CUPS, the variation of the royalty rates is ...[indistinct] and they need to test this adjustment to see if we can reduce the variation in the royalty rates.

MR NO: Dr, you must understand that the fact that you are an expert does not mean that you are liberty to simply come to Court and express opinions and think that because you are an expert we have to accept your word unequivocally and unconditionally. How it normally works is that you place before the Court the reasons that informs your opinion in a way that enables both the counter party and the Court to meaningfully interrogate your opinions, but it appears to me that you elected to do the exact opposite. And that is simply to come to Court and to make statements and express opinions, but opinions that appear to me to be completely unsupported by any form of empirical evidence, or research data that you are prepared to share with either the Court, or the experts that advise the commissioner.

DR: Counsel, you are so wrong. But your assessment is so extensive that I cannot address all of them but let me assure you that I have no expectation that the Court will accept my statements without support. I do not have any special privilege and I do not have any such expectation. So to impute that expectation for me is baseless.

MR NO: What I am putting to your Dr ...[intervenes]

DR: No, I am not finished sir.

MR NO: Carry on.

DR: To impute motive to my document is irresponsible. You do not know my motives. I have said to you my motive is to be transparent, is to eliminate the question and to exercise intellectual honesty. Further to claim that I am making statements without support is inconsistent with my testimony, because I have said repeatedly, but you want to scratch my skin and you want to bleed, you want me to bleed, but I will not allow you to do it. You want to push me over.

COURT: Okay, Dr, I think let us not be emotional here, the question was other than this particular article in your footnote, is there anything else that you can refer the SARS team which MR NO represents to support your contentions around the research. So is there something else that they can look at?

DR: Thank you, I do not believe I am being emotional, I am being rational. I tried to make reference to other publications, but SARS counsel did not want me to go there. I have supported my statement that here we have a CUP and a most reliable data point based on the comparability factor that we called characteristics of the property. And I have established, unless I have shown otherwise that the characteristics of the property is the same between the CUP and the OPCOS. I have also stated that I analysed the function performed by the licensee ...[indistinct] uncontrolled licensee and the controlled licensee. And I have concluded based on that analysis that the function performed by the licensee are the same. So I have a basis to draw my conclusion. So your distaste counsel is with respect to functions, to the contractual terms. And in that regard I have amongst the papers that I have published, I have cited a paper in which I investigate some of these factors. Yes it is in the pharmaceutical industry, it is patented, if I cannot find a relationship in the patented it is not like that I find marketing tangibles, but I leave that for the ...[indistinct] so to say that I have no basis and that I have no support from my ...[indistinct] is incorrect.

MR NO: Thank you, Dr, I believe His Lordship, extended an invitation to you and we ...[indistinct] your responses. Dr, according to paragraph 43 you consider exclusivity, duration and geographic market to have a ...[indistinct] influence on the royalty rates, is that correct?

DR: Yes, I read it on paragraph 43, the last sentence.

MR NO: And the statement is preceded and presumably informed by the prior sentence which says:

"Prior empirical analysis shows that in many industries certain juristic anticipated, or presumed factors, such as contract duration, exclusivity and territory show conflicting ...[indistinct] the royalty rate."

What does the word conflicting mean?

DR: Conflicting tool regarding expectations. So for example ...[intervenes]

MR NO: Not consistent?

DR: Conflicting, it conflicts with expectation. So one would expect that an exclusive agreement would produce a higher royalty rate than a none exclusive agreement, but that is not what the data show. The data shows a conflict with that expectation. It shows wither no effect, or a negative effect.

MR NO: And that leads to your conclusion that exclusivity, duration and geographic marker has got a tendency ...[indistinct] is that correct?

DR: Yes.

MR NO: And they are therefore of none relevance as a comparability factor in application of the CUP method in this case?

DR: In this case.

MR NO: Assuming that ...[intervenes]

DR: It is an ...[indistinct] statement that I make.

MR NO: Sorry can I finish my statement please. Concerning brand licenses in the telecommunications industry.

DR: I apologise for interrupting you, you were facing down and I could not see you.

MR NO: I am sure you can hear me.

DR: I apologise.

MR NO: Thank you, no offence taken Dr, please respond if you want to.

DR: So I am basing the empirical statement, I am not making a theoretical statement, I recognise that in certain samples I have not found them, but one could find relationships that were not conflict with expectations and that are significant, but I have not found such samples.

MR NO: Can I then take you to a document which appears at page 03-198. Do you recognise this document?

DR: Yes, it is ...[indistinct] produced in February 2014, so if it was a child, it would be eight years old.

MR NO: I beg your pardon?

DR: If it was a child, the child would be 8 years old.

MR NO: I am sure. You are the author of this document, is that correct?

DR: Yes, I am.

MR NO: And this was a report to review a report that had been prepared by Brand Finance, is that correct?

DR: Yes, it is right on the title.

MR NO: And Brand Finance considered, well they sought to apply the CUP method to three transactions. Do you recall?

DR: Yes, so I did not know that this document was going to be submitted. So you would have to show me the paragraph that you want to refresh my memory.

MR NO: On page 03-210, it explains the purpose of the report is to review certain reports prepared by Brand Finance. Sorry, 03-201. Can you see the purpose?

DR: Yes.

MR NO: It reviews certain reports by Brand Finance and then there are three agreements that were listed and you will recall applied the CUP method to those three agreements and you then say in the paragraph that follows that:

"The purpose of our review is to determine if Brand Finance report satisfies the armlength standard under the OECD transfer pricing guidelines in multinational enterprises and tax administrations."

Which you define as the OECD guidelines, correct?

DR: Yes and given the date of this report the guidelines that I am referring to is 2010.

MR NO: Yes.

DR: Because a subsequent one was 2017, three years after I draft this report. So these citations are to the OECD guidelines of 2010.

MR NO: Yes. And then at the foot of page 03-202 just to remind you, you discarded the first two agreements on the basis that they were both controlled transactions and then the third agreement you discarded on the basis that it is albeit a non-controlled transaction, but it is not comparable, do you see that at the top of the page? The CUP method is not controlled, but it is not comparable, that is your conclusion in one sentence, do you recall that?

DR: Yes and I believe I recall the reasons why I rejected this agreement.

MR NO: Yes, we will get there in a moment. On page 03-204, you explain the CUP method and in paragraph 3.1 on the same page you identify the MNE agreements. Do you see that? And these were described as the controlled transactions and the review and those are the MNE agreements that are then listed, do you see that?

DR: Yes, I do.

MR NO: And what you then do it seems to me quite sensibly, before you look towards the agreement that is offered as a CUP, you first look at the MNE agreements and you consider in paragraph 3.1 the similarities amongst the MNE agreements, do you see that? And over the page on page 03-206 you consider the differences amongst the MNE agreements. Is that correct?

DR: Yes.

MR NO: And that appears to be a sound and scientific approach to look first at the similarities and differences amongst the controlled agreements, assuming that you want to apply through the CUP method the uncontrolled agreement to each one of the controlled transactions. Not so?

DR: Your statement is long. So I am saying it is not so to what statement?

MR NO: What I am saying Dr and I would imagine it is uncontentious, is that the methodology that you adopted in this report appears to me to be a sound approach. The first step is that you consider the similarities and differences amongst the controlled transactions as a first step in the process, accepting that you want to apply the uncontrolled transaction to each one of the controlled transactions.

DR: It is a sound approach, I agree to it.

MR NO: In paragraph 3.1.2 you deal with the differences amongst MNE agreements. Do you see that?

DR: Yes, I do.

MR NO: And then you deal with the fees payable, do you see that? And over the page in the middle of the paragraph you deal with the duration, do you see that? And you identify the fact that in the case of certain of these agreements they continue until the concession seizes, or until one party terminates the agreement. And that the remaining agreements have a ...[indistinct] all of which are renewables ranging from 9 years for Ghana to 10 years for Afghanistan and the Congo to 15 years for Cyprus. Do you see that?

DR: I do.

MR NO: And you then say in the concluding paragraph that each of these differences, so those are the differences that you have now identified under the heading, differences amongst MNE agreements, each of these differences can materially affect comparability, is that correct?

DR: Yes, I read the paragraph.

MR NO: And is the statement factually correct?

DR: Two sentences on the paragraph, two different statements.

MR NO: Can you deal with the first statement first, Dr, is the statement, the first statement factually correct?

DR: Each of these differences can materially affect comparability. It is, I continue to ascribe to this statement, the word is can materially affect, can.

MR NO: It is similar, is it not, Dr, to paragraph 2.15 of the OECD guidelines which reads that none of the differences between the transactions being compared between the ...[indistinct] and the total of those transactions could materially affect the price in the open market, it is no different to what is recorded in paragraph 2.15 of the OECD guidelines, is it?

DR: I think the ...[indistinct] is the same, the phrasing is different. The OECD speaks negative and I speak in positive.

MR NO: And you then continue to say that:

“Brand Finance erred in assuming that all the MNE agreements have the same contractual terms and are located in territories within the same regulatory restrictions.”

Is that correct?

DR: It is, the statement that you have read it correct.

MR NO: So you criticise Brand Finance in making the assumption in doing a CUP analysis that as between the MNE OPCOS, that the same contractual terms apply and that they are located in territories with the same regulatory restrictions. You criticise them for that assumption. Correct?

DR: Yes, I said they erred in assuming, that is not what I am doing, I am not assuming.

MR NO: Well their assumption is wrong? That is the error, their assumption is wrong?

DR: You mean Brand Finance?

MR NO: Yes, because ultimately you reject their analysis based on this, not so?

DR: It is not so. I know why I rejected the agreement. I rejected the agreement for two reasons. It is not correct to say that I reject the agreement, because they assumed. What I mean here is that they assumed, or they took ...[indistinct] position that these factors are not important. I continue to hold that the factors are important. And I said that I am not dis-considering the facts. I said that based on measurements they are not determinants of royalty rates. That article that I referred to pharmaceutical was published in 2017, so this is research that I have done past this document, but I do not see anything wrong with the two statements contain and this paragraph that we are discussing.

MR NO: I do not see anything wrong ...[indistinct] I am just reading it for what it is. Let us carry on. Paragraph 3.2 over the page, the heading is misapplication of the CUP method. Do you see that?

DR: I do.

MR NO: And so Brand Finance erred in applying the CUP method to determine arm length royalty rates for the MNE agreements. So you still not peeking outside the MNE agreements, you just looking at the comparability of the MNE agreements, the OPCO agreements, the controlled transactions. You say their analysis neglected important factors of comparability under the OECD guidelines. Is that correct?

DR: That is what I wrote.

MR NO: Yes and is the statement factually correct?

DR: It is factually correct and I will give you the reason why it is factually correct. Are you prepared to hear it now?

MR NO: Can you hold that thought for a moment and then I will give you an opportunity, let us just complete reading the document. So you then in the next paragraph deal with the OECD guidelines and the CUP method. And you record that for purposes of the application of the CUP method to intangible licenses a controlled transaction in an uncontrolled transaction are comparable if none of the differences between them could materially affect the royalty, or if “reasonably accurate” adjustments can be made to eliminate the material effects of any such differences. It seems to be an accurate recordal of paragraph 2.15. You then say and this is now under the heading, misapplication of the CUP method and the introductory sentence, their analysis neglected important factors of comparability. You say:

“In order to establish comparability between controlled and uncontrolled transactions.”

Now let me just pause here. We are dealing with the MNE agreements, we are dealing with the MNE brand, is that correct?

DR: I believe we are dealing with seven intangibles.

MR NO: Yes,

“It is necessary to compare attributes for comparability factors including the characteristics of the property, or services transferred, the functions performed taking into account assets used and risks assumed, contractual terms, including license rights transferred, economic circumstances, business strategies

pursued and business strategies pursued by the parties. Two contractual terms include the licensees duration, territory and exclusivity."

The three factors that you told His Lordship, moments ago are irrelevant to a CUP analyses, because they have absolutely no influence.

MR T SC: M'Lord, he never said that they are irrelevant to a CUP analysis, he said on the contrary, he considered all three of them.

COURT: *Ja*, I did not understand him to say that.

MR NO: You considered them and you based on your empirical evidence concluded that they do not have any material effect on price. Let me rephrase it. And therefore no difficult, well therefore not applicable in your CUP, of no moment in your CUP analysis. The total opposite, I put it to you Dr, of what you stated in this royalty statement report in 2014 where you were called upon to criticise Interbrand and gave the opinion that they misapplied the CUP method. Can you explain your complete about turn, Dr?

DR: So the about turn, the contradiction is in your mind. I do not see any contradiction between the paragraph, this long paragraph that we have read and statements that I have made in testimony. You have isolated three factors of contractual terms. If you look at the middle of my paragraph. And the sentence that begins:

"In order to establish comparability being controlled and uncontrolled transactions, it is necessary to compare attributes for comparability factor including."

There is no reduction as you have between what I wrote and the reduction to three factors:

"Including characteristics of the property."

That was a key element that lead me to revert the agreement from Brand Finance. Functions performed, that was another key comparability factor. And it remains true that as a matter of practise, as a matter of following the guidelines of the OECD, you need to consider contractual terms and the contractual terms are decomposed into these three factors, duration, territory and exclusivity. And nowhere in my testimony have I said and if I did I stand corrected, that this factor should not be considered. I said that in the context of the CUP from the agreements I could not measure the effect, but I was not satisfied with that result. I relied on ...[indistinct] that I did, subsequent after 2014, I published and 2017 when I published again I think in 2020 another article about this topic in 2020, because knowledge is not stationary, we gain knowledge with research and with time. So my discontent and my critic of the Brand Finance is that they were unaware, they were dismissive of the comparability factors that must be considered if we are to follow the OECD guidelines. And in context and here it is my recollection, so like all recollections it can be viable, or subject to correction, I found that this document of MNE ...[indistinct] another property, it violated what I call the ...[indistinct] of a CUP, the characteristics of the property, it violated it. It violated the functions performed, the licensee performed this document produced by Brand Finance ...[indistinct] that is my recollection. That related to telecom and my recollection is also that the territory was in Canada, Canada is a rich country under the classification of the World Bank and the ...[indistinct] OECD, so there were three factors that disqualified that single agreement as an external CUP. And because we only had one factor we could not test if these contractual terms that I call key here would be tested. So I do not see the contradiction that you are imagining.

MR NO: Yes, Dr, I think the only difficult is that you are considering the MNE agreements, your analysis is concerned with the similarities and differences amongst the MNE agreements but let me just ask you and we can conclude on this topic. The sentence that starts with the words. "In order to establish comparability", in the fourth line of the second paragraph. From the word, "In order", to the end of the paragraph where it ends with the words, exclusivity, do you stand by this statement, or these statements, or do you no longer ascribe to this opinion?

DR: I do not believe that I am expressing opinion here in this paragraph. I am paraphrasing the guidelines. As to your statement that I considered in this document the similarities and differences in the 2014 document, but in here I do not want to paraphrase you in a way that is ...[indistinct] I heard you say that I did not do it in the 2022 document, I call attention to an exhibit that I believe I have in this document what is a comparison of ...[indistinct] and you are going to find a similar exhibit in the 2022 document. So it is not correct to infer that I did not consider the similarities and differences. They are contained, I believe in my EXHIBIT 1.1, or 1.2 of my 2022 report.

MR NO: Dr, I am merely trying to establish something very simple and it matters not whether you call it an opinion, or a statement. You can call it whatever you want to. Do you stand by what is recorded in this paragraph from the word, "In order to", and ending with the word, "Exclusivity", do you stand by what is recorded in this document?

DR: Yes, I do.

MR NO: We will then tomorrow consider the extent to which you complied with the approach that you appear still to advocate. Thank you M'Lord.

COURT: I think we can adjourn then, thank you very much DR, we will resume tomorrow, Thank you very much, we will adjourn for the day.

DR: Thank you, Judge and thank you everyone participating.

COURT: Thank you. We can now adjourn.

APPENDIX C3

ANOTHER EXAMPLE OF THE CROSS-EXAMINATION OF AN EXPERT WITNESS

This example illustrates the difficult questioning an expert may undergo in a trial. When compared to the paltry information in most TP studies, one understands the importance of keeping detailed and accurate proof and records to support the arm's length price of what is being supplied, to support a TP study and not be exposed to negative outcomes if cross-examined at a tax trial. The interrogation of the evidence must take place at the time of the TP study to ensure its accuracy.

Judge M.M

Please go ahead. Cross examination.

Adv. NO SC:

Thank you, my Lord. Good morning, Mr. R.

Mr. M.R:

Good morning.

Adv. NO SC:

Mr. R, at the outset of your evidence you were invited to correct some errors in your report. Do you recall that?

Mr. M.R:

Yes.

Adv. NO SC:

And you identified two errors. The first one was the years of your experience, which is now 20 years and no longer 17 years. And the second correction that you made was in respect of paragraph 91 on page 07-702 of your report. Is that correct?

Mr. M.R:

If that is the reference to RI, then? Yes.

Adv. NO SC:

And you corrected that to replace RI with Agency?

Mr. M.R:

Yes, that is correct.

Adv. NO SC:

And are those the only corrections that you want to make?

Mr. M.R:

Yes. Well, other than what we just described, the issue that I felt could have been perhaps better described as wide variation and results as opposed to results being highly sensitive. Just that minor point there? Yes.

Adv. NO SC:

Now, can I just ask you, Mr. R, I assume that you studied your expert report in some detail before you gave evidence in these proceedings and that I assume is how you picked up on these two mistakes?

Mr. M.R:

Yes. I reviewed my report before this trial.

Adv. NO SC:

And how did it come about that you incorrectly in paragraph 91 initially referred to RI.

Mr. M.R:

So, the Excel files, the correlation files that were the basis for the role of brand calculation were not marked by the provider of the data. And I had come across one research study conducted in Country A for MNE, which was by RI. So, I had made the assumption that the data was from RI, when in fact, as we know it was provided by the Agency.

Adv. NO SC:

Can I ask you, Mr. R, did you consider the reports of the other experts?

Mr. M.R:

No, I have not reviewed those.

Adv. NO SC:

Not at all.

Mr. M.R:

Correct.

Adv. NO SC:

Now, can I then ask you just more generally the Agency report, there was a report in 2010 and the further report in 2011 and there is also references to a report in 2008. Are you aware of that?

Mr. M.R:

Yes.

Adv. NO SC:

The commercial relationship between Agency and MNE has been a longstanding relationship. Is that correct?

Mr. M.R:

Well, I am aware that 2008 was the first project that I am aware of. So, it depends on what you mean by longstanding.

Adv. NO SC:

Well, let us take it then from 2008 onwards. That relationship continues. Is that correct?

Mr. M.R:

The 2008, 2010, 2011 reports can be considered part of a relationship because the first set of the relationship, because 2008 and 2010 were two brand valuation exercises. And then the 2011 report was a transfer pricing analysis that that was based on the data from the 2010 exercise. So, as I am aware, there was then a hiatus until I was asked to work on the 2014 reports. And then I have advised and been, you know, working on this case from time to time since then.

Adv. NO SC:

Since 2014?

Mr. M.R:

With large pauses and large gaps, but yes.

Adv. NO SC:

And attached to your report, at page 07-737 is a of documents that you reviewed in the course of preparing your report. Is that correct?

Mr. M.R:

Could those put on the screen? Yes, I see it. Yes.

Adv. NO SC:

Did you compile that list?

Mr. M.R:

Yes.

Adv. NO SC:

And is that an exhaustive list of all of the documents that you have considered and reviewed in the course of preparing your report?

Mr. M.R:

I believe so. I have paid much more attention to the Transfer Pricing Guidelines and the Agency reports versus section 31 of the Tax Act, for example. But, yes, correct. Is that it, have you scrolled down? Is that the full list. Okay. Yes.

Adv. NO SC:

Are you satisfied?

Mr. M.R:

Yes.

Adv. NO SC:

Can I just in that context, ask you, you made a reference in your Evidence in Chief, you used the word raw data? Can I just understand what you mean with that word "raw data"?

Mr. M.R:

Are you referring to when I was talking about the financial data or the market research data?

Adv. NO SC:

You used the word raw data in respect of the Excel spreadsheets.

Mr. M.R:

Yes. So, I meant the data, the correlation analysis data provided by the Agency. Well, sorry, the spreadsheets were both the financial data and the market research data. So again, I do not quite recall, but in both cases, it was either financial data, which would have been provided by the MNE in this trial or it was the correlation analysis data provided by the Agency.

Adv. NO SC:

So, can I just understand, do you consider the correlation calculations that was done by the Agency? Do you consider that to be raw data?

Mr. M.R:

No, the raw data would be the market research data. Agency will have then conducted the statistical analysis to arrive at a correlation. So, it would not be statistical analysis. It means the data would've been analyzed and therefore wouldn't be raw.

Adv. NO SC:

And what is presented in those Excel spreadsheets, is simply the result of a calculations that would say?

Mr. M.R:

Yes, it's the calculation by the Agency of the correlations.

Adv. NO SC:

And, the document wouldn't fit the descriptions, Mr. R, of raw data? Would it?

Mr. M.R:

No. It wouldn't.

Adv. NO SC:

The raw data lies in the market research.

Mr. M.R:

Yeah. The underlying ... in any research?

Ja.

The underlying data is the response - what we would describe as respondent level data. It is the pure, you know, the source data.

Adv. NO SC:

So, when you use the word raw data in response to the question, we must understand there to be registered to the financial data that was provided.

Mr. M.R:

Yes. I don't recall exactly when I ... But, yes, the raw data - the source data might be a better term. From our perspective, the source data for our calculations.

Adv. NO SC:

I'm quite happy to use your terminology. I'm not particular of your terminology, but I suppose it doesn't matter whether you call it source data or raw data. The simple point, Mr. R is that the Excel spreadsheet that you reviewed, simply contains the result of calculations done by the Agency. Is that correct?

Yes.

And that document itself, does not permit you the ability to interrogate the accuracy of what is contained in those spreadsheets. Is that correct?

Mr. M.R:

Yes. It doesn't contain the raw respondent level data on which the calculations were based. No.

Adv. NO SC:

On the topic, Mr. R, of terminology - I had some difficulty following your evidence in chief and, I had the same difficulty in reading your report, because a constant feature of both your oral and written evidence is the word "we". And I have some difficulty just understanding what you mean when you constantly use the word "we". Can I accept, as an absolute minimum, that the word "we", wherever you use it, includes "I".

Mr. M.R:

Well, I wasn't involved in the 2011 exercise. So, I'm referring to "we" collectively, as Agency.

Adv. NO SC:

Sorry, just listen to the question: I haven't referred you to Agency. I didn't refer you to any particular document. But I am asking you, when you use the word "we", can I assume that that includes "I". In other words, you. Wherever we find a reference in the transcript or in your witness statement to the word "we", must we assume that that includes "I"?

Mr. M.R:

Not when I'm referring to analysis conducted in 2011 when I wasn't at the company. If I'm understanding your question correctly. I may not be.

Adv. NO SC:

Mr R, your witness statement was your choice of words. Correct? You drafted the witness statement?

Mr. M.R:

Yes, I did. Yeah.

Adv. NO SC:

Are there instances in your witness statement where you used the word "we", that does not include you?

Mr. M.R:

Yes. "We" was a reference - a collective term for Agency and anything that was done in 2011 or before, I was not involved in, but I've reviewed the working files that were used, but I wasn't involved personally.

Adv. NO SC:

But is that not a rather confusing choice of word, Mr. R? How would the objective reader of your report understand the word "we" when you use it? Would it to be reasonable to say that the objective read would understand the word "we" to include you? Or I?

Mr. M.R:

Yeah, it's possible.

Adv. NO SC:

So, what you're saying is, depending on the timeframe, the word "we" may either be a reference only to the Agency, or to you and I?

Mr. M.R:

Yes.

Adv. NO SC:

So, must we read all references in your report and understand your model evidence in these proceedings to mean that, with reference to anything that happened or was done after November 2011, that "we" includes you?

Mr. M.R:

I've been involved in this from the 2014 report.

Adv. NO SC:

From 2014?

Mr. M.R:

Yes. There was a gap between the 2011 report and the 2014 report. I don't believe anything happened between those years. Certainly nothing I was involved in.

Adv. NO SC:

But is the cut-off date 2014?

Mr. M.R:

After the time that I was personally involved in this dispute.

Adv. NO SC:

So, references to you prior to “we” prior to 2014 is a reference exclusively to Agency and, references after 2014 to “we”, is a reference to you and Agency?

Mr. M.R:

Well, if I’m making a reference after 2014 to something that was done in 2011, it’s still referring to Agency without me, because I wasn’t there.

Adv. NO SC:

So, Mr. R, can I just ask you? I’m just trying to understand what it is that you are trying to support in these proceedings through your expert evidence. I understand that you give evidence about a methodology and, that methodology is explained in several steps in your report. And you say that that is a methodology that is consistently used by the Agency and that that methodology has been followed by the Agency. Is that correct? That’s the first input of what you say to his lordship in these proceedings?

Mr. M.R:

Yes.

Adv. NO SC:

And do you then go further, and do you vouch, as a professional with expertise - both in accounting and in the world of marketing - for the accuracy of the calculations and the results, as they are presented in your report?

Mr. M.R:

Yeah. I vouch for the analysis that Agency conducted, based on the data provided. Yes

Adv. NO SC:

You see, that is the first step. That is the methodology. I am asking you something different. Must, his Lordship understand your evidence to be an assurance by an expert acting independently that the computations as they are set out in your report and the results that flow therefrom are factually accurate?

Mr. M.R:

Yes, I believe they are.

Adv. NO SC:

And can you just explain to me, Mr. R what is it that you do as an independent expert to give His Lordship, this assurance? You would understand and accept that this is a very significant and far-reaching assurance that you are giving His Lordship, as an independent professional? So can I ask you, what would be the steps that you would consider necessary for you to follow in order to ensure that what you have just told me is an assurance on which the court can rely.

Mr. M.R:

That I have already read the reports from 2011, 2010, the brand valuation report to have reviewed the working files on which the calculations were based to check.

Adv. NO SC:

I am the quite a slow writer and this is quite important so if you would just bear with me. So, the second step is you would review the working files on which?

Mr. M.R:

On which the calculations are based and review the files, review the reports, and make sure that the method that is a sensible, reasonable methodology was applied in arriving at the arm’s length rate.

Adv. NO SC:

Now, so in terms of documentation, what you consider necessary is to thoroughly read the 2010 and 2011 reports, and then you say to review the working files on which the calculations ... Is that correct? Whose working files with that be Mr. R?

Mr. M.R:

Agency.

Adv. NO SC:

Agency? And would you just care, Mr. R in your Appendix C just to identify for me, under the list of documents, the working files that you referring to.

Mr. M.R:

Can I get it put up on screen? I am just trying to get to appendix C on my own version, but yes, no, those are not mentioned in the report.

Adv. NO SC:

Why not Mr. R?

Mr. M.R:

Just a simple oversight.

Adv. NO SC:

Oversight. Did you share those working files with MNE's attorneys?

Mr. M.R:

Yes, they have been, and we have been reviewing them in the bundle.

Adv. NO SC:

You have been reviewing them in the bundle.

Mr. M.R:

The Excel sheets that we were reviewing earlier on today.

Adv. NO SC:

The Excel sheets. Mr. R, if I understand it correctly, are not the Excel sheets of Agency, but were in fact the Excel sheets that were prepared you say by the Agency?

Mr. M.R:

Those were Agency files, ones that included data provided by the Agency, but then that data was then manipulated to, I do not mean manipulated in a negative sense, but were just, the data was used to calculate the role of brand calculation as I describe in my report. So those files include Agency, the data receive from Agency, but then we go on to do more with that data to arrive at the role of brand calculation.

Adv. NO SC:

Are those the working files that you are referring to?

Mr. M.R:

Yes.

Adv. NO SC:

Okay. And you say that that together with a careful reading of the 2010 and 2011 reports are sufficient to place you in a position to give His Lordship an assurance as a qualified independent professional that these calculations are accurate and reliable?

Mr. M.R:

Yes.

Adv. NO SC:

Mr. R, so must I understand that you do not ... Well, let us just be clear that those files that you are referring to the Excel files and the income statements and balance sheets are the workings of others.

Mr. M.R:

Yes, I should have recreated that the table in the report that shows the brand earning the brand contribution per OpCo resulting in the 3.3 number. I have validated those calculations myself.

Adv. NO SC:

We do not validate the calculation. You simply use their calculations in order to do a further calculation.

Mr. M.R:

But I have created a spreadsheet where I have just checked that the calculation is correct.

Adv. NO SC:

Yes. You are doing exactly what I put to you. You are using their calculations and then you do a further calculation in order to verify their calculations. But that is where it ends, correct?

Mr. M.R:

Yes.

Adv. NO SC:

And as we have established those Excel spreadsheets is no more than data that has been captured by someone else.

Mr. M.R:

The intangible earnings calculations is the Agency calculations. As is the role of brand calculation. The source data for the intangible earnings was the balance sheet and P and L data from MNE and the source data of the role of brand was the data from Agency, but the subsequent calculations were Agency.

Adv. NO SC:

And the Agency, what you referred to as calculations, the Excel spreadsheets those are their calculations and it is presented to you as a cold hard fact.

Mr. M.R:

The correlations are their calculations. The role of brand is the Agency calculation.

Adv. NO SC:

So, must I understand your evidence to be Mr. R that as a professional independent expert on who, the court must place reliance, you do not consider it necessary to interrogate the raw data that informed the calculations on which you rely.

Mr. M.R:

In all these scenarios, we rely on other professionals to support in certain situations and Agency are, you know, a reputable firm that exists to this day. We would very rarely get involved in looking at respondent level data from a research study. We would rely on we and till today and regularly do so rely on professional reputable agencies to run certain statistical analyses on our behalf.

Adv. NO SC:

Mr. R, with respect, I am not too concerned about what you do in your business on a day to day. We are not running a business. We are running a court trial. My question to you is very specific. Do you think it is adequate and appropriate for you to give the level of assurances that you do to a point of law without having interrogated a shred of raw data informing the calculations of others on which you place blind reliance?

Mr. M.R:

Yes, I think that is perfectly reasonable. Provided the provider of that data is a reputable running that analysis.

Adv. NO SC:

And can I ask you one thing else, Mr. M.R? So, you suggest that his Lordship must accept your word unequivocally and unconditionally. And does that also mean that the Commissioner must accept your word unconditionally and should not be placed in the position itself to interrogate the raw data that informed the calculations made by these persons on who you place such heavy reliance.

Mr. M.R:

I am providing my opinion how. I do not. Could you, sorry, could you repeat the question or perhaps break it down and repeat it back as there may two questions there?

Adv. NO SC:

Let me make it simple. Mr. R, I would imagine that you would accept without difficulty that a counterparty litigation in this case, THE REVENUE AUTHORITY would not be in a position to interrogate the accuracy of the calculations on which you are happy to rely blindly, if that data is not shared with him.

Mr. M.R:

They would not be able to look at the raw data if it is not shared with them. No.

Adv. YES SC:

My Lord, if I may just understand what my learned friend is putting? Is he saying that THE REVENUE AUTHORITY did not have the Agency data input?

Adv. NO SC:

No, I was asking the witness a question, a theoretical question, whether one would be able to do or to verify these calculations if you do not have access to it or the data. And I believe that was question.

Adv. YES SC:

The question very clearly postulated that the Revenue authority did not have that information. Is that what my learned friend is putting?

Adv. NO SC:

It is a fact, my Lord, that the Revenue authority does not have that information and that that information was not discovered.

Adv. YES SC:

Sorry. There are two different issues. The one is whether the Revenue authority has the information and the other is whether it was discovered. My learned friend suggests that the Revenue authority did not have the information and it has not been discovered.

Adv. NO SC:

That is correct.

Adv. YES SC:

Thank you, my Lord. Right, Thank you. Sorry.

Judge M.M:

Do you want to just repeat the question then for Mr. R?

Adv. NO SC:

My Lord, I think the witness has answered the question that the Revenue authority would not be able to interrogate the accuracy of these calculations absent at all, the raw data. Is that (inaudible) Mr. R?

Mr. M.R:

Yes. The correlation analysis from Agency is based on raw data to validate that a hundred percent independently of Agency, you would need the raw data.

Adv. NO SC:

And can I then ask you, Mr. R, just to turn to page 07-703 of your report. At the foot of the page, paragraph 92.2.2.4. You see that statement?

Mr. M.R:

Yes.

Adv. NO SC:

We determined whether an attribute was functional or emotional based on expert judgment and experience. Now unfortunately the statement is not made with reference to a specific date. But can I ask you in that sentence, the word “we”, who does that refer to?

Mr. M.R:

This was the Agency team in 20... - well it is the Agency team that ran the 2010 brand valuation analysis, because that is where the role of brand was originally calculated for the 2010 brand valuation.

Adv. NO SC:

Mr. R, I must say I find this remarkable. You deliver a report, and you accept that any reasonable reader of your report, including the Revenue authority lead representatives and its own experts would understand 92.2.2.4 at the very least to include you. Is that a fair reading of that sentence?

Mr. M.R:

It was intended as a collective reference to the Agency and not to my personal involvement.

Adv. NO SC:

Mr. R would you please listen to the question? The question is not with reference to what you may or may not subjectively intend. The question is, is it reasonable to say that any reasonable reader of this sentence contained in a report filed by you and written by you would have read and understood the word “we” there at least to be inclusive of you?

Mr. M.R:

Yes, I should have been more accurate with my language.

Adv. NO SC:

But why were you not more accurate, Mr. R?

Mr. M.R:

I do not know.

Adv. NO SC:

You do not know.

Mr. M.R:

It is a long report. I should have perhaps been clearer as you are pointing out.

Adv. NO SC:

Mr. R, it is not a question of being clear. The inference that you were a party to the exercise of expert judgment and experience is just plainly false?

Mr. M.R:

I am clarifying now that it was the experience of the Agency team, who will also have been experienced in running brand valuations as the Agency, as a respected valuation firm. So, I was referring to the Agency team, so I would like to clarify that now.

Adv. NO SC:

So, what you are telling His Lordship as an expert is that the Agency team, they applied their expert judgment and experience in discerning whether an attribute is functional or emotional. Is that what you are telling His Lordship.

Mr. M.R:

That is what I am saying, yes.

Adv. NO SC:

And you are vouching for their, whoever they may be, expert judgment and experience and the accuracy of their lineation of functional versus emotional.

Mr. M.R:

I have reviewed those attributes myself and it looked to be a reasonable exercise based on my judgment as well. But it was not me that did the original analysis.

Adv. NO SC:

Because this is a very different sentence. It says, we determined. Would it have been difficult for you to say that Agency this amorphous animal who employs, I would imagine many, many people, that that entity exercised its expert judgment and experience and that you then wade in after the fact and in your expert judgment and experience they correctly distinguished between functional and emotion?

Mr. M.R:

Yes. That would have been a more accurate description.

Adv. NO SC:

Just a bit, lot less of a bang.

Mr. M.R:

Sorry? Not really.

Adv. NO SC:

It would have been far less powerful to state it like that. It shows exactly what the level of your involvement was as opposed to what you pretend it was.

Mr. M.R:

I never pretended that I was part of the 2011 exercise. My CV states that I was not employed by the Agency at the time, so it would be ridiculous of me to try and pretend I was involved.

Adv. NO SC:

But you do pretend, Mr. R, that you as part of the royal “we”, using your expertise and judgment determined whether the attributes were functional or emotion.

Mr. M.R:

I have reviewed what was done and it seems reasonable.

Adv. NO SC:

Because the process of determining the attributes, Mr. R, is in itself a very significant exercise. Is it not?

Mr. M.R:

Yes. It is an important part of the key input to the analysis. Yes.

Adv. NO SC:

And that is a very different exercise than the one that you now concede to be the sum of your involvement, and that is an ex post facto review of these attributes.

Mr. M.R:

It is a different role doing it for the first time versus reviewing it. It is a different activity.

Adv. NO SC:

Yes. Because you have explained, and we will get to that in quite a bit of detail.

...

Mr. M.R:

I wasn't aware of the specific sample sizes at the time of writing report, no.

Adv. NO SC:

Mr. R the same had apply to the quotas, you hadn't acquainted yourself at the time or in 2014 or at any time, there after about the quotas that were identified and whether or not those quotas were in fact be presented or not. Simply didn't ask and didn't apply yourself.

Mr. M.R:

It wasn't possible or at least I wasn't aware of how to do that because the only files I was able to obtain were the correlation files, the output from the Agency analysis.

Adv. NO SC:

And the Revenue authority wouldn't be in no better position to interrogate those numbers as to what you tell us now.

Mr. M.R:

No, suppose not.

Adv. NO SC:

Can I ask you, we're still on page 07-700. You offered a slide, so the following slide from the 2010 Agency report provides an explanation of the role of brand based on my review of the Excel working files that contain survey calculations for

each OpCo and my knowledge of the Agency methodologies, the approach adopted, and the rationale applied are explained below. Is that correct?

Mr. M.R:

Yes, that's correct.

Adv. NO SC:

There's nothing that you want to change in that sentence.

Mr. M.R:

Paragraph 89?

Adv. NO SC:

Yes.

Mr. M.R:

Please just give me a moment. Well in addition, I had a conversation with CH in order to try to verify my understanding of the methodology based on his memory of what was done at the time as well.

Adv. NO SC:

When was this?

Mr. M.R:

I couldn't tell. I mean during the process of the creation of the 2022 report, I couldn't tell you precisely, but some time ago.

Adv. NO SC:

And then we see in figure one over the page, is that correct?

Mr. M.R:

Yes, this is a visual representation of the methodology that was used in the 2010 round valuation report.

Adv. NO SC:

And it again refers to how we calculate out of that. That wouldn't be you, that would be an independent.

...

So, then can I ask you to turn to paragraph 91 on page 07-702. Bear with me.

Mr. M.R:

Paragraph 91. Yes.

Adv. NO SC:

And it reads, the first sentence reads, in this instance, market research was sourced from a brand tracker survey conducted by a reputable market research firm, and that reputable market research firm has now been substituted with the Agency. Is that correct?

Mr. M.R:

Yes.

Adv. NO SC:

That's the only amendment that you wanted to make to that paragraph, is that correct?

Mr. M.R:

Please give me a moment. Read the full paragraph. Well, clearly the description of the research was based on, sorry, I shouldn't say clearly. The description of that research in the remainder of the paragraph is based on sight of the research report that I was able to obtain, which as I actually, I say that there, that you see the reference to the research report. Clearly that would need to be amended to reflect the Agency study.

Adv. NO SC:

You lost me Mr. R. Just repeat what you're saying. So, we, we've now substituted the words with the Agency what else do you want to amend?

Mr. M.R:

The description of the research below was based on a site of a research report.

Adv. NO SC:

Tell me how you want us to read the paragraph and what must be inserted.

Mr. M.R:

It wasn't possible during all of this. Obviously, this work happened in 2011, so I was not able to obtain the Agency report until it's been provided recently. So, I wouldn't be able to replace the description of the research would need to be replaced with the Agency description, but I don't have access to that or at least it's, it's only been provided recently in the documents that were discovered a few days ago.

Adv. NO SC:

Mr. R sorry, you know when Adv YES SC certainly didn't get the impression that he was rushing you through your evidence and wasn't allowing you every possible opportunity to correct your report exactly as you wanted it to be. You were as particular as to point out to all of us that you now have 20 years' experience and not only 17. When I started my examination of you, I asked you once again whether those two corrections are the only two corrections that you want to make to your report, and you then again, confirmed that but for those two corrections and the one that you added your description of the criticism about the variables, but for that you were entirely satisfied with the content of your report. So, why now, Mr. R? Is this paragraph not to your liking?

Mr. M.R:

Well, you pointed out an oversight on my part, which is after discovering or understanding that the correlation analysis came from a different research agency, you are correctly pointing out that this description should also change, because it's based on the RI report.

Adv. NO SC:

So, how would you want to change paragraph 91?

Mr. M.R:

I would need to review the Agency, replace it with the details of the Agency study.

Adv. NO SC:

Can I ask you in footnote 41, the references that you offered in footnote 41.

Mr. M.R:

Yes, that's the same.

Adv. NO SC:

Just a moment. Please, would you just bear with me. My Lord, if I might just have a moment?

Thank you, my Lord. Now you reference in footnote 41, ED 171.2, which is an example of market research report based on this brand tracker research for Country A. Is that correct?

Mr. M.R:

That is the reference to the research report, yes.

Adv. NO SC:

And who conducted that research?

Mr. M.R:

That was RI.

Adv. NO SC:

RI? Do you want to not amend the first sentence of paragraph 91, or do you want to keep it as a research division?

Mr. M.R:

No, the relevant data is from Agency and I was my misunderstanding that it was from RI because the audit trail, given the time that reference is not relevant because it, it is the Agency data that has been used.

Adv. NO SC:

Who conducted the research in Country A, Mr. R?

Mr. M.R:

RI.

Adv. NO SC:

And then you say, do I understand it correctly, footnote 41 is now evidentiary support for what the statement made in the first sentence of paragraph 91. That's normally what you do footnote. Is that?

Mr. M.R:

Yes, it was a reference to what I was referring to above i.e. The RI.

Adv. NO SC:

Well, let's continue the sentence. It says a sample questionnaire. Well can I just ask you this? What is the significance of the market research conducted in Country A to this matter?

Mr. M.R:

At the time a copy of the report, sorry, there isn't the Country A study was the report that I was able to obtain from our records, but this clearly Country A is the licensor. So, that data doesn't inform the royalty rate. It was simply illustrative of the type of research that was being conducted in various markets.

Adv. NO SC:

Mr. R is the short answer to my question not that it's entirely irrelevant?

Mr. M.R:

It was illustrative of the type of brand tracker data that was informing the other markets, but it's not relevant to the calculation of rates for OpCo.

Adv. NO SC:

There are "a number of" OpCo's at stake in this matter. You could have referenced any one of them. It's as useful to reference Country A as it is to reference America. Great.

Mr. M.R:

Yes, I didn't, I was not able to obtain other research reports from our files.

Adv. NO SC:

So that's the difficulties that you weren't able to obtain other reports, Correct?

Mr. M.R:

Correct. So, this was correct,

Adv. NO SC:

Yes. And, and of course for the very obvious reason that you're relying on the 2010 Agency report, it had absolutely nothing to do with this matter or transfer pricing. Is that correct?

Mr. M.R:

No, I was, no, that's not, that's not correct that the 2010 report is relevant in that it, um, that was the exercise during which the role of brand was calculated and the, um, intangible earnings and the brand earnings, the, the data for that calculation came from the 20 20 10 study

Adv. NO SC:

I'm referring to at the time, 2010.

Mr. M.R:

At the, at the time that, at the time the 2010 analysis, um, I can only assume was, well, as you've pointed out, the objectives of the study in 2010 were not transfer pricing related at that time.

Adv. NO SC:

You think, so sample questionnaire for Country B is provided at DE 17 1.1. Is that correct?

Mr. M.R:

Yes, that's what it says there. Yes.

Adv. NO SC:

But why is it a sample questionnaire? Why is it not an actual questionnaire? What do you mean when you say sample.

Mr. M.R:

Sorry? That may be misleading. All I mean by a sample there is, here is a questionnaire for Country B, which is a sample exhibit as it were of questionnaires that would also have been produced for other markets.

Adv. NO SC:

And can I ask you, Mr. R, did you provide to Country B the questionnaire, do you.

Mr. M.R:

These were files that were kind of unearthed from the Agency server by my colleague.

Adv. NO SC:

And where all the, you would no doubt have also asked to be provided with sample questionnaires for the other countries that were surveyed.

Mr. M.R:

There was a limited amount of information on record given the time elapsed. So, I obtained what I could, but that is why, you know, I only had the research report for Country A, for example.

Adv. NO SC:

It, just confine ourselves to the questionnaire. I mean, the questionnaire is the first port of call in assessing the broad data. You want to be sure that the correct questions were asked, not so, so the survey would tell you actual survey document with inform the questions that were actually asked, not so?

Mr. M.R:

Yes.

Adv. NO SC:

Yes. So, just at the most rudimentary level, one would at least want to be certain that the same questions for asked in every territory that was surveyed, not so?

Mr. M.R:

I think typically no, I think that would be an unnecessary an extreme level of due diligence given that we are working with a reputable research firm providing the data.

Adv. NO SC:

Mr. R I must tell you I find what you say astounding. You are a witness in high court proceedings. The stakes are incredibly high. The consequences either way are substantial, your evidence is presented as that of an independent expert. And you have made it clear the response to pointed questions that I asked you that as a professional you can give His Lordship and this Court every assurance that the data and the evidence that you present is reliable and accurate and the most rudimentary step is simply asked to be provided with copies of the questionnaires in every country that were surveyed in order to ensure that the questions were consistently asked. And that the correct questions were consistently asked of the people that participated in the survey you consider to be too onerous a task.

Mr. M.R:

The correlation analysis that I reviewed, the working file, lists the attributes that where that the analysis was conducted on, it is pretty reasonable to assume that the agency providing that data has not gone in and manipulated or changed the attributes from what they actually were in the survey.

Adv. NO SC:

And can I ask you then, did those analyses, I think you referred to them as Excel spreadsheets, did those Excel spreadsheets then offer you the comfort that the same questions were asked in each territory and that you have a uniform questionnaire and a uniform response?

Mr. M.R:

The attributes may have slightly varied between countries, but that is the available data on which to run the calculation.

Adv. NO SC:

The attributes slightly vary.

Mr. M.R:

Sorry, can you repeat your question. If you wouldn't mind repeating your question.

Adv. NO SC:

So, I am concerned about the fact that you did not even ask to be provided with copies of the actual questionnaires that were used in the different OpCo company countries that were surveyed. And your response is that you took comfort in the Excel spreadsheets, which as we now know, is no more than the result of a computation made by a third party. Now did the Excel spreadsheets give you the comfort that the correct questions were asked in the countries that were surveyed and that the survey information was a reliable as presented.

Mr. M.R:

The Excel spreadsheets represent the attributes listed in those Excel spreadsheets. It is reasonable to assume that those attributes represent the questions that were asked in the survey because otherwise the agency providing that survey would be going in and somehow changing the attributes. So, it is perfectly reasonable to assume that those attributes in those correlation files were representative of the attributes that were asked in the survey. And perhaps you could, if I have not answered all of your questions, perhaps you could point out the bits that I have missed.

Adv. NO SC:

And the attributes are identified for the reason. You agree on that.

Mr. M.R:

Yes.

Adv. NO SC:

Because they are considered to be relevant to the inquiry as to what constitutes purchase Is that correct?

Mr. M.R:

Those attributes would have been selected because they are considered relevant to understand how customers perceive the MNE in this trial on those attributes.

Adv. NO SC:

Yes. And you would then take that questionnaire and you would replicate it, and you would go to different OpCos, and you would ask those questions, you would get answers and you would then digest those answers. Is that correct?

Mr. M. R

Yes.

Because the questions are important. The answers are why you ask the questions in the first place. Correct?

Mr. M.R:

Yes, that is right...

APPENDIX C4

HOW TO PREPARE FOR A TRIAL WITH YOUR EXPERTS

THE ROLE OF THE EXPERT

The expert's role is to assist the court in issues that requires specialist knowledge. Transfer pricing is a specialist field and will require expert evidence.

THE CHOICE OF AN EXPERT

- Consider the choice of expert carefully.
 - Remember, the onus is on the taxpayer and the goal is to present a strong and credible case and choosing the right expert can significantly contribute to that goal.
 - Availability and Commitment
 - Usually, an expert witness will be elsewhere employed as well.
 - Make sure your expert has the time and commitment to thoroughly review your case, prepare a comprehensive report and is available for trial (taking into account possible postponements).
- Credentials
 - Your expert must have specialist training, knowledge, skill and experience.
 - Formal qualifications without experience may not be sufficient and vice versa.
 - Transfer pricing is a wide field – make sure your expert can speak authoritative on the particular issue of the case.
- Experience in the court room
 - Prior experience is invaluable.
 - An expert who is familiar with the legal process and has testified before may be able to handle cross-examination better.
- Objective opinion
 - Your expert must be neutral and unbiased.
 - A perception of impartialness strengthens credibility.
 - Avoid using the device of a novel method. He will defend his own method and will struggle to be unbiased.

- Communication skills
 - Must be an eloquent speaker.
 - It is almost impossible to avoid the highly technical nature of transfer pricing evidence. The court must be able to follow your expert's reasoning.
 - He must be able to pick up on the nuances in cross-examination.
 - He must be able to communicate complex concepts clearly and effectively.
- Legal admissibility
 - Some jurisdictions have specific rules about who can serve as an expert witness.
- Compatibility
 - Choose an expert with whom you and your legal team can work effectively.

EVIDENCE IN CHIEF OF EXPERT WITNESS

- Consider how the technical issues should be presented during evidence in chief.
 - Traditional evidence in chief - question and answer session.
 - Visual aids can enhance the clarity of the expert's testimony.
 - » Slide presentation by the witness instead of traditional questions and answers.
 - » Consider including charts, graphs and diagrams.
 - » Assist in the presentation of technical evidence.
 - » Visual impact may help the court to better understand (e.g bubble charts showing proportions).
 - » Make sure the visual aids correspond to the existing evidence.
- Factual Foundation
 - Establish the factual foundation for the expert's opinion. Make sure the expert has reviewed all the relevant evidence and facts before forming their conclusions.
 - If the factual basis is incorrect, the opposing counsel will take advantage of it to undermine the credibility of the expert's opinion.
- Appropriateness of the method
 - Demonstrate the suitability of the methodology used by the expert in the circumstances.
 - Connection to Transfer Pricing Guidelines
 - Connect the factual foundation and the method used to the Transfer Pricing Guidelines to help the court understand the significance of the expert's testimony in the context of the issue at hand.
- Limitation of Opinion
 - Be transparent about any limitations in the expert's opinion.
 - If there are any areas where the expert did not have sufficient information or made assumptions the expert should acknowledge this.
 - If not, it will be revealed during cross examination and portrayed during arguments as an 'unwilling concession' that was made.
- Keep it clear and concise.
 - Encourage the expert to keep it concise, easily understandable and to avoid unnecessary jargon.

PREPERATION FOR CROSS-EXAMINATION

By preparing for cross-examination, you can enhance the expert witness' readiness and increase his effectiveness in defending his opinions.

- Anticipate potential areas of attack.
 - Work with the expert to identify possible weak points.
 - Make sure the witness is well-prepared to answer to any challenges to their opinions.
 - The witness must be prepared to make concessions when necessary.
 - Instead of point-blank denial, an answer of: "It is possible but highly improbable" would add to the credibility of the expert in the eyes of the court.
- One of the aims under cross-examination will be to establish an error in the premises.
- Once the error is established, the inquiry will be how far that error bears on the result.

-
- o Your witness should be prepared to answer to any of the weaknesses in his methodology.
 - Another line of attack is on the justification for drawing any inferences or conclusions by the expert.
 - o A competent witness will concede that someone else may think differently and draw different conclusions but will demonstrate convincingly why his opinion would be more correct or probable.
 - Prepare your witness to look out for subtle distortions.
 - o Your witness should not agree to propositions that only superficially correspond with his evidence in chief or previous answers given under cross-examination.
 - o The distortions are deliberate, and the aim is to establish contradictions.
 - Stay calm.
 - o Emphasise the importance of remaining calm and composed.
 - o Avoid becoming defensive or argumentative.
 - o Remind him to always answer thoroughly and respectfully.
 - Listen carefully to questions.
 - o Train your expert to listen carefully to questions before responding.
 - o He is allowed to ask the cross-examiner to break up longer questions into short ones.
 - o Ask to repeat a question when unclear.
 - o Respond only once he fully understands the question.
 - Limit responses to questions asked.
 - o Encourage the expert to provide concise responses that directly and only addresses the question asked.
 - o Long-winded answers open the door for the opposing counsel to explore unrelated topics.
 - Avoid speculation or guessing.
 - o If he doesn't know the answer to a question, it is acceptable to say so rather than providing inaccurate information.
 - Documents and exhibits.
 - o If the expert relies on documents or exhibits, make sure he has reviewed them recently and thoroughly.
 - o Previous Opinions and published literary works.
 - o Make sure your expert recently and thoroughly reviewed any of his prior related opinions or published literary works as he may be cross-examined on them.
 - Other Experts' reports
 - o Consider whether your experts should review each other's reports. It will depend on the circumstances.
 - o If they do, make sure they are thoroughly prepared to be cross-examined on them.
 - Other Expert's oral evidence
 - o Consider whether it will be beneficial or detrimental for experts sit in on each other's testimony's. Again, it will depend on the circumstances.
 - Role-playing sessions
 - o Simulate cross-examination scenarios.
 - o This helps the expert to become comfortable with the dynamics of questioning and responding under pressure.
 - o Help to familiarise the expert with courtroom etiquette, including addressing the judge properly and maintaining eye contact.

APPENDIX C5

ADMISSIBILITY OF HEARSAY EVIDENCE BY AN EXPERT WITNESS

This example of an application to the tax court to admit hearsay evidence from an expert witness was to assist the corporation proving the deductibility of management fees paid to its parent company. It was not necessary for the witness to be an expert. The witness could have been a factual witness instead. But by calling an expert witness to testify, the corporation was attempting to bolster the admissibility of the factual evidence with the expert opinion and practical knowledge of the expert from their extensive experience in similar transactions pertaining to management fees paid in MNE groups.

Many of the footnotes refer to documents peculiar to this case and illustrate the necessity for corroborating details. For confidentiality reasons, the actual documents are not included here.

If you are going to rely on hearsay evidence, which will happen oftentimes in TP tax trials, it will be necessary to apply the exceptions to hearsay evidence to allow the admission of that evidence at trial. In some jurisdictions specific exceptions apply. See the USA FRE rules. In other jurisdictions, such as in South Africa, an application may have to be made to the tax trial court for the admissibility of the hearsay evidence. See the draft application example below which deals with such a hearsay evidence admission application.

**IN THE SPECIAL COURT FOR INCOME TAX APPEALS
HELD AT HARARE
CASE NO. ITC ../..**

In the matter between:

TAXPAYER

Appellant

and

THE ZIMBABWE REVENUE AUTHORITY

Respondent

HEADS OF ARGUMENT

ADMISSIBILITY OF EVIDENCE

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THE FACTS

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CLOSING SUBMISSIONS

THE FACTS

1. In the Letter of Assessment dated 7 April 2017,¹ the Respondent's reasons for disallowing the management fees in paragraph 1.3 was that the Appellant 'failed to substantiate and submit proof that the services involved were rendered to the company by its holding company'.
2. The Respondent's reason for disallowance was therefore a failure to substantiate services rendered. The Respondent did not specify or give any legal basis at the time of issuing the assessments why the agreements detailing the services to be provided, the invoices and further explanations of the nature of the services rendered that were provided to the Respondent prior to assessment were not acceptable as sufficient evidence.
3. In a letter dated 12 June 2017² the final position reached at a meeting held on 3 May 2017 on the investigation work was recorded by the Respondent as that the 'company has failed to substantiate and to submit satisfactory documentary proof confirming the cost build up and work done in respect of the management fees claimed'. This was regarded by the Respondent as being sufficient evidence and the Appellant was required to provide the costs incurred by the service provider in rendering the service – thereby confirming the cost build up and work done.
4. In the Determination of the Objection dated 23 November 2017³ the Respondent clarified its reason for requesting the cost build-up of the supplier as 'This was mainly done in order to verify how the management fees were determined as well as to confirm the nature of the work done and to match the actual work done to the amounts paid.' (our emphasis)
5. In the Commissioner's case, the Respondent further clarified its reasons for regarding the cost build-up as sufficient evidence:⁴

"It is submitted that the management fees payable to the taxpayer HoldCo should not be measured by the expenses that the taxpayer HoldCo incurs in general but should be related to the expenses that the taxpayer HoldCo incurs in rendering the service or activity to the Appellant. It is that relationship between the services to be rendered and the forecasted fees payable that the appellant was supposed to justify." (our emphasis)
6. The enquiry now shifted from proof that services were rendered or work was performed, which was based on the Respondent's interpretation of the extract from CF (Pvt) Ltd v Zimbabwe Revenue authority,⁵ to an arm's length enquiry, where the relationship between the cost of services rendered and fees charged were measured.

1 Rule 11 documents: p 194.

2 Rule 11 documents: p169.

3 A2: par 2.4 p6.

4 A4: par 74.

5 HH-99-18: page 39 "*The principle of law that Lewis JP appears to have approved in Commissioner of taxes v A, supra, by reference to the two Australian cases...was that an expenditure or loss arising from the terms and conditions set out in a contract is incurred when the contracted work is performed.*"

7. The Appellant provided a cost build up in the 20 November 2018 presentation (“the cost build up”)⁶ and obtained the services of an expert witness to interrogate the calculations thereof in order to provide and opinion, inter alia, on the reasonableness of the inter-company charges from a transfer pricing point of view.⁷ Subsequently, it was agreed between the parties that transfer pricing and arm’s length pricing was not an issue and as a result the evidence of the expert witness was withdrawn by the Appellant.
8. It has, however, now become clear that the Respondent still requires the Appellant to substantiate the supplier’s cost build-up. The line of questioning by the Respondent’s counsel confirms this.
 - i. In the cross-examination of taxpayer witness on 9 March 2020, the Respondent attempted to obtain Mr G’s agreement that the Respondent’s request for the full details of the cost of the services was necessary to substantiate the substance of the agreement.⁸ Mr G disagreed by stating that the substance of the agreement was the provision of the services⁹ and that the Respondent was asking for more than the substance of the agreement.¹⁰
 - ii. In addition, an attempt was made by the Respondent to discredit the cost build-up by insinuating that it is a reconstruction of the past.¹¹
9. The onus is on the Appellant to prove that services were rendered. The Appellant has done so with the agreements, invoices, payments and proof of physical services rendered. However, the Respondent was not satisfied, and it appears that the cost build up has become the conclusive evidence for the Respondent in this dispute.
10. Despite the fact that the cost build up was provided in the form of budgeted¹² and actual¹³ figures which corresponds to the monthly charge of \$45 000 per the agreement¹⁴ and therefore illustrates the relationship between the services and forecasted fee, the Respondent is not willing to accept it and requires further substantiation thereof.

THE ISSUE

11. The Appellant wishes to call the expert witness who did extensive work on the cost build up when transfer pricing was still an issue,¹⁵ to give evidence on the financial, commercial and tax aspects of the pricing of intra-group services and in particular the cost build up.
12. The Respondent objected to this request on the basis that the expert evidence is irrelevant.

THE LAW

13. The Civil Evidence Act¹⁶ provides in section 26 that:
14. “Evidence that is irrelevant or immaterial and cannot lead to the proving or disproving of any point or fact in issue shall not be admissible.”
 - i. In assessing whether information of potential evidence is sufficiently relevant to be admitted, the following steps should be followed:¹⁷
 - ii. Step 1: Identify and state the issue arising from the case that you wish the court to decide.
 - iii. Step 2: Identify and state the information or evidence the Appellant wish to admit.
 - iv. Step 3: Assess whether that information if admitted, would have the potential to help the court draw inferences about the issue.
 - v. Step 4: If the answer is in the affirmative, the information is relevant and should be admitted and vice versa.
15. In PPCZ v Zimbabwe Revenue authority¹⁸ the following was argued by Mr Magwaliba, the Respondent in the

6 DD1: page 31.
 7 Appellant’s Additional Summary of Evidence filed on 8 January 2020.
 8 Mr G cross examination: 37:18.
 9 Mr G cross examination: 37:54.
 10 Mr G cross examination: 38:45.
 11 Mr G cross examination: 44:11.
 12 DD1: page 31.
 13 SUPPL 12.6 page 810 provided April 2018.
 14 DD.9 clause 4.1: p759.
 15 Appellant’s Additional Summary of Evidence filed on 8 January 2020.
 16 Chapter 8:01.
 17 The Law of Evidence In South Africa: par 40.2 page 227.
 18 HH 755-19 ITC 14/18: page 6.

present case:

“...Mr Magwaliba for the respondent, started off by pointing out that in terms of S63 of the ITA the appellant carried the burden of proof and to that end the appellant could lead evidence and produce necessary documents to prove its case. Mr Magwaliba went further to state that the nature of the appeal was that it was an appeal in the wide sense where the court is entitled to re-hear the whole matter.”

16. And at page 13 Mr Magwaliba confirmed that this is “an appeal in the wide sense”. The appellant could have produced any evidence to enhance its case.

APPLICATION OF THE LAW

Step 1:

17. The issue may be a fact in issue (factum probandum) or sub-issue of a fact in issue.¹⁹
18. The fact in issue is whether services were rendered to the Appellant.

Step 2:

19. The evidence that the Appellant wishes to admit to the court is to call the expert witness, an experienced expert witness in intra-group company transactions relating to financial, commercial and tax aspects in the pricing of intra-group services, to testify.
20. In giving testimony, the expert witness will also admit supporting calculations or spreadsheets in support of the testimony.

Step 3:

21. The test is whether that evidence, if admitted, would have the potential to help the court draw inferences or conclusions about the issue. In other words, whether the evidence is closely enough to the issue the Appellant needs to prove.²⁰
22. In the Commissioner’s case, the Respondent argued that, in the absence of a cost build-up being provided, the management fee charged is a guessed estimate with no actual basis.²¹
23. The Respondent further required the Appellant to justify the relationship between the forecasted fee of \$45 000 per month and the services to be rendered.²²
24. The cost build-up was therefore required by the Respondent as supporting evidence in order to verify whether services were rendered.²³
25. It is therefore undisputed that the Respondent regard the cost build-up as crucial evidence or close enough to the issue to be proved. It is puzzling why further evidence thereon is now being objected to by the Respondent.
26. The cost build-up will assist the court in drawing a conclusion as to:
i. How the management fees were determined;
ii. The nature of the work performed;
iii. The relationship between the forecasted fee of \$45 000 per month and the services to be rendered;
iv. Whether the management fee was a “guessed estimate” with no actual basis.
27. These issues go towards the heart of the dispute.
28. The cost build-up is an accounting spreadsheet containing data and calculations which need to be interpreted by the court in order to arrive at the conclusions listed above. Expert evidence will generally be received by the court when the facts in issue relate to accounting principles.²⁴
29. The expert witness reviewed the cost build-up. The expert witness analysed the calculations of the different categories of services rendered and verified it against the source documentation that was used at the time to calculate the estimated fee to be used in the negotiations of the fixed fee of \$45,000 per month.

19 The Law of Evidence In South Africa: par 40.2 note 22 page 227.

20 The Law of Evidence In South Africa: par 40.2 footnote 26 page 227.

21 A5 Commissioner’s case: par 73.

22 A5 Commissioner’s case: par 74.

23 Rule 11 documents: p169.

24 The Law of Evidence in South Africa: par 60.1 page 398.

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30. Therefore, the expert witness will:
- i. give evidence on the methodology followed in calculating the cost build-up;
 - ii. be able to explain to the court how the management fee was determined in total and for each component (or nature of service);
 - iii. explain the relationship between the forecasted fee and the services to be rendered;
 - iv. be able to address the Respondent's request for full details of the cost of the services in order to substantiate the substance of the agreement;²⁵ and
 - v. be able to address the concerns of the Respondent that the cost build up it is a reconstruction of the past.²⁶
31. In addition, the expert witness will be able to testify whether, in the expert witness's experience:
- i. The cost build-up is a fair and reasonable representation of the typical shared service costs;
 - ii. The methodology followed for calculating the management fee is fair and reasonable;
 - iii. The fee is excessive or not;
 - iv. A service recipient would ever be privy to the cost build up calculations since salaries of employees are confidential information;
 - v. It is common to charge a fixed fee to be determined at the beginning of the year, negotiated between the parties and formulated in an agreement.
32. All of the above will assist the court in arriving at the conclusions to be drawn in paragraph 26 above.
33. In addition, the dicta from the PPCZ case (supra) confirm that the Appellant can produce any evidence to enhance its case.

Step 4:

34. The conclusion to be drawn by applying steps 1 – 3 is that the evidence of the expert witness is relevant and should be admitted.

CLOSING SUBMISSIONS

35. Based on the above, it is submitted that the expert evidence of the expert witness, which the Appellant wishes to introduce, is relevant and will assist the court in arriving at conclusions on the issue of whether services were rendered to the Appellant.
36. The expert evidence of the expert witness should be admitted to court.

Dated 13 March 2020

²⁵ Mr G cross examination: 37:18.

²⁶ Mr G cross examination: 44:11.

APPENDIX C6

RULES OF EVIDENCE

Evidence in a tax trial is very tricky and sometimes the outcome is unpredictable. The judge's standards and knowledge of evidence may vary widely, resulting in conflicting judgments.

Read the following extracts on evidence which are, with respect, considered a correct reflection of the rules of evidence.

Read these in contradistinction to **Case Study 3** at the end of the Appendices. This was a management fees case argued by me in Zimbabwe, where we presented similar evidence to what is set out below.

The court found against us. Yet in the extracts below setting out evidence arguments, the similar evidence presented by the taxpayer in the tax trial was considered convincing.

The judge in our tax trial in **Case Study 3** was a retired magistrate with no tax trial experience. Was that the reason for the difference?

Be that as it may, we approached the tax trial on the basis we would most likely lose, and made sure the evidence was carefully recorded for the purposes of going on appeal to the Supreme Court.

The matter is currently on appeal.

Pay careful attention to these extracts as they will apply to your TP case.

SUPPORTING ARGUMENTS TO EVIDENCE

Section 63 of the ITA places the burden of proof on the Appellant.

Firstly, the burden of proof must be discharged on a balance of probabilities and all that is required in this regard from the taxpayer is to tilt the scales of justice slightly in its favour. The Respondent (revenue authority), on the other hand,

believes that the scale should be tilted at a far greater angle.

Refer to the Respondent (revenue authority) representative's submissions in *DEB (Pvt) Ltd v ZIMRA* at page 6 where he appears to suggest a certain document would "put the Appellant's case beyond doubt". Is that "reasonable doubt"? As that is not the standard applicable in tax cases.

Secondly, *H Ltd v Commissioner of Taxes*¹ sets the tone of how this burden is to be discharged. Goldin J held that when it comes to determining those balance of probabilities there are two main lines of approach, which are not mutually exclusive, namely, credibility and probability.² In determining whether a witness is to be believed or not, the court must have regard to the probability of his story. But there may be cases where probability will have to yield to credibility; for a court may believe a witness, despite improbabilities in his evidence and where it does so, it may find that any burden of proof resting on him has been discharged.³ Where the probabilities are evenly balanced, a finding of credibility might well be the determining factor.⁴

Furthermore, when it comes to weighing up probabilities, it must be remembered that a trial judge is not concerned with what is or is not probable when dealing with abstract businessmen or normal men, but he is concerned with what is probable and what is not probable as regards the particular individual situated in the particular circumstances in which they were.

A simple illustration of these principles can be found in *SW (Pvt) Ltd v ZIMRA*.⁵ In this case ZIMRA had to prove that the appellant became liable to pay service fees for services rendered in respect of a technical service agreement. One of the factual questions was whether services were in fact rendered by the appellant. ZIMRA argued, and the court accepted, that the mere existence of a valid agreement between the parties and the subsequent conduct of the parties gave rise to the physical rendering of services. In addition, the admission of liability that the agreed management services were rendered, and the making of provisions for such fees in the management accounts, constituted sufficient proof that the management fee expenses were incurred. The standard of proof was therefore met, triggering the payment of withholding tax to ZIMRA.

Why is the standard of proof now different for the Appellant? There should not be

double standards in applying the rules of evidence.

It is common cause that valid agreements exist, that the management fees were invoiced, paid and that the Appellant agrees to its liability that there were management services.

Furthermore, the Respondent accepted the invoices as valid VAT tax invoices to claim input tax credits by the Appellant, as testified by N. If the Respondent was consistent with its reasoning that management services were not rendered and received, then it would have disallowed the input tax credits as well.⁶

Schedule 12(13) to the ITA, dealing with rules for regulating appeals, provides as follows:

"If any facts are in dispute either the appellant or the Commissioner may call such evidence and produce such documents at the hearing of the appeal as may be deemed material and relevant."

In *PPCZ v Zimbabwe Revenue authority*⁷ the following was argued by Mr Magwaliba, counsel for the Respondent in this case, and followed by that court in its judgment at page 13:

"...Mr Magwaliba for the respondent, started off by pointing out that in terms of S63 of the ITA the appellant

1 34 SATC 57 1925 TPD.

2 34 SATC 57 1925 TPD at 60.

3 34 SATC 57 1925 TPD at 60.

4 34 SATC 57 1925 TPD at 60.

5 HH 499-19; p 7.

6 N Evidence in Chief 13 March 2020: p61 00:08 – p62 02:36.

7 HH 755-19 ITC 14/18: page 6.

carried the burden of proof and to that end the appellant could lead evidence and produce necessary documents to prove its case. Mr Magwaliba went further to state that the nature of the appeal was that it was an appeal in the wide sense where the court is entitled to re-hear the whole matter...The appellant could have produced any evidence to enhance its case."

The Appellant produced over 1700 pages of additional evidence in the Rule 11, most of which had previously been supplied to the Respondent.

During the course of the trial, the Court heard evidence from the following witnesses on behalf of the Appellant to corroborate the discovered documents for 2015 (applicable to all years 2010-2015 as evidence) produced at trial in terms of Rule 11:

G, who was the CFO of the Group and oversaw the charging of the management fees by Group to the Appellant when he took up that position during the 2015 year of assessment. In this regard, his testimony in relation to the rendering of management services in 2015 to the Appellant by Group, is equally applicable to any of the evidence in relation to the years of assessment dated back to 2010. He also represented the Appellant, with MR G, during the audit leading up to this case;

L, who during the entire period, and in 2015 was the legal advisor who was able to testify about the rendering of the management services by Group to the Appellant, not only in respect of legal services, but by virtue of his occupying various positions within Group in its interactions with the Appellant;

C, who during the entire period was the Human Resource Executive at the Appellant with in-depth knowledge of the purpose behind the Collective Bargaining Agreement and the provision of the canteen meals to factory workers;

G, who with his team, has prepared and administered the tax affairs of the Appellant over the entire period, interacting with all the other witnesses in the rendering of management services by Group to the Appellant and represented the Appellant in the audit leading up to this case;

N, who during 2015 was the CFO of the Appellant and was able to testify as to the management services received by the Appellant from Group. In this regard, his testimony in relation to the receipt of management services in 2015 by the Appellant from Group, is equally applicable to any of the evidence in relation to the years of assessment dated back to 2010.

It is noteworthy that the Respondent produced no witnesses to explain why the Appellant had produced insufficient evidence to prove the incurring of its management services fees. The lack of a Respondent witness also denies the court the opportunity to interrogate why the applicable law and section underpinning the application of penalties is absent.

The Zimbabwe Civil Evidence Act⁸ ("Civil Evidence Act") provides the following in section 14 which is important in assessing the admissibility of the evidence tendered in this case on behalf of the Appellant by its representatives, Group:

14. Business Records

- (1) In this section –
"business" includes a trade, profession or calling or any other such occupation or activity."
- (2) A statement contained in a document shall be admissible as evidence of any fact stated therein of which direct oral evidence would be admissible if –
 - (a) the document is or form part of the records appertaining to or kept by or for business or at any time formed part of such records; and

- (b) the statement in the document was made, or may reasonably be supposed to have been made, in the ordinary course of or for the normal purposes of the business –
- (i) by a person who had or may reasonably be supposed to have had personal knowledge of the fact concerned; or
- (ii) on the basis of information supplied directly or indirectly by a person who had or might reasonably be supposed to have had personal knowledge of the fact concerned.

A document which is admissible under this section may be produced in evidence by any person who for the time being has custody of the document or is responsible for managing the business for which the document was produced.”

The Rule 11 documents containing statements presented to the Court through the testimony of the above-mentioned witnesses comply with the jurisdictional requirements of section 14:

- formed part of records of the businesses (at any time), there being no contemporaneous requirement with date stamps and author identity as suggested by the Respondent’s representation in cross-examination;
- the statements in the documents (as corroborated by the testimony of the witnesses) were made in the ordinary course or for the normal purposes of the businesses; and
- by a person who had or may reasonably be supposed to have had personal knowledge of the facts concerned; or
- on the basis of information supplied directly or indirectly by a person who had or might reasonably be supposed to have had personal knowledge of the facts concerned; and
- may be produced in evidence by any person who had custody of the document or is responsible for managing the business for which the document was produced, namely any of the abovementioned witnesses.

In this regard the business evidence in the form of the statements contained in the documentation, and the corroborating oral evidence that has been presented to this Court by the witnesses, must be accepted as admissible evidence in the Appellant discharging, on a balance of probabilities, its burden of proof. Together with the credibility and probability of the corroborating oral evidence, the balance of probabilities clearly tilt in favour of the Appellant.

Furthermore, evidence of a statement made by a person in writing or who saw, heard or otherwise perceived statements made that were not in the Rule 11 documents, but to which they testified, shall be admissible as evidence of any fact. In this regard, reference is made to Section 27 of the Civil Evidence Act which reads as follows:⁹

27. First-hand hearsay evidence

- (1) *“Subject to this section, evidence of a statement made by any person, whether orally or in writing or otherwise, shall be admissible in civil proceedings as evidence of any fact mentioned or disclosed in the statement, if direct oral evidence by that person of that fact would be admissible in those proceedings.*
- (2) *Evidence of a statement referred to in subsection (1) shall be admissible even where the person who made the statement is called as a witness in the proceedings concerned.*
- (3) *If a statement referred to in subsection (1)–*
 - (a) *is not contained in a document, no evidence of the statement shall be admissible unless it is given by a person who saw, heard or otherwise perceived the statement being made;*
 - (b) *is contained in a document, no evidence of the statement shall be admissible except the document itself, or a copy of the document if such copy is admissible in terms of this Act or any other law.*
- (4) *In estimating the weight, if any, to be given to evidence of a statement that has been admitted in terms of subsection (1), the court shall have regard to all the circumstances affecting its accuracy or otherwise and, in particular, to–*
 - (a) *whether or not the statement was made at a time when the facts contained in it were or may*

⁹ G, L and N all perceived first-hand hearsay evidence in relation to the Rule 11 documents in emails, reports, comparison tables, minutes of meetings, and the like.

-
- reasonably be supposed to have been fresh in the mind of the person who made the statement;
and*
- (b) *whether or not the person who made the statement had any incentive, or might have been affected by the circumstances, to conceal or misrepresent any fact.*
- (5) *This section shall not be construed as limiting any provision of this Act or any other law providing for the admissibility of statements made by persons who are not called as witnesses to testify to such statements.”*

If one considers the credible *ipse dixit* of the witnesses and the probability of what they were testifying in relation to the admissible statements contained in the business records of the Appellant and Group produced in terms of Rule 11 to prove Group in fact rendered the management services and the Appellant in fact received the management services, it is abundantly clear that on the balance of probabilities that management services were in fact rendered by Group and received by the Appellant favours the Appellant. If the court accepts this, on the Respondent’s version, the management services expenditure has been incurred, and the Appellant succeeds on this issue, and is entitled to claim the management services expenditure.

Attempts were made by the Respondent’s representative to suggest that some of the witnesses were presenting hearsay evidence, were not authors of the documents, or failed to introduce further corroborating ‘hard evidence’¹⁰ to this Court to meet the balance of probabilities standard. This critique is misplaced and pushes the onus of proof standard beyond what is required in this court. Any hearsay critique is overruled by the hearsay exception provisions of section 14 and 27 of the Civil Evidence Act where these statements are admissible. Any critique on the failure to produce even more ‘hard evidence’ is overruled by the credible *ipse dixit* of all the testifying witnesses that the management services were in fact rendered and received. All the witnesses had first-hand knowledge in terms of their personal interactions with various individual providers of the management services in Group, even though they may not have been the authors of various business records (which in any event is not a requirement).

Once again, the evidence presented in respect of 2015 is equally conclusive to the earlier periods, commencing 2010. Both G and N occupied their respective positions in 2015. In addition, both have been with the Group in the prior years where they first-hand witnessed and testified to comparable management services being rendered to other subsidiaries in the Group, as well as to the Appellant.

Business records that contain admissible statements in this case are all the Rule 11 documents, which include the comparison tables with cost savings as set out on pages 799 onwards¹¹ and the cost build-up or recovery basis on page 31¹² that were drawn up by Group and verified and checked by N. N also testified on 16 April 2021 that he had reviewed all the Rule 11 documents and was satisfied as to the truthfulness of their content to the best of his knowledge. There is no plausible reason to reject his credibility and the probability of his testimony in this regard. It is submitted that, in any event, this request by the Respondent for cost build-up details was unlawful as section 15(2)(a) does not contain as a jurisdictional fact that a cost-build up must be provided by the Appellant to prove that it incurred the management fee expenses.

In this regard, the finding of this Court must be that, on a balance of probabilities, the onus of the Appellant has been discharged and that the management services were in fact rendered by Group and received by the Appellant for the periods in question, and as such the entire amount of the management fees is deductible.

10 Emanating from A.4 Commissioner’s case: par 40 an incorrect application of the law by the Respondent is advanced. The *CF (Pvt) Ltd* case “B HOA7” at page 45 Justice Kudya J, with reference to management fees, made a passing or an *obiter* remark after the Appellant had abandoned the management fees claim acknowledging they had made an incorrect return in respect of the claims for management fees. This was not part of the court’s *ratio*. There is no definition or explanation what ‘hard evidence’ is. And this is now incorrectly being relied upon by the Respondent in its flawed reasoning. This out of context quote on the so-called ‘hard evidence’ principle relied on by the Respondent appears again in the *PPCZ* case “B HOA10” where Mtshiya AJ simply and incorrectly refers to the ‘trite principle’ that incorrectly flows from Kudya J’s passing or *obiter* remark in the *CF (Pvt) Ltd* case on ‘hard evidence’. This is simply not the law, or the creation of any new principles defining ‘hard evidence’ of services rendered that must be produced for incurring management fee deductible expenditure in terms of the jurisdictional facts of section 15(2) (a).

11 SUPPL 12.5.

12 DD 1: p 31.

APPENDIX D

TAX RISK MANAGEMENT

An important feature in all tax risk management processes I follow, setting up a tax risk steering committee under the attorney/client privilege is essential. My textbook below is a key guide in doing this. Please read and review the content carefully. It will save any MNE enormous amounts of tax.

AN EXTRACT FROM THE TEXTBOOK: TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES BY PROF. DR. DANIEL N. ERASMUS (THE POST 2022 EDITION)

For a free PDF copy of the entire book laying out a tax risk management process, please contact the author at daniel.n.erasmus@me.com.

The Tax Team

THE TYPICAL TAX team consists of the following personalities:

- CFO or business owner
- Tax manager
- Accounting tax advisors and other outside tax advisors
- The legal team, as leaders of the tax team to ensure legal privilege
- The various participants in the tax team need to be carefully defined.

CFO or Business Owner

IT IS VERY important that the CFO or business owner (in the case of small businesses) takes a primary role and interest in the tax risk management affairs of the business. It often happens in businesses that the CFO or business owner merely is the point of contact for a tax compliance officer to report to. This must change to ensure that a culture of transparency toward tax risk management issues starts developing in the business. The CFO or business owner will obviously have a very close liaison with the CEO, the audit committee, and other board members from time to time. It is imperative

that he or she has a very direct interest in the tax risk management issues being monitored and managed by the tax manager.

The CFO or business owner will become the reporting link to the audit committee and the rest of the board.

Usually the CFO or business owner, as member of the tax team, will be the point of contact with the tax compliance officer, with officials from the revenue authority and the revenue authority representative, if it is necessary to make representations to the revenue authority in respect of any of the tax risk management issues under consideration.

The CFO or business owner will be the chairperson of all the tax team meetings that take place from time to time. As the head of financial issues within the business, all tasks emanating from the tax team meetings will ultimately involve reporting directly back to him via the tax compliance officer of the business. In this way transparency and ongoing communication is ensured.

Tax Manager

FROM THE OUTSET it should be made clear that the tax manager role in a small business is usually handled by the accountant. The accountant will now have the comfort of 24/7 support under the tax-Radar™ insurance program offered through www.taxrisk.co.za to cover tax audit exposure through an insurance policy ready to pay for any support required when a revenue authority tax audit commences in South Africa. Outside South Africa a tax risk steering committee management process is available through the author, where more details can be obtained from the author at daniel.n.erasmus@me.com.

Apart from being a skilled tax compliance officer, the tax manager will not only be responsible for usual tax compliance duties but will also be responsible for ensuring that the uncovered tax risk areas within the business are properly dealt with. To be able to do this the tax manager must have direct access to the CFO or business owner. In this regard the tax manager must be able to communicate directly with the CFO or the business owner if there are any concerns that the tax manager may have in relation to these transactions.

The tax manager must have access to the internal audit team of the business and as such be entitled to review any financial accounting issues which the tax manager believes may have a tax impact. In this regard there are many historical financial accounting issues relating to accounting provisions, related party transactions, and the like which may have created tax risk issues. These risks would have not been uncovered in the past, simply because they have not been thoroughly examined. Open access must be given to the tax manager to attend to these functions and duties.

The tax manager must have access to the heads of operations to be able to communicate with them and to review any operational transactions that they may become involved in, once again to assess any emerging tax risks that may occur because of steps taken in these operating divisions or subsidiaries.

The tax manager is responsible for driving the tax strategy process within the business and in this regard is responsible for ensuring that a date, time, and place is set for the tax strategy process. In addition to this the tax manager is also responsible for ensuring that the tax strategy process be revisited once every six months. In this regard the backing of the CFO or the business owner of the business must be sought and obtained.

The tax manager must organize the tax team meetings, tax reviews, and any of the tax work that flows from the tax team process toward minimizing the tax risk issues within the business.

The tax manager will form the point of contact between the business and the revenue authority representative who will be met with from time to time to ensure that the tax risk issues that are being reviewed within the business are brought up to date and communicated, where need be, with the revenue authority.

ACCOUNTING AND OTHER outside tax advisors will form a very important part of the tax team.

They will be requested to review all historical and current tax information relating to the businesses that are in their possession. In this regard they will be required to make this information available on a systematic basis to the tax team from time to time for the tax team to review this information. The relevance of reviewing the information which is in the possession of these outside tax advisors is to establish what information they have is relevant and irrelevant to any future revenue authority audit that might be conducted. It should be borne in mind that information which is in the possession of these outside tax advisors which may be irrelevant may in any event be attached by the revenue authority officials conducting audits, which in turn may lead to unnecessary avenues being explored by the revenue authority officials giving rise to additional resources having to be allocated to show the revenue authority officials that the information is irrelevant. In practice what normally happens is that this irrelevant information leads to a whole host of unnecessary questions and investigations which ends up wasting everybody's time.

These outside tax advisors will also be key in participating in giving the historical perspective to any potential tax issues or problems that have been identified within the tax team. In this regard these historical perspectives will play a very important role in determining which of the potential tax issues should fall on-the-radar screen and which of these should fall off-the-radar screen. Often participants from the outside tax advisors have been involved with the business for a very long time and are able to give very in-depth information as to the reasons behind certain transactions having taken place in the past.

The Legal Team

"These best practices include:

- (1) communicating clearly with the client regarding the terms of the engagement and the form and scope of the advice or assistance to be rendered;*
- (2) establishing the relevant acts, including evaluating the reasonableness of any assumptions or representations;*
- (3) relating applicable law, including potentially applicable judicial doctrines, to the relevant facts; (4) arriving at a conclusion supported by the law and the facts; (5) advising the client regarding the import of the conclusions reached; and (6) acting fairly and with integrity in practice before the IRS."*

Source: Regulations Governing Practice Before the IRS: Preamble to the 2004 amendments to Circular 230, published in Treasury Decision (T.D.) 9165 on December 20, 2004.

THE LEGAL TEAM must have experience in the tax risk management process that is being embarked upon by the business, involving a multiskilled group of participants who must play different roles in the review of the on-the-radar screen and off-the-radar screen tax issues. The legal team function will be fully covered in the tax-Radar™ program offered to the small business through its accounting firm.

The legal team must also be tasked with the responsibility of holding all sensitive information flowing from the tax team tax risk management process so that this sensitive tax information can be reviewed and analyzed before the outcomes are discussed with the other members of the tax team, the audit committee, and finally the board. It is ultimately the decision of the board then what to do with the outcome that flows from this sensitive information in the hands of the legal team, subject to legal privilege.

They will be involved in collating, requesting, and distributing any technical opinions sought from outside tax advisors to always ensure the legal privilege over these opinions. Where necessary, they will attach any supporting documentation which has been obtained by a factual analysis of the facts surrounding or giving rise to these opinions being sought, which supporting facts, as attached to these opinions, will also fall under this legal privilege. This will ensure that this information will form part of the opinions, subject to the legal privilege, and will tie down all loose ends that may create problems for the business going forward, being tied down in a structured and logical sequence and format.

APPENDIX E

WHY ARE TAXPAYERS SELECTED FOR TAX AUDITS?

This is an extract from the SARS website (SARS.gov.za) in South Africa, explaining why taxpayers are selected for tax audits. The content is universal and applicable to other jurisdictions.

Another useful source of information is the USA IRS website that contains the actual information of various business types that may undergo IURS tax audits.

See: <https://www.irs.gov/businesses/small-businesses-self-employed/audit-techniques-guides-atgs>

EXAMPLE OF BEING AUDITED OR SELECTED FOR VERIFICATION IN SOUTH AFRICA

Being selected for an audit and being selected for verification are two different processes. See further down on this webpage if you want to know about being audited.

What is verification?

Verification is a face-value verification of the information declared by the taxpayer on the declaration or in a return. This involves a comparison of this information against third party data gathered by SARS from various sources, the financial and accounting records and/or other supporting documents provided by taxpayers to ensure that the declaration/return is a fair and accurate representation of the taxpayer's tax position. Once you have submitted your declaration/return, your declaration/return could be selected for verification.

Who can be selected for verification?

Any taxpayer can be selected by SARS for verification for the purpose of proper administration of tax, including on a risk basis.

What steps should I take if I am selected for verification?

If you are selected for verification, you will be notified by SARS through an official letter. This letter will indicate the due

date / time frames within which you must submit either:

- The requested relevant material (supporting documents) / other information/ forms; or
- A Request For Correction (RFC). A RFC must be submitted if you wish to change your original declaration.

The required relevant material will differ depending on the tax type. If you are an eFiler, you can use this channel to submit your relevant material. Scan your relevant material and save it on your computer/desktop. Log onto eFiling, upload your relevant material and submit them on eFiling. Please remember to click 'submit' in order to send the relevant material to SARS. Alternatively, you can submit your relevant material via the SARS Online Query System on the SARS website. If unsure, you may book an appointment at a SARS branch and submit your relevant material there.

Top Tips:

- The relevant material needed will be listed in the verification letter sent by SARS.
- The link to upload relevant material on eFiling is only available upon receipt of the letter requesting the relevant material (refer to the relevant guides on eFiling):
 - o Upload all the relevant material as requested in the above-mentioned letter.
 - o Once all the relevant material has been uploaded, click the 'submit' button to submit it to SARS. PLEASE NOTE that once the relevant material is submitted, the link will close and you will not be able to upload any further relevant material. It is therefore important that you click submit ONLY when all documents have been uploaded.
- Make sure the original letter sent by SARS is included when you submit relevant material on the SARS Online Query system or via the branch, as it contains a unique bar-coded reference that links the uploaded relevant material to your tax records.
- Ensure that the following standards are adhered to when relevant material are uploaded:
 - o The file type may be .pdf, .doc, .docx, .xls, .xlsx, .jpg and .gif to enable SARS to view the documents.
 - o The maximum allowable size per document is 5MB and a maximum of 20 documents may be uploaded.

What can I expect during the verification?

If you are subject to a verification, we will endeavour to:

- Notify you that the return or declaration is subject to verification.
- Conclude verification within 21 business days from the date all required relevant material is received, if your return is for the current filing period.

A letter requesting further relevant material could be issued if the relevant material initially supplied was not sufficient to finalise the verification.

If you have a refund due, the refund will not be paid out while the verification is in progress.

SARS must ensure that the tax position declared is in line with the relevant tax legislation. If it is found to be incorrect, an assessment will be raised.

The levying of understatement penalties must be considered where an understatement occurred. The percentage of a penalty varies from 0% to 200%. Harsher penalties are reserved for culpable repeat offenders or obstructive taxpayers.

What if I do not respond to the request for relevant material?

If you do not respond by submitting a RFC or providing the relevant material, a second letter will be sent to you. If you still do not respond within the specified timelines, a revised assessment will be issued based on the data at SARS' disposal.

Top Tip: It is better to respond to all queries straight away. Taxpayers found to be obstructive could face higher penalties should it be found that an understatement occurred.

What can I expect when the verification is finalised?

Once the verification is finalised, you can expect one of the following:

- Where no further risk(s) were identified and no finding was made, a Notification of the finalisation of the verification via eFiling, email or post;
- Where no further risk(s) were identified and a finding was made, a Notice of Assessment of the revised assessment via eFiling, email or post;
- Where further risk(s) were identified, a Referral for Audit Letter via eFiling, email or post. Your return/declaration is then referred for an audit. If you have a refund due, the refund will only be paid once the audit is complete and the specific refund validations were passed.

A SARS assessment normally becomes final within three years from the date of assessment (non-self-assessment taxes like Income Tax) or five years from date of assessment (self-assessment taxes like Value-Added Tax). However, SARS does have the right to open an already prescribed assessment where fraud, misrepresentation or non-disclosure of material facts is identified. Furthermore, SARS has the right to extend the prescription date in certain instances. If you are aggrieved by the assessment, you can dispute it. Refer to Objections for more guidance on that process.

What is an audit?

It is an examination of the financial and accounting records and/or the supporting documents of the taxpayer to determine whether the taxpayer has correctly declared his/her tax position to SARS. Where the taxpayer has not made a declaration or filed a return, it is an investigation regarding whether the taxpayer's actions comply with the provisions of the relevant tax legislation.

Who can be selected for audit?

Any taxpayer can be selected by SARS for an audit for the purpose of proper administration of tax, including on a risk basis. Taxpayers may also be selected for audit on a random or risk basis.

What should I expect if I am referred for an audit?

If you were subject to a verification and the verification process has been completed, your tax affairs could still be referred for audit as part of the SARS compliance process. This does not mean that an audit has commenced. You must still await a formal Notification of Audit letter (where the audit has been allocated to a specific auditor).

What steps should I take if I am selected for an audit?

An audit is only deemed to commence once a formal Notification of Audit by a specific auditor is issued to the taxpayer. If relevant material (supporting documents) is requested in the Notification, you should submit the relevant material to SARS within the specific timelines stipulated in the Notification. Alternatively, arrangements will be made with you to conduct a field audit at your convenience. Photocopy costs can be recovered from SARS where a field audit is conducted, provided that certain requirements are met. The required relevant material will differ depending on the tax type and scope of the audit. Please note that SARS can also obtain relevant material from any third party. The relevant material is preferred in electronic format and arrangements can be made for an Electronic Forensic Specialist to download these from your computer systems. If you are an eFiler, you can scan your relevant material and save them on your desktop. Log onto eFiling, upload your relevant material and submit them via eFiling. Please remember to click 'submit' in order to send the relevant material to SARS. Alternatively you can make arrangements with the specific auditor (SARS official) indicated on the letter to collect the requested relevant material or to have it delivered.

Top Tips:

- Make contact with the specific auditor (SARS official) mentioned in the letter.

-
- The link to upload relevant material on eFiling is only available upon receipt of the letter requesting the relevant material (refer to the relevant guides on eFiling):
 - o Upload all the relevant material as requested in the above-mentioned letter.
 - o Once all the relevant material has been uploaded, click the 'submit' button to submit it to SARS. PLEASE NOTE that once the relevant material is submitted, the link will close and you will not be able to upload any further relevant material.
 - Make sure the original letter sent by SARS is included when you submit relevant material on eFiling or via the branch, as it contains a unique bar-coded reference that links the uploaded relevant material to your tax records.
 - Ensure that the following standards are adhered to when supporting relevant material are uploaded:
 - o The file type may be .pdf, .doc, .docx, .xls, .xlsx, .jpg and .gif to enable SARS to view the documents.
 - o The maximum allowable size per document is 5MB and a maximum of 20 documents may be uploaded.
 - Should you require any further assistance, contact the specific auditor (SARS Official) mentioned in the Notification of Audit.

What can I expect during the audit?

You can expect the following:

- The Notification of Audit will indicate the initial scope of the audit;
- A Notification where additional material is required;
- The SARS Auditor will produce an Authorisation Letter where a field audit is conducted;
- All Covid-19 protocols will be adhered to at all times during the field audit.
- Progress reports of the stage of the audit will be issued at intervals of 90 calendar days from the date of the Notification of Audit;
- If you have a refund due, the refund will not be paid out during the execution of the audit.

The progress reports may not apply if SARS is of the view that it will impede or jeopardise the outcome of the audit.

By its nature, an audit is a more intrusive process than a verification and the scope could be extensive. The audit could be completed within anything from 30 business days to 12 months, or even longer, depending on the complexity of the matter, the volumes of transactions involved and the level of co-operation by the taxpayer.

SARS can request additional or further relevant material throughout the audit. If you do not respond by submitting the relevant material when requested, SARS will raise an assessment based on information readily available or obtained from a third party.

SARS may make an original, additional, reduced or jeopardy assessment based on an estimate.

- Should you require any further assistance, contact the specific auditor (SARS official) mentioned in the Notification of audit letter.

Top Tip: It is better to respond to all queries straight away. Taxpayers who are obstructive could face higher penalties should it be found that an understatement occurred.

What can I expect when the audit is finalised?

At the conclusion of the audit, we will endeavour to:

- Where potential adjustments were identified, issue an Audit Findings Letter indicating the grounds for the proposed assessments within 21 business days. SARS will provide the taxpayer at least 21 business days to respond to the Audit Findings Letter.

- Conclude an audit within 90 business days from the date all required relevant material is received.
- Provide a Finalisation of Audit Letter detailing the grounds for the assessment (including the amounts) if it is found that your tax position is incorrect or provide a Finalisation of Audit Letter to conclude the audit where no findings were made.

SARS must ensure that the tax position declared is in line with the relevant tax legislation. If it is found to be incorrect, an assessment will be raised.

You can expect an Audit Findings Letter indicating the findings of the audit once completed, unless you waive the right to receive such letter. You need to respond to this Audit Findings Letter within 21 business days indicating your agreement or disagreement with the proposed adjustments, imposition of understatement penalties and/or interest. You must also provide evidence to support your view where you disagree and provide reason(s) and evidence as to why understatement penalties and/or interest should not be imposed.

Kindly note that the Audit Findings Letter does not apply if SARS is of the view that it will impede or jeopardise the outcome of the audit.

The response to the Audit Findings Letter will be considered in determining whether the proposed audit findings should remain or not.

If SARS is still of the view that a revised assessment must be done; or where the taxpayer chose not to respond to the Audit Findings Letter, the imposition of understatement penalties must be considered. The levying of understatement penalties must be considered where an understatement occurred. The percentage of a penalty varies from 0% to 200%. Harsher penalties are reserved for culpable repeat offenders or obstructive taxpayers. Thereafter a revised assessment will be raised.

A Notice of Assessment and a Finalisation of Audit Letter detailing the grounds of the assessment (including amounts) will be issued via eFiling, email or post. Any refund due to you will be paid out after the completion of the audit, subject to specific refund validations being passed. An assessment may also result in tax owing to SARS. The payment due date of such debt will be stipulated in the Notice of Assessment.

A SARS assessment normally becomes final within 3 years from the date of assessment (non-self-assessment taxes like Income Tax) or five years from date of assessment (self-assessment taxes like Value Added Tax). However, SARS does have the right to open an already prescribed assessment where fraud, misrepresentation or non-disclosure of material facts is identified. Furthermore, SARS has the right to extend the prescription date in certain instances.

If no finding was made as result of the audit or SARS conceded based on the response by the taxpayer to the Audit Findings Letter, a Finalisation of Audit Letter will be issued via eFiling, email or post.

If you are aggrieved by the assessment, you can dispute it. Refer to Objections for more guidance on that process.

If you are aggrieved by the original assessment based on an estimate, you can submit the complete and correct return within 40 business days from the date of assessment.

- Should you require any assistance after finalisation of the audit, contact the SARS Contact Centre on 0800 00 7277.

Voluntary Disclosure Programme

At all times, during verification or audit, the taxpayer can approach the Voluntary Disclosure Unit to make a voluntary disclosure. Refer to the Voluntary Disclosure programme for more guidance on that process.

APPENDIX F

RULES OF ENGAGEMENT AT COMMENCEMENT OF THE TAX AUDIT

Tax audits are very daunting. Thus, it is important to know the MNE's rights and the duties of the revenue authority. Pay careful attention to what follows, in conjunction with the many letter templates supplied in this book that apply at the commencement of an audit. The MNE has rights. Use them or lose them. But don't complain if you don't use them.

INTRODUCTION

Any tax audit (when initiated by a revenue authority) can be daunting for taxpayers responsible for tax management, and thus, it is essential to understand how to manage this assistance. Here is some guidance on the important topics that need to be addressed in such a situation.

To ensure a compliant and non-tax evading taxpayer group of companies, the following topics should be addressed:

1. Outcome to be achieved: Before engaging with the revenue authority, it is important to have a clear idea of the outcome that is sought to be achieved. The objective of the engagement should be to conduct it efficiently and effectively while being examined professionally and objectively.
2. Matters to be avoided: Three areas should be avoided in setting the objectives to be achieved:
 - Absence of objectivity in examination and position;
 - The audit going off on tangents or irrelevant or immaterial matters;
 - Excessive and unnecessary time and resource utilization.
3. Access powers of the revenue authority: The power conferred on the revenue authority to acquire information is fundamental to the conduct of the revenue authority audit activities. The powers that allow the revenue authority to compel the provision of information or documents and/or to compel custodians of documents, records, and information to allow the revenue authority staff access to those sources of information very similar in various jurisdictions. I reference the applicable sections in the Australian Income Tax Act by way of an example to illustrate the rights of taxpayers and the obligations of revenue authorities. These are Sections 263 and 264 of the Income Tax Assessment Act.¹

¹ Corrs Chambers Westgarth Lawyers, Breakfast Series Client Presentation 24 & 28 May 2002.

4. Jurisdictional Limitations on these powers: Jurisdictional limitations on the revenue authorities' power to acquire information should be kept in mind.
5. Confidential business relationships: Taxpayers must be cautious of maintaining confidential business relationships while providing information to the revenue authority.
6. Access to computers: The revenue authority may access computers during an audit, and therefore, taxpayers should be aware of the implications. Rather provide information that has been extracted and checked by the taxpayer. Open ended access will cause potential problems.
7. Offshore information: It is important to understand the implications of the revenue authority's ability to access offshore information. Here the wording of double-tax agreements as they interrelate with domestic secrecy provisions is important.²
8. Revenue authority guidelines: Taxpayers must familiarize themselves with the revenue authority guidelines to ensure compliance.
9. Taxpayers' charter: The Taxpayers' charter outlines taxpayers' rights and obligations, and it is important to understand them.
10. Procedures for access to company records: Taxpayers should be aware of the procedures for providing access to company records.
11. Copying company documents: Taxpayers should be aware of the revenue authority's ability to copy company documents.
12. Use of outside experts by the revenue authority: Taxpayers should be aware of the revenue authority's ability to engage outside experts, especially when the "Tax Inspectors Without Borders" initiative is implemented.
13. Restricted source documents: Taxpayers should be cautious of providing access to restricted source documents.
14. Legal profession privilege: Taxpayers must be aware of legal profession privilege while providing information to the revenue authority.
15. Freedom of information: The revenue authority may disclose information under the Freedom of Information Act, and taxpayers should be aware of this, and check this against the domestic secrecy provisions in the domestic tax legislation.
16. Interface with the revenue authority: Taxpayers must ensure that the interface with the revenue authority is professional and objective. All interactions should be "on the record" and reduced to writing and official minutes of meetings.
17. Conduct of meetings: The conduct of meetings with the revenue authority should be professional and objective. Take note of the recommendation for minutes of meetings.
18. Dispute resolution approaches: Taxpayers must be aware of the various dispute resolution approaches available to them.
19. Settlement approaches: Settlement approaches must be considered by taxpayers during an audit. Here, make sure that whatever is proposed by the revenue authority is within the scope of their powers, as they may not deviate from the letter of the law, no matter how attractive the proposition.

In conclusion, engaging with the revenue authority can be a daunting task for many taxpayers, but it is important to approach it with a clear plan and understanding of the potential outcomes. By setting clear objectives and avoiding common pitfalls, such as a lack of objectivity or excessive resource utilization, taxpayers can work with the revenue authority to ensure an efficient and effective audit process. It is also important to understand the revenue authority's access powers and to carefully manage confidential business relationships to ensure that all parties can work together productively. Ultimately, the goal should be to achieve a fair and reasonable outcome for both the taxpayer and the revenue authority.

AUSTRALIAN JURISPRUDENCE

Jurisdictional Limitations on Information Gathering Powers

It is a foundational principle of statutory interpretation that a statutory power may only be exercised for the purpose for which it has been conferred. Courts in Australia and across the common law world have consistently affirmed that

² See **Appendix G** on a MNE being asked to provide information to a revenue authority where it is not a taxpayer. Special rules apply that emerge from DTAs. See **Appendix H** for a suggested response.

statutory authority cannot be expanded by implication or applied beyond the scope intended by Parliament. This principle frames the Commissioner of Taxation's access and information-gathering powers under the the Australian Income Tax Assessment Act³ (ITAA 1936), most notably those contained in sections 263 and 264.

Case law makes clear that the Commissioner's powers must always be exercised in pursuit of statutory purposes. In *Swan Hill Corporation v Bradbury* (1937) 56 CLR 746, the High Court of Australia declared:

"The jurisdiction conferred by statute cannot be extended by implication to matters not within its scope, and it is necessary that the jurisdictional facts should exist before the power can be exercised."

This statement has become a touchstone for understanding the boundaries of statutory powers. Likewise, in Shrimpton v The Commonwealth and Another (1945) 69 CLR 613, the Court reinforced the principle that statutory powers cannot be read more broadly than the words of the statute allow:

"The powers conferred by a statute cannot be enlarged or diminished by construction, and it is necessary that the purpose of the power should be ascertained from the language of the statute."

Similar observations appear in *R v Bromhead and Another; Ex Parte Miss Daveney Pty Ltd* (1946) 73 CLR 237 and *Samrein Pty Ltd v Metropolitan Water Sewerage and Drainage Board* (1982) 41 ALR 467, among others. Together, these cases underscore the importance of statutory purpose as a limiting factor on the Commissioner's powers.

Express and implied statutory purposes

In some instances, the statute itself specifies the purpose for which a power can be exercised. For example, section 264(1)(b) allows the Commissioner to compel evidence or documents, but only where the information is relevant to a person's income or assessment. Section 264A is even narrower, authorising the Commissioner to seek information from offshore only if it relates directly to the assessment of the taxpayer who receives the notice.

By contrast, section 263 employs broad wording, empowering the Commissioner to access premises and examine documents "for any of the purposes of this Act." Such wide language grants significant discretion, but it remains tethered to the overall objectives of the ITAA 1936. Other provisions, such as section 264(1)(a), do not specify any purpose at all. Yet courts have consistently held that such powers are still bounded by the purposes of the statutory scheme in which they appear.

Legislative guidance on statutory purpose

Although the ITAA 1936 does not always define its purposes explicitly, some provisions provide general guidance. Section 17, for example, provides for the levy of tax on taxable income derived during a year of income. Section 8 charges the Commissioner with the general administration of the Act, including the making of assessments (section 169) and the recovery of tax (Part VI, Division 1). Sections 263 and 264(1) must therefore be understood as tools designed to enable the Commissioner to carry out these functions.

As Mason J explained in *Commissioner of Taxation v ANZ Banking Group Ltd; Smorgon and Others* (1979) 143 CLR 499 at 535:

"The powers conferred upon the Commissioner must be circumscribed by reference to this purpose."

Judicial reluctance to define outer limits

A recurring difficulty is that the ITAA 1936 does not always state its purposes clearly. In such situations, courts have often been reluctant to prescribe hard boundaries, preferring instead to apply broad principles. Over time, decisions from *Industrial Equity* through to *Deloitte Touche Tohmatsu* have developed a framework for evaluating whether particular

3 Income Tax Assessment Act 1936 (Cth) (ITAA 1936).

exercises of power are consistent with the statute.

Industrial Equity Limited & Anor v Deputy Federal Commissioner of Taxation & Ors⁴ (Fed Ct - Single Judge)

Einfeld J, at first instance in *Industrial Equity*,⁵ held that '[t]he Commissioner's prime functions are to determine tax liability with accuracy and collect tax found to be due' and that these are purposes of the Act.⁶ Interestingly, Einfeld J went on to cite instances where a use by the Commissioner of his section 263 power would not be for the purposes of the ITAA (1936). His Honour stated that the Commissioner does not have power to use section 263 to conduct statistical, information gathering or other 'lesser exercises' such as financial or other census-type operations.⁷

The High Court in *Industrial Equity*⁸ neither approved nor disapproved of Einfeld J's comment. Accordingly, it cannot be dismissed altogether. Einfeld J's comment may cast a shadow over the Commissioner's practice in Australia of requiring that certain financial and other information be included in tax return cover sheets.

Sometimes revenue authorities will distribute circulars to obtain information from a body of taxpayers to understand certain aspects of their business dealings and transactions. This calls into question the power of the revenue authority to do so. Is this power within the scope of their powers and the jurisdictional facts of the governing legislation? Revenue authorities are creatures of statute.

Kerrison and Another v Commissioner of Taxation⁹

In *Kerrison and Another v Commissioner of Taxation*¹⁰ Bollen J considered whether the request by a taxation officer for access to bank safe deposit boxes which he believed may contain gold bullion or paper relating to the taxation affairs of the taxpayers was for the purposes of the ITAA (1936). Part of the taxpayers' submission was that the Commissioner could only exercise his power in section 263 if he held a belief, based upon reasonable grounds, that the boxes contained material relating to the income or assessment of the taxpayers.

Bollen J held that -

"... the answer probably is that the idea of a reasonable belief that the boxes contained material relating to income or the assessment of income tax of the taxpayers is comprehended in the phrase "for the purposes of this Act". If [the taxation officer] had no such belief on reasonable grounds he could hardly have been seeking access "for the purposes of the Act".¹¹

His Honour found that the actions of the taxation officer in the particular instance, including peering through holes in the boxes and weighing the boxes, resulted in the officer having a reasonably based belief that the boxes contained gold and papers which might relate to the gold and hence the assessment to tax of the taxpayers.¹² In addition, the fact that asset betterment assessments had already been issued to the taxpayers did not preclude the request for access to the boxes from being for the purposes of the ITAA (1936) since the taxation officer intended to adjust those statements depending upon the contents of the boxes.¹³

It may happen that whilst investigating the tax affairs of a taxpayer, the revenue authority may come upon another encroachment of the law unrelated to the tax affairs. In most countries the secrecy provisions will protect the taxpayer because the other encroachment has nothing to do with tax.¹⁴

4 89 ATC 4864.

5 Id.

6 Ibid at 4877.

7 Id.

8 90 ATC 5008.

9 82 FLR 223.

10 Id.

11 82 FLR 223 at 234.

12 Id.

13 Id.

14 For further information on this topic please contact the writer

In *Southwestern Indemnities Limited*¹⁶ the Court held that the Commissioner could use his power in section 263 to investigate the Australian taxation affairs of non-residents.

That case involved a request by a taxation officer under section 263 for access to ledger records of the Norfolk Island branch of the Bank of New South Wales. The Applicant, a Norfolk Island resident company with shareholders who were all natural persons resident in Norfolk Island, contended that access to its bank ledger cards should be denied because the Act had no application to a Norfolk Island resident which had only received Norfolk Island sourced income. The Commissioner submitted that he did not concede that the Applicant's only income was derived from a source in Norfolk Island by a resident of that island. The Commissioner further submitted that, in any event, his purpose in seeking access to the bank's records was to pursue investigations into the taxation liability of persons other than the taxpayer.

Barwick CJ considered that the Commissioner was not obliged to accept the Applicant's assertions as to residence and source of its income and accordingly held that

*"... an examination of the applicant's affairs to test its assertions as to residence and income source is within the purposes of the Act."*¹⁷

His Honour concluded that the exclusion from the application of the Act of the Norfolk Island sourced income of Norfolk Island residents did not mean that the powers under s 263 were unavailable to the Commissioner in respect of the books and documents of the taxpayer. His Honour also held that the purposes of the Act which the Commissioner claimed to be pursuing included investigation into the affairs of other taxpayers and that this was sufficient to satisfy the condition of making the access request for the purposes of the ITAA (1936).¹⁸

***Clyne v Deputy Federal Commissioner of Taxation and Anor*¹⁹**

In *Clyne*²⁰ the Court held that the Commissioner was able to exercise his access powers in section 263 of the ITAA (1936) to determine the tax liability of a bankrupt's clients or to consider whether to reassess the bankrupt taxpayer to tax.

***The Commissioner of Taxation of the Commonwealth of Australia and Others v The Australia and New Zealand Banking Group Limited and Smorgon and Others*²¹**

In *Smorgon*²² the Court confirmed in very broad terms that the powers granted to the Commissioner under the ITAA (1936) must be exercised for the purposes of the Act. Further, those purposes are to ascertain the taxable income of any person (not just the recipient of the access request) and the tax payable on that income.

The Court in *Smorgon*²³ also upheld the notion in *Southwestern Indemnities*²⁴ that a right of access is not confined to documents relating to the income of the person who has possession of the documents at the time.²⁵

***Sharp & Anor v Deputy Federal Commissioner of Taxation & Ors*²⁶**

In *Sharp*²⁷ the Applicants sought interlocutory relief in respect of an exercise of power under section 263 by taxation officers seeking access to fax books recording facsimile transmissions sent. The Applicants submitted that the taxation officers were seeking access to the fax books for the purpose of gathering information rather than to assess a taxpayer's

15 (1973) 129 CLR 512.

16 Id.

17 (1973) 129 CLR 512 at 519.

18 Id.

19 85 ATC 4597.

20 Id.

21 (1979) 143 CLR 499.

22 Id.

23 Id.

24 (1973) 129 CLR 512.

25 (1979) 143 CLR 499 at 534 per Mason J.

26 88 ATC 4165.

27 Id.

taxable income.

Beaumont J found that there was no evidence that the officers were ‘gathering information for its own sake’ and that the evidence was consistent with the officers having a purpose of investigating whether a person had a liability to tax under the ITAA (1936).²⁸ Beaumont J in effect held that the exercise of access and information gathering powers cannot be for no purpose at all, but rather, must be directed towards gathering information in order to determine a person’s tax liability or for some other purpose of the ITAA (1936).

Simionato Holdings Pty Ltd v Federal Commissioner of Taxation (No 2)²⁹

In *Simionato Holdings*³⁰ von Doussa J held that the collection and recovery of tax is a purpose of the ITAA (1936).

His Honour upheld the actions of taxation officers in using the access power in section 263 to obtain information in banking records to pass on to the liquidator of a group of companies for use in Public Examination proceedings under Pt 5.9 of the Corporations Law. The ultimate purpose of this action was to maximise the return to creditors (including the Commissioner) from the liquidation of the companies.

Von Doussa J held that the decision in *Industrial Equity*³¹ does not mean that the Commissioner will only be acting for the purposes of the Act where he is endeavouring to determine the taxable income of taxpayers. His Honour determined that in considering what is a purpose of the Act in the context of section 17 of the ITAA (1936):

*“[t]hat section provides not only that income tax is levied upon the taxable income derived during a year of income, but also that the income tax “shall be paid”. The payment of tax is as much part of the primary purpose of the ITA Act as the levy of tax . . .”*³²

His Honour went on to state that the assessment and recovery of tax are “the two sides of the same coin” and that “[t]he effective raising of revenue under the ITA Act requires that both functions be fulfilled.”³³

May v DFC of T³⁴

The case *May v Deputy Commissioner of Taxation (DFC of T)* primarily involved a dispute about the Commissioner of Taxation’s authority under section 264 of the Income Tax Assessment Act to demand specific information related to employee share acquisition plans and benefit trust arrangements. The Deputy Commissioner issued notices requiring Mr. May to provide detailed information concerning these arrangements, which the firm had prepared for its clients. Mr. May argued that the information sought by the Commissioner was not sufficiently clear and that much of it could be subject to legal professional privilege. However, the court ultimately upheld the Commissioner’s right to request the information, stating that the Commissioner had acted within the proper scope of his powers under section 264, which allows for the collection of information necessary for the administration of tax laws.

The court also discussed procedural fairness in relation to the rights of the clients affected by the notice. Although the court recognized that clients’ interests might be impacted, it found that the statutory powers of the Commissioner justified the request for information without a prior requirement for client notification or consent.

This case highlights the broad powers granted to tax authorities in obtaining information to ensure compliance with tax laws and demonstrates the potential limitations on claims of legal professional privilege in such contexts.

28 Ibid at 4167-4168.

29 95 ATC 4720.

30 Id.

31 90 ATC 5008.

32 95 ATC 4720 at 4726.

33 Ibid at 4727.

34 98 ATC 4960.

These cases considered whether section 264 notices issued to professional firm were valid, being issued for the purposes of the ITAA (1936).

Two general propositions can be drawn:

- i. that notices issued to enable the Commissioner to perform his functions under the ITAA (1936) or for the proper administration of the Act are permitted under section 264(1)(a);
- ii. general enquiries to gather information to consider the taxation impact of a type of transaction and the scope of that transaction are either purposes of the ITAA (1936) or part of the administration of the ITAA (1936) and therefore permitted exercises.

Conclusion to Australian jurisprudence

The case law on sections 263 and 264 of the ITAA 1936 reveals a consistent judicial theme: statutory powers must be exercised only for the purposes of the Act. Courts have repeatedly emphasised that the Commissioner cannot act arbitrarily or beyond statutory purpose.

Yet the same body of case law confirms the breadth of the Commissioner's authority. Powers of access and information gathering extend to third parties, to non-residents, and to both assessment and collection of tax. They can be used to test assertions about residence and income source, and to investigate broader patterns of transactions.

The balance is one of breadth constrained by purpose. The Commissioner has wide-ranging tools at his disposal, but those tools must always be deployed in pursuit of the statutory objectives of assessment and collection. As Mason J observed in *Smorgon*, the Commissioner's powers "must be circumscribed by reference to this purpose."

AMERICAN JURISPRUDENCE

American jurisprudence has also developed significantly in this area.³⁶ A summary of American jurisprudence, analogous to the principles discussed above, includes:

- in making inquiries and obtaining information from taxpayers, the investigation must have a legitimate purpose;
- the information must not already be in the State's possession;
- all procedural steps must have been followed; the demands must not be overbroad;
- taxpayers do not have to manufacture documents not in their possession; and
- must relate to persons and information that will have a bearing on the tax being investigated in respect of the taxpayer under investigation.

³⁵ 98 ATC 5192.

³⁶ For American comparative law that may influence court decisions in countries with Constitutions that are allowed to develop with reference to foreign law, such as South Africa in terms of s 39(1)(c) of the Constitution: *US v McCarthy* 514 F.2d 368: '...(1) that the investigation has a legitimate purpose and that the inquiry may be relevant to that purpose, (2) that the information sought is not already within the Government's possession, and (3) that the Government has followed the procedural steps required by the Internal Revenue Code'; *Martin v Chandis* 128 F.2d 731: where the Ninth Circuit held: '(t)he rights of an internal revenue agent to require production of papers and records for examination are statutory, and in order to obtain the relief granted by statute, he must bring himself within the terms thereof'; In *US v Williams* 337 F. Supp. 1114: '...message slips held by taxpayer's telephone answering service ... to check his returns ... subpoena was overbroad and out of proportion to ends sought, and as such not entitled to enforcement'; *First National Bank of Mobile v US* 160 F.2d 532: where '(a) third party should not be called upon to produce records and give evidence ... unless such records and evidence are relevant to or bear upon the matter being investigated'; *US v Coopers and Lybrand* 413 F. Supp. 942: where 'Internal Revenue Service summons requesting records, papers, and other data of a taxpayer will be enforced only if the information sought is not already in the possession of the IRS is designed to protect taxpayers and third parties from the abuse of summons power'; *Hubner v Tucker* 245 F.2d 35: where a '(s)pecial agent, internal revenue service, who sought to enforce subpoena against third person to compel production of records in investigation of others' tax liability, had no right to examine any paper unless it was proved to have therein entry relating to tax liability of persons under investigation, under statute relating to examination of books and witnesses'; *US v Brown* 536 F.2d 117: where the court held "'Books, papers, records, or other data" to be produced under ... the Internal Revenue Code relating to examination of books and witnesses ... did not ... authorize the IRS to require the manufacture of documents or other data for examination'; *Local 174 International Brotherhood of Teamsters v US* 240 F.2d 387: where '(i)n proceeding by revenue agents to compel union's production of records relating to transactions with taxpayer-president, agents had burden to show that demand was reasonable under all circumstances and to prove that books and records were relevant or material to tax liability of taxpayer and that union possessed books or records containing items relating to taxpayer's business'. (Emphasis supplied); See also *US v Newman* 441 F.2d 170.

SOUTH AFRICAN JURISPRUDENCE

In South Africa a lawful decision of the revenue authority must comply with the constitutional obligations of:

- impartially,
- fairness,
- equitable and unbiased conduct,
- in an accountable and transparent fashion with timely, accessible and accurate information, in respect of section 195(1) of the Constitution.³⁷

To ensure the lawfulness of an inquiry and audit, consideration must also be given to any legitimate expectation created by the South African Revenue Authority in its Code of Conduct and its internal guidelines when auditing a taxpayer, which includes:

- a). 'insight into...the business process of the taxpayer...';³⁸
- b). '(after) screening the tax returns...(the taxpayer)...warrant(s) an audit...';³⁹
- c). it has identified 'which elements of the tax return(s) need to be audited...';⁴⁰ and
- d). obtaining 'information from other sources...(on)...the potential issues of the relevant case...'.⁴¹

The inquiry and audit should be based on specific facts as effectively called for in the definition of 'for the purposes of the administration of this Act' as defined in the Tax Administration Act, 2011:

- a). there must be an amount received by accrued to any person that must be in question;
- b). there must be a property disposed of under a donation;
- c). there must be a dividend declared under investigation;
- d). the investigation must be in relation to an inquiry in a return, financial statement, document, declaration of facts or valuation, and the originating document must also exist to enable the further inquiry;
- e). the investigation must relate to the determination of the liability for any tax, interest or penalty; here the existence of general evidence to suggest that the person is a taxpayer should at least exist;
- f). the investigation must relate to collecting a liability, and the liability must exist;
- g). ascertaining whether or not an offence has been committed by the taxpayer, whilst conducting the inquiry and audit. This is a very controversial issue as civil investigation provisions are being used to investigate criminal conduct by the taxpayer, where the taxpayer is being compelled⁴² to give incriminating evidence, in contravention of the provisions of s 35(3) of the Bill of Rights. This is prima facie unconstitutional unless certain Constitutional guarantees are provided;
- h). ascertaining general compliance, which is vague⁴³ and very general; this should also be prefaced by evidence that the person under investigation is the subject of an inquiry and audit owing to the existence of some evidence that warrants the exercise of the power to ensure that the decision of SARS is not arbitrary, capricious or has an ulterior or improper purpose. The random selection⁴⁴ of a taxpayer, without any form of preparatory justification by SARS for the inquiry and audit, may fall foul of the impartiality⁴⁵ provision in s 195(1) of the Constitution.

37 For a copy of the writer's PhD thesis in respect of tax audits in South Africa and compliance with the Constitution, please email the writer.

38 *Ibid.* at page 2.

39 *Ibid.* at page 4.

40 *Ibid.* at page 5.

41 *Ibid.* at page 6.

42 Constitution ss 35(3)(h)-(j). See also *ITC 1818* 69 SATC 98 and *Seapoint Computer Bureau (Pty) Ltd v McLoughlin and de Wet NNO* 1997 (2) SA 636 (W).

43 See *Local 174 International Brotherhood of Teamsters v US*, 240 F.2d 387 for comparative American jurisprudence where the court held (quoted from the headnote): 'agents had [a] burden to show that [the] demand was reasonable under all circumstances and to prove that books and records were relevant or material to tax liability of taxpayer ...and the taxpayer... possessed books or records containing items relating to taxpayer's business.'

44 In *US v Third Northwestern National Bank* 102 F Supp 879 the court held (quoted from the headnote): 'A "fishing expedition" under statute permitting Internal Revenue agent to examine records bearing upon matters to be included in income tax return cannot amount to an inquiry or arbitrary inquiry on the part of an Internal Revenue agent, and determination as to whether inquiry is reasonable, and therefore justifiable "fishing", must be determined from all the facts in each case, including the end for which the information is sought, and proof and prevention of tax frauds is not the only factor to be considered'. This basic requirement limits a simple random taxpayer selection without SARS performing some preparatory work.

45 In *Reckitt and Coleman (NZ) Ltd v The Taxation Board of Review and The Commissioner of Inland Revenue* Turner J stated: 'It is of

It should also be clear that the audit or investigation is in respect of a named person who is or should be a 'taxpayer' as defined;

- i). the enforcement and performance of administrative function provisions, which again is a very vague and general provision, requiring some justification⁴⁶ from the South African Revenue Authority that the inquiry and audit is necessary and within the scope and purport of its powers, as qualified by the requirement of effectiveness and efficiency set out in section 4(2) of the Act governing the South African Revenue Service.

All of these facts will have a source, giving rise to the initial information upon which South African Revenue Authority relies to enable it to commence the inquiry and audit in the first place. At this point it becomes important for South African Revenue Authority to follow its own internal guidelines, and to provide the necessary justification to proceed with the inquiry and audit, otherwise the conduct of South African Revenue Authority will prima facie be unlawful. Furthermore, taxpayers can also expect that in carrying out its audit and inquiry functions, South African Revenue Authority will not act in a vexatious or oppressive manner towards those taxpayers.⁴⁷

SUMMARY OF CONCLUSIONS MEETING JURISDICTIONAL REQUIREMENTS

As mentioned above, the cases do not provide definitive guidance on the scope of the purposes of the relevant legislation. However, it is possible to distil the following broad principles from the cases.

- (i) The primary purpose of the legislation is usually to levy tax upon the taxable income of a person derived during a year of income and the question of whether something is a purpose of the legislation is determined by reference to this primary purpose. Accordingly, the due making of assessments to tax and the recovery of tax payable by taxpayers are purposes of the legislation because they are a part of the process of levying tax.⁴⁸
- (ii) A tax audit, by its inherent nature of being an enquiry into the taxable income of taxpayers, satisfies the test that it be undertaken for a purpose of the legislation unless the reason for conducting the audit has so altered its essential nature that it no longer has as its purpose the enquiry into taxable income.⁴⁹
- (iii) Determining whether to make an assessment, making or calculating the amount of the assessment, determining whether an assessment should be amended, amending an assessment, ascertaining the assessable income of a taxpayer to determine whether an assessment should be made or amended or to make or amend an assessment and identifying those who have received assessable income are usual purposes of the legislation.⁵⁰
- (iv) The exercise of a power of access to documents is for a purpose of the legislation if the person exercising the power has a reasonably based belief that the relevant documents relate to the income or assessment of income tax of taxpayers.⁵¹
- (v) Access and information gathering powers can be exercised to check that the taxing provisions of the legislation that have no application to a particular taxpayer, eg. an examination of documents to check taxpayers' assertions as to residence and income source is for a purpose of the legislation.⁵²
- (vi) Access to a taxpayer's documents for the purpose of determining the taxable income of other taxpayers and the tax payable on that income is usually for a purpose of the legislation.⁵³

the highest public importance that in the administration of [tax] statutes every taxpayer shall be treated exactly alike, no concession being made to one to which another is not equally entitled...Where there is no express provision for discretion, however, and none can be properly implied from the tenor of the statute, the Commissioner can have none; he must with Olympian impartiality hold the scales between the taxpayer and the crown giving to no one any latitude not given to others.'

46 For the requirements of lawful justification, see *Premier of Mpumalanga and Another v Executive Committee of the Association of Governing Bodies of State-Aided Schools: Eastern Transvaal* 1999 (2) BCLR151 (CC) at para [42]: '...no question of justification ...can arise as the decision taken...did not constitute 'a law of general application' as required by that provision...'; cf. *Registrar of Pension Funds and another v Angus NO and others* [2007] 2 All SA 608 (SCA) where the court held 'in terms of law [of general application]' would enable a decision. SARS decisions are enabled 'in terms of law [of general application]'.

47 *Chairman of the Board on Tariffs and Trade and Others vs Brenko Inc and Others* 64 SATC 130 at para's [29] and [30], where it was held by the Supreme Court of Appeal that '...investigatory proceedings, which have been recognised to be absolutely essential to achieve important policy objectives, are nevertheless subject to the constraint that the powers of investigation are not exercised in a vexatious, oppressive or unfair manner (cf. *Bernstein and Others v Bester and Others NNO* 1996(2) SA 751 (CC) at 584F-I)...'; See also *Gardener v East London Transitional Local Council and Others* 1996(3) SA 99 (E) at para's 116E-G.

48 See *Industrial Equity* 90 ATC 5008.

49 Id.

50 90 ATC 5008 per Gaudron J at 5018.

51 See *Kerrison* 82 FLR 223.

52 See *Southwestern Indemnities* (1973) 129 CLR 512.

53 See *Southwestern Indemnities* (1973) 129 CLR 512 and *Smorgon* (1979) 143 CLR 499.

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- (vii) The collection and recovery of tax are considered for the purposes of the legislation as the levying of tax.⁵⁴
 - (viii) Use of the investigatory powers to gather information for its own sake is not a use of those powers for the purposes of the legislation.⁵⁵
 - (ix) Use of the investigatory powers to conduct a statistical, information gathering or census-type exercise is not a use of those powers for a purpose of the legislation.⁵⁶

DIFFICULT QUESTIONS

In an information gathering notice the Commissioner can ask a range of questions, some of which may be very difficult (at times impossible) to answer. Examples might be questions relating to events which happened ten years ago. This does not make the section notice invalid. A recipient can comply by simply saying “I cannot remember”.

CONFIDENTIAL BUSINESS RELATIONSHIPS

It is important to note that informal cooperation with the revenue authority does not set aside confidentiality obligations. If a person discloses information without a lawful obligation to do so, they may be exposed to legal action. This underscores the need for careful consideration of the legal and contractual obligations regarding confidentiality before disclosing information to the revenue authority.

In some cases, legal precedent may provide guidance on the extent of confidentiality obligations. For example, in the case of *Simionato Holdings*, it was held that the confidentiality obligations of a taxpayer? did not extend to information that was lawfully required by the revenue authority. Similarly, in *Sharp and Industrial Equity*, it was held that contractual confidentiality obligations were set aside when the revenue authority exercised its formal powers.

However, it is important to note that not all cases are the same, and legal precedents may not always apply. In *Industrial Equity*, for example, Einfeld J. held that the extent to which confidentiality obligations are set aside depends on the facts of each case. Similarly, in *McLaren v DFC of T*, Gray J. held that confidentiality obligations may not be set aside if disclosure would be unfair or contrary to the public interest.

In summary, confidentiality is an essential element of business relationships, but it may be set aside in certain circumstances, such as when the revenue authority exercises its formal powers. Before disclosing any information to the revenue authority, it is important to consider the legal and contractual obligations regarding confidentiality, as well as the specific facts of the case.

ACCESS TO COMPUTERS

As more businesses adopt electronic record-keeping systems, the revenue authority requires that these records be kept in a form that their staff can access and understand to determine a person’s taxation liability. Computer records are usually recognized as documents and the word record usually includes information stored by means of a computer. This means that any electronically stored records must be provided to the revenue authority with all reasonable facilities and assistance for the effective exercise of their powers to do so.

The revenue authority policy is usually that the occupier of the building must provide reasonable facilities and assistance that extend, where necessary, to the provision of login codes, keys, passwords, etc., for the effective exercise of any such powers. Once the information has been located, revenue authority staff should ask the occupier to copy all the relevant information onto storage devices provided by the revenue authority. However, in all but exceptional circumstances (such as by virtue of a court order), revenue authority staff are not to operate the computer system of the custodian.

While the revenue authority has the authority to seek access to computers and information stored on them, there are regulations on how these demands might be satisfied. Usually, legislation such as an Interpretation Act provides that

54 See *Simionato Holdings* 95 ATC 4720.

55 See *Sharp* 88 ATC 4165 and *Industrial Equity* 90 ATC 5008 per Gaudron J.

56 *Industrial Equity* 89 ATC 4864 per Einfeld J.

where a person who keeps a record of information by means of a mechanical, electronic or other device is required by or under that legislation to produce the information or a document containing the information to, or make a document containing the information available for inspection by, a court, tribunal or person, the requirement shall be deemed to oblige the person to produce or make available for inspection, as the case may be, a writing that reproduces the information in a form capable of being understood by the court, tribunal, or person.

Therefore, *prima facie*, any access request that can be satisfied by producing a paper printout must be complied with. However, revenue authorities usually policy invite taxpayers to carry out the copying of these electronic records where it is necessary to download them onto revenue authority computers.

It is important to note that although businesses have the option to keep records electronically, they must ensure that they are in a form that can be accessed and understood by the revenue authority to comply with their obligations. This includes providing reasonable facilities and assistance to the revenue authority when requested and complying with the regulations set out in the governing legislation. Failure to comply with these obligations may result in penalties or legal action.

OFFSHORE INFORMATION

The revenue authority is empowered to request information or documents from taxpayers located outside the country. However, the revenue authority cannot compel the production of such information or documents. However, failure to comply with an offshore information notice may result in the documents or information not being admissible in evidence in the event of a disputed assessment.

In *F.H. Faulding v FCT*,⁵⁷ the scope of section 264A of the ITAA (1936) in Australia was considered by the court. It was established that the power granted under section 264A is only available for the purpose of obtaining information or documents relevant to the assessment of the taxpayer. The intention of the section is to place an obligation on the taxpayer to obtain or pressure others to provide information and documentation that is overseas. The revenue authority may issue an offshore information notice even if compliance is onerous or impossible if there is a reasonable basis to believe that relevant information or documents exist.

However, if the only purpose of the notice is to obtain an evidentiary sanction, the notice would not be relevant to the assessment of the taxpayer's affairs and would be invalid. The power does not extend to requiring recorded statements to be obtained by the taxpayer from a third party. If there is no reasonable basis to believe that relevant information or documents exist, the revenue authority does not have the power to request the information or documents.

It is important for taxpayers who receive an offshore information notice to check the terms of the notice to ensure that each request is relevant to their assessment and that the request is only directed to them and not to third parties, including other group companies.

In the *Faulding* case, the offshore information notice was declared invalid because some parts of the request were beyond the power granted under section 264A. Although not all the items were beyond the power, the invalid components were so inextricably mixed up with the valid requests that severance was impractical.

In summary, the power granted to the revenue authority under a section such as section 264A of the ITAA (1936) to request information or documents from taxpayers located outside the country is only available for the purpose of obtaining information or documents relevant to the assessment of the taxpayer if there is a reasonable basis to believe that relevant information or documents exist. If the only purpose of the notice is to obtain an evidentiary sanction, the notice would not be relevant to the assessment of the taxpayer's affairs and would be invalid. The power does not extend to requiring recorded statements to be obtained by the taxpayer from a third party.

57 94 ATC 4867 at 4903 per Cooper J.

GUIDELINES

Many revenue authorities' issues tax audit guidelines. Reference was made above to guidelines in South Africa. They provide detailed information on what taxpayers can expect from revenue authority staff.

In the case of *Deloitte Touche Tohmatsu v DFC of T*,⁵⁸ Justice Goldberg addressed the relevance and status of these guidelines. He noted that they do not have the status of a legislative enactment but are rather the creation of the Commissioner and the revenue authority. However, he also stated that they are a relevant consideration to which the revenue authority and its officers must have regard. In fact, they may even create a legitimate expectation in taxpayers and their professional accounting advisors that they will be complied with according to their terms.

Goldberg J acknowledged that the guidelines are not a source of rights per se, but rather a relevant consideration for decision-making. He noted that while the guidelines were simply guidelines and not to be construed and applied "over critically", they were still a matter to be considered by an administrative decision-maker. In other words, they may create an administrative estoppel, which could prevent the revenue authority from taking a different position on a particular issue if it has given a taxpayer an expectation that it would behave in a certain way.

Goldberg J also emphasized that the weight to be given to the guidelines is a matter for the decision-maker, not the court. Thus, while the guidelines can be enforced to a degree, their application ultimately depends on the specific circumstances of each case.

TAXPAYERS' CHARTER

Many revenue authorities issue a Taxpayer Charters that set out the rights, obligations, and standards that taxpayers and the revenue authority should adhere to, providing a framework for a fair, reasonable, and transparent taxation system. In South Africa the Taxpayer Charter is underpinned by section 195(1) of the Constitution (a high standard of professional ethics; efficient, economic, and effective use of resources; services must be provided impartially, fairly, equitably and without bias, and public administration must be accountable) placing a Constitutional obligation on that revenue authority to perform their duties accordingly, lest they fall foul of fundamental principles in that Constitution. Similar positions will ensue in other countries.

The Taxpayers' Charter emphasizes the importance of treating taxpayers fairly and reasonably. Taxpayers should be treated as honest unless they act otherwise. The revenue authority is accountable for its actions, and taxpayers' privacy should be respected, with their information kept confidential. The revenue authority also aims to help minimize taxpayers' costs in complying with the tax law.

In return, taxpayers have certain obligations under the Tax Charter. They are required to keep records in accordance with the law, take reasonable care in preparing documents, and be truthful in all dealings with the revenue authority. These obligations are essential to ensure that the tax system operates fairly and effectively.

The Tax Charter usually contains details of procedures, which include, providing notification of the intention to make enquiries or conduct an audit, providing tax office identification and telephone contact numbers, explaining the expected nature, scope, and duration of the audit, advising that taxpayers may have a representative present, and giving taxpayers reasonable time and opportunity to consult with their representatives.

During an enquiry or audit, the tax officer is required to ask clear and unambiguous questions. Taxpayers should be provided with an explanation of their obligations prior to any formal interview and given a reasonable opportunity to consult with their representatives or advisors. If the interview is taped, taxpayers should be provided with a free copy of the audio tape. Taxpayers should also be given reasonable time to collect their records and documents, and their right to legal professional privilege should be respected, with adequate opportunity given to claim privilege. Furthermore, some advice between taxpayers and their professional accounting advisors should remain confidential. The tax officer should provide written receipts for any records collected and make enquiries of third parties with discretion. Finally,

58 [1998] FCA 1439; 40 ATR 435.

taxpayers should be given the opportunity to give their views on any relevant issues.

At the completion of an enquiry or audit, the tax officer is required to clearly explain the basis of any adjustments. Taxpayers should be given an opportunity to explain any circumstances that they believe could justify a reduction of any penalty or interest, and the tax officer should be accompanied by at least one other officer during any settlement meeting. The terms of any settlement agreement should be documented, and a copy provided to taxpayers.

In return, the revenue authority expects that taxpayers will keep records in accordance with the law, provide tax officers with full and free access, allow tax officers to make copies or take extracts of documents, provide reasonable facilities and assistance to tax officers, and provide complete and accurate responses to requests for information. These obligations are essential to ensure that the tax system operates effectively and efficiently.

The revenue authority usually seeks to complete an enquiry or audit in the shortest possible time. However, the time taken will depend on several factors, such as the type of enquiry, the adequacy of the taxpayer's records, the availability of information, the complexity of the matter, and the level of the taxpayer's co-operation. These factors are important and can be used to keep the audit on track.

PROCEDURES FOR ACCESS TO COMPANY RECORDS

The provision of information and inspection access to the revenue authority can be approached in different ways by taxpayers. Although legislation mandates occupiers of premises to offer reasonable facilities and assistance, it does not necessarily entail doing the revenue authority's job for them. However, to ensure a smooth and swift management of an audit, taxpayers are encouraged to proactively locate and submit all relevant files and records to the revenue authority upon request. Failure to provide such assistance could result in an indefinite extension of the audit process, imposing considerable resource costs on both parties.

COPYING COMPANY DOCUMENTS

There are usually sections that empowers the revenue authority to access books, documents, or papers and make copies or extracts for any purpose under the relevant legislation. It's important to note that the revenue authority cannot seize or remove the original documents from the premises without the consent of the custodian. Although the access provisions allow officers to make copies, there is no prescribed method for doing so. It's believed that the legislation allows officers to copy documents using any appropriate means, such as handwritten copies, photocopies, photographs, or even digital copies.

To ensure minimal disruption to business operations and efficient management of the audit, it's advisable to provide the revenue authority with copies of the requested documents. This approach will save time and resources that would have been spent waiting for the revenue authority to make their own copies and may also reduce the risk of damage or loss of the original documents.

USE OF OUTSIDE EXPERTS BY THE REVENUE AUTHORITY

The revenue authority is usually vested with wide-ranging powers to obtain detailed and complex information from taxpayers. In certain circumstances, the revenue authority may need to enlist the help of outside experts to interpret and analyse this information. The *Consolidated Press Holdings v Federal Commissioner of Taxation*⁵⁹ the case dealt with the appointment of a private practising accountant by the Australian Commissioner for Taxation to assist in the interpretation and analysis of information passed on to him. The affected taxpayer contended that the appointment of an outside expert contravened Section 16 of the Taxation Administration Act 1953 (of the Australian legislation) and that the taxpayer had a reasonable expectation that the information would not be communicated outside the revenue authority without consultation with the taxpayer.

59 95 ATC 4231.

The Federal Court in the *Consolidated Press* case found that the appointment of the expert did not contravene Section 16. In his judgment, Lockhart J clarified that Section 16 is a constraining provision and not an empowering one. It does not provide the Commissioner with the power to engage external individuals or organisations to perform services; rather, such powers are granted elsewhere in the Assessment Act and the Taxation Administration Act of the Australian legislation. However, Lockhart J *Consolidated Press* case emphasised the importance of ensuring that the confidence of taxpayers in the taxation system and its integrity is maintained while engaging outside experts. He also noted that any such appointment should be made only after careful selection of the persons involved and that the confidentiality of taxpayers' affairs must be maintained.

Lockhart J *Consolidated Press* case also acknowledged that while the Commissioner was empowered to engage outside experts, the appointment of experts must observe the rules of natural justice, and taxpayers must have a say in the decision-making process. The court recognised that the affected taxpayer had a legitimate and reasonable expectation that the information would not be communicated outside the revenue authority without consultation with the taxpayer. In the *Consolidated Press* case, the Commissioner had not given the taxpayer an opportunity to oppose the appointment of the outside expert, which Lockhart J deemed to be a breach of the rules of natural justice (which apply in most jurisdictions: Administration conduct which must be fair, reasonable, comply with the audi alteram partem rule, not be biased, and be proportionate to the taxpayer rights being transgressed).

The Federal Court's decision in *Consolidated Press* aligned with the High Court's decision in *Johns v Australian Securities Commission*,⁶⁰ where the commission released confidential information to a Royal Commission that was holding a public hearing. In Johns case, Brennan J stated that the exercise of authority conferred by a particular section is capable of adversely affecting the interests of an examinee who has a prima facie entitlement to confidentiality. Therefore, there is an obligation on the person proposing to exercise the authority to observe the rules of natural justice. In *Consolidated Press*, Lockhart J echoed this sentiment and stated that the Commissioner must observe the rules of natural justice when appointing an outside expert.

Lockhart J clarified that the *Consolidated Press* judgment was not a bar to the Commissioner's appointment of an outside expert. However, it emphasised that natural justice must be observed and that the affected taxpayer must have an opportunity to oppose the appointment. Therefore, if the Commissioner appoints outside experts in the future, the appointment must be preceded by appropriate discussions between the revenue authority and the affected taxpayer to ensure that the requirements of natural justice are observed.

In conclusion, while the revenue authority has broad powers to obtain information from taxpayers, it must ensure that these powers are exercised within the bounds of natural justice. The appointment of outside experts must be carefully considered, and the confidentiality of taxpayers' affairs must be maintained. The affected taxpayer must also have a say in the decision-making process and be given an opportunity to oppose the appointment of an outside expert. If these requirements are met, the appointment of outside experts can aid the Commissioner in performing their functions more effectively.

FREEDOM OF INFORMATION

During an audit, it is important for taxpayers to maintain a clear line of communication with the revenue authority to ensure that the audit stays on track. This may involve seeking information from the revenue authority about its views on various topics or its opinions on the taxpayer under examination. While it would be ideal for the revenue authority to freely provide this information, sometimes it is necessary for the taxpayer to request access to relevant documents to achieve this goal.

Under the Freedom of Information legislation, taxpayers usually have the right to request access to information held by government bodies, including the revenue authority. However, there are exemptions to this right where certain documents may be withheld. These include documents protected by legal profession privilege, documents that could prejudice an ongoing investigation, documents containing information prohibited from release under secrecy

60 (1993) 178 CLR 408.

provisions, documents containing information contrary to the public interest, and documents forming part of a deliberative process.

In balancing the public interest in maintaining a functional revenue collection system with the public interest in ensuring that taxpayers have access to information about what the revenue authority thinks or knows about them, it is important to carefully consider each request for access to documents. While legal profession privilege is a key consideration in determining which documents can be withheld, it is not the only factor that must be considered.

In situations where access to documents is necessary, taxpayers must make a formal request to the revenue authority under the relevant Freedom of Information legislation. This request should clearly identify the documents being sought and provide a reason for the request. The revenue authority will then consider the request and determine whether any exemptions apply.

Overall, while it is important to maintain open lines of communication with the revenue authority during an audit, taxpayers also have the right to request access to relevant documents under Freedom of Information legislation. By carefully balancing the public interest in maintaining a functional revenue collection system with the public interest in ensuring that taxpayers have access to relevant information, it is possible to strike an appropriate balance that allows for effective and efficient audits.

INTERFACE WITH THE REVENUE AUTHORITY

Maintaining consistency in interface with the revenue authority is crucial for keeping the audit process focused and avoiding tangential departures. This not only benefits the revenue authority but also the taxpayer. However, achieving consistency requires a high level of commitment on the part of the taxpayer. It involves considerable effort to gain a complete understanding of the transactions and events under review, as well as the commercial drivers for these events and their proper tax implications.

Having multiple staff members interface with the revenue authority increases the risk of variation in approach, leading to confusion and misinterpretation. This often happens when different staff members use different language to convey the same message. For instance, two people may convey the same message with slightly different phrasing, such as “it was not intended to” and “it was intended not to.” Depending on the importance of the intention in determining the correct tax reflection of the event, these differences in phrasing can lead to unnecessary discussions and debates.

To avoid these issues, it is essential to have a single point of contact who is responsible for all communication with the revenue authority. This person should be well-versed in the audit process and should have a complete understanding of the transactions and events under review. Having a single point of contact ensures consistency in communication and reduces the risk of misunderstandings or misinterpretations.

Moreover, having a consistent interface with the revenue authority allows the taxpayer to better understand the revenue authority’s position on any given topic, including its position on the taxpayer itself and the topics under examination. This understanding is crucial for keeping the audit on the desired path and avoiding any unnecessary tangential departures.

In conclusion, consistency in interface with the revenue authority is a critical aspect of the audit process. It requires a high level of commitment on the part of the taxpayer and a clear understanding of the transactions and events under review. Having a single point of contact for all communication with the revenue authority ensures consistency and reduces the risk of misunderstandings. Furthermore, a consistent interface with the revenue authority allows the taxpayer to better understand the revenue authority’s position, helping to keep the audit on the right track and avoiding unnecessary tangential departures.

CONDUCT OF MEETINGS

Continuing from the subject of interface with the revenue authority, the effective management of meetings is of utmost importance. To keep the audit on the desired trajectory, it is essential to maintain an open dialogue between

the involved parties. Regular meetings with predetermined agendas and active participants are more likely to address issues, differences of opinion, and clarify facts and positions earlier rather than later. This practice assists in identifying any tangential departures from the audit's proper conduct in a timely manner.

Moreover, meetings that are documented and the minutes agreed upon create a comprehensive record of discussions that help prevent the audit from straying off course. Documenting meeting discussions is a fundamental element in establishing accountability and transparency throughout the audit process. These minutes help to ensure that all parties are aware of the audit's progress, and there is a clear understanding of the issues addressed and the decisions made. The minutes can also serve as a reference point for the audit's future direction and ensure that the audit remains on track.

Furthermore, a clear and concise agenda must be established before each meeting. The agenda should reflect the audit's goals and objectives and the issues that need to be addressed in the meeting. Participants should be prepared to discuss and provide input on the items listed on the agenda. A well-organized and structured agenda ensures that the meeting remains focused, and the audit objectives are met.

DISPUTE RESOLUTION APPROACHES

The resolution of disputes between taxpayers and the revenue authority can be a complex and challenging process, with a range of options available for addressing differences of opinion. The four key stages at which these disputes can be resolved include:

- between the taxpayer and the auditors,
- between the taxpayer and specialist units within the revenue authority,
- through private arbitration, and
- through litigation.

It is important to note that auditors often have a greater attachment to issues than other specialist units within the revenue authority and therefore may require external input to restore objectivity to their thinking. In contrast, taxpayers may have a significant attachment to issues but can benefit from engaging external advisors who can provide independent views on the proper tax outcome. This can help to avoid deadlocked issues and reduce the need to move disputes to other areas of the revenue authority.

Specialist units within the revenue authority may be guided by policy as much as by the words of the legislation, and therefore it is important to address all relevant aspects of the legislation, relevant authorities, and revenue authority policy when dealing with these personnel. In some cases, private arbitration may be an option for resolving disputes, but this requires considerable effort on the briefing material. If a taxpayer can agree a brief with the revenue authority, then this is a less costly way of settling differences of opinion.

Private arbitration may involve different approaches, including the opinion of an independent person to determine the result or dropping the issue if the independent person supports the taxpayer, but litigating if the independent person supports the revenue authority. While the latter approach may appear one-sided in favour of taxpayers, it is important to note that the taxpayer would typically have an independent view on the proper tax outcome before engaging in such an exercise. If the independent view supports the revenue authority, the taxpayer will have the option to litigate in the same way it has to litigate any disallowed objection decision.

Litigation is often the last resort for resolving disputes and can be costly if the taxpayer loses, as both the tax and litigation costs are payable. Tax litigation is like other forms of litigation, in that it is difficult to predict how the evidence will be perceived by the court with certainty. As a result, it is important for taxpayers to carefully consider their options at each stage of the dispute resolution process, to weigh the costs and benefits of each approach, and to engage expert advisors who can provide objective and independent views on the matter at hand.

SETTLEMENT APPROACHES

Avoid a bargaining process between parties and rather make detailed representations to the revenue authority on the relevant issues and why the taxpayer position is preferred. I have followed this route oftentimes, with a very successful outcome for the taxpayer. In my over 30 years of practicing in tax disputes, my taxpayer clients have been exposed to over US\$4 billion in taxes, and on average have paid out less than 3% claimed by the revenue authorities. Oftentimes, this was achieved through a settlement process based on detailed representations on the issues in dispute.

While this approach may not always be practicable due to a lack of evidentiary information or the complexity of issues, the preferred process of negotiated settlement is on an issue-by-issue basis. This approach also sets a basis of assessment for future income years. Revenue authorities usually provide settlement guidelines to assist in the process.

Usually, the revenue authority takes the position that questions of ability to pay are not relevant in determining a taxpayer's taxable income but may consider payment arrangements tailored to the taxpayer's economic circumstances. Revenue authorities are not permitted to use the threat of prosecution or severe penalties as a leverage in settlement negotiations. Additionally, officers do not have any authority to make it a condition of a settlement agreement that a taxpayer will not be prosecuted or that proceedings associated with a prosecution will not be taken. However, there is a clear divide between a civil tax audit and one that has become a criminal investigation. Many revenue authorities fail to understand the distinction and thus much of the evidence they rely upon to pursue a criminal action may be flawed and inadmissible. This favours a negotiated settlement where criminal proceedings are a potential threat. In situations where the law on the relevant issue is relatively settled, the revenue authority will aim to maintain a firm position. This usually includes situations where the revenue authority has issued a public ruling on the matter.

When a written settlement agreement is entered into, it has impacts for both the taxpayer and the revenue authority. The revenue authority expects the taxpayer to not object to the issue of assessments in line with the settlement agreement. Conversely, the taxpayer can expect that the revenue authority will not further examine their affairs unless new evidence arises that indicates avoidance or evasion. Additionally, taxpayers can expect that the settlement agreement will be used as a basis for assessing tax payable in relation to similar issues in future assessment years. However, the revenue authority generally reserves the right to make different assessments where circumstances have changed materially, or the law has changed materially.

It is important to note that the revenue authority's approach to settlements does not preclude the use of alternative dispute resolution methods. For example, taxpayers and the revenue authority may use mediation or other alternative dispute resolution processes to reach a settlement. However, the revenue authority's guidelines aim to promote transparency and consistency in settlement processes.

APPENDIX G

REQUEST FOR INFORMATION UNDER A TYPICAL SECTION OF AN INCOME TAX ACT

This is a request for information by a revenue authority from an MNE not registered as a taxpayer in-country. See the suggested response in **Appendix H**. Special rules come into play under the DTAs.

Mauritian Company ('the company')

The Uganda Revenue Authority ('URA') has made a request for exchange of information under Article 27 of the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income between Mauritius and Uganda in respect of the above mentioned company.

To enable us to give effect to the request, we would appreciate it if you could, by virtue of section 124(1)(b) of the Income Tax Act, kindly submit the following information and documents relating to the above-mentioned period for onward transmission to the URA:

- a) Incorporation details of the company including the details of the past and current directors;
- b) Shareholders and ultimate beneficial owners;
- c) Nature of business;
- d) Current registered address;
- e) Company's registration status for tax purposes in Mauritius;
- f) Copies of Memorandum and Articles of Association of Company from incorporation and any changes effected to date;
- g) Management or organizational structure of the Company clearly indicating the departments, names of employees and their roles;
- h) Group structure of the Company indicating its parent and associated entities;
- i) Board minutes showing management decisions regarding the determination of the prices, rights and obligations of contracting parties regarding the sale of vermiculite originating from Uganda for the period under review;
- j) Audited and signed financial statements;
- k) Details of bank accounts held by the Company including account opening details, signatories to these accounts;
- l) Sales contracts and invoices between the Company and the final consumers/third parties for vermiculite

originating from Uganda;

- m) Sales contracts between the Uganda company and the Company;
- n) Bank statements of the Company showing payments to the Uganda Company for the period under the review;
- o) Bank statements of the Company showing money received from third parties in respect of minerals sold which originates from Uganda; and
- p) Any other relevant documentary evidence that will enable us confirm the details of the transaction.

We thank you for your cooperation in this matter.

APPENDIX H

ASK THE REVENUE AUTHORITY TO JUSTIFY WHY IT IS ASKING FOR INFORMATION

This template can be used by a MNE requested to give information to a revenue authority where it is not registered as a taxpayer in-country. Many international tax principles come to play, as covered in the template.

The Director-General
Mauritius Revenue Authority
Attn: Ms. AM
Email: email address

Dear Madam,

RE: REQUEST FOR INFORMATION IN TERMS OF SECTION 124(1)(b) OF THE INCOME TAX ACT

1. We refer to your letter dated 27th July 2022 (“the MRA Request”) in terms of which the Director-General of the Mauritian Revenue Authority (“MRA”) has requested detailed information from Taxpayer Ltd (“TXP”) about its affairs made in accordance with section 124(1)(b) of the Mauritius Income Tax Act (“the MITA”), which request has arisen by virtue of the same request for the same information from the Uganda Revenue Authority (“URA”) requested in accordance with Article 27 of the Mauritius-Uganda Convention for the Avoidance of Double Taxation and Prevention of Fiscal Evasion (“the DTA”).
2. Given the alarming scope and detail of the proprietary information that has been asked for in the MRA Request, much of which is of a proprietary nature, as well as the fact that TXP has no business activity or tax obligations owed to the URA, the board of TXP decided to seek international tax and legal advice in order to determine TXP’s legal obligations in this matter and how exactly to respond to the MRA. Firstly, we wish to place on record that we in no way wish to be anything other than completely co-operative in providing whatever information is lawfully required in accordance with the MITA or any other applicable laws in Mauritius. However, we have been advised to respectfully draw the MRA’s attention to the following:
 - 2.1. Section 124(1)(b) places an obligation on TXP to furnish the MRA with such information as may be requested for the purpose of enabling the MRA to “comply with any request for exchange of information under an arrangement made pursuant to section 76” of the MITA. Section 76(1) enables the Minister to enter into

arrangements with the government of a foreign country such as Uganda for the exchange of information with a view to assisting (i) either the determination of credits and exemptions in respect of taxes of any kind or description, and foreign tax covered under the arrangement (namely the DTA), or (ii) in the prevention of fraud. It is submitted that the MRA Request is limited to the aforementioned purposes. Since TXP has never in its history relied on any exemptions, credits or relief from taxes in Uganda, whether in terms of the DTA or otherwise, the only possible basis on which the MRA request may be lawfully empowered is in the event of reasonable evidence to suggest that the activities of TXP (whether alone or in conjunction with others) involves fraud;

- 2.2. Article 27(1) of the DTA empowers the URA and the MRA to require the exchange of information between them, either in the carrying out of the DTA (where its application and benefits have been relied upon by a taxpayer) or in the course of carrying out the provisions of the domestic laws of Mauritius and/or Uganda. However, Article 27(2) of the DTA stipulates that the exchange of information powers granted in terms of Article 27(1) may not be construed so as to impose upon the MRA the obligation to supply information which is not obtainable by the MRA under the laws of Mauritius or in the normal course of the administration of TXP in Mauritius by the MRA (Article 27(2)(b)), or to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process (Article 27(2)(c)).
3. Given the conditions and limitations placed on the MRA in terms of section 124(1)(b) read together with section 76(1)(b) of the MITA, and having due regard to the fact that TXP had never relied upon nor been granted benefits (whether in the form of exemptions, tax credits or otherwise) in terms of the DTA, we have been advised that the only lawful grounds to empower the URA, and the MRA, to request the various information outlined in the MRA Request is that of an allegation of fraud, which is categorically denied, and we hereby put the relevant authority alleging such to the proof thereof.
4. We have also been advised that Article 27(2)(b) does not permit the MRA to compel TXP to supply it with information which the MRA is not otherwise entitled to obtain under the laws of Mauritius. Such information that the MRA is not entitled to as aforesaid includes the information requested in terms of (g), (h) and (i) of the MRA Request. Furthermore, Article 27(2)(c) would not permit the MRA to share information concerning TXP with the URA under the DTA where such information constitutes its trade and commercial secrets and trade processes that are not within the public domain and would be extremely damaging to TXP if placed within the hands of any competitor of or supplier to TXP, as provided for in Article 27(2)(c), which would include the information outlined in (j), (k), (l), (n) and (o) of the MRA request.
5. TXP is committed to be completely co-operative in addressing lawful and valid reasons for the request for information by the URA, within the limitations placed in terms of Article 27(2) of the DTA, as well as sections 124(1)(b) read with section 76(1)(b) of the MITA. We therefore request more detailed reasons why the URA are requesting this information. However, as a gesture of co-operation, we are prepared to place on record now that in relation to the period under review, namely “the dates”:
 - 5.1. TXP was (and still is) a completely independent and active company carrying on its business as a going concern with its own management, funding and operations carried out as a Mauritian taxpayer with representatives in various countries;
 - 5.2. neither TXP nor its beneficial owners had any direct or indirect interest in any Ugandan tax resident company, including NamedCo;
 - 5.3. No stakeholders or management of NamedCo are involved with the decisions and operations of TXP;
 - 5.4. The shareholders and ultimate beneficial owners of TXP were completely unrelated to the shareholders and beneficial owners of NamedCo;
 - 5.5. The mere acquisition of commodities from NamedCo conducted at arms-length without any physical presence or fixed place of business by TXP within the jurisdiction of Uganda, does not result in TXP being subject to any of the laws of Uganda, including (without limitation) the Ugandan tax laws;
 - 5.6. TXP acquires commodities from various suppliers in different jurisdictions and sells those commodities to numerous unrelated customers worldwide for gain, and on the basis that a minority of the commodity acquisitions as well as sales of TXP arise from NamedCo products;
 - 5.7. Unless under clear legal compulsion to do so, the board of TXP would be negligent in sharing proprietary information relating to its pricing models, marketing techniques, distribution strategies and the identity of its various worldwide customers and other financial affairs, which information if obtained by suppliers such as NamedCo or other competitors would jeopardise the very existence of TXP’s business.

-
6. Having regard to legal advice that TXP has obtained regarding its rights and the limitations placed upon the MRA and URA in terms of the DTA, subject to obtaining more clarity from the URA as to the reasons for and purpose behind the request for information outlined in the MRA Request, TXP will have no objection to furnishing the information outlined in items (a),(b),(c), (d), (e), (f) and (m) of the MRA Request. We have been further advised that any other information outlined in the MRA Request need not be disclosed unless compelling and substantive evidence of fraud is presented by the MRA (or the URA), with any insinuation of fraud hereby being vehemently denied.
 7. TXP is at your disposal to answer any further questions and assist with the resolution of this matter, subject to compliance with the relevant laws.

Yours Sincerely,

For: **TXP Ltd**

Duly authorised Director

APPENDIX I

TYPICAL TAX RISK REVIEW PROCESS

This Appendix was referred to in **Chapter 5** on The Audit Findings. This sets out an example of the typical risk review process engagement by a multi-national corporation to determine all tax risks that might give rise to disputes with a revenue authority. This process should commence well before an audit by a revenue authority so as to plan for potential outcomes and possibilities for settlement and resolution.

Group Ltd Case Study Report generated after the internal Tax Risk Management (“TRM”) Strategy Workshop chaired by your tax dispute attorney¹ to ensure “attorney/client”) privilege exists over any documentation so that the documentation cannot be used as evidence by the revenue authority in a tax audit and any ensuing tax dispute – unless the MNE agrees otherwise. This workshop may be the starting point of an ongoing TRM tax risk steering committee in the MNE, commenced as a result of a tax audit. However, it is advised that MNEs do not wait for a tax audit before commencing this process. Quarterly TRM tax risk steering committee meetings will assist greatly in managing down any tax risks going forward.²

BACKGROUND

Group Ltd has exposure on tax in numerous areas. It may be that a tax audit has been initiated. This process will identify the estimated worst case exposure in US\$ (or relevant currency) determined after assessing and quantifying the tax risk in the areas set out below.

The following key tax risk areas exist:

- transactional risk
- operational risk
- compliance risk

¹ For example, Dr Daniel N Erasmus (the author), who as an attorney with the relevant tax dispute litigation knowledge and experience, has chaired various tax risk steering committees. This person must be in a position to advise the MNE on potential tax litigation arising from any of the tax risks identified to ensure the “attorney/client privilege” claimed by the MNE is not a ruse.

² The author published “Tax Intelligence: The 7 Habitual Mistakes made by Companies” in May 2010, available in print from Amazon.com. This book details the formation and management of a TRM tax risk steering committee. A **free pdf copy** can be obtained directly from the author.

-
- financial accounting risk
 - management risk
 - reputational risk

HIGH LEVEL OBJECTIVES

The primary objectives of the project are as follows:

1. Immediately intercede with the revenue authority (this may be as a result of the commencement of a tax audit) to take control of the tax risk process to resolve all tax issues and ensuring the development of an effective working relationship.
2. Conduct a full review of all areas of exposure of Group Ltd regarding tax risk, with the end output clarifying the probability of risks and the likelihood of occurrence and the impact on both financial and reputation areas of the exposure materializing.
3. Make recommendations to the audit committee of a plan to resolve these areas of exposure (ensuring attorney & client privilege is maintained through recommendations emanating through the Tax Legal Team appointed to oversee and guide the process).
4. Ensure that a full and comprehensive plan is prepared for each risk item, irrespective of whether the audit committee decides to address them or not.
5. Following the Tax Steering Committee recommendation, interacting with the revenue authority to ensure full and final settlement of the risks agreed upon.
6. If the project is commenced due to a tax audit, the time estimates below will most likely have to be shortened significantly, as most enquiries require a response within 30 days. In that case, the appropriate extension of time must be agreed with the revenue authority usually through an initial LETTER OF ENGAGEMENT proposed by Group Ltd as drafted by the Tax Legal Team. This letter will record the rights and duties of both parties, with a recommendation of a timeline, along the timeline in the table below.

The secondary objectives are:-

1. Ensure the establishment of an effective working relationship between the revenue authority and Group Ltd.
2. Set up an effective and appropriate world class tax department at Group Ltd under an appropriately selected tax manager.
3. Ensure that any tax issues arising at the Group Ltd's SA are dealt with in this project period, as far as practically possible.
4. Review the appropriateness of the current accounting firm and tax advisors, and recommend changes to the relationships and firms, if necessary.

Tax Team

CFO, Tax Manager, Tax Legal Team and Existing Tax Advisors.

See table on following page.

CONCLUSION

IN ADDITION to the above, the report will include the estimated budget to execute the TRM Process. An amount of up to approximately 1% of the quantified tax risk exposure is budgeted to fund the resources required to complete the initial implementation phase, and leading up to the revenue authority sign-off of the on-the-radar screen issues, and the successful shelving of the current off-the-radar screen issue. The CFO must be engaged to be able to report to the executive committee why this is necessary. The professional effort made at this early stage will result in significant savings in additional tax assessments, penalties and interest in the foreseeable future.

Progress in the TRM process is monitored through ongoing quarterly tax steering committee meetings. An example of the quarterly report is provided.

HIGH LEVEL PROCESS

	Indicative Timing
Project Commencement • Project brief agreed • Tax Team constituted	Eg. Early June
Internal Processes	
Information gathering	June – July
Propose high level process and early interaction with the revenue authority	End July
Evaluation of risks incl. follow-up investigations	July – August
Tax team meeting to evaluate risks and agree plan	End August
The revenue authority interaction	
Work teams with the revenue authority	July - Feb
Tax findings meetings	Oct - Feb
Prepare Reasons	Oct - Feb
Detailed revenue authority presentations	Oct – Feb
Assessments issued	Mar – April
Objections	May – June
Finalisation/Settlement Process	
Settlement or similar discussions on a “without prejudice” basis	March
Tax team meeting to agree settlement parameters	March
Finalization of agreed settlements	End March

APPENDIX J

TRM TAX STEERING COMMITTEE RISK REVIEW TEMPLATE

This template is referred to in Chapter 5 on The Audit Findings. It is associated with the initial tax risk review strategy plan initiated by a tax risk steering committee under the attorney/client privilege to identify and manage all tax risks in the MNE.

See Templates on following page.

No	Description	Info Documents / Available		Identification of SARS Tax Issues			Risk Assessment			Way Forward	Responsibility	
		Yes	No	No Issue	Transaction Issue already Identified	New Tax Category Risk	Probable	Possible	Low		Person	Time
1.	Method used to calc media rights									Factual enquiry.	DNE*/Tax Manager Name	2 weeks
										Legal opinion.		2 weeks
2.	US\$ values of media rights.									Factual enquiry.	DNE*/Tax Manager Name	2 weeks
3.	Media rights agreement.									Factual enquiry.	DNE*/Tax Manager Name	4 weeks
4.	Board other minutes – re media rights.									Factual enquiry.	DNE*/Tax Manager Name	2 weeks
5.	Proof of payment for media rights.									Factual enquiry.	DNE*/Tax Manager Name	4 weeks
6.	Copies of associated entities financial statements.									Factual enquiry. Legal opinion.	DNE*/Tax Manager Name	2 weeks

No	Description	Info / Documents Available		Identification of SARS Tax Issues			Risk Assessment			Way Forward	Responsibility	
		Yes	No	No Issue	Transaction Issue already Identified	New Tax Category Risk	Probable	Possible	Low		Person	Time
7.	Details of interest and dividend flows within associated entities.									Factual enquiry.	DNE/Tax Manager Name	2 weeks
8.	Proof of payments for sponsorships.									Factual enquiry.	DNE/Tax Manager Name	2 weeks
9.	Marketing costs reimbursements.									Factual enquiry.	DNE/Tax Manager Name	4 weeks
10	Copies of all related opinions.									Factual enquiry.	DNE/Tax Manager Name	4 weeks
11	Determine reasons why sponsorship payments are not of a capital nature									Legal opinion.	DNE/Tax Manager Name	2 weeks
12	Details of financial benefits due to sponsorship payments.									Factual enquiry.	DNE/Tax Manager Name	2 weeks
13	Detail of management fees and references to sponsorship.									Factual enquiry.	DNE/Tax Manager Name	4 weeks
14	Details of QpCos in countries where sponsorship payments made.									Factual enquiry. Legal opinion. Factual enquiry.	DNE/Tax Manager Name	4 weeks

APPENDIX K

REVENUE AUTHORITY LETTER OF ENGAGEMENT AT THE COMMENCEMENT OF A TAX AUDIT

This is referred to in **Chapter 5** on The Tax Audit. This letter is addressed to the revenue authority at the commencement of a tax audit, setting out the lawful terms of engagement to be adhered by the revenue authority in conducting the tax audit. This is necessary as oftentimes the revenue authority will ignore their lawful responsibilities.

Dear Sirs,

“We refer to your letter of engagement dated xx.

The 14 day period you have afforded the taxpayer, in light of the substantial amount of information required, is unreasonable and is contrary to the undertaking given by SARS that they will comply with the standards set for the levels of service as contained in the SARS Service Charter read with section 4(2) of the SARS Act and section 195 of the Constitution, as well as section 33 of the Constitution which demands that fair administrative procedures should be followed by SARS, particularly in conducting an audit.

NOTE: Although the example letter references South African legislation, in other jurisdictions look out for the revenue authority governing legislation. It informs what standard the revenue authority must adhere to with useful references to Constitutions and administrative law principles. Section 4(2) of the SARS Act¹ SARS must perform its functions in the most cost-efficient and effective manner and in accordance with the values and principles mentioned in section 195 of the Constitution. Section 195 of the Constitution reads:

“195 Basic values and principles governing public administration

- (1) Public administration must be governed by the democratic values and principles enshrined in the Constitution, including the following principles:*
 - (a) A high standard of professional ethics must be promoted and maintained.*
 - (b) Efficient, economic and effective use of resources must be promoted.*
 - (c) Public administration must be development-oriented.*
 - (d) Services must be provided impartially, fairly, equitably and without bias.*

¹ The South African Revenue Service Act No. 34 of 1997.

- (e) *People's needs must be responded to, and the public must be encouraged to participate in policy-making.*
- (f) *Public administration must be accountable.*
- (g) *Transparency must be fostered by providing the public with timely, accessible and accurate information.*
- (h) *Good human-resource management and career-development practices, to maximise human potential, must be cultivated.*
- (i) *Public administration must be broadly representative of the South African people, with employment and personnel management practices based on ability, objectivity, fairness, and the need to redress the imbalances of the past to achieve broad representation."*

Section 33 of the Constitution required the Promotion of Administrative of Justice Act 3 of 2000 to be promulgated, in a sense codifying administrative law.² This should also be read with the key tax audit provisions of sections 40 to 46 of the TAA.³

2.2 Named Audit Firm is scheduled to re-commence their audit in respect of the taxpayer during November xx, with the result that a considerable amount of the Finance team's time and resources, during November

through to December xx, will be taken up;

2.3 A number of key employees, are currently, and will be, on leave during the latter parts of November xx through to mid-January xx.

3. Under the circumstances, the 14-day period should be extended to at least the end of xx.
4. Furthermore, you are requested to please provide us with a copy of SARS' proposed audit plan pertaining to the taxpayer. This is in accordance with the requirements expected of SARS officials that same be documented in terms of SARS' internal audit manual procedures.

NOTE: Refer to **Appendix M: SARS Internal Audit Manual** ⁴ for extracts, guiding the revenue authority auditors on what to do.

5. With respect to the specific information requested by SARS, the taxpayer would like to point out the following overriding factors which are obviously obligations imposed upon SARS and binding on SARS in as much as it is binding on the taxpayer to furnish SARS with information specifically sought in accordance with a specific named empowering provision in the VAT Act.
6. In this regard, the taxpayer is under an obligation to provide SARS with information that is in existence and in possession of the taxpayer. The taxpayer is not in a position to give any opinions or explanations to SARS in respect of any of the information that is in existence and in its possession. Accordingly, any information that is requested by SARS, that is already in the possession of SARS, cannot be requested of the taxpayer again. SARS is duty bound to obtain the information which it already has in its records and should encroach as little as possible upon the rights of the taxpayer. To this extent, SARS should not be seeking duplicate information if already in their system.
7. With particular reference to the paragraph in SARS' letter of engagement listing what is required, we respond as follows:
 - 7.1. The detailed nature of the business is information that can be obtained from the taxpayer's previously submitted tax returns, which can in turn be discussed if they are not clear from all the other information that is already in your possession, or which can be obtained from the outstanding returns submitted to you.
 - 7.2. The provision of a group structure is not information envisaged in any information of the VAT Act or the Income Tax Act, unless SARS is able to provide the taxpayer with specific authority to the contrary.
 - 7.3. Explain how the business is financed: The financing that is procured by the business is set out in the taxpayer's financial statements, which are already in SARS' possession together with previous annual tax

² The Promotion of Administrative Justice Act provides the purpose as "**TO give effect to the right to administrative action that is lawful, reasonable and procedurally fair and to the right to written reasons for administrative action as contemplated in section 33 of the Constitution of the Republic of South Africa, 1996; and to provide for matters incidental thereto.**"

³ Tax Administration Act 28 of 2011.

⁴ See Glossary of Terms.

returns provided to SARS. Insofar as the original information provided to SARS is not sufficient, SARS is requested to specify which aspects of the information already provided to them is not clear to SARS and in what respect, and precisely what SARS is seeking clarification on.

- 7.4. Provide electronic input and output VAT reports/summary: SARS should request precise detail in this regard. The taxpayer compiles the tax returns and submits same to SARS in the time periods required in terms of the VAT Act. This information is therefore already in SARS' possession and it is not entirely clear what additional information that currently exists is being sought from the taxpayer.
- 7.5. List all bank accounts: All relevant business accounts are already known to SARS as the taxpayer has been utilising the SARS e-filing option for a considerable period of time, and accordingly the requested information is available in terms thereof.
- 7.6. Bank statements in respect of the accounts listed above: All financial information is highly confidential and will be made available to SARS, should they still require same, during their visit.
- 7.7. The income tax returns for the tax years 2005 to 2008: As explained above, Named Audit Firm is currently scheduled to re-commence their audit during November 2010. This imminent audit covers the following financial periods:
 - 7.7.1. 6 month period ended 30 June xx;
 - 7.7.2. Financial years ended 30 June xx and xx respectively.

We are not able to confirm at this stage when Named Audit Firm expects to conclude their External Audits. The taxpayer has received the audited annual financial statements for xx and xx and outstanding tax returns pertaining to these financial periods will be submitted shortly.

Please note that the taxpayer's financial year end was changed from 31 December to 30 June during xx.

8. In light of the above, you will appreciate that most, if not all, the information and documentation you have requested will soon be available to SARS once the outstanding tax returns have been submitted. You will no doubt agree that the proposed audit will be an inefficient use of SARS' resources until such time as you have received and considered the returns, as well as reviewed all the documentation already in SARS' possession. Consequently, we request from SARS that the audit be held in abeyance pending the outcome of the foregoing.
9. We await your confirmation in this regard. Alternatively, SARS is requested to extend the 14-day deadline to the end of January/mid-February xx.
10. In accordance with SARS' standard practice, a letter of findings must be issued after the conclusion of an audit and before any assessment is raised, and the taxpayer must be afforded a reasonable opportunity to respond thereto. This due process which SARS regularly follows ensures the taxpayer has the right to be heard before administrative action, which adversely its interests, is taken.

We look forward to hearing from you.

Yours faithfully

APPENDIX L

DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF A TAX STEERING COMMITTEE

Prof Dr Daniel N Erasmus

EXECUTIVE SUMMARY: WHY IS A TAX STEER COMMITTEE SO IMPORTANT IN AN ORGAISATION?

In the complex landscape of global taxation, establishing a Tax Steering Committee (TSC) is instrumental for multinational corporations to maintain tax compliance and minimize risks. This eBook explores the expertise of Prof. Dr. Daniel N. Erasmus and his team from Tax Risk Management in forming effective tax steering committees and the critical role of client-attorney privilege in these settings.

The Role of a Tax Steering Committee

A Tax Steering Committee is pivotal for coordinating tax strategies, ensuring compliance, and managing tax-related risks across multiple jurisdictions. It typically consists of senior executives, financial officers, and legal advisors who oversee and direct a company's tax operations. Their responsibilities include aligning tax strategies with business objectives, staying updated on tax laws, and ensuring transparent tax practices.

Expert Guidance by Prof. Dr. Daniel N. Erasmus and Team

Prof. Dr. Daniel N. Erasmus, a leading tax advisor and advocate, specializes in tax risk management and dispute resolution. His expertise is critical in the strategic formation and operation of a TSC. Here's how his team can assist:

1. Strategic Formation: Helping define the scope, roles, and responsibilities of the TSC to ensure alignment with corporate strategies.
2. Risk Management: Providing insights on potential tax risks and strategies to mitigate them.
3. Regulatory Compliance: Offering updated knowledge on changing tax regulations and compliance requirements globally.

-
4. Training and Education: Equipping TSC members with the necessary training to handle tax issues proficiently.

Advantages of Client-Attorney Privilege in Tax Steering Committees

Client-attorney privilege preserves the confidentiality of communications between a client and their legal advisor. Its integration into tax steering committees offers several benefits:

- Confidentiality: Ensures sensitive tax-related discussions and strategies remain protected from external and internal breaches.
- Legal Safeguard: Protects organisations in legal disputes by keeping the advice received from tax attorneys confidential.
- Strategic Planning: Facilitates open and honest communication about tax risks and strategies without fear of exposure.

Why Consult Tax Risk Management?

Engaging with Prof. Dr. Erasmus and his team at Tax Risk Management provides a strategic advantage in managing complex tax issues:

- Expertise and Experience: Access to seasoned tax professionals who understand the intricacies of tax laws and compliance.
- Customised Solutions: Tailored strategies that align with specific business needs and regulatory requirements.
- Proactive Risk Management: Early identification and resolution of potential tax issues before they escalate.

CHAPTER 1: THE IMPORTANCE OF A TAX STEERING COMMITTEE

Understanding Tax Compliance

Understanding tax compliance is essential for multinational corporations to ensure they are meeting their legal obligations and avoiding costly penalties. Tax compliance refers to the process of adhering to tax laws and regulations set forth by the government. This includes accurately reporting income, expenses, and other financial information to tax authorities in a timely manner. Failure to comply with tax laws can result in severe consequences, such as fines, audits, and legal action.

One of the key components of tax compliance is understanding the tax laws and regulations that apply to your business. This requires staying up-to-date on changes in tax legislation and seeking guidance from tax professionals when necessary. It is important for executives, CFOs, and financial directors to have a solid understanding of the tax laws that govern their operations to ensure compliance and mitigate risks.

Forming a tax steering committee can be a valuable tool for multinational corporations looking to improve their tax compliance efforts. A tax steering committee is a group of individuals within the organization who are responsible for overseeing tax compliance and ensuring that the company is meeting its tax obligations. This committee can help streamline tax processes, identify potential compliance risks, and develop strategies for mitigating those risks.

Establishing a tax steering committee requires careful planning and consideration. It is important to select individuals with diverse backgrounds and expertise in tax, finance, and legal matters to serve on the committee. Additionally, the committee should have clear objectives and responsibilities outlined to ensure that everyone is on the same page and working towards a common goal of improving tax compliance within the organization.

In conclusion, understanding tax compliance is crucial for multinational corporations to avoid legal issues and financial penalties. By forming a tax steering committee and ensuring that executives and financial professionals have a solid understanding of tax laws and regulations, companies can improve their tax compliance efforts and minimize risks. It

is important for businesses to stay proactive in their tax compliance efforts and seek guidance from tax professionals when needed to ensure they are meeting their obligations and operating within the law.

Benefits of a Tax Steering Committee

Tax compliance is a critical aspect of any business operation, especially for multinational corporations. To ensure tax compliance and effective tax planning, establishing a Tax Steering Committee can be extremely beneficial. A Tax Steering Committee is a dedicated group of executives, financial directors, accountants, lawyers, and consultants who work together to oversee and manage the company's tax strategy. By forming a Tax Steering Committee, companies can streamline their tax compliance processes, reduce the risk of non-compliance, and optimize their tax strategies.

One key benefit of having a Tax Steering Committee is the ability to centralise tax decision-making. However the committee should not be left just for tax decision-making. It should discuss and record all matters of material and/or strategic nature within the organisation.

It is essential for the Tax Steering Committee to discuss and record all significant organizational matters. Such documentation is crucial because issues often resurface years later when substantial staff changes might have occurred. Without these records, reconstructing events can become a costly and time-consuming endeavour. Prof. Dr. Daniel N. Erasmus and his team often face these challenges when key personnel are no longer available.

With a dedicated committee in place, decisions regarding tax planning, compliance, material decisions and strategy can be made more efficiently and effectively. This helps to ensure that all relevant parties are involved in the decision-making process and that the company's tax strategy aligns with its overall business objectives. By centralising these functions companies can avoid duplication of efforts, reduce the risk of errors, and improve overall tax compliance. It also ensures that records are accessible, which simplifies addressing queries or resolving complex tax issues in the future.

Another major benefit of a Tax Steering Committee is the ability to enhance communication and collaboration among key stakeholders. By bringing together executives, financial directors, accountants, lawyers, and consultants on a regular basis, companies can ensure that all relevant parties are informed and engaged in the tax planning process. This helps to facilitate better communication, coordination, and collaboration among different departments and functions within the organization. By fostering a culture of collaboration and transparency, companies can improve their tax compliance processes and enhance their overall tax strategy.

Furthermore, a Tax Steering Committee can help companies stay ahead of changing tax regulations and developments. Tax laws and regulations are constantly evolving, and it can be challenging for companies to stay abreast of these changes. By establishing a Tax Steering Committee, companies can ensure that they have a dedicated group of experts who are responsible for monitoring and analyzing changes in tax laws and regulations. This can help companies adapt their tax strategies accordingly, stay compliant with the latest regulations, and minimize the risk of non-compliance.

In conclusion, a Tax Steering Committee can provide numerous benefits for multinational corporations looking to enhance their tax compliance processes and optimize their tax strategies. By centralizing tax decision-making, enhancing communication and collaboration, and staying ahead of changing tax regulations, companies can improve their overall tax compliance and reduce the risk of non-compliance. For executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants, forming a Tax Steering Committee is essential for effectively managing the complexities of tax compliance in today's global business environment.

Risk of Non-Compliance

Non-compliance with tax regulations can pose significant risks to multinational corporations, impacting their reputation, financial stability, and overall business operations. In today's complex global tax landscape, the consequences of non-compliance are more severe than ever before. As such, it is crucial for executives, CEOs, CFOs, financial directors, accountants, financial managers, risk managers, lawyers, and consultants to understand the risks associated with non-

compliance and take proactive measures to mitigate them.

One of the most significant risks of non-compliance is the potential for hefty fines and penalties imposed by tax authorities. Failure to comply with tax regulations can result in costly audits, investigations, and legal proceedings that can drain a company's financial resources and tarnish its reputation. In extreme cases, non-compliance can lead to criminal charges and imprisonment for responsible individuals within the organization. These financial and legal consequences can have far-reaching implications for a company's bottom line and its ability to conduct business in the future.

Non-compliance also poses a risk to a company's reputation and brand image. In today's hyper-connected world, news of tax scandals and controversies can spread like wildfire, damaging consumer trust and loyalty. Customers, investors, and other stakeholders may view a company that engages in non-compliance as unethical and untrustworthy, leading to a loss of business and investment opportunities. In the age of social media and instant communication, the impact of a tarnished reputation can be swift and long-lasting.

Furthermore, non-compliance with tax regulations can lead to operational disruptions and inefficiencies within a multinational corporation. Tax audits and investigations can divert valuable time and resources away from core business activities, causing delays in decision-making and hindering growth opportunities. Additionally, the uncertainty and instability created by non-compliance can erode employee morale and productivity, leading to higher turnover rates and decreased organizational effectiveness. By failing to comply with tax regulations, companies risk undermining their own operational efficiency and competitiveness in the global marketplace.

In conclusion, the risks of non-compliance with tax regulations are numerous and far-reaching for multinational corporations. Executives, CEOs, CFOs, financial directors, accountants, financial managers, risk managers, lawyers, and consultants must recognize the potential consequences of non-compliance and take proactive steps to address them. By establishing a tax steering committee and implementing robust compliance procedures, companies can mitigate the risks associated with non-compliance, safeguard their reputation and financial stability, and ensure long-term success in today's complex global tax environment.

CHAPTER 2: ESTABLISHING A TAX STEERING COMMITTEE

Identifying Key Stakeholders

Identifying key stakeholders is a crucial step in the process of establishing a tax steering committee for multinational corporations. In order to effectively drive tax compliance within an organization, it is essential to identify and engage with key stakeholders who have a vested interest in the company's tax strategy. These stakeholders may include executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants.

Executives play a significant role in shaping the tax strategy of a multinational corporation. They are responsible for setting the overall direction of the company and ensuring that tax compliance is a priority. CEO, CFO, and financial directors are also key stakeholders who have a deep understanding of the financial implications of tax decisions. Their input and support are critical in driving tax compliance and minimizing tax risks.

Accountants and financial managers are instrumental in implementing tax strategies and ensuring that the company complies with tax laws and regulations. They play a key role in preparing tax returns, conducting tax planning, and managing tax audits. Risk managers are also important stakeholders who assess and mitigate tax risks within the organization. Their expertise in identifying potential risks and developing risk management strategies can help prevent costly tax issues.

Lawyers and consultants are valuable resources for multinational corporations seeking to establish a tax steering committee. They provide legal and strategic advice on complex tax issues, help navigate international tax laws, and ensure compliance with regulations. Their expertise in tax planning, transfer pricing, and tax litigation can help

companies develop effective tax strategies and minimize tax liabilities.

It is strategically important to include a representative of a law firm on the steering committee to ensure client-attorney privilege. This is particularly beneficial when discussing the tax matters of an organization, as it helps protect sensitive information and ensures that discussions about legal and tax issues remain confidential.

In conclusion, identifying key stakeholders is a critical step in forming a tax steering committee for multinational corporations. Executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants all play essential roles in driving tax compliance and managing tax risks. By engaging with these stakeholders and leveraging their expertise, companies can develop effective tax strategies, minimize tax liabilities, and ensure compliance with tax laws and regulations.

Defining Roles and Responsibilities

In order to effectively drive tax compliance within a multinational corporation, it is essential to clearly define the roles and responsibilities of a tax steering committee. This subchapter will outline the key functions and duties that members of the committee should uphold in order to ensure effective tax management and compliance.

First and foremost, it is important for executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants to understand the purpose of a tax steering committee. The committee is responsible for overseeing the organization's tax strategy, ensuring compliance with local and international tax laws, and managing tax risks effectively. By establishing a tax steering committee, multinational corporations can streamline their tax planning processes and minimize the risk of non-compliance.

When forming a tax steering committee, it is crucial to appoint individuals with the necessary expertise and experience in tax matters. Executives should select members who have a strong understanding of local and international tax laws, as well as the ability to analyze complex tax issues and propose effective solutions. By assembling a diverse team of professionals, the committee can leverage a wide range of skills and perspectives to address tax challenges and opportunities.

Each member of the tax steering committee should be assigned specific roles and responsibilities based on their areas of expertise. For example, financial directors may be responsible for overseeing tax reporting and compliance, while risk managers may focus on identifying and mitigating tax risks. By clearly defining the duties of each committee member, multinational corporations can ensure that all aspects of their tax strategy are effectively managed and monitored.

Furthermore, the tax steering committee should establish clear communication channels and reporting structures to facilitate transparency and accountability. Regular meetings should be scheduled to review tax performance, discuss emerging tax issues, and make strategic decisions on tax planning. By maintaining open lines of communication and fostering collaboration among committee members, multinational corporations can enhance their tax compliance efforts and drive sustainable business growth.

In conclusion, defining roles and responsibilities within a tax steering committee is essential for multinational corporations seeking to establish effective tax management practices. By appointing qualified professionals, assigning specific duties, and fostering transparent communication, organizations can ensure that their tax strategy is aligned with business objectives and regulatory requirements. Ultimately, a well-functioning tax steering committee can help multinational corporations navigate the complexities of the global tax landscape and achieve long-term success in today's competitive business environment.

Governance Structure

Creating a governance structure for a tax steering committee is essential for ensuring effective tax compliance within multinational corporations. The first step in establishing this structure is to clearly define the roles and responsibilities of the committee members. Executives, CEOs, CFOs, financial directors, accountants, financial managers, risk managers,

lawyers, and consultants all play a crucial role in the tax compliance process, and it is important to allocate specific tasks and duties to each member.

Once roles have been defined, the next step is to establish clear communication channels within the committee. Regular meetings should be scheduled to discuss tax compliance issues, share updates on tax regulations, and address any concerns or challenges that may arise. It is important for committee members to have open lines of communication with one another in order to effectively collaborate and make informed decisions.

In addition to regular meetings, it is also important to establish reporting mechanisms within the governance structure. Financial reports, tax filings, and other relevant information should be shared with the committee members in a timely manner so that they can closely monitor the corporation's tax compliance efforts. This transparency is crucial for identifying potential risks and ensuring that corrective actions can be taken promptly.

Another key aspect of creating a governance structure for a tax steering committee is to establish accountability measures. Committee members should be held responsible for their individual tasks and duties, and there should be clear consequences in place for any failures to meet compliance standards. By holding each member accountable for their contributions to the committee, multinational corporations can ensure that tax compliance remains a top priority.

Overall, creating a strong governance structure for a tax steering committee is essential for multinational corporations looking to enhance their tax compliance efforts. By defining roles and responsibilities, establishing clear communication channels, implementing reporting mechanisms, and enforcing accountability measures, corporations can effectively manage their tax compliance risks and ensure that they are meeting all regulatory requirements. This governance structure will help to streamline the tax compliance process and ultimately protect the corporation from potential penalties and liabilities.

Responsibilities of the Chairperson of the Tax Steer Committee

The role of the Chairperson of the Tax Steer Committee is a crucial one, requiring a high level of expertise, leadership, and responsibility. The Chairperson is tasked with overseeing the operations of the committee and ensuring that its objectives are met effectively and efficiently. In this subchapter, we will delve into the specific responsibilities that come with being the Chairperson of the Tax Steer Committee.

First and foremost, the Chairperson is responsible for setting the agenda for committee meetings and ensuring that all members are well-prepared and informed about the topics to be discussed. This involves conducting thorough research, staying updated on tax laws and regulations, and collaborating with other members to address any pressing issues or concerns. The Chairperson must also ensure that meetings are conducted in a timely manner and that all relevant information is presented and discussed.

Additionally, the Chairperson plays a key role in fostering communication and collaboration among committee members. This includes encouraging open and constructive dialogue, resolving conflicts or disagreements that may arise, and promoting a spirit of teamwork and unity. The Chairperson must lead by example and demonstrate strong communication and interpersonal skills in order to effectively engage with diverse stakeholders and facilitate productive discussions.

Furthermore, the Chairperson is responsible for overseeing the implementation of decisions and recommendations made by the committee. This involves working closely with other members, as well as external stakeholders such as government agencies, legal advisors, and financial experts, to ensure that the committee's goals are achieved and that all necessary actions are taken. The Chairperson must also monitor progress, track outcomes, and adjust strategies as needed to address any challenges or obstacles that may arise.

Lastly, if the Chairperson is a representative of a law firm with tax litigation experience and in depth international tax knowledge, the information shared in any meetings will mostly be subject to the attorney/client privilege, which protects the information from attachment by revenue authorities.

Prof Dr Daniel N Erasmus and his team have handled close to \$5 billion worth of disputes, and on average, clients have paid out no more than 3%. In many of these cases, this was delivered through careful management of a Tax Steering Committee. They are, therefore, perfectly placed to assist in guiding the setting up of a Tax Steering Committee and playing the role of chairman.

CHAPTER 3: FORMING A TAX STEERING COMMITTEE FOR MULTINATIONAL CORPORATIONS

Considerations for Global Tax Compliance

Global tax compliance is a critical aspect for multinational corporations to consider in today's complex business environment. With the increasing scrutiny from tax authorities around the world, it is imperative for companies to ensure that they are meeting their tax obligations in all jurisdictions where they operate. This requires a strategic approach and a dedicated focus on tax compliance at a global level.

When considering global tax compliance, there are several key considerations that multinational corporations must take into account. One of the most important factors is understanding the tax laws and regulations in each jurisdiction where the company operates. This includes keeping up to date with changes in tax legislation, as well as understanding the specific requirements for reporting and compliance in each country.

Another important consideration for global tax compliance is the need for effective communication and coordination between different departments within the organization. This includes working closely with the finance, legal, and tax departments to ensure that all relevant information is shared and that there is a cohesive approach to tax compliance across the organization.

In addition, multinational corporations must also consider the potential risks and challenges associated with global tax compliance. This includes understanding the potential for tax audits, penalties, and other consequences of non-compliance. By proactively identifying and addressing these risks, companies can better protect themselves and ensure that they are meeting their tax obligations in all jurisdictions.

Establishing a tax steering committee can be a valuable tool for multinational corporations looking to improve their global tax compliance. This committee can help to provide oversight and guidance on tax compliance issues, as well as facilitate communication and coordination between different departments within the organization. By forming a tax steering committee, companies can ensure that they are taking a proactive and strategic approach to global tax compliance, ultimately helping to mitigate risks and ensure compliance with tax laws and regulations around the world.

Managing Cross-Border Tax Risks

Cross-border tax risks have become a significant concern for multinational corporations operating in today's globalized economy. These risks can arise from a variety of sources, including differences in tax laws and regulations between countries, the complexity of international tax structures, and the increased scrutiny of tax authorities around the world. Managing these risks effectively is critical to ensuring compliance with tax laws and regulations, as well as minimizing the potential for costly penalties and reputational damage.

Establishing a Tax Steering Committee can be a valuable tool for managing cross-border tax risks. This committee, composed of executives, CEO, CFO, Financial Directors, Accountants, Financial Managers, Risk Managers, Lawyers, and Consultants, is responsible for overseeing the company's tax strategy and ensuring compliance with tax laws and regulations in all jurisdictions where the company operates. By bringing together a diverse group of stakeholders with expertise in tax compliance, risk management, and corporate governance, the Tax Steering Committee can provide valuable insights and guidance on how best to navigate the complex landscape of international taxation.

Forming a Tax Steering Committee for multinational corporations requires careful planning and coordination. The committee should have a clear mandate and objectives, including identifying and managing cross-border tax risks,

ensuring compliance with tax laws and regulations, and providing strategic guidance on tax planning and reporting. Members of the committee should have the necessary expertise and experience to effectively fulfill their roles, and regular communication and collaboration among committee members are essential to ensure that the company's tax strategy is aligned with its overall business objectives.

Effective management of cross-border tax risks requires a proactive approach to tax compliance and risk management. The Tax Steering Committee should regularly review and assess the company's tax strategy and compliance practices, identify areas of potential risk, and develop strategies to mitigate those risks. This may involve implementing internal controls and processes to ensure accurate and timely reporting of tax obligations, conducting regular audits and reviews of the company's tax positions, and engaging with tax authorities to resolve any disputes or issues that may arise.

In conclusion, managing cross-border tax risks is a complex and challenging task for multinational corporations. By establishing a Tax Steering Committee and forming a team of experts to oversee the company's tax strategy and compliance practices, companies can effectively navigate the complexities of international taxation and minimize the potential for costly penalties and reputational damage. With careful planning, coordination, and proactive risk management, multinational corporations can ensure compliance with tax laws and regulations in all jurisdictions where they operate, while also maximizing their tax efficiency and strategic value.

Implementing Technology Solutions for Tax Compliance

Implementing technology solutions for tax compliance is crucial in today's business environment, especially for multinational corporations. With the constantly changing tax regulations and the increased scrutiny from tax authorities, it is essential for companies to leverage technology to ensure compliance and mitigate risks. By implementing the right technology solutions, companies can streamline their tax processes, improve accuracy, and reduce the likelihood of errors or audits.

One of the key benefits of implementing technology solutions for tax compliance is the ability to automate repetitive tasks and calculations. This not only saves time and resources for the tax department but also reduces the risk of human error. By automating tasks such as data collection, calculations, and reporting, companies can ensure greater accuracy and consistency in their tax compliance efforts.

In addition to automation, technology solutions can also provide companies with real-time insights into their tax data and liabilities. By integrating tax software with their financial systems, companies can access up-to-date information on their tax positions, enabling them to make more informed decisions and respond quickly to any changes in tax regulations. This level of visibility and control is essential for multinational corporations operating in multiple jurisdictions with complex tax requirements.

Furthermore, technology solutions can help companies stay compliant with tax regulations by providing built-in compliance checks and alerts. By setting up automated reminders and notifications for key deadlines and requirements, companies can avoid costly penalties and interest charges. This proactive approach to compliance not only helps companies avoid risks but also enhances their overall reputation and credibility with tax authorities.

Overall, implementing technology solutions for tax compliance is essential for multinational corporations looking to establish a tax steering committee and improve their tax governance practices. By leveraging automation, real-time insights, and compliance checks, companies can streamline their tax processes, reduce risks, and ensure compliance with the ever-changing tax landscape. Executives, CFOs, financial directors, accountants, and other key stakeholders should prioritize investing in technology solutions to drive tax compliance and enhance their overall tax management strategies.

CHAPTER 4: BEST PRACTICES FOR TAX STEERING COMMITTEES

Regular Meetings and Communication

Regular meetings and communication are essential components of a successful tax steering committee. In order to effectively manage tax compliance and risk, it is imperative that the committee members meet on a consistent basis to discuss relevant issues and make informed decisions. By holding regular meetings, executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants can ensure that they are staying up-to-date on the latest tax regulations and requirements.

During these meetings, it is important for committee members to communicate openly and honestly about any potential tax issues or concerns. This open dialogue can help to identify areas of risk and develop strategies to mitigate them. By fostering a culture of transparency and collaboration, the committee can work together to address any challenges that may arise and ensure that the organization remains in compliance with tax laws and regulations.

In addition to regular meetings, effective communication among committee members is also critical. This includes sharing information, updates, and best practices to ensure that everyone is on the same page when it comes to tax compliance. By keeping the lines of communication open, executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants can work together to create a unified approach to tax management that aligns with the organization's overall goals and objectives.

Furthermore, regular meetings and communication can help to build trust and cohesion among committee members. By working collaboratively to address tax compliance issues, executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants can develop a shared understanding of the organization's tax strategy and goals. This shared vision can help to ensure that everyone is working towards the same objectives and can increase the likelihood of success in managing tax compliance and risk.

In conclusion, regular meetings and communication are essential components of a successful tax steering committee. By meeting regularly and communicating openly and honestly, committee members can work together to address tax compliance issues, identify areas of risk, and develop strategies to mitigate them. Through effective communication and collaboration, executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants can ensure that the organization remains in compliance with tax laws and regulations and achieves its overall tax management goals.

Continuous Education and Training

Continuous education and training are essential components of maintaining a successful tax steering committee within a multinational corporation. As tax laws and regulations are constantly evolving, it is imperative that members of the committee stay up-to-date on the latest developments in order to effectively steer the company towards compliance and minimize tax risks. By investing in continuous education and training, executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants can ensure that they have the knowledge and skills necessary to navigate the complex world of taxation.

One of the key benefits of continuous education and training is the ability to proactively identify and address potential tax issues before they become major problems. By staying informed about changes in tax laws and regulations, committee members can anticipate challenges and develop strategies to mitigate risks. This proactive approach can help multinational corporations avoid costly penalties and fines, as well as protect their reputation in the eyes of stakeholders and regulatory bodies.

In addition, continuous education and training can help members of the tax steering committee stay ahead of emerging trends and best practices in tax compliance. By participating in workshops, seminars, and conferences, executives and other key stakeholders can gain valuable insights from industry experts and peers. This knowledge sharing can help them identify opportunities for improvement within their own organization and implement innovative solutions to

enhance tax compliance and efficiency.

Furthermore, continuous education and training can foster a culture of compliance and accountability within the organization. By demonstrating a commitment to ongoing professional development, committee members can set a positive example for employees at all levels. This can help promote a strong ethical foundation and a sense of responsibility towards tax compliance, which can ultimately benefit the company as a whole.

Overall, investing in continuous education and training for members of the tax steering committee is a wise decision for multinational corporations looking to establish effective tax governance. By staying informed, proactive, and innovative, executives, CEO, CFO, financial directors, accountants, financial managers, risk managers, lawyers, and consultants can help steer their organization towards compliance and success in an ever-changing tax landscape.

Monitoring and Reporting Tax Compliance Metrics

Monitoring and reporting tax compliance metrics is a crucial aspect of the responsibilities of a Tax Steering Committee. In order to ensure that the organization is meeting its tax obligations and adhering to relevant regulations, it is essential to establish a framework for tracking and evaluating key tax compliance metrics. This subchapter will explore the importance of monitoring and reporting tax compliance metrics, as well as provide guidance on how to effectively implement a monitoring and reporting system within the organization.

One of the primary objectives of monitoring and reporting tax compliance metrics is to provide transparency and accountability to stakeholders. By regularly tracking and reporting on key tax compliance metrics, the Tax Steering Committee can demonstrate to executives, shareholders, and other stakeholders that the organization is committed to fulfilling its tax obligations in a responsible and ethical manner. This transparency helps to build trust and credibility with stakeholders, which is essential for maintaining a positive reputation and good relationships with regulators.

In addition to providing transparency and accountability, monitoring and reporting tax compliance metrics can also help to identify areas of potential risk and non-compliance within the organization. By analyzing key tax compliance metrics, the Tax Steering Committee can pinpoint areas where the organization may be falling short in terms of meeting its tax obligations and take corrective action to address these issues. This proactive approach to risk management can help to prevent costly penalties and legal disputes, as well as protect the organization's reputation and financial stability.

Effective monitoring and reporting of tax compliance metrics also enables the Tax Steering Committee to make informed decisions about tax planning and strategy. By tracking key metrics such as effective tax rate, tax liabilities, and tax credits, the committee can assess the impact of current tax policies and identify opportunities for optimization. This data-driven approach to tax planning can help the organization to minimize tax liabilities, maximize tax benefits, and ultimately improve its overall financial performance.

In conclusion, monitoring and reporting tax compliance metrics is a critical function of a Tax Steering Committee and plays a key role in ensuring that the organization meets its tax obligations, manages tax risks effectively, and optimizes its tax position. By establishing a framework for tracking and evaluating key tax compliance metrics, the committee can provide transparency and accountability to stakeholders, identify areas of risk and non-compliance, and make informed decisions about tax planning and strategy. Ultimately, effective monitoring and reporting of tax compliance metrics can help to protect the organization's reputation, financial stability, and long-term success.

CHAPTER 5: SUCCESS STORIES

Effective Tax Steering Committees

Tax steering committees play a crucial role in ensuring effective tax compliance within multinational corporations. By bringing together key stakeholders such as executives, CFOs, financial directors, accountants, and lawyers, these

committees are able to provide strategic guidance and oversight on all tax-related matters.

The tax steering committees have played a critical role in driving tax compliance and ensuring that their organizations are in good standing with tax authorities. By having a dedicated group of individuals focused on tax matters, these companies have been able to stay ahead of changing tax regulations and minimize their tax risks. This has not only helped them avoid costly penalties and audits, but has also enabled them to optimize their tax positions and improve their bottom line.

For executives, CFOs, financial directors, accountants, and other professionals involved in tax compliance, establishing a tax steering committee can be a valuable investment. By forming a committee that brings together key stakeholders and experts, multinational corporations can effectively manage their tax risks and optimize their tax positions.

Lessons Learned and Key Takeaways

One key lesson learned from our research and experience is the importance of having a dedicated tax steering committee to oversee and guide tax compliance efforts within a multinational corporation. By bringing together key stakeholders from various departments, such as finance, legal, and risk management, the tax steering committee can ensure a coordinated and comprehensive approach to managing tax risks and opportunities.

Another key takeaway is the need for effective communication and collaboration among committee members. By fostering an environment of open dialogue and sharing of information, the tax steering committee can make informed decisions and take timely actions to address tax compliance issues. Regular meetings and updates are essential to keep all members informed and engaged in the process.

Furthermore, our research has shown that having a tax steering committee in place can help multinational corporations stay ahead of changing tax regulations and requirements. By staying informed and proactive, the committee can help the organization navigate complex tax landscapes and mitigate potential risks of non-compliance.

In conclusion, forming a tax steering committee is a strategic imperative for multinational corporations looking to enhance tax compliance and manage risks effectively. By following best practices and lessons learned from successful tax steering committees, executives and financial professionals can ensure that their organizations are well-equipped to meet the challenges of today's global tax environment.

CHAPTER 6: THE FUTURE OF TAX COMPLIANCE AND THE ROLE OF TAX STEERING COMMITTEES

Emerging Trends in Tax Regulation

As tax regulations continue to evolve in response to the changing global economy, it is important for multinational corporations to stay ahead of emerging trends in tax regulation. In order to effectively manage tax compliance and mitigate risks, many corporations are establishing tax steering committees comprised of executives, financial directors, accountants, lawyers, and consultants.

One of the emerging trends in tax regulation is the increasing focus on transparency and reporting requirements. With the implementation of measures such as the OECD's Base Erosion and Profit Shifting (BEPS) project, tax authorities are cracking down on tax avoidance strategies used by multinational corporations. This has led to greater scrutiny of transfer pricing arrangements, intercompany transactions, and tax planning structures. A tax steering committee can help ensure that the company is in compliance with these new reporting requirements and is prepared for any audits or investigations.

Another important trend in tax regulation is the move towards digitalization and automation of tax processes. Tax authorities are increasingly using technology to streamline tax compliance and enforcement efforts. This includes the use of data analytics, artificial intelligence, and blockchain technology to track transactions, detect tax evasion, and improve tax collection. A tax steering committee can help the company leverage these technologies to enhance tax compliance and risk management.

In addition, there is a growing emphasis on sustainability and social responsibility in tax regulation. Tax authorities are looking at the environmental and social impact of corporate tax planning strategies, as well as the contribution of companies to the communities in which they operate. This has led to the development of new tax incentives for companies that demonstrate good corporate citizenship. A tax steering committee can help the company navigate these new regulations and take advantage of opportunities to align tax planning with sustainability goals.

Overall, staying abreast of emerging trends in tax regulation is crucial for multinational corporations to maintain compliance and manage risks effectively. By forming a tax steering committee comprised of key stakeholders from various departments, companies can ensure that they are well-equipped to address the challenges and opportunities presented by evolving tax regulations. This proactive approach to tax compliance can help companies not only avoid costly penalties and reputational damage, but also enhance their overall financial performance and sustainability.

Adapting to Regulatory Changes

Adapting to regulatory changes is a crucial aspect of tax compliance for multinational corporations. As tax laws and regulations are constantly evolving, it is essential for organizations to stay informed and up-to-date on any changes that may impact their tax obligations. This is where a tax steering committee can play a vital role in helping organizations navigate these changes and ensure compliance with the latest regulations.

Establishing a tax steering committee can provide a platform for executives, CFOs, financial directors, accountants, and other key stakeholders to come together and discuss the implications of regulatory changes on the organization's tax strategy. By having a dedicated committee focused on tax compliance, organizations can proactively address any potential issues that may arise as a result of new regulations, and develop a strategic plan to adapt to these changes effectively.

Forming a tax steering committee for multinational corporations is particularly important, as these organizations are subject to a complex web of international tax laws and regulations. By bringing together experts in tax law, financial management, risk management, and other relevant fields, multinational corporations can ensure that they have the necessary expertise to navigate the intricacies of global tax compliance.

In addition to helping organizations adapt to regulatory changes, a tax steering committee can also play a crucial role in identifying opportunities for tax optimization and risk mitigation. By regularly reviewing the organization's tax strategy and identifying areas for improvement, the committee can help ensure that the organization is maximizing its tax efficiency while minimizing its exposure to potential risks.

Overall, adapting to regulatory changes is a critical aspect of tax compliance for multinational corporations. By establishing a tax steering committee and bringing together key stakeholders to focus on tax strategy, organizations can proactively address regulatory changes, optimize their tax obligations, and mitigate potential risks. In today's ever-changing tax landscape, having a dedicated committee focused on tax compliance is essential for organizations looking to stay ahead of the curve and ensure long-term financial success.

Leveraging Technology for Enhanced Tax Compliance

In today's rapidly evolving business landscape, multinational corporations face increasingly complex tax compliance requirements. The key to navigating this complex terrain lies in leveraging technology to enhance tax compliance. By harnessing the power of technology, organizations can streamline their tax processes, improve accuracy, and minimize the risk of non-compliance.

One of the most effective ways to leverage technology for enhanced tax compliance is through the implementation of tax compliance software. These sophisticated tools are designed to automate tax calculations, filings, and reporting, reducing the burden on tax teams and minimizing the risk of errors. By utilizing tax compliance software, organizations can ensure that they are meeting their tax obligations in a timely and accurate manner, while also freeing up valuable resources to focus on strategic tax planning initiatives.

Another key technology tool for enhancing tax compliance is the use of data analytics. By leveraging data analytics tools, organizations can gain valuable insights into their tax data, identify trends and patterns, and proactively address potential compliance issues. With the power of data analytics, tax teams can make more informed decisions, optimize their tax strategies, and mitigate risks more effectively.

In addition to tax compliance software and data analytics, organizations can also benefit from leveraging cloud technology for enhanced tax compliance. Cloud-based tax management solutions offer the flexibility and scalability needed to meet the unique needs of multinational corporations. By moving their tax processes to the cloud, organizations can access their tax data from anywhere, streamline collaboration between tax teams and stakeholders, and ensure data security and compliance.

In conclusion, leveraging technology is essential for enhancing tax compliance in today's complex business environment. By investing in tax compliance software, data analytics, and cloud technology, organizations can streamline their tax processes, improve accuracy, and minimize the risk of non-compliance. For multinational corporations looking to establish a tax steering committee, technology will play a crucial role in driving tax compliance and ensuring long-term success.

CHAPTER 7: CONCLUSION

Recap of Key Points

In this subchapter, we will recap some of the key points discussed in the book "Driving Tax Compliance: The Essential Role of a Tax Steering Committee". This information is essential for executives, CEO, CFO, Financial Directors, Accountants, Financial Managers, Risk Managers, Lawyers, and Consultants who are involved in establishing a tax steering committee for multinational corporations.

First and foremost, it is crucial to understand the importance of establishing a tax steering committee within a multinational corporation. This committee plays a vital role in ensuring tax compliance, managing risks, and optimizing tax strategies. By bringing together key stakeholders from various departments, the tax steering committee can align tax planning with the overall business strategy of the organization.

Secondly, forming a tax steering committee requires careful consideration of the composition and roles of its members. Executives and senior management should be actively involved in the committee to provide strategic direction and oversight. CFOs and Financial Directors can bring their financial expertise to the table, while Accountants and Financial Managers can provide valuable insights into tax planning and compliance issues.

Risk Managers play a crucial role in identifying and assessing potential tax risks, while Lawyers can provide legal guidance on complex tax matters. Consultants can also offer valuable expertise and external perspectives to help the committee make informed decisions. By having a diverse and knowledgeable team, the tax steering committee can effectively address the complex tax challenges faced by multinational corporations.

Furthermore, the tax steering committee should focus on key areas such as tax planning, compliance, reporting, and audit readiness. By developing a comprehensive tax strategy that aligns with the organization's business goals, the committee can minimize tax risks and maximize tax efficiency. Regular monitoring and reporting of tax activities are also essential to ensure compliance with local and international tax laws.

In conclusion, establishing a tax steering committee is essential for multinational corporations looking to drive tax compliance and optimize tax strategies. By bringing together key stakeholders and experts from various departments, the committee can effectively manage tax risks, ensure compliance, and enhance the overall tax function of the organization. By following the key points outlined in this subchapter, executives, CFOs, Financial Directors, and other professionals can build a successful tax steering committee that adds value to their organization.

Implementing a Tax Steering Committee in Your Organization

Establishing a Tax Steering Committee can be a crucial step in ensuring tax compliance and managing tax risks for multinational corporations. This subchapter will provide insights and guidelines on how to set up a Tax Steering Committee within your organization effectively. The committee will play a vital role in overseeing tax strategy, governance, and compliance, ultimately helping to drive the organization towards its financial goals.

Forming a Tax Steering Committee requires careful consideration of the key stakeholders who should be involved. Executives, CEO, CFO, Financial Directors, Accountants, Financial Managers, Risk Managers, Lawyers, and Consultants are all essential members of the committee. Their diverse expertise and perspectives will ensure that the committee can effectively address the complex tax issues facing multinational corporations.

The first step in establishing a Tax Steering Committee is to define its purpose and objectives. This will help guide the committee's activities and ensure that it remains focused on driving tax compliance within the organization. The committee should also establish clear roles and responsibilities for its members, outlining who is responsible for overseeing specific tax-related tasks and decisions.

Once the purpose and objectives of the Tax Steering Committee have been defined, the next step is to create a structured meeting schedule. Regular meetings will allow the committee to stay informed about the organization's tax position, assess potential risks, and make informed decisions about tax strategy. It is essential that meetings are well-organized and productive, with clear agendas and action items.

In conclusion, forming a Tax Steering Committee for multinational corporations is a critical step in ensuring tax compliance and managing tax risks effectively. By involving key stakeholders, defining clear objectives, and establishing a structured meeting schedule, the committee can play a vital role in driving the organization towards its financial goals.

Executives, CFOs, Financial Managers, and other key professionals must work together to establish a Tax Steering Committee that is effective, efficient, and proactive in addressing tax-related challenges. The Impact of Driving Tax Compliance with a Tax

Steering Committee

Tax compliance is a crucial aspect of any business operation, and it is essential for companies to have a structured approach to managing their tax obligations. One effective way to ensure tax compliance is by establishing a Tax Steering Committee within the organization. This committee plays a vital role in overseeing and guiding the company's tax strategy, ensuring that all tax obligations are met in a timely and efficient manner.

The impact of driving tax compliance with a Tax Steering Committee is significant. By having a dedicated group of individuals focused on tax matters, companies can proactively identify potential risks and opportunities in their tax planning. This helps to prevent costly mistakes and ensures that the company is in full compliance with all tax regulations.

For multinational corporations, the need for a Tax Steering Committee is even more critical. With operations in multiple jurisdictions, these companies face complex tax challenges that require a coordinated and strategic approach. By forming a Tax Steering Committee that includes representatives from various departments and regions, multinational corporations can ensure that their tax strategies are aligned with their overall business objectives.

The Tax Steering Committee also plays a crucial role in fostering a culture of tax compliance within the organization. By promoting transparency and accountability in tax matters, the committee helps to instill a sense of responsibility among employees at all levels. This not only reduces the risk of non-compliance but also enhances the company's reputation and credibility in the eyes of stakeholders.

Final Thought

The formation of a Tax Steering Committee, guided by experts like Prof. Dr. Daniel N. Erasmus and his team, is crucial for multinational corporations to navigate the challenging waters of global taxation. The inclusion of client-attorney privilege within the TSC further strengthens its effectiveness, providing a secure framework for managing tax compliance and strategy. For comprehensive support in establishing a robust tax steering committee, consider consulting the experts at Tax Risk Management.

A Tax Steering Committee charter is necessary to outline the purpose, responsibilities, and structure of the committee, providing a clear roadmap for how it should operate within the organization. The charter serves as a guiding document for the committee members and ensures alignment with the overall goals of the corporation.

Next, we will offer a tax compliance checklist specifically tailored for multinational corporations. This checklist covers key areas such as transfer pricing, international tax planning, and compliance with local tax laws in various jurisdictions. By following this checklist, organizations can ensure they are meeting their tax obligations while minimizing risks and potential liabilities.

Finally, we will provide a recommended reading list for executives and financial professionals interested in deepening their understanding of tax compliance and risk management. These resources cover a range of topics, from international tax regulations to best practices for managing tax audits. By staying informed and up-to-date on the latest developments in tax compliance, professionals can make informed decisions that benefit their organizations.

Overall, these resources are invaluable for those looking to establish a tax steering committee or enhance their existing tax compliance processes within multinational corporations. By leveraging these tools, organizations can improve their tax governance, mitigate risks, and ensure compliance with tax laws and regulations around the world.

APPENDIX M

EXTRACTS – SARS INTERNAL DRAFT AUDIT MANUAL

What follows are extracts of some of those duties contained in the SARS Internal Draft Audit Manual, appropriate to the duty to promote and maintain high standards of professional ethics, with appropriate commentary:

*'In order to carry out his tasks properly the auditor has to make professionally and technically sound decisions on the nature and scope of the audit. This requires insight into the knowledge of the business process of the taxpayer as well as those of the industry or target group of which it is part.'*¹

...

*'SARS intends to give each taxpayer/group of taxpayers the attention which is necessary according to its tax importance and tax risk.'*²

...

*'The object of an audit is in general the examination of [a] tax return of a taxpayer and/or the books and records on which the tax return is based.'*³

...

'The risk profiling team will manually select cases to be audited by screening the tax returns in order to determine the level of risk per case,

*and to establish which cases warrant an audit (desk or field) selection will be done under the guidance and ambit of the Manual Risk document.'*⁴

'1 THE AUDIT ASSIGNMENT

The audit plan includes the schedule and set up of audits to be carried out within a certain time period. The audit plan translates itself into the audit assignment, which indicates which taxpayers and which elements of the tax return(s) need to be audited. This is important for each auditor, as it sets out the nature and scope of the audit.

1 Op Cit, 2.

2 Op Cit, 2.

3 Op Cit, 2.

4 Op Cit, 4.

The audit assignment is thus the link between the audit plan and the auditing process.⁵

‘2 STAGE 1: AUDIT PLANNING

... The team leader will have to prioritise each case assigned. All decisions taken at this stage of the audit process and all information and considerations on which decisions are based, are recorded in the audit file.⁶

‘Pre-planning

Not as critical in our environment, although the following two components of pre-planning should still be relevant:

- An engagement letter informing the taxpayer of the audit, i.e. notice of the intention to audit, when, purpose, approximate duration, information required and other general aspects.
- Allocation of staff in respect of the specific engagement.’

‘Collecting Information

Prior to the audit, information will have to be collected, on the taxpayer to be audited, as this will provide insight into the entity.

- Information on the taxpayer himself. Obtained from the existing tax files of the taxpayer. ...
- Information from other sources (third parties) ...
- Information on the business processes, administrative organisation and the internal control of the entity. ...
- Information from minutes of meetings e.g. board of ...
- Information from the file of the tax consultant and/or accountant/ external auditor of the taxpayer. ...

The auditor should restrict the initial information collected to the potential issues of the relevant case, which will be of value to the audit of the risk areas identified.

...’

‘Carrying out the preliminary analytical review

The purpose of this exercise is not to produce volumes of interesting, but ultimately useless information.

... The preliminary review may require that the auditor researches the tax laws and court cases that are relevant to particular issues to be examined in the audit of the entity. Notes on the research are incorporated into the audit working papers.’

‘Risk analysis based on the tax return

In determining which activities will be carried out to achieve the audit objectives, the team leader continually considers the relationship between the cost and the benefits of the audit ...’

‘3 STAGE 2: THE IMPLEMENTATION OF THE AUDIT PROGRAMME

The general rule is as follows:

- Where the auditor finds no or immaterial mistakes or errors, the audit in that particular area should be stopped.
- Where many material mistakes or errors are detected, the audit should be expanded in that particular area.
- If it appears that the taxpayer’s returns are substantially correct, the audit should be terminated.

The auditor must consider whether advice or support from a well-informed colleague is necessary. Consultation with colleagues will ensure that the auditor is better informed when making decisions.

All decisions at this stage of the auditing process, as well as the information and considerations, on which they are based, are recorded in the audit file. Sampling techniques are encouraged while performing the audit.’

5 Op Cit, 5.

6 Op Cit, 6.

‘4 STAGE 3: CONCLUSION

In this stage of the auditing process the auditor in charge reviews and summarises the findings of the audit and forms a conclusion based on these findings.

During the discussion with the taxpayer the auditor informs him of the conclusions reached on the tax return(s) and explains the decision. If the taxpayer does not agree with the judgement, the auditor listens to the reasons and considers whether these reasons may call for an adjustment of the conclusion. If it is decided that no adjustment is required, bearing in mind the outcome of previous consultation with colleagues, the auditor discusses the taxpayer’s reason and arguments with the audit manager.

Where compromises are reached, they are recorded in the file and included in the report. SARS and the taxpayer should sign the compromises.

After the concluding discussions with the taxpayer and the audit manager, the position of SARS is determined. There are two possibilities:

- No further action is required; or
- The results of the audit necessitate further action, which usually involves adjustment of the assessments as well as the levying of interest, penalties and additional tax.

In some instances this is not sufficient and it is necessary to extend the audit to the criminal domain. This calls for a change in the nature of the audit. The timely recognition of such a change, is an essential element of the auditing process. Refer to part 7 of the audit manual.

The audit report is completed and forwarded to the team leader who reviews, monitors and controls the completion and quality of the audits being performed.

The team leader communicates the relevant findings to the research and analysis team and the risk evaluation committee.’

CONCLUSION

In a careful perusal of these extracts from the SARS Internal Draft Audit Manual, it becomes apparent that taxpayers need not tolerate non-compliance by SARS with its Constitutional duty to maintain and promote a high standard ethics in executing its functions as tax administrator. Any non-compliance by SARS will amount to conduct that is unconstitutional.

APPENDIX N

THE ABD VS THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICE (UNREPORTED) JUDGMENT

What follows is the written judgment handed down in a tax court, chaired by an experienced intellectual property High Court judge, together with an accountant assessor and a business assessor. The facts and legal issues appear from the judgment, but I have inserted notes to provide additional explanations where necessary.

Although this judgment deals with the complex TP area of intellectual property rights, it illustrates the complex layers that must be researched, developed and prepared when pursuing in a TP tax trial.

By way of introduction, I provide a –

SUMMARY OF THE CASE:

Appellant: ABD, a South African communications company with subsidiaries (OpCos) worldwide.

Respondent: Commissioner for the South African Revenue Service (SARS).

Nature of Dispute:

ABD appeals against an increased tax assessment imposed by SARS for the tax years 2009–2012.

The case concerns a transfer pricing dispute over royalty payments made by 14 OpCos to ABD.

Key Facts

Royalty Payments:

ABD licensed its intellectual property (IP) to the OpCos, charging a flat royalty rate of 1%.

SARS contested this rate, arguing it was below an arm's length price and adjusted the rate under **section 31(2) of the Income Tax Act, 58 of 1962**.

SARS's Basis for Adjustment:

SARS initially relied on the opinion of Mr V but later engaged Dr F (a new expert in 2020), whose methodology proposed a variable royalty rate.

Dr F used a willingness-to-pay (WTP) approach, concluding that the royalties should vary across countries and years, with rates ranging from 0.8% to 9.2%.

ABD's Objection:

ABD argued that the flat 1% royalty was reasonable and consistent with an arm's length price based on the advice of a consultancy, I.

ABD contended that SARS's reliance on Dr F's methodology was flawed and inconsistent with established OECD Transfer Pricing Guidelines.

Legal Issues

Section 31 of the Income Tax Act (1962):

Permits SARS to adjust transfer pricing if the consideration charged between related parties is below arm's length price.

OECD Guidelines on Transfer Pricing:

Both parties relied on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2022 version), which provides methods to determine arm's length prices.

Determination of the Arm's Length Price:

SARS sought to increase ABD's royalty rate using Dr F's WTP model, while ABD argued that an internal Comparable Uncontrolled Price (internal CUP) model, based on a 2018 Cyprus transaction, was a more accurate measure of arm's length price. The internal CUP was relied upon to corroborate the Transactional Profit Split Method (TPSM) methodology relied upon by the Applicant in its TP study.

Analysis of Transfer Pricing Models

Transactional Profit Split Method (TPSM):

ABD relied on TPSM through experts MR and Ms N, but this methodology was ultimately not decisive. The court did not comment or analyse this method.

Comparable Uncontrolled Price Method (CUP):

ABD's expert, Dr S, used an internal CUP derived from the 2018 Cyprus transaction, where a license agreement was concluded at arm's length. This was used to corroborate the Applicant's TPSM.

The court found that the Cyprus CUP was a more reliable indicator of arm's length pricing.

Dr F's WTP Model:

SARS relied on Dr F's WTP model to calculate the price premium for the ABD brand, but the court rejected this approach due to:

- Incorrect assumptions about the nature of the rights licensed;
- Inaccurate survey questions; and
- Lack of established acceptance of the WTP methodology in transfer pricing litigation.

Key Findings

Incorrect Valuation by SARS:

Dr F valued a broader set of rights than those actually licensed to the OpCos, erroneously including goodwill. His methodology (WTP) was found unreliable and untested in transfer pricing litigation.

Acceptance of Cyprus internal CUP:

The court concluded that the 1% royalty charged by ABD was consistent with an arm's length price, based on the Cyprus internal CUP.

Rejection of SARS's Additional Assessments:

SARS's additional assessments, based on Dr F's flawed methodology, were set aside.

COURT'S CONCLUSION

Appeal Succeeds:

ABD's appeal was upheld, and SARS's additional assessments for 2009–2012 were set aside.

Costs Awarded to ABD:

SARS was ordered to pay ABD's costs from October 2020 (when Dr F's report was first received), including:

- Costs of two counsel; and
- Qualifying fees of Dr S and half of Ms N's fees.

KEY LESSONS AND PRECEDENT ESTABLISHED

Preference for internal CUP Method:

Where a valid internal CUP exists, it is the preferred method to establish an arm's length price.

Caution with Novel Methodologies:

The court emphasized caution in accepting novel methodologies such as the WTP approach in transfer pricing cases. Fairness in Additional Assessments:

SARS's reliance on multiple experts with shifting methodologies (from Mr V to Dr F) was criticized, contributing to the finding that SARS's grounds of assessment were unreasonable.

Final Order

- ABD's appeal for the tax years 2009–2012 is upheld;
- SARS's additional assessments for these years are set aside; and
- SARS is to pay ABD's costs, including the costs of two counsel and the qualifying fees of Dr S and half of Ms N's fees.

THE ABD VS THE COMMISSIONER FOR SOUTH AFRICAN REVENUE SERVICE (UNREPORTED) JUDGMENT

The ABD vs The Commissioner for South African Revenue Service (unreported) judgment is as follows (which has gone on appeal to the Supreme Court in South Africa in 2025):

In this case ABD (X) appeals against an increased assessment imposed on it by the Commissioner for South African Revenue Service (SARS) the respondent. The case raises certain unique questions about a practice known as transfer pricing.

- [1] ABD is a South African Communications company with subsidiaries worldwide. These subsidiaries are operating companies, with local shareholders, but having ABD as a significant shareholder. ABD licences its intellectual property to these operating companies (from now on referred to as OpCos) in return for which they pay ABD a royalty.
- [3] The present case involves the royalty payments made by fourteen of the OpCos to ABD during the periods 2009 to 2012. ABD charged all of them the same royalty rate of 1% for the right to use its intellectual property. The extent of what that right represented is in dispute. The calculation of the royalty rate is based on two factors. The size of the profit earned by the Opco from the use of the IP and then how that profit is divided between the Opco and ABD. ABD's counsel came up with a useful metaphor to describe this exercise. He said the first determination is about the size of the pie and the second about how to divide the pie.
- [4] What emerges in this litigation is that there are different methodologies that experts may use in performing these calculations. Nevertheless, there is at least an agreement on the principle to be applied. The royalty must be at arms-length – i.e., what would it be if it was between two independent enterprises as opposed to a company taxed in one jurisdiction and its subsidiary taxed in another.
- [5] In 2011 ABD retained the services of a consultancy known as I to advise it on what royalty it should charge its various OpCos. I procured research on the subject and then, informed by that, came up with the recommendation that a royalty of 1% could be justified.
- [6] SARS contends that the 1% is not an arms-length royalty. On various occasions it issued an additional assessment to increase the royalty. SARS relied on the Commissioner's powers in terms of section 31(2) of the Income Tax Act 58 of 1962 (Income Tax Act) to do so.
- [7] That section in its then formulation provided that:
- 131(2) Where any supply of goods or services has been effected-*
- (a) *between -*
- (i) *(aa) a resident; and*
- (bb) any other person who is not a resident; or (ii)...*
- (b) *at price which is either—*
- (i) *less than the price which such goods or services might have been expected to fetch if the parties to the transaction had been independent persons dealing at arm's length (such price being the arm's length price); or*
- (ii) *...*
- the Commissioner may ... in the determination of the taxable income of either the acquirer or supplier, adjust the consideration in respect of the transaction to reflect an arm's length price for the goods or services."*
- [8] Put more succinctly the Commissioner had the power to adjust the consideration to reflect an arm's length price if he considered the price received was less than it would have been in an arm's length transaction between independent persons. That begs the question central to this case; how does one determine an arm's length price?
- [9] For that purpose, SARS first relied on the expertise of a Mr V. His report led to an additional assessment being levied by SARS that ABD considered excessive and has formed the basis of this appeal. However, during the course of these appeal proceedings, in October 2020, SARS retained the services of a new expert, an economist, Dr F. Based on his recommendation SARS seeks to adjust the royalty rate further to conform with what he calculates should have been the arms-length royalty rates payable in the tax years from 2009 to 2012.
- [10] The difference between the V and F calculations is over how they calculated the size and division of the pie. Mr V relied on ABD's consultant's figures for the size of the pie as 3% of turnover, but then made his own determination

on its division. He said that ABD was liable for the full 3%. ABD whilst agreeing with his determination of the size of the pie disagrees with his determination of its division. (He considered that ABD should be considered to have 100% of the pie. ABD disputes this.) By contrast Dr F recalculated the size of the pie (leading to a much larger pie; on average 47% as opposed to V's 3%); but divided the pie between ABD and the OPCO's, thus reducing ABD's share of the pie to 6% from V's 100%.² ABD disagrees with F's calculation of the size of the pie but agrees with his division of the pie.

[11] Since in this appeal SARS relies on Dr F's approach and no longer that of Mr V, it is to his conclusions about the size of the pie I concern myself.

[12] In contrast to ABD's flat royalty rate of 1% for all the OpCos over the entire four-year period, SARS, advised by Dr F, now contends ABD should have charged a variable royalty rate depending on the country and the year it was earned. The fluctuations created by adopting his approach are considerable. Thus, in one instance the royalty rate he considers to be appropriate has been below 1% (Sudan in 2011) while in another he contends it should have been charged at 9.2% (Syria in 2010).

[13] I set out below the table of the royalties that Dr F, and now SARS acting on his advice, contends should have been charged by ABD to these fourteen OpCos during the period 2009 to 2012. This royalty rate is not yet the subject of a further increased assessment, but SARS seeks an order from the court in terms of section 129(2)(b) of the Tax Administration Act (TAA) that this additional assessment be adjusted to reflect these rates as set out in the table.

Opco	2009	2010	2011	2012
Afghanistan	1.7%	3.2%	1.9%	1.7%
Benin	3.5%	4.9%	2.0%	2.3%
Cameroon	2.7%	3.6%	1.5%	1.7%
Congo	2.2%	4.0%	1.8%	1.7%
Cyprus	1.9%	4.1%	1.5%	1.5%
Ghana	2.2%	4.2%	1.5%	1.4%
Guinea-Bissau	4.6%	4.3%	2.3%	1.5%
Ivory Coast	1.7%	2.6%	1.4%	0.9%
Rwanda	9.2%	6.5%	1.8%	5.3%
Sudan	1.3%	1.8%	0.8%	0.9%
Syria	4.9%	9.2%	6.7%	5.8%
Uganda	1.9%	2.7%	1.3%	1.2%
Yemen	1.9%	3.6%	4.5%	1.5%
Zambia	1.3%	1.8%	0.7%	1.0%

- [14] ABD's principal relief is for the court to uphold its appeal and for the court to set aside the additional assessments for the 2009-2012 tax years. SARS relief is for the court to alter the additional assessments in terms of section 129(2)(b) of the Tax Administration Act, 28 of 2011, to reflect the quantifications done by Dr F set out in the table above.

Transfer Pricing

- [15] The Corporate Finance Institute (CFI) gives a useful definition of transfer pricing: *"Transfer pricing refers to the prices of goods and services that are exchanged between companies under common control. For example, if a subsidiary company sells goods or renders services to its holding company or a sister company, the price charged is referred to as the transfer price."*¹

Entities under common control refer to those that are ultimately controlled by a single parent corporation.

- [16] The CFI goes on to explain why companies may use transfer pricing: *"Multinational corporations use transfer pricing as a method of allocating profits (earnings before interest and taxes) among their various subsidiaries within the organization.*

Transfer pricing strategies offer many advantages for a company from a taxation perspective, although regulatory authorities often frown upon the manipulation of transfer prices to avoid taxes. Effective but legal transfer pricing takes advantage of different tax regimes in different countries by raising transfer prices for goods and services produced in countries with lower tax rates. In some cases, companies even lower their expenditure on interrelated transactions by avoiding tariffs on goods and services exchanged internationally." (My emphasis)

- [17] This last observation has salience for the present case. ABD makes the point that ABD has no incentive to charge its OpCos a lower royalty to avoid paying higher taxes in South Africa. A table in the record sets out the marginal tax rates in both South Africa and the jurisdictions. This shows that for most of them the tax rates in the jurisdictions where the OpCos were located, were equal to or higher than the South African tax rate. But it was argued that there was a further disincentive to under charge on the royalty. ABD has minority shareholders in most of the OpCos. If it were to undercharge the OpCos through the royalty this would mean it inflated its profits in the OpCos. The result of this is that the minority shareholders would be rewarded with profits that exceeded their shareholdings.

- [18] SARS did not place these facts in dispute. Rather it said this consideration was irrelevant to the assessment of the current matter. That may be so. But it is relevant to the genesis of the rate that ABD has adopted. It starts, as I noted earlier, with ABD commissioning I, a consultancy, to advise it on the value of its intellectual property.

- [19] I compared royalty rates in 18 territories where ABD OpCos were located and came to the following conclusion: *"The ABD Group Royalty Rates were found to be in a range from 0.7% to 1.3%, depending on the financial performance, market share and brand health of the ABD brand in each territory. The average ABD Group Royalty Rate was found to be 1%, which would be a suitable rate if ABD preferred to have a uniform approach across all licensees. This approach also acknowledges the "halo" effect of the ABD brand across the various territories."*²

- [20] ABD followed the advice I gave it. It had two aspects to it; that ABD should apply a rate that was an average of the rates of the territories considered. This led to an adoption of a rate of 1% (The range of the rates was between 0.7% and 1.3% thus much flatter than the rate range calculated by F); and second that applying a uniform rate had practical implications for both ABD and the OpCos. I explained why:

*"An average rate will mean that both ABD Group and the licensees will have some confidence about the likely levels of payment and so can plan accordingly. By averaging the rate across a number of years, both ABD Group and the licensees benefit from smoothing the effect of fluctuations in performance."*³

SARS additional assessments

- [21] The dispute between ABD and SARS had its origins with ABD's 2009 assessment. SARS initially accepted ABD's royalty calculations in 2009. But in 2014, SARS undertook a transfer pricing audit. The outcome was that in March 2014 SARS issued an additional assessment for ABD's 2009 tax year. Several more adjustments followed.

1 Corporate Finance Institute – accessed on 3 October 2023.

2 I's ABD Royalty Analysis March 2011, Caselines 02-10.

3 Ibid, Caselines 02-6.

- [22]. According the ABD's rule 32 statement for the 2009 year the chronology of SARS's changes was:
*SARS based its determination of arm's length royalties, initially on a 2009 expert report of BF on ABD Brand Strength Analysis but later in part on a 2011 report of I Sampson on ABD Royalty Rate Analysis; and on 2015 and 2016 reports of Mr V*⁴
- [23] But now, as noted, SARS seeks to rely on the work of Dr F in 2020 for the additional assessments which lead to a much greater liability for ABD than would have been the case under the earlier V based assessments. This has led to ABD to accuse SARS of a 'flip flop', a charge SARS vehemently denies. But ABD argues, as one of its grounds of appeal, that SARS could only issue an additional assessment in terms of section 92 of the Tax Administration Act 28 of 2011 (TAA), if it is satisfied that "...an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the fiscus". SARS, it argues, could not rationally have been satisfied that the original assessment did not reflect the correct application of the Act. What ABD is arguing here is that even if the Commissioner has the power to act in terms of section 31(2) of the Income Tax Act to adjust a price to reflect an arm's length price, this does not give SARS the power to act in terms of section 92 of the TAA, to make an additional assessment, because even if the price was not an arm's length price that is not a correct application of the TAA, because there is no obligation for a taxpayer to charge an arm's length price. Subtle as this argument is, its determination can wait for another day. I will proceed on the premise that SARS has such a power to act in terms of section 92 of the Tax Administration Act read with section 31(2) of the Income Tax Act."

Overview

- [24] The case is unusual in that neither side, despite lengthy heads of argument has produced a single case on the central topic of the case – the approach a court should adopt to the subject of transfer pricing. Instead, both sides have relied on a document produced by the Organisation for Economic Cooperation and Development (OECD) entitled "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" (Guidelines). During the course of this litigation reliance was placed on two versions of the Guidelines; one dated 2017 and the other 2022. While there are differences between the two, insofar as the relevant paragraphs in the Guidelines concern the present case, these are not material, and I will reference the 2022 Guidelines. It is a detailed document extending to more than 600 pages if one includes the annexures. The natural question to be asked is why if there is such detail in the Guidelines would disputes over its application still arise? The answer is that in many pertinent areas the Guidelines are expressed either in equivocal terms or create exceptions to more general suggested principles. It is in these interstices that the roots of the present dispute emerge.

Terminology

- [25] The guidelines contain useful definitions of the key terms used in the case. We start with the concept of an arm's length transaction which is defined as one where: "*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.*"⁵
- [26] But it is important not to pay mere lip service to the concept of the arm's length principle. Its rationale for trade consequences and for fairness must be appreciated. The Guidelines in the foreword explain:
- [27] "*A major reason is that the arm's length principle provides broad parity of tax treatment for members of MNE groups and independent enterprises. Because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positions of either type of entity. In so removing these tax considerations from economic decisions, the arm's length principle promotes the growth of international trade and investment.*"⁶
"*Tax administrations should not automatically assume that associated enterprises have sought to manipulate their profits.*"⁷

4 CaseLines 003-243 paragraph 34.
5 See Guidelines, defined section.
6 Guidelines paragraph 1.8.
7 Guidelines paragraph 1.2.

- [28] Nevertheless, in the even-handed manner the Guidelines are drafted, they go on to state:
*“When transfer pricing does not reflect market forces and the arm’s length principle, the tax liabilities of the associated enterprises and the tax revenues of the host jurisdictions could be distorted.”*⁸
- [29] This then leads on to the central problem faced in this case. How does one assess whether a transaction between associated enterprises, referred to in the language as a “controlled transaction”, is one at arm’s length and hence from a tax perspective of the jurisdiction in question, benign? The solution in the guidelines is to adopt one of the various methodologies it recommends be followed. They serve as the litmus test to a transaction – is it or is it not the equivalent of an arm’s length transaction - one between independent enterprises shaped by the operation of market forces.
- [30] Four experts testified about what the appropriate methodology to be used was, and conversely, what was not. Testifying for ABD were three experts but they relied on different methodologies. Two of them MR and RN testified that the royalty represented that of an arm’s length transaction using a method known as the Transactional Profit Split Method or TPSM. I explain later what this method means. However, a third expert for ABD, Dr S, employed what is known as the Comparable Uncontrolled Price Method, or CUP. Ms N gave supporting evidence for Dr S on the CUP application as well.
- [31] Thus, what ABD sought to do is to justify its royalty as one that is arm’s length based on two distinct methodologies. SARS relied in the hearing on a single expert, Dr F who also used the TPSM method but relied on a different data set to that used by MR and Ms N.”

What are the methods

- [32] The two methods of relevance in this case are the TPSM and the CUP
- (i) Transactional Profit Split Method (TPSM)**
- [33] In the Guidelines the definition is broken up into two. First it defines a transactional profit method as:
“A transfer pricing method that examines the profits that arise from particular controlled transactions of one or more of the associated enterprises participating in those transactions.”
- [34] In a further definition TPSM is then defined as:
“A transactional profit split method that identifies the relevant profits to be split for the associated enterprises from a controlled transaction ...and then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm’s length.”
(Emphasis provided)

(ii) Comparable uncontrolled price method (CUP)

- [35] In the Guidelines a CUP is defined as:
“A transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.” (Emphasis provided)
- [36] As is evident from the underlined portions of these definitions there is a wide margin for interpretation on their application. For this reason, the Guidelines attempt to put some more flesh on these definitions in sections that discuss them in further detail.
- [37] Before I do so there is another definition that is relevant to the issues. Given that the asset in this case is a set of IP rights it is an intangible. The Guidelines define intangibles as:
*“...something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Rather than focusing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction.”*⁹
- [38] As part of its treatment of what an intangible is the Guidelines go on to discuss what a brand means for the purpose of a transfer pricing analysis.
“The term “brand” is sometimes used interchangeably with the terms “trademark” and “trade name.” In other

8 Guidelines paragraph 1.3.

9 Ibid 6.6.

contexts, a brand is thought of as a trademark or trade name imbued with social and commercial significance. A brand may, in fact, represent a combination of intangibles and/or other items, including among others, trademarks, trade names, customer relationships, reputational characteristics, and goodwill. It may sometimes be difficult or impossible to segregate or separately transfer the various items contributing to brand value. A brand may consist of a single intangible, or a collection of intangibles ..."

- [39] One of the central issues of criticism that ABD have with Dr F is the notion that he has valued the wrong brand. Use of the term 'wrong' brand is a misnomer. What the criticism of Dr F is, is that he has valued the ABD brand based on an extended notion of what has been transferred to the OpCos. As I go into in more detail later ABD contends that the licences to the OpCos are limited to the use of tradenames and trademarks not goodwill. Dr F has assumed it includes all rights to a brand, including goodwill, thus making these intangibles appear more valuable than they in fact are. Thus, if they are more valuable a higher royalty than the 1% would appear justified. ABD disputes this premise."

ABD's case

- [40] As I mentioned earlier ABD's case rested on the testimony of three experts. Two experts (MR and Ms N) relied on TPSM method, and one, Dr S, relied on a CUP, although supported by Ms N on some aspects of this.

X on TPSM

- [41] MR is a London based professional employed by I. He leads I's brand valuation practice and has eighteen years' experience in this area. He has a background as a chartered accountant as well as in marketing. He relied for his expert report on an earlier I report prepared by colleagues and this in turn was based on survey evidence conducted by a company called Dashboard. MR conceded he was not involved in the preparation of either. Key to the I analysis is a technique used to value a brand known as the Role of Brand Index or ROBI. This technique seeks to measure the degree to which a brand plays a role in driving customer choice and then expressing that as a percentage.

- [42] SARS challenged the fundamental legal basis for MR's testimony on the basis that it constituted inadmissible hearsay. ABD argued that survey evidence has been held admissible as an exception to the hearsay rule in certain circumstances. I provisionally admitted this testimony and deferred argument on this issue until the end of the case.

- [43] In the interim, prior to my making a ruling on this issue, ABD sought to deal with the hearsay criticism by leading a witness, a Mr Y, whose firm was involved in some of the data calculations that formed the data used in the I report. But at the end of the case, SARS argued that Mr Y could not close the gap that remained in the chain of this evidence, to rescue it from a hearsay objection as it was Mr Y's partner, not him, who had performed the data analysis. SARS conceded that survey evidence can be admitted as an exception to the hearsay rule in terms of Hearsay Act,¹⁰ and that in the leading case on the point, McDonalds, the court had stated that a properly conducted survey could be admitted in evidence without requiring affidavits from the respondents. But SARS went on to argue that the court in McDonalds has also held that this was subject to the proviso that the opposing party (in this case SARS) is given an opportunity to check the results of the survey. SARS contended that it had not been given access to such results.¹¹

- [44] ABD argued at the end of the case that MR's testimony was not hearsay as SARS had earlier admitted the I report and hence ABD could rely on this admission. It also sought to argue that if it was hearsay the evidence for the same reason ought to be admitted. As I have not ended up relying on ABD's TPSM evidence I do not need to decide this point.

- [45] Separately from this hearsay legal challenge, Dr F addressed what he said were eight main flaws with the I's methodology. I do not need to consider if any of these criticisms, legal or economic are valid. What it does illustrate is the vulnerability of the TPSM technique in disputes about intangibles when based on evidence from surveys. Nevertheless, ABD does not need to succeed on both methodologies it seeks to rely on. It only needs to succeed on one. I for this reason go on to discuss the case ABD made on the application of the CUP method.

¹⁰ Section 3 of the Law of Evidence Amendment Act, 45 of 1988.

¹¹ *McDonalds Corporation v Joburgers Drive-In- Restaurant* 1997(1) SA 1 (A) at pages 26-27.

- [46] This aspect of the case was a departure from what X had relied on previously in the I reports, where the TPSM was applied. The case largely relied on the testimony of Dr S although his testimony was bolstered in certain aspects by Ms N.
- [47] The Guidelines make it clear that where a CUP is applicable it is the preferred method to be used.
“Where it is possible to locate the comparable cup, it is the preferred method for the determination of arm’s length price.”
- [48] The reasons for this go back to the original analysis of the transfer pricing problem. It is the one method that seeks to replicate how market forces would work for a transaction between independent entities. However, the criteria for selecting an appropriate CUP are strict. Put differently, whilst a CUP, if it works, is considered the best method to apply, it also has the most hoops for the party relying on it to pass through.
- [49] What Dr S did was to go through the history of the OpCos and in doing so he identified a transaction that he considered met the requirement for a CUP and more specifically an ‘internal CUP’. (I explain what this term means later) The transaction is known as the Cyprus transaction as it involved ABD’s sale of a subsidiary based in Cyprus to a third party, XX Telecomms. The sale took place on 15 July 2018. However, it did not at the time include a brand licence agreement. But on 3 September 2018 the parties concluded a brand licence agreement. What is significant is that this licence agreement took place at a time when the Cyprus entity was now independently owned. Thus, argues ABD, the parties were at arm’s length at the time the agreement to licence the brand was concluded. The material terms of the licence were that the brand was licenced for a period of three years to Monaco, but the latter was given the right to terminate the brand agreement at any time with immediate effect.
- [50] Dr S makes the point that not only is the Cyprus agreement a suitable candidate for a CUP, but it is also what the Guidelines term an ‘internal CUP’. An internal CUP is described as a transaction between one party to the controlled agreement (in this case ABD) and an independent party (XX). Dr S’s evidence is that not only is a CUP superior to other methods, but also that an internal CUP, if available, is superior to an external CUP (one where neither party is party to the controlled transaction).
- [51] Dr S here is not relying on his own opinion but the OECD Guidelines as this extract from his report explains:
“To corroborate using an internal CUP as the most reliable information available, OECD TPG ¶3.27 states that “[i]nternal comparables may have a more direct and closer relationship to the transaction under review than external comparables.”
OECD TPG ¶3.29 follows that “whenever reliable internal comparables exist, it may not be necessary to search for external ones.”¹²
- [52] The Guidelines go on to explain the advantage of an internal CUP:
“The financial analysis may be easier and more reliable as it will presumably rely on identical accounting standards and practices for the internal comparable and the controlled transaction. In addition, access to information on internal comparables may be both more complete and less costly.”
- [53] When the original V report was done Dr S looked at an external CUP as a basis for comparison. This proved unsuitable as it was not possible to conclude without further facts that it was reliable. But in contrast when the Cyprus transaction became known its utility as an internal CUP became clear to him.

Criticism of Dr S

- [54] SARS did not contest the idea that if a suitable internal CUP was available, it was the most reliable method to use. It could hardly do so given that SARS accepts the authority of the Guidelines. Rather, SARS questioned whether the Cyprus transaction was a reliable comparable based again on what it said the Guidelines required. The Guidelines lay out certain requirements which are common to all methodologies. These requirements are summarised as;
§1.36 *“The economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations between the associated enterprises in order to accurately delineate the actual transaction can be broadly categorised as follows:*

¹² S expert report paragraph 51.

- *The contractual terms of the transaction (D.1.1).*
 - *The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices (D.1.2).*
 - *The characteristics of property transferred or services provided (D.1.3).*
 - o *The economic circumstances of the parties and of the market in which the parties operate (D.1.4).*
 - *The business strategies pursued by the parties (D.1.5)."*
- [55] What the Guidelines state in relation to the CUP method is where there are differences in comparables the CUP method is still recommended, provided that these differences can be measured and hence accounted for.
- [56] The line of cross examination was to ask Dr S if he had considered certain factors that the Guidelines indicate are relevant to all methodologies i.e. would apply both to the CUP and the TPSM methods. Whilst acknowledging that they did, Dr S conceded he had not, but said not all these factors were relevant in all situations. He eschewed he said a mechanistic approach to their application.
- [57] He was also pressed on whether there were differences. He acknowledged that there were. The Guidelines also state that in using the CUP method if there are differences these should be measured and taken into account if the method is to be used. Dr S was asked if he had measured the differences in his analysis. He said he was unable to measure them and hence had not. It was put to him that on this basis the CUP method which he had espoused was not a useful comparable in these circumstances. There were differences which he had conceded existed, but he had not measured.
- [58] Dr S insisted however that notwithstanding this criticism the Cyprus agreement was still an appropriate candidate as an internal CUP. Most of the differences were not relevant on his assessment whilst others which might be were not material. To the obvious criticism that if he could not measure them how could he be so sure that they were not material he had two responses. First, he stressed the distinction between the asset value of an intangible asset and the royalty rate as this passage in his cross-examination illustrates:
"[COUNSEL FOR SARS]: The question was whether economic circumstances and we referred specifically the size of market, the extent of competition, the availability of substitute goods and services, the nature and extent of government regulation of the market is a relevant comparability factor to the CUP Method.
- [59] MR S: Well, here there are several factors and I have conveyed that these factors are not relevant for the determination of royalty rates. *They may be relevant for the determination of the asset value of the property but not the rate of the income."*
- [60] In relation to the measurability challenge Dr S relied on his own resource that he keeps of royalty values for his company known as Royalty Stat. He describes Royalty Stat as a company that inter alia provides:
"Comparable royalty rates (in the form of a commercial online database) drawn from proprietary compilations of publicly available license or similar. (such as asset purchase) agreements within the meaning of the OECD Transfer Pricing Guidelines..."
- [61] Based on his experience of this database, first set up in 1999, he said that the differences were never material in royalty agreements. Thus, what Dr S does is to give both a theoretical and an empirical (based on his own research) response to the criticism that the Cyprus CUP was not a true comparable.
- [62] Ms N dealt with two of the issues about comparability – exclusivity and duration. The Cyprus agreement unlike some of the other Opco agreements gave Monaco exclusivity. The Cyprus agreement was for 3 years but other Opco agreements varied in duration – some for 10 years some indefinite.
- [63] She testified that normally exclusivity would command a higher price since it allows a greater degree of market power and influence. But like Dr S her view was that in practical terms exclusivity does not have a material impact on price. She also testified that duration does not have a material influence on the value of the brand and hence the royalty. This she based on her many years of encountering such agreements. But she also offered a rationale. She said a longer agreement meant less risk for the licensor and hence it might agree to a lower royalty i.e. even less than 1%. She supported Dr S's view that the Cyprus CUP as an internal CUP, provided an appropriate benchmark for an arm's length royalty.
- [64] In addition to being used to put forward his own transfer pricing analysis Dr F was also used by SARS to offer a critique of the ABD experts. The broad thrust of this criticism was to suggest that relying on the Cyprus transaction as a proxy for a CUP was misplaced because the agreement did not meet the requirement of comparability. But a number of these criticisms were based on a legal rather than an economic analysis and as ABD has persuasively argued were based on error.

- [65] Dr F argued that the rights granted in the Cyprus CUP were not the same as those granted to the OpCos. But under cross examination this turned out to be a legal error because he assumed that the rights given by ABD to ABD Dubai which included goodwill had been given to the OpCos– as it happened these rights were more limited and did not include goodwill.
- [66] Then he argued that the agreement with Cyprus could not be regarded as one with an independent entity because ABD Cyprus had historically been an ABD Opco. In terms of the Guidelines an entity is not independent of another if it is an associate. An associate is an enterprise that is controlled by the other entity. But when the IP agreement was reached with XX X, the Cyprus Opco was under the latter’s control, and no longer ABD’s. The IP agreement was, it must be recalled, reached some months after ABD Cyprus had been sold to XX and the latter had assumed control over the former. The test for when the enterprise is considered independent must be at the time that the IP agreement is concluded because at that time the negotiations take place between independent parties thus replicating a situation where market forces operate to determine the royalty rate.
- [67] The next issue was over what the Guidelines term ‘unique and valuable’ contributions. If both parties in a controlled transaction make unique and valuable contributions to the IP that is being licenced, then this may make comparing transactions more complex because this aspect cannot be measured. Dr F argued the OpCos make a unique and valuable contribution to the IP. ABD does not dispute this. The question rather is whether the unique and valuable contributions that the OpCos make in terms of their respective agreements are distinctive from one another. If not, the fact that each separately makes unique and valuable contributions is of no significance unless these contributions are distinct from one Opco to another. ABD argued that none of the agreements was exceptional in the sense they made contributions not made under any of the other Opco agreements. But this was not merely its contention.
- [68] Even on SARS own case they are not. Dr F stated in one of his reports that *“I analysed the OPCOS collectively rather than as separate entities due to their comparable functional profiles.*
- [69] If this is the case then the fact that the OpCos each make unique and valuable contributions, does not detract from the comparability of the Cyprus CUP, because these contributions were, taken as a whole, similar.

Dr F

- [70] Dr F was the only expert called by SARS to testify. Dr F is an economist and a partner in an economic consultancy known as Copenhagen Economics where he heads the Intellectual Property Valuation & Transfer Pricing service. He regularly advises private clients and authorities on transfer pricing issues including in the Communications industry.
- [71] Dr F served two purposes for the SARS case. First, he served as rebuttal witness for the expert testimonies of Dr S, MR, and Ms N respectively. Secondly, he advanced his own theory applying the TPSM to the royalty issue which led him to conclude that the previous assessment had significantly underestimated the size of the pie and using his application of the TPSM he came to size of the pie substantially larger than his predecessor Mr V –from 3% to 47 %. (Note the language size of the pie is that used by counsel in the hearing and is not that of Dr F).
- [72] I have dealt with Dr F’s critique of the application of the CUP method. As I have not considered ABD’s TPSM submissions I do not need to consider Dr F’s critique of them, save to note that he did not accept their analysis as a correct application of the TPSM.
- [73] Dr F filed two expert reports as well as a set of slides when he testified. But in brief what he set out to do was to make use of a methodology which attempted to calculate the incremental price consumers are willing to pay for a brand. The theoretical basis for this is as follows. Companies develop brands so that consumers will pay more for them than for a rival product. It is this brand, which is licenced, in this case to the OpCos, for which the royalty is then charged.
- [74] In order to determine the brand value of the ABD brand and hence the arm’s length royalty, he made use of a technique known as the willingness to pay or WTP. He sought to investigate how much more a buyer was willing to pay for a branded product versus an unbranded product. That way he concluded he could calculate the value of the brand. This is how he explains it in his report:
“A brand relates to a “trademark or trade name imbued with social and commercial significance. ABD customers are willing to pay an incremental price due to the social and commercial significance that the relevant brand has in the market. Such social and commercial significance arises due to branding activities performed by ABD. I denote this

incremental price the brand price premium. All else being equal, the OpCos benefit from the use of the relevant brand by earning higher revenues.”¹³

[75] As he expressed it elsewhere:

A customer segment that prefers one seller’s product over another, has a higher willingness to pay (“WTP”) for the preferred product, all else being equal.

[76] What Dr F did to calculate the WTP was very ambitious. He developed a survey with a series of questions in which ABD customers in some of the fourteen jurisdictions under assessment, were asked about their preferences for the ABD brand versus a hypothetical company which was non-existent. Thus, its purpose was to survey ABD’s customers’ preference for paying a premium or incremental price for its mobile services versus that of a hypothetical company.

[77] As an organisational task and its attention to detail this was a most impressive effort. SARS also had to meet an early warning from ABD that it would challenge the admissibility of the surveys as hearsay. In response SARS procured confirmatory affidavits from a large number of its researchers who had conducted the interviews. It is not clear if it was able to do so for all. Nevertheless, the case started with what appeared to be ABD’s acceptance that the hearsay issue had been satisfactorily addressed. It was only at the eleventh hour during final argument, and in response to a question from the court about the hearsay issue, that ABD indicated that it had never made such a concession. I considered that raising the issue at that late stage and then only in response to a question from the bench, was manifestly unfair to SARS. I will accept that even if the affidavits did not cover all the surveys that from a point of fairness, SARS should be allowed to have this evidence admitted. In any event the entire ABD case during the trial was conducted on the basis that it was admitted, thus distinguishing it from the approach of SARS which had challenged the admissibility of ABD’s survey evidence from the outset.

[78] I now turn to how the survey was used. The WTP technique is not an invention of Dr F. He testified that it had been used previously by the United Kingdom’s erstwhile Competition Commission.

[79] The primary enquiry of the WTP method is to ascertain the price premium the consumer is willing to pay. But as Dr F noted it is “difficult to observe price premiums directly in the market.” His solution to this conundrum was to devise a survey whose purpose was to compare the ABD brand with the brand of another product which provided the identical products and services. To do this he developed a hypothetical new entrant to the respective markets which he called Tele Green. Since Tele Green would be unknown to the respondent (the person interviewed) it would serve to compare ABD with an unbranded product and hence test the customer’s willingness to pay the premium for ABD.

[80] He designed the survey questions, trained the researchers on how to complete it and then when the results were completed and tabulated, he measured them quantitatively. In order to do a quantitative exercise, the respondent had to give a number in answer to the questions. Thus, one question was “*What the price of Tele Green would have to be for you to choose it*”.

[81] Although fourteen markets are under assessment the WTP study was conducted in only six markets. Three of which he termed legacy markets. These are markets where the operating company had always been part of ABD. These were (Cameroon, Ivory Coast and Uganda). In three other markets the operating companies had been acquired by ABD from another firm, Investcom, and were re-branded as ABD companies in 2006-2007 year. These are Benin, Ghana, and Sudan. Dr F used this survey data from the six markets to estimate a WTP for the remaining eight markets. The survey was based on the responses from 2,713 business to consumer and 1,245 business to business customers.

[82] The results of the surveys showed that price premiums customers were willing to pay for X branded products varied from 35% to 79% for the business to consumer market and 24% to 52% for the business-to-business market.

[83] What this exhaustive effort in the survey is meant to do, is to bring him to a figure that he can then plug into his further calculations. He goes on to use terminology which is confusing because he speaks of ‘brand revenue’ and also ‘revenue attributed to the brand’, which sound similar, but he uses as distinct concepts.

[84] His first step is to isolate brand revenue from non-branded revenue. This is an accounting exercise He says he took these figures from the financial statements and where he did not have them for each year, he used an average, based on the years he had. It was necessary for him to do this as OpCos earn some revenue from selling the ABD branded services and products, but also earn other revenue from selling phones and equipment. Since selling phones and equipment have nothing to do with the operational business of the ABD brand, he excluded this revenue

13 ¹⁵F report dated 2 October 2020, paragraph 140.

which he referred to as non-branded revenue, from the total revenue earned to get a total he refers to as the ABD branded revenue.

[85] At this stage his figure is a pure revenue figure for selling ABD branded products and services. But recall that his object is to reach a figure that reflects the value added by the brand. This figure is not apparent from the mere revenue figure for the sale of brand related products and services.

[86] This is where the WTP exercise comes in. His next step is to calculate the revenue attributable to the brand. What he means here is the price premium earned by selling the ABD brand. This is an economic concept as opposed to an accounting one. The price premium arrived at is the difference between what a consumer would pay for the same service unbranded as opposed the one that is ABD branded. Since unlike the branded revenue figure this cannot be derived from financial statements this is where the WTP figures fit in.

[87] He performs a set of further set of calculations to arrive, using the data obtained from the WTP survey, at a weighted price premium for all the OpCos for all the periods. This application of the method is not criticised, so I have not burdened the decision by going through the calculations. But his approach to considering costs which was his next step was disputed so I detail this.

[88] He sought to determine which costs were attributable to the brand. Dr F used this figure to determine the contribution made by each party to the revenue attributable to the brand. He then used this relative contribution to work out the split between the respective Opco and ABD. The final step was then to multiply the revenue attributable to the brand with split factor to arrive at royalty rates expressed as a percentage. He did this for all fourteen OpCos for all the years that were the subject of the assessment viz. 2009 to 2012. This led to a wide variance in rates with the lowest at 1.1% and the highest 6.7%.

Criticism of F's approach

[89] The most significant critique of Dr F's valuation is a legal one, but it has profound implications for his survey on which it is contingent. ABD as noted earlier argue that Dr F has valued the wrong brand. As I stated earlier this is a misnomer. He has valued the correct brand which is the ABD brand. Rather the critique is that he has misconstrued the extent of the rights to the brand which the OpCos acquired. Dr F has assumed that ABD licensed the OpCos more extensive branding rights than it did. He assumed part of the rights licensed included goodwill. This error then had implications for the survey questions on which the WTP calculations were based. Questions in the survey were based on the goodwill of the ABD brand. This meant the survey was premised on the ABD transferring greater rights to the OpCos and hence a more valuable IP right than they in fact enjoyed.

[90] It is understandable how this error came about. In 2006 ABD acquired a company called Investcom which was renamed ABD Dubai. ABD then entered into a Master Licence agreement with ABD Dubai. ABD Dubai was given the right to sublicense these rights. This Master licence gave extensive IP rights including goodwill to ABD Dubai. But the licence agreements with the OpCos did not follow this wording. They had the right to use the ABD logo, trademarks etc., but this did not include goodwill.

[91] I quote here from the Cameroon agreement which is representative of the language of all the others.
"The licensor grants to the licensee and the Licensee accepts, a non-assignable non-exclusive right to use and exploit the trademarks in relation to the licensed products in the territory ..."

[92] This understanding of the limited rights that were transferred is replicated in the pleadings. Thus, in SARS Rule 31 statement the limited extent of this right is acknowledged.

MATERIAL FACTS UPON WHICH SARS RELIES IN OPPOSING THE APPEAL

ABD (Pty) Ltd ("ABD SA") and ABD Group Management Services Ltd are the legal owners of the:

15.1 ABD trademarks; and

15.2 copyright subsisting in ABD logos prepared by ABD, excluding know-how, customer data and telecommunication licenses, (hereinafter individually or collectively referred to as the "IP").

[93] In the ABD's Rule 32 statement this paragraph 15 is admitted. It is thus common cause on the pleadings what the extent of the rights being licensed to the OpCos was, and this is consistent with the terms of the Opco agreements.

[94] In the I report this limitation is recognised in the following paragraph: *"In this report, the term brand refers to the ABD name, logo and other associated visual and intellectual property brand elements and systems. It focuses on the legally protectable, verbal and visual and IP elements."*

[95] It is true that sometimes ABD's experts used the term 'brand' without qualification. But this cannot be regarded

as a concession. It is accepted by both parties that the term brand can have both a limited and extended meaning. The guidelines recognise this as well.

“The term brand is sometimes used interchangeably with the terms trademark and trade name. In other contexts, a brand is sort of as a trademark or trade name imbued with social and commercial significance.”

[96] So too did Dr F in his report where he states this about brands: *“As seen from the above, a brand can serve different roles as Maruya and Mishra outlined in their literature review.”*

[97] But what matters is what was licenced because that is the basis on which the royalty is established, and this, as I mentioned earlier, is the limited right to the use of the trademarks. It does not include goodwill or to phrase it differently, customer perceptions of the service. And there is a good reason that the Opco agreements didn't include goodwill. That is because the goodwill that would redound to their benefit is something that they would develop from their own efforts in their respective markets; it is not something they would need to licence from ABD.

[98] The error in respect of the brand then infected the approach to the survey that Dr F conducted. This is clear from several of the questions which clearly contemplate goodwill. For instance, respondents were asked about the reasons why they might use ABD as their mobile service provider. Amongst the pre-determined choices for answers are the following: “Good customer service”; and “ABD has the most accessible refills” and; “ABD has the widest coverage”. But all these answers reflect on the efficiency of the respective OpCos, not the rights that have been licensed. It is hard to see why these answers, whichever is chosen, form a reliable basis for an exercise in valuing an arm's length royalty rate for the right to use trademarks.

[99] But this was not the only criticism that ABD made of the survey. It was, ABD argued, biased from the manner in which the questions were framed. For instance, the survey asked respondents the reasons why they might prefer ABD. But this was not an open-ended question. Respondents were given five choices. The interviewer was prompted with following instruction. “Please insist until an effective response is achieved. Must be marked as ‘Agree’ for at least one option to proceed”. Thus, anyone who might choose a reason other than the five designated was excluded from the survey.

[100] It was put to Dr F in cross examination that if the reason the respondent preferred ABD was because its prices were lower this was not an option. Thus, if this was the case the interview either ended (skewing the sample) or continued with the respondent giving a false reason thus biasing the sample

[101] A further criticism of its reliability is that the survey was performed in 2020. Yet respondents had to indicate what they might have done in the period 2009 –2012. They were asked: *“What the price for Tele Green would have had to be for you to choose it instead 2009-2012., Please indicate on a scale below”*

[102] 40% of the respondents would have been teenagers a decade before. As counsel for ABD put it in cross examination to Dr F, some of them may not have been old enough to have a phone in this earlier period let alone pay for it. But even if they weren't teenagers, the reliability of this question asked in 2020 about a willingness to pay for a period that commenced ten years earlier is self-evidently unreliable. Dr F was forced to assess the willingness to pay in the years under assessment. But doing so, many years later, was never going to get answers to which one could attach any reliability. This makes the survey despite its exhaustiveness an exercise in futility, built on questions whose answers can make no claim to rigour or reliability. If the WTP is erected on such shaky foundations for its data, then it does not constitute a reliable metric to suppose what an arm's length royalty would have been for this period. But its most fundamental problem is that it tested a willingness to pay for rights that were broader than those the subject of the licence agreement. This false premise infects the entire value of the exercise.

[103] But the content of the survey is not the only question mark that hangs over Dr F's efforts. ABD also challenged the way he applied the TPSM. ABD argued that Dr F had used revenue, not profits, to calculate his royalty rate. His premise is based on the incremental revenue earned by the OpCos from using the ABD brand. ABD argues that he has not taken into account the increased costs that the OpCos incur to earn the price premium. Challenged on this Dr F said this was a distortion of his evidence as he does take costs into account when he does his revenue split, as he did so on the basis, pro rata, of what the respective marketing costs of the OpCos and ABD were. But that argues ABD is to use costs to perform a different exercise. It does not entail an enquiry into the costs the OpCos incur to earn the price premiums.

[104] Here again ABD relies as the source for its approach commentary in the Guidelines:

“Most commonly, the relevant profits to be split under the transactional profit split method are operating profits. Applying the transactional profit split method in this manner ensures that both income and expenses of the MNE are attributed to the relevant associated enterprise on a consistent basis. However, depending on the accurate delineation of the transaction, it may be appropriate to split a different measure of profits such as gross profits, and

then deduct the expenses incurred by or attributable to each relevant enterprise (excluding expenses already taken into account).”¹⁴

[105] There was a lengthy cross examination on this issue but Dr F continued to justify his approach, although when challenged, he could not locate it in the Guidelines, except in paragraphs which referred in the broadest terms to adopting a pragmatic approach. The debate ended inconclusively with Dr F reluctant to concede the point. But what it does illustrate is that Dr F relies on a methodology that is unorthodox and outside of the mainstream approaches.

[106] As the conclusion of his testimony the court asked him if the WTP methodology had been used previously in a transfer pricing case. Dr F said he was not aware if it had been used in any litigation although he said he had used the technique for many years in dealing with tax authorities. He also cited its usage by the United Kingdom’s then regulator the Competition Commission.¹⁵ But to be clear, the usage by a competition regulator is for market definition not to deal with a transfer pricing problem. Dr S remarked in his report that the Competition Commission has “...no authority in transfer pricing compliance”

[107] Dr F remarked that he had been using WTP for fifteen years in dealings with tax authorities who had accepted it. I accept that this may be so but given that the technique has not to our knowledge been used in litigation before, in a transfer pricing case, we must approach its usage with caution. The methodology employed as well as the survey questions have been justifiably criticised. In the well-known United States Supreme Court case of *Daubert*, where the court deals with the admissibility of expert testimony in a jury trial the following test was developed to consider whether an expert’s methodology was valid:

- a. Whether the technique or theory in question can be, and has been tested;
- b. Whether it has been subjected to publication and peer review;
- c. Its known or potential error rate;
- d. The existence and maintenance of standards controlling its operation; and
- e. Whether it has attracted widespread acceptance within a relevant scientific community.¹⁶

[108] While the *Daubert* test is used by US courts to decide whether expert evidence should be admitted in a jury trial, which is not what we are dealing with here, it is nevertheless a useful test to apply when considering the weight which should be given to the acceptance of a novel methodology over the acceptance of a more conventional one.

[109] On that test, the fact that the WTP methodology has been used by a competition regulator for one purpose does not signify widespread acceptance by the transfer pricing community for its purposes. Given that this community is an active one, regularly preparing and updating guidelines one might have expected this technique to gain some mention if it was accepted. It has not. The Competition Commission’s report on this technique is dated 2010. Nor was there any evidence of its acceptance by courts or peer review by the academic community for its use as a technique in transfer pricing cases. Nor does it tick the boxes of the other factors set up in the **Daubert** test.

[110] Perhaps the WTP survey may prove useful as a benchmark when a taxpayer is negotiating with an authority. But in contested litigation the current survey and application of the WTP method has not yet been shown to be a reliable foundation for the application of the TPSM.

[111] By way of contrast the Cyprus CUP, has of all three models presented to us, proved the most persuasive. The Guidelines suggest that this is the preferred method when it can be used. The facts of this case bolster that proposition. Despite two applications of the TPSM method relying on different methodologies (ROBI by MR for ABD) and WTP by F, each has been shown to have yielded widely different outcomes. The Cyprus CUP most closely resembles what would be achieved in a market-based arm’s length negotiation. Whilst there are criticisms of its application, they are not conclusive. They amount to saying that certain factors such as exclusivity, duration and territory might have led to a different outcome. But these are speculative not conclusive criticisms. Speculation

¹⁴ Guidelines, op cit., paragraph 2.162.

¹⁵ In a report emanating from consultants employed by the Competition Commission to review the Willingness to pay survey, dated April 2010, the following is stated: “*The Competition Commission (CC) frequently uses surveys when conducting competition investigations and the evidence from these surveys are an important component of its findings. Survey evidence is also proving to be useful in remedies work. Such surveys are undertaken in a wide range of sectors which has included, for example, personal banking, gaming, betting, retail, travel, packaging, advertising and storecards. They are commissioned to fill in gaps in knowledge such as customer response to price changes, customer switching behaviour if there are changes in the market and the value that customers put on alternatives and their attributes. Such research can inform market definition and the analysis of competitive effects.*”

¹⁶ *Daubert v. Merrell Dow Pharmaceuticals Inc.*, 509 U.S. 579 (1993). *Daubert* has often been referred to in judgments of South African courts. See for instance, *SMD Communications CC v Mutual & Federal Insurance Company Ltd* [2009] JOL 24577 (WCC) at paragraph 57; *Bee v Road Accident Fund* [2018] JOL 40197 (SCA) at paragraph 25; and *Member of the Executive Council for Health, Limpopo Provincial Government v LWM obo DM (Member of the Executive Council for Health, Eastern Cape as Amicus Curiae)* [2022] JOL 56067 (SCA) at paragraph 51.

does not amount to refutation. By contrast the criticism of Dr F's approach has a solid factual basis. Its assumptions, legal, economic, and accounting have been dismantled. If this were not enough it is an untested methodology for use in litigation in transfer pricing cases.

[112] Both Dr S and Dr F were the subject of criticism that they were biased witnesses who refused to make concessions. Both of them were strong willed personalities who frequently embarked on a lecture when a short answer was all that was required. Despite this I see no reason to discredit either. As Zeffertt and Paizes remark in their textbook, when dealing with the value of expert evidence on conflicting opinions: "The resolution of the conflict between such rivals will generally not depend on credibility, but rather in the reasoning inherent in them."¹⁷ In this case the choice of the Cyprus CUP advanced by Dr S, and supported by Ms N, as opposed to the TPSM, based on the WTP method, advanced by Dr F has been based on the reasoning advanced, not the credibility of either expert.

[113] I conclude that the Cyprus CUP serves as a comparable internal CUP. The royalty in that agreement was 1%. On that basis the royalty of 1% charged by ABD to the other OpCos constitutes a reasonable arm's length royalty. That being the case there was no factual justification for the Commissioner to have adjusted the royalty in terms of the then section 31 of the Income Tax Act. The appeal succeeds.

It is not necessary for this reason to consider the several other administrative law grounds and accounting issues raised by ABD in its appeal.¹⁸

[114] I appreciate that the outcome of this case will be of great disappointment to SARS which put into it extensive resources to create a precedent in this seldom litigated field of tax law. But this not only meant it running contrary to the opinions and approach of its initial expert (which meant effectively dispensing with his views without explanation and engaging a new expert) but fighting a case where there appeared to be no rationale for the taxpayer to have any motive to shortchange the South African fiscus as I mentioned earlier in this decision.

Costs

[115] Ordinarily ABD as the successful party would be entitled to its costs. But as the issue of costs in tax appeals is dealt with in terms of the TAA, a different costs regime applies. Section 130(1)(a) provides that the Tax court on appeal may on application by the aggrieved party grant an order for costs in favour of that party if the SARS grounds of assessment or decision were unreasonable.

[116] SARS argues that ABD has not made this showing. It is correct that in seeking costs ABD has not addressed itself to the requirements of this section. But in its administrative law arguments about what they termed 'SARS flip flop', referring to its switch in its reliance on Mr V to its reliance on Dr F, ABD has made out a case that the decision to change its approach and now seek the new higher assessment, based on an analysis that has not met the test of rigour is unreasonable. However, this should only influence a cost award from the time of the first Dr F report in 2020.

[117] ABD asks for costs of two counsel. Given the complexity and length of the case this is justified. SARS also made use of two counsel. As far as experts are concerned given that the case succeeds based on the costs of the Cyprus CUP, I will allow for the costs of the experts who supported this opinion again after the period of the Dr F report. This means I will allow the qualifying fee of Dr S as well as half the costs of Ms N, since some of her testimony related to the ROBI method used in MR's TPSM analysis, which has not determined the outcome of the case.

Order

It is ordered that:

- a. ABD's appeal in relation to the years 2009 – 2012 is upheld.
- b. The additional assessments for 2009-2012 are set aside.
- c. SARS is to pay ABD's costs, from the date of receipt of the first report by Dr F in October 2020, including costs of two counsel, and the qualifying fees of the following experts; Dr S and half of those of Ms N.

¹⁷ D.T. Zeffertt and A.P. Paizes. "*The South African Law of Evidence*" (Lexis Nexis) Third edition, pages 341-2.

¹⁸ ABD raised quantum issues in respect of three of the OpCos (Zambia, Congo, and Rwanda) and a Mutual Agreement Procedure (MAP) issue in respect of Rwanda and Uganda. It also appealed against the imposition of interest in terms of section 31 of the Income Tax Act.

APPENDIX N1

MS N – ANALYSIS ON EVIDENCE ON CUP

In the ABD trial set out in **Appendix N**, expert witness Ms N gave evidence in the trial supporting her opinion that the internal CUP corroborated the PSM methodology of the taxpayer in the determination of the ALP for the royalty rate charge. The first column reflects the page numbers in the court record of the evidence given by her in the court evidence transcript. The “Evidence” column sets out a summary of the evidence given. This type of summary is provided as an example of the detailed evidence given and is used to support the final closing arguments to the tax court.

Transcript		Evidence referred to		OECD referred to		Evidence	Ground of Appeal
From	To	Document	Reference	Para	Reference		
EXAMINATION IN CHIEF OF MS N ON CUP (18-689(4) to (18-702(25) / 6000(4) to 6013(25))							
Overview of the CUP Method							
18-689(15) / 6000(15)						The CUP is the most direct and precise way of establishing market price for transfer of goods or services.	
18-689(18) / 6000(18)						CUP method closely linked to the product - important to compare the underlying IP. Look at price for same underlying IP in the market.	
18-690(3) / 6001(3)						Brand licence agreement is an internal CUP because entered into between ABD and 3rd party for the right to use the same IP. Internal CUP gives you closest approximation to a market price. Method that gives most accurate answer.	
18-690(17) / 6001(17)	18-691(7) / 6002(7)					OECD Guidelines clear on how to treat differences between 3rd party agreement and related party agreement. If there are differences and they do not materially affect the price - use as CUP. If there are differences and materially affect the price AND you can make adjustments - use as CUP. If there are material differences and cannot adjust then it renders the agreements non comparable.	
18-691(7) / 6002(7)	18-691(11) / 6002(11)					CUP is the preferred method where you have a choice between methods.	
Comparability Analysis: Contractual Terms							
18-691(12) / 6002(12)		Sale Agreement	11-46 / 2653			Date: 15 July 2018, Parties: ABD Dubai and XX Telecom	
18-692(2) / 6003(12)		Brand Licence Agreement	11-1 / 2608			Date: 3 Sep 2018; Parties: ABD and ABD Cyprus.	
18-692(19) / 6003(19)			11-4 / 2611			<u>Key clauses are comparable:</u>	
18-693(16) / 6004(16)			11-5 / 2612, clause 4 and 2.2			Type of agreement the same - licence to use the brand.	
18-694(9) / 6005(9)	18-695(11) / 6006(11)					Exclusivity: Cyprus exclusive and intercompany agreements are some exclusive and some non-exclusive. Exclusivity either do not have a	

						material effect on price or commands a higher price. Based on my 23 yrs of experience I have not seen exclusivity driving price.	
18-695(12) / 6006(12)	18-695(24) / 6006(24)		11-5 / 2612 clause 4.1			Royalty rate is 1% of turnover under Cyprus and intercompany agreements. Some intercompany agreements have bundled IP.	
18-695(24) / 6006(24)	18-696(22) / 6007(22)	Brand Licence Agreement	11-15 / 2612 clause 17.1			Duration: 3 years vs varying terms for intercompany agreements. In my experience term does not impact. Longer period equals less risk and lower price for intercompany agreements.	
18-696(23) / 6007(23)	18-697(14) / 6008(14)		11-26 / 2633, 11-33 / 2640, 11-34 / 2641			Rights licenced: despite detail difference standard form of Opco agreements is to licence the use of the list of ABD trademarks and copyrighted marks.	
18-697(15) / 6008(15)	18-698(5) / 6009(5)					Conclusion: Cyprus agreement closest to what we can get to market price. Differences do not have a material effect on price. If choice between methods, then CUP is first choice.	
18-698(6) / 6009(6)		Ms N Report para 141	07-779 / 1179			Differences have no material effect on price.	
18-698(14) / 6009(14)	18-699(1) / 6010(1)	Ms N Report para 142	07-780 / 1180			OECD says CUP still valid if differences have no material effect on price.	
18-699(2) / 6010(2)	18-701(3) / 6012(3)	Ms N Report para 141	07-779 / 1179			None of the differences would render the intercompany agreements more valuable than the Cyprus agreement.	
Dr F criticism							
18-701(4) / 6012(4)		Ms N Report para 145	07-780 / 1180			Transitional agreement: the brand licence agreement was entered into subsequent to the disposal of shares and was between independent parties under separate terms and conditions. The terms and conditions different to initial agreement - excludes for instance management fees. Terms & conditions not governed by Purchase and Sale agreement - outside of that agreement. Transition means timeframe - duration does not have impact on price.	

18-702(1) / 6013(1)		Ms N Report para 148	07-781 / 1181			Sufficiently independent: terms and conditions of brand licence agreement are independent. Not driven by relationship in terms of shareholding or control between the parties and therefore satisfies the CUP.	
CROSS EXAMINATION OF MS N ON CUP (18-715(13) to 18-815(21) / 6026(13) to 6126(21))							
Economic Circumstances irrelevant							
18-715(13) / 6026(13)						Ms N acknowledged that 14 OpCos operate in different jurisdictions and the markets and economic circumstances of the OpCos are different and diverse.	
18-718(19) / 6029(19)	18-719(2) / 6030(2)					However, one does not consider economic and market factors in comparability analysis in the application of a CUP - one purely <u>look</u> at underlying IP	
18-729(25) / 6040(25)	18-730(3) / 6041(3)					Economic Circumstances are irrelevant to CUP	
18-731(10) / 6042(10)	18-731(22) / 6042(10)					Economic Circumstances depend on nature of IP looked at. Irrelevant to right of use of intangibles.	
18-737(19) / 6048(19)	18-738(19) / 6049(19)					Functions performed, economic circumstances and business strategies are irrelevant in the context of a CUP analysis for right of use of the brand.	
Internal Analysis of ABD Agreements							
18-720(3) / 6031(3)		2014 BF Report	03-205 / 675			Ms N agree with Dr S approach to undertake an internal analysis as per BF Report. SARS questions her on her own internal analysis.	
18-720(25) / 6031(25)	18-721(16) / 6032(16)					I have done one in preparation for trial. Differences are in my report but not in that level of detail.	
Territory / Geographic location irrelevant							
18-722(10) / 6033(10)		2014 BF Report	03-207 / 677 fn 12			Ms N does not agree with fn 12 Dr S's 2014 Report that says: "Differences in contractual terms and territory are important to establish the comparability of intangibles..."	
18-724(14) / 6035(14)	18-726(21) / 6037(21)					I do not endorse Dr S's statement if territory means geographical location.	
18-733(22) / 6044(22)	18-734(2) / 6045(2)					Ms N confirmed again territory not relevant to CUP for use of intangibles.	
						Only relevant where there are government regulations that prevent payment of royalties.	

Functional Analysis Irrelevant							
18-729(4) / 6040(4)	18-729(20) / 6040(20)					In Ms N experience, functions, assets and risks not part of CUP analysis.	
18-731(10) / 6042(1)	18-731(22) / 6042(22)					Functions, assets and risks not part of analysis of right of use of intangibles.	
18-737(19) / 6048(19)	18-738(19) / 6049(19)					Functions performed, economic circumstances and business strategies are relevant in the context of a CUP analysis for right of use of the brand. These factors are crucial for ensuring that the transactions being compared are truly comparable and that the prices reflect an arm's length standard	
Business Strategies Irrelevant							
18-730(4) / 6041(4)	18-730(6) / 6041(6)					Business strategies irrelevant to analysis involving intangibles	
18-731(10) / 6042(10)	18-731(22) / 6042(22)					Business Strategies depends on nature of IP looked at. Irrelevant to right of use of intangibles.	
18-737(19) / 6048(19)	18-738(19) / 6049(19)					Functions performed, economic circumstances and business strategies are irrelevant in the context of a CUP analysis for right of use of the brand.	
Differences in markets							
18-734(3) / 6045(3)		MR Report	07-709 / 1110 para 104			SARS: MR report illustrates the fundamental differences between the characteristics and financial position in the markets and Zambia and Nigeria. Is that irrelevant in CUP analysis? Factors such as economic conditions, market size, competition, and regulatory environment can significantly impact pricing and must be considered to ensure that the transactions being compared are truly comparable and reflect an arm's length standard	
18-734(14) / 6045(14)						Yes, when looking at right to use intangibles, geographic location does not impact price unless there are specific government regulations that limits payment of royalties.	
18-734(24) / 6045(24)						MR is not referring to geographical location but to the fact that economic circumstances in the markets are fundamentally different.	
18-735(7) / 6046(7)						Ms N maintains it is entirely irrelevant.	

Bundled IP							
18-740(15) / 6051(15)						Ms N says that some OpCos have bundled IP. They are not comparable.	
18-741(9) / 6052(9)						However, some Agreements break up the rights of use between the different IP and are then still comparable.	
18-742(14) / 6053(14)	18-742(21) / 6053(21)					Agreements that are not comparable were not qualified in Ms N's report. The reason being that the ABD legal team advised it was only a drafting issue, and IP was generally uniformly applied.	
18-743(6) / 6054(6)	18-743(11) / 6054(11)						
18-745(3) / 6056(3)	18-745(12) / 6056(12)						
18-744(23) / 6055(23)	18-745(2) / 6056(2)					Put: Position not stated in your report. As an independent expert, one would have expected you to take ownership of your report and state your views honestly as you hold them.	
Contractual terms							
18-746(17) / 6057(17)	18-748(1) / 6059(1)	Ms N report	07-749 / 1149			SARS: Sale and Purchase Agreement not listed in your report as one of the documents considered. Ms N acknowledged that it should have been included.	
18-748(5) / 6059(5)	18-749(10) / 6060(10)					Ms N considered the Sale and Purchase Agreement to make sure it did not influence the Brand Licence Agreement. For example, the rebranding. Found not influenced the terms of the brand licence agreement. Found terms and conditions were between independent parties. No influence, and valid CUP	
18-749(11) / 6060(11)	18-751(9) / 6062(9)					6-month period to rebrand irrelevant because term of agreement has no impact on price.	
18-751(10) / 6062(10)						Term / Duration of Agreement no impact on price.	
18-752(12) / 6063(12)	18-754(7) / 6065(7)					Ms N agrees that the end goal of the agreement is to rebrand and divest itself and the brand would disappear.	1.20, 1.32.2, 1.32.3, 1.32.4
18-754(8) / 6065(8)	18-754(18) / 6065(18)					Ms N is questioned on whether the Licensee is expected to spend money and efforts towards preservation and improvement of the ABD Brand during this limited period of rebranding?	
18-754(19) / 6065(19)	18-755(8) / 6066(8)					Ms N contends that there is a requirement for the licensee to maintain the brand in same fashion as previously. SARS challenges this by saying that one would	

						not proactively run expensive marketing and advertising campaigns to build the brand that you are busy divesting from. Ms N says that those things don't come into play, functions, assets and risks are irrelevant to the analysis	
18-801(11) / 6112(11)				1.36	14-1312 / 3992	SARS: Each bullet under para 1.36 cross-references to further parts of section D of Chapter 1	
18-801(17) / 6112(17)				1.36	14-1312 / 3992	First bullet in para 1.36 (contractual terms) references to D1.1.	
18-802(12) / 6113(12)				D1.1 para 1.42	14-1314 / 3994	"...Where a transaction has been formalised...those agreements provide the starting point...". With the emphasis on 'starting point' meaning there is more that should follow.	1.31.4
18-803(7) / 6114(7)						SARS contends that this is contrary to Ms N's statement that there is nothing more to consider than just the written agreements (refer to 18-783(20) / 6094(20))	
18-803(11) / 6114(11)	18-803(25) / 6114(25)			1.42	14-1314 / 3994	Para 1.42 does not refer to CUP but to TPSM where you start with the agreement and then move to the functional and risk analysis. In broader context it is the starting point.	
18-805(1) / 6116(1)	18-805(25) / 6116(25)			1.43	14-1315 / 3995	SARS refers to para 1.43 "However, the written contracts alone are unlikely to provide all the information...Further information will be required taking into consideration evidence of the commercial or financial relations provided by the economically relevant characteristics in the other four categories...the functions performed...Taken together, the analysis of economically relevant characteristics in all five categories provides evidence of the actual conduct..."	
18-806(9) / 6117(9)						Ms N persist it is not relevant to CUP method as it is a one-sided method.	
18-806(11) / 6117(11)	18-806(19) / 6117(19)					Put: Ms N evidence contradicts evidence of Dr S, direct contradiction of OECD Guidelines that Ms N considers binding. Ms N unwilling to make obvious concessions and her evidence has no credibility.	

Para 1.36 not applicable to CUP						
18-755(4) / 6066(4)	18-760(1) / 6071(1)	2014 BF Report	03-208 / 678	1.36	14-1312 / 3992	Comparability factors questioned on relate to other methods - not a CUP analysis in relation to right to use IP. Never read para 1.36 as applicable. Based on my experience not applicable. SARS: Contrary to Dr S 2014 Report which sites para 1.36 as relevant to the CUP.
18-779(11) / 6090(11)	18-782(4) / 6093(4)					Factors in para 1.36 not specific to a method but contractual terms and characteristics of the property are relevant.
18-782(5) / 6093(5)	18-782(11) / 6093(11)					Ms N agreed that her evidence was that para 1.36 not applicable to the CUP
18-783(5) / 6094(5)						In support of her contention that para 1.36 not applicable to CUP, Ms N refers to:
18-783(8) / 6094(8)				1.41	14-1314 / 3994	Para 1.41 which says "For a discussion of the relevance of these factors for the application of particular pricing methods, see the consideration of those methods in Chapter II."
18-783(20) / 6094(20)	18-784(11) / 6095(11)			2.14	14-1369 / 4048	In application of CUP, you compare on basis of product. So, you look at nature of IP and use of brand and the price for that. So, you look at contractual terms and not other factors.
18-785(20) / 6096(20)	18-787(6) / 6098(6)			6.116 - 6.127	14-1554 - 14-1557 / 4230 - 4233	These are the comparability factors that relate to intangibles when you apply a CUP, but each type of intangible would have its own comparability factors. For marketing intangibles it would be, nature of transaction, underlying IP and the structure of the payment.
18-793(16) / 6104(16)						Put: I have given Ms N every opportunity to support her contention that Para 1.36 not applicable to the CUP.
18-793(23) / 6104(23)	18-798(4) / 6109(4)					SARS takes Ms N through their evidence that Chapter 6 is supplemental to para 1.36:
18-794(1) / 6105(1)				6.3	14-1517 / 4193	"The principles of Chapters I-III of these Guidelines apply equally to transactions involving intangibles and those transactions which do not."
18-794(9) / 6105(9)				1.36	14-1312 / 3992	Para 1.36 is part of Chapter 1 under subheading: "D.Guidance for applying the arm's length principle."
18-794(14) / 6105(14)				6.3	14-1517 / 4193	"Under those principles, as is the case with other transfer pricing matters...the conditions that would have been agreed"

18-795(15) / 6106(15)				6.4	14-1518 / 4194	"In order to determine arm's length conditions for the use or transfer of intangibles it is important to perform a functional and comparability analysis in accordance with Section D.1 of Chapter I..."	
18-795(22) / 6106(22)				6.4	14-1518 / 4194	"...based on identifying the intangibles and associated risks in contractual arrangements and then supplementing the analysis through examination of the actual conduct of the parties based on the functions performed, assets used, and risks assumed, including control of important functions and economically significant risks."	
18-796(10) / 6107(10)				6.110	14-1553 / 4229	"... contain principles to be considered and a recommended process to be followed in conducting a comparability analysis. The principles described in those sections of the Guidelines apply to all controlled transactions involving intangibles".	
18-796(24) / 6107(24)				D.2, 6.115	14-1554 / 4230	"Supplemental guidance regarding transfers of intangibles ...".	
18-797(8) / 6108(8)				6.115	14-1554 / 4230	"This section provides supplemental guidance...or rights in intangibles..."	
18-798(6) / 6109(6)				B	14-1369 / 4048	Heading: "Comparable uncontrolled price method"	
18-798(14) / 6109(14)				2.14	14-1369 / 4048	General description of CUP method	
18-798(17) / 6109(17)				2.15	14-1369 / 4048	"Following the principles in Chapter I..."	
18-799(6) / 6110(6)				2.16	14-1369 / 4048	"It may be difficult...effect on price"	
18-799(14) / 6110(14)				2.17	14-1370 / 4049	"In considering whether...Chapter I"	
18-799(23) / 6110(23)	18-800(2) / 6111(2)					SARS contends that all of this tells us you don't simply look at product comparability, you need to look at the broader business functions as spelt out in Chapter 1 and including para 1.36.	

18-800(6) / 6111(6)	18-801(10) / 6112(10)					Ms N maintains her position that para 1.36 does not apply to the CUP.	
Comparability Factors							
18-760(12) / 6071(12)	18-761(7) / 6073(7)					Ms N identified 5 factors that could ordinarily apply to comparability, i.e. duration, geographic location, exclusivity, degree of protection & anticipated benefits.	
1. Duration							
18-761(8) / 6072(8)	18-761(21) / 6072(21)					Duration does not impact price as it relates to the use of brand. It is irrelevant.	
18-775(10) / 6086(1)	18-775(13) / 6086(13)					Duration may have impact when it relates to different types of IP but not when it comes to brand.	
18-806(21) / 6117(21)		Ms N Report	139.4 at 07-778 / 1178			"Useful life - in general intangibles expected to provide market advantages for a longer period of time will be more valuable than similar intangibles providing such advantages for a shorter period of time..."	
18-809(20) / 6120(20)						SARS contends that this statement in Ms N report contradicts her evidence that duration has no impact on price. Ms N was not aware that the brand licence agreement was terminated after 9 months.	
18-813(19) / 6124(19)	18-814(2) / 6125(2)	Ms N Report	139.4 at 07-778 / 1178			Put: To suggests that a contract with useful life that is limited to 6-month period is comparable to one with indefinite period is absurd.	
2. Exclusivity							
18-761(22) / 6072(22)	18-761(24) / 6072(24)					Ms N says it is irrelevant	
3. Anticipated Benefits							1.20.4, 1.24.2
18-761(25) / 6072(25)	18-762(3) / 6073(3)					Because we use the ABD Brand in both related and unrelated parties there is the same expectation of future benefits. It is irrelevant.	
18-764(5) / 6075(5)	18-764(8) / 6075(8)						
18-765(3) / 6076(3)	18-765(6) / 6076(6)						
18-765(22) / 6076(22)	18-766(4) / 6077(4)					Ms N contends that anticipated benefits are the same whether you use the brand for 6 months or indefinite.	

18-766(17) / 6077(14)	18-767(3) / 6078(3)					It is not the actual return. Not relevant when you use the exact same brand.	
18-770(17) / 6081(17)	18-771(3) / 6082(3)					SARS: What benefit is referred to? The term, revenue, more customers, better market share, credibility, integrity.	
18-772(3) / 6083(3)	18-773(13) / 6084(13)					All benefits are irrelevant because brand is the same. Questioned whether there <u>are</u> any external support for her view. Ms N mentioned principles in caselaw, years of looking at agreements and understanding what impacts the price.	
18-814(3) / 6125(3)	18-815(15) / 6126(15)	Ms N report	para 139.5 at 07-778 / 1178			Profit potential the same because you use the same brand. Duration has immaterial impact on price.	
18-815(16) / 6126(16)						Put: your position is absurd and without credibility.	
4. Geographic location							
18-762(4) / 6073(4)	18-762(5) / 6073(5)					Ms N says it is irrelevant.	
18-773(19) / 6084(19)	18-774(14) / 6085(14)					Even agreements that cover the world at large still does not have an impact on price.	
5. Degree of protection							
18-762(7) / 6073(7)	18-762(9) / 6073(9)					Ms N says it is irrelevant.	
Conclusion on Comparability							
18-763(1) / 6074(1)	18-763(24) / 6074(24)					All five comparability factors need to be considered BUT they are irrelevant in the sense that they do not have a material impact on price.	
Ms N relies on OECD Guidelines when it suits her							
18-732(10) / 6043(10)	18-733(21) / 6044(21)			1.36	14-1312 / 3992	I am not saying para 1.36 is incorrect, nor am I ignoring it but para 1.36 refers to comparability analysis in many circumstances, not only the right to use intangibles. In my experience I have not seen these factors influence the price.	
						Put: "Ms N it seems to me, with respect, that when it suits you to rely on the OECD Guidelines you do and when it doesn't suit you to rely on the OECD Guidelines you simply ignore them."	
18-777(22) / 6088(22)	18-779(10) / 6090(10)	Ms N Report	para 5, 07-744 / 1144			Ms N taken to specific paras in her Report and asked whether she consider OECD Guidelines binding on her. She confirmed that she relied on the Guidelines in the	

			para 18, 07- 752 / 1152			application of section 31 and that they are binding.	
			para 19, 07- 752 / 1152				
			para 20, 07- 752 / 1152				

RE-EXAMINATION OF MS N ON CUP (18-840(9) to 18-844(21) / 6151(9) - 6155(21))

18- 840(9) / 6151(9)				1.36	14- 1312 / 3992	Para 1.36 part of general guidance on arm's length principle, not part of any particular method. Evidence not that factors are irrelevant to the CUP method.	
18- 841(16) / 6152(16)				1.127	14- 1342 / 4022	Characteristics of property are relevant to CUP.	
18- 842(21) / 6153(21)	18- 844(21) / 6155(21)			1.130, 1.132, 1.133	14- 1343, 14- 1344 / 4023, 4024	Economic Circumstances, specifically Geographic markets. Ms N's opinion that para 1.133 is not relevant to CUP.	

APPENDIX N2

DR S – ANALYSIS ON EVIDENCE ON CUP

In the ABD trial, expert witness Dr S gave evidence in the trial supporting his opinion that the internal CUP corroborated the PSM methodology of the taxpayer in the determination of the ALP for the royalty rate charge. The first column reflects the page numbers in the court record of the evidence given by him in the court evidence transcript. The “Evidence” column sets out a summary of the evidence given. This type of summary is provided as an example of the detailed evidence given and is used to support the final closing arguments to the tax court.

Transcript		Evidence referred to		OECD referred to		Evidence	Ground of Appeal
From	To	Document	Reference	Para	Reference		
EXAMINATION IN CHIEF OF DR S ON CUP (18-856 to 18-892 / 6167 to 6203)							
General principles							
18-856(2) / 6167(2)				OECD Model Tax Convention	Art 9(1) 14-36 / 2946	Art 9 is the foundation of the Guidelines. At the heart of the founding principle is the arm's length principle. Distinction in Art 9(1)(a) and (b) between associated enterprises (under common control) and independent enterprises important.	
18-857(24) / 6168(24)				Glossary	14-1291 / 3972	Definition of arm's length principle	
18-859(4) / 6170(4)	18-859(9) / 6170(9)					First test is to ask on what terms parties at arm's length would have contracted. <i>Sine qua non</i> condition of arm's length principle.	
18-859(10) / 6170(10)	18-859(22) / 6170(22)			Glossary	14-1291 / 3972	Definition of associated enterprises . Parties are associated if one of them meet the conditions of Article 9 (1)(a) or (b) at.	
18-859(23) / 6170(23)				Glossary	14-1296 / 3977	Definition of Profit Split Method . One of the methods but not the preferred method. PSM does not determine royalty rates, it determines and splits operating profits.	
18-863(20) / 6174(20)				Para 3.55	14-1437 / 4116	Arm's length principles is not a point but a range.	
18-865(9) / 6176(9)	18-865(13) / 6176(13)					Any number of experts in good faith can come to different conclusions if you use a process of elimination and minimise the variants amongst the experts.	
18-865(13) / 6176(13)						Object of exercise is to determine the price at which people at arm's length would have contracted.	
18-869(11) / 6180(11)	18-870(18) / 6181(18)	Dr S Report	07-808 / 1208			ABD and XX Telecom are independent parties in terms of Article 9(1)(a) and (b) (14-36 / 2946)	
		Sale and Purchase agreement	11-46 / 2653				
18-870(19) / 6181(19)	18-871(4) / 6182(4)					CUP analysis is an analysis based on price. All other methods are based on profits.	

18-871(4) / 6182(4)	18-871(20) / 6182(20)					CUP = Attractive method because you are high on the income statement (revenue level). Because you analyse price you have to pay attention to the product. CUP method is reliable because it is not subject to deductions that can be manipulated.	
18-871(21) / 6182(21)	18-872(14) / 6183(14)					The fact that one of the parties to the controlled transaction is also a party to the uncontrolled transaction does not detract from the value of the CUP, it is called an internal CUP. It is a valid standard to assess controlled transactions.	
18-872(15) / 6183(15)		Dr S Report	07-810 / 1210	2.15	14-762 / 3663	Most direct and reliable method. Because we use one level or component namely revenue. There is no aggregation in which information is lost.	
18-873(25) / 6184(25)		Dr S Report	07-811 / 1211, para 28			Greater weight is given to characteristics of property because differences in property influences price.	
18-874(6) / 6185(6)						In CUP we analyse price. Price is attributed to a property.	
Comparability Analysis							
18-874(16) / 6185(16)	18-875(19) / 6186(19)	Dr S Report	07-811 / 1211, para 29			In CUP method important to look at characteristics of property and the contractual terms.	
			07-836 / 1236, Ex 1.1			3 key contractual terms in exhibit: 1. duration, 2. territory, 3. exclusivity.	
18-875(19) / 6186(19)						Several elements of Cyprus agreement that make it serve as a CUP:	
18-875(24) / 6186(24)	18-876(8) / 6187(8)					1. The property is the same (characteristics of the property)	
18-876(8) / 6187(8)						2. Functions of the licensee is the same as the controlled licensee.	
18-876(14) / 6187(14)	18-877(10) / 6188(10)					3. Duration . Not the same. Cyprus and Nigeria are 3 yrs. Others have different types of duration, for e.g. 10 yrs, 8 yrs and indefinite. Does duration have effect on royalty rates? To test I need external comparables but is not necessary because we have internal CUP.	

18-882(14) / 6193(14)	18-883(25) / 6194(25)					Statistical analysis of royalty rates in various industries done. I have found no relationship between royalty rates and duration.	
18-878(5) / 6189(5)			EX 1.3 at 07-849 / 1249			4. Territory. Ex 1.3 shows we have rich and poor countries. Cyprus has high per capita income but tiny population. So, market potential is similar or higher than some of the more popular countries but with lower per capita income.	
18-878(23) / 6189(23)						Concluded from this exercise that the territory or population is not going to be a factor that is going to influence or lead to adjustments.	
18-879(6) / 6190(6)	18-879(9) / 6190(9)					Different countries with more or less similar levels of per capita income or at least at a narrow range. None of the countries can be classified as rich.	
Duration is 3 yrs - not 6 months							
18-884(1) / 6195(1)		Brand licence agreement	11.15 / 2622, clause 17.1			SARS argues term is only 6 months. Incorrect interpretation. <i>Relevant clauses that contradicts SARS' view are:</i>	
18-885(9) / 6196(9)		Sale and Purchase agreement	11-46 / 2653,			Date: 15 July 2018	
18-885(20) / 6196(20)			11-69 / 2676, clause 18.1			"The Purchaser shall within six (6) months after the Closing Date, procure that the name of the target companies...is changed to a name..."	
18-886(20) / 6197(20)						Only means that the official name of the company be changed, not the branding of the business or its products.	
18-887(3) / 6198(3)		Brand licence agreement	11-4 / 2611			Date at the top of page is 3 Sep 2018	
18-887(22) / 6198(22)	18-888(8) / 6199(8)		11-4 / 2611, clause 2.1			'Term' is defined	
18-888(9) / 6199(9)			11-15 / 2622, clause 17.1			'Term' is 3 years	
18-888(19) / 6199(19)			11-5 / 2612, clause 4.1			Fees are paid 'each year'. Contemplates a number of yrs.	
18-888(24) / 6199(24)			11-5 / 2612,			Reference to 'Payment Period' is annual arrangement	

			clause 4.2				
18-889(5) / 6200(5)			11-5 / 2612, clause 4.4			Reference to 'Payment Period' is annual arrangement	
18-889(8) / 6200(8)			11-6 / 2613, clause 4.9			Provision for termination or expiry of the 3-yr term	
18-889(16) / 6200(16)			11-11 / 2618, clause 11			Rebranding separate to name of the company	
18-890(5) / 6201(5)			11-12 / 2619, clause 11.2			Obligation to provide plan for rebranding within 24 months, within the 3 yrs.	
18-890(15) / 6201(15)	18-891(2) / 6202(2)		11-15 / 2622, clause 17&18			Licensee entitled to use the ABD branding of the agreement.	
18-891(3) / 6202(3)	18-891(14) / 6202(14)	Dr S Report	Para 42 07-814 / 1214			On proper analysis of agreement, it was a three-year licence and not 6 months. I expressed my view of duration based on the provisions of the contract as read today.	
Conclusion on CUP							
18-891(15) / 6202(15)	18-892(24) / 6203(24)					In contrast to the analysis I had done in the past for ABD, there is a new fact that must be considered, i.e. licence agreement between ABD and XX Telecom. This is the most reliable piece of information that we have to determine the royalty rate and any other method based on profit split will be less reliable.	

CROSS EXAMINATION OF DR S ON CUP (18-962(6) to 18-1149(8) / 6273 to 6460)

Dr S omitted important qualification in Para 2.15 of OECD Guidelines

18-963(4) / 6274(4)	18-964(22) / 6275(22)			2.15	14-762 / 3663	Dr S omitted the qualification in para 2.15 which says, "where it is possible to locate a comparable controlled transaction...". Dr S accepts the point but contends that in his case he did locate the uncontrolled transaction.	

Para 2.15 of OECD Guidelines - Differences not measured							
18-965(6) / 6276(6)	18-966 / 6277			2.15	14-762 / 3663	Dr S criticised for concluding that there are no differences (18-965(19)) / 6276(19). He says there are differences, but they cannot be measured, and they do not have a material effect on royalty rates, only an effect on value of the intangible (18-966(16) / 6277(16))	1.26
18-967(2) / 6278(2)				2.15	14-762 / 3663	Dr S agrees that royalty rate is a proxy for price in the context of para 2.15	
18-968(11) / 6279(11)	18-991(3) / 6302(3)					SARS: Illogical to conclude that differences would not materially affect the price if one is not able to measure them. Dr S base his conclusion on: (1) statistical analysis described from 18-969(3)/6280(3) and at 18-1012(18) / 6323(18) (2) research described from 18-974(12) / 6285(12) Conclusion not based on comparability analysis of external comparable (18-977(4) / 6288(4)). Also see 18-989(19)-(24) / 6300(19)-(24): 'I have acknowledged differences, and I have stated that the differences cannot be measured in the context of one agreement. And I have further stated that I made an inference they are not material based on statistical research that I have made.'	
Comparability Analysis not undertaken							
18-992(5) / 6303(5)	18-992(16) / 6303(16)			1.36	14-1312 / 3992	Dr S agrees that analysis requires a comparison between Cyprus Agreement and 13 Opco Agreements with reference to comparability factors in para 1.36.	
18-992(18) /	18-992(21) / 6303(21)					Dr S contends some factors more relevant to CUP than others.	

6303(18)							
18-993(3) / 6304(3)	18-995(17) / 6306(17)					Business strategies not considered. Dr S: it was considered but found to be irrelevant. Relevant only for-profit methods. Refer also to 18-999(11) - (25) / 6310(11)-(25) for business strategies in Dr S's report. <i>Refer to separate heading below.</i>	
18-995(18) / 6306(18)	18-999(2) / 6310(2)					Economic Circumstances not considered. Dr S contends that it was considered but found to be irrelevant. Relevant only to determine the value of intangibles. <i>Refer to separate heading below.</i>	1.26
						Dr S contends primary factors are:	
18-1001(25) / 6312(25)	18-1003(4) / 6314(4)					(1) characteristics of the property	
18-1003(5) / 6314(5)	18-1003(14) / 6314(14)					(2) Functions performed are the same	
18-1003(15) / 6314(15)	18-1005(11) / 6316(11)					(3) Contractual Terms. Differences in duration, exclusivity and territory cannot be measured but conclude that they do not materially affect the royalty.	
18-1005(12) / 6316(12)	18-1007(24) / 6318(24)					(4) the fact that licensor and licensee are independent. Also, of relevance here is minorities and the motive to avoid tax.	
18-1009(5) / 6320(5)	18-1015(10) / 6326(10)					SARS challenges the conclusion on comparability factors identified and how Dr S complied with para 2.15. Dr S contends that one cannot adjust for characteristics of property and functions performed. Contractual terms can be adjusted if sufficient data	

						available. Dr S explains again that 3 contractual terms cannot be measured but based on his research do not have a material effect on the royalty rate.	
Empirical studies - not evidence of conclusions drawn							1.28
18-1015(11) / 6326(11)	18-1016(16) / 6327(16)	Dr S Report	fn30 07-815 / 1215			SARS questions Dr S' research in footnote 30 to para 43 of written statement.	
18-1016(17) / 6327(17)	18-1017(7) / 6328(7)					SARS contends that empirical studies of crucial importance to conclusion but only supported by an article dealing with the characteristics of pharmaceutical patterned royalty rates.	
18-1017(8) / 6328(8)	18-1019(9) / 6330(9)					Dr S contends that he did substantial analysis on many industries testing the effect of duration, exclusivity and territory on royalty rates (not in his report).	
18-1019(10) / 6330(10)	18-1020(12) / 6331(12)					Court extended an invitation to Dr S to refer SARS to other material which support his contentions. Dr S did not do so in his response.	
2014 BF Report contradicts evidence in current matter							1.28;1.2
19-1022(9) / 6333(9)	18-1023(14) / 6334(14)	2014 BF Report	03-210 / 680			Purpose of report was to review the BF Report.	
18-1024(6) / 6335(6)						SARS: In 2014 BF Report, Similarities and Differences between ABD agreements considered. Dr S concluded that duration can materially affect comparability.	
18-1026(25) / 6337(25)	18-1028(10) / 6339(10)					Dr S: concluded that BF erred in assuming that the ABD agreements have the same contractual terms and are located in territories within the same regulatory restrictions. Dr	

						S says the mistake is that BF assumed. He is not assuming.	
18-1028(11) / 6339(11)						SARS: You say that BF analysis neglected important factors of comparability.	
18-1029(20) / 6340(20)	18-1030(20) / 6341(20)					SARS: In 2014 Dr S concludes that 3 factors (duration, territory and exclusivity) relevant to CUP. SARS contends that this is contrary to Dr S's testimony in current matter.	
18-1030(21) / 6341(21)	18-1032(16) / 6343(16)					Dr S explains that there is no "contradiction". Nowhere did I say that the factors should not be considered. I said that in the context of the CUP agreement I could not measure the effect. I relied on research published subsequent to BF Report. BF was dismissive of factors that must be considered.	
18-1036(3) / 6347(3)	18-1040(23) / 6351(23)	Dr S Report	07-816 / 1216, para 49			SARS contends that para 49 of Dr S's 2022 report at 07-816 which states that "The Cyprus Agreement fulfils the requirements for the application of the internal CUP method..." contradicts the statement at 03-208 / 678 of 2014 report "In order to establish comparability between controlled and uncontrolled transactions, it is necessary to compare attributes or "comparability factors", including ...contractual terms" specifically, duration, territory and exclusivity.	
		2014 BF Report	03-208 / 678				

18-1038(23) / 6349(23)	1041(17) / 6352(17)					Dr S confirms that he did consider the factors and performed a comparability analysis for each.	
18-1078(8) / 6389(8)						SARS contends that Dr S's comparability analysis is contrary to his 2014 Report where he said "In order to establish comparability between controlled and uncontrolled transactions, it is necessary to compare..."comparability factors", including... functions performed (taking into account assets used, and risks assumed) ..."	
Not Independent - Cyprus agreement not an uncontrolled transaction							
18-1040 / 6351	18-1051 / 6362	Dr S Report	Ex 1.2 at 07-837 / 1237	1.36, 1.42, 1.43, 1.47	14-1312, 14-1314, 14-1316 / 3992, 3994, 3996	SARS: Internal analysis of ABD agreements not compliant with D1.1 and paras 1.42, 1.43 and 1.47. Prior existence of the agreement between the parties not acknowledged as required by para 1.47.	
18-1040(24) / 6351(24)	18-1046(9) / 6357(9)	Dr S Report	Ex 1.2 at 07-837 / 1237	1.36, 1.42, 1.43	14-1312, 14-1314-15 / 3992, 3994-3995	Internal analysis: SARS refer to para 1.42 and 1.43 of OECD TPG which says that agreements are the starting point and that further information need to be consider on conduct of parties. Dr S confirmed he did internal analysis at Ex 1.2 and that his analysis is compliant with D1.1 read with para 1.42 and 1.43 of OECD Guidelines.	
18-1046(10) /				1.47	14-1316 / 3996	SARS: para 1.47 of OECD TPG requires you to take into account all	

6357(10)						economically relevant characteristic of transaction.	
18-1047(24) / 6358(24)						Dr S: para 1.47 begins with conditional statement "Where there is doubt..." and I had no doubt.	
18-1050(1) / 6361(1)		Model Tax Convention	14-36 / 2946			Moreover, the agreement satisfies the condition of independence in terms of sub-para 1(a) and 1(b) of Article 9 of the Model Tax Convention on income and capital.	
18-1052(3) / 6363(3)	18-1053(20) / 6364(20)					SARS: Agreement is a transitional agreement with a limited duration, with the objective to terminate the licence agreement and ceasing the use of the brand (rebranding). Dr S contends that this does not invalidate the fact that the independent licensee has the rights to use the marketing intangible for 3 years. The legal form of the agreement must be respected.	
Functional analysis - No evidence that Dr S performed a functional analysis							
18-1059(5) / 6370(5)		Dr S Report	Ex 1.1 at 07-836 / 1236; Ex 1.2 at 07-837 / 1237	1.51	14-1318 / 3998	My 2022 Report is compliant with para 1.51. I considered and concluded that the functions performed by the Monaco agreement are the same or similar the functions of each of OpCos, that licences the same or similar intangibles from the ABD owners.	

18-1061(16) / 6372(16)	18-1074(17) / 6385(17)					Put: Dr S's exhibits 1.1 and 1.2 do not bear testimony of any Functional analysis as contemplated in para 1.51 of the OECD Guidelines.	
18-1063(9) / 6374(9)	18-1064(7) / 6375(7)					Dr S: Functional analysis is important when using profit methods e.g. TNMM method. No need to consider assets used and risks assumed when investigating agreements. Agreements don't make reference to assets employed (asset is the intangible asset in the agreement) and risks assumed. The important factors in para 1.36 are the characteristics of the property and the contractual terms. Functions performed not ordinarily considered as agreement does not describe what the licensee does - it is irrelevant. All that is relevant are the restrictions to the rights being licenced.	
18-1065(11) / 6376(11)						Para 1.36 contains general factors. Some are relevant for the application of some methods and some to other methods.	
18-1065(14) / 6376(14)						Business strategies and economic conditions: These two factors are relevant for determining value of intangible but not to determine an arm's length royalty.	1.2 6

6357(10)						economically relevant characteristic of transaction.	
18-1047(24) / 6358(24)						Dr S: para 1.47 begins with conditional statement "Where there is doubt..." and I had no doubt.	
18-1050(1) / 6361(1)		Model Tax Convention	14-36 / 2946			Moreover, the agreement satisfies the condition of independence in terms of sub-para 1(a) and 1(b) of Article 9 of the Model Tax Convention on income and capital.	
18-1052(3) / 6363(3)	18-1053(20) / 6364(20)					SARS: Agreement is a transitional agreement with a limited duration, with the objective to terminate the licence agreement and ceasing the use of the brand (rebranding). Dr S contends that this does not invalidate the fact that the independent licensee has the rights to use the marketing intangible for 3 years. The legal form of the agreement must be respected.	
Functional analysis - No evidence that Dr S performed a functional analysis							
18-1059(5) / 6370(5)		Dr S Report	Ex 1.1 at 07-836 / 1236; Ex 1.2 at 07-837 / 1237	1.51	14-1318 / 3998	My 2022 Report is compliant with para 1.51. I considered and concluded that the functions performed by the Monaco agreement are the same or similar the functions of each of OpCos, that licences the same or similar intangibles from the ABD owners.	

18-1065(20) / 6376(20)						I did consider functions performed by licensee because I concluded that the OpCos performed the same functions as Cyprus because Cyprus was part of ABD.	
18-1066(3) / 6377(3)		2014 BF Report	03-208 / 678			SARS contends that Dr S's argument is contrary to his 2014 Report where he said, "In order to establish comparability between controlled and uncontrolled transactions, it is necessary to compare..."comparability factors", including... functions performed (taking into account assets used, and risks assumed)... "	
18-1066(7) / 6377(7)	18-1067 / 6378					Dr S: this is a general statement and not specifically referring to the CUP. SARS: " necessary " is the key word.	
18-1071(1) / 6382(1)						SARS contends that first step is a comparability analysis. Dr S contends that the steps are: 1. to qualify the agreement. Determine that between independent parties. 2. Consider Comparability factors relevant to CUP (characteristics of property and contractual terms (duration, territory and exclusivity). 3. Determine materiality.	

18-1078(7) / 6389(7)		2014 BF Report	03-208 / 678	1.51	14-1318 / 3998	SARS contends that Dr S's analysis is non-compliant with para 1.51 of the OECD Guidelines and contradicts his report at 03-208 / 678 where he indicated that a functional analysis is a necessary component in doing a comparability analysis.	
18-1078(14) / 6389(14)						Dr S: Functions performed by the licensor and licensee are not conveyed in a licence agreement. Crucial to look at 1. identity of the parties, 2. description of intangibles, 3. rights that are conveyed, 4. restrictions on the licence. In this regard his 2022 report complies with relevant comparability factors of the CUP.	
18-1084(21) / 6395(21)	18-1085(9) / 6396(9)					Put: Dr S's report does not bear testimony to any analysis of risk.	
18-1085(10) / 6396(10)	18-1086(14) / 6397(14)	2014 BF Report	03-208 / 678	1.51	14-1318 / 3998	Put: Dr S's analysis is non-compliant with para 1.51 of the OECD Guidelines and contradicts his report at 03-208 / 678 where he indicated that a functional analysis is a necessary component in doing a comparability analysis.	
Economic Circumstances not considered in Dr S's comparability analysis							
18-1086(15) / 6397(15)		2014 BF Report	03-208 / 678			SARS: Dr S states in 2014 report that economic circumstances is a necessary	

						comparability factor in the CUP method to determine an arm's length royalty rate.	
18-1086(23) / 6397(23)				D1.4, 1.130	14-1343 / 4023	Para 1.130 of OECD Guidelines gives a long list of factors to consider.	
18-1088(3) / 6399(3)						Dr S contends that geographic market is relevant to CUP and considered under contractual terms. Other factors are relevant for-profit methods only (e.g. level of market). Some factors are relevant when determining the value of intangibles, which is not the objective.	1.2 6
18-1088(16) / 6399(16)	18-1089(16) / 6400(16)					Dr S explains why level of market is only relevant to profit method.	
Business Strategies not considered in Dr S's comparability analysis							
18-1089(17) / 6400(17)		2014 BF Report	03-208 / 678	D1.5	14-1344 / 4024	SARS: Dr S states in 2014 report that business strategies is a necessary comparability factor in the CUP method to determine an arm's length royalty rate.	
18-1090(13) / 6401(13)						Dr S: Business strategies relevant to profit methods.	
18-1092(2) / 6403(2)						Dr S explains why business strategies is only relevant to profit method. Business strategies cannot be ascertained from a licence agreement - therefore irrelevant to cup. Only relevant to value of intangible.	1.2 6

18-1092(16) / 6403(16)	18-1093(15) / 6404(15)					Put: approach non-compliant with OECD Guidelines and contrary to 2014 Report.	
Territory: Dr S's assessment in 2022 contradicts his Ex 1.3 and assessment in 2014							
18-1093(16) / 6404(16)		<i>Dr S Report</i>	para 43-44 at 07-814-815 / 1214 - 1215			Dr S Report: Exclusivity, Duration and Geographical markets have tenuous influence on royalty rates. They are "presumed or hypothesised" factors.	
18-1094(19) / 6405(19)	18-1097(25) / 6408(25)	<i>2014 BF Report</i>	03-210 / 680, para b)			SARS: Hudson Bay CUP rejected on the basis that territory was different. Dr S says no it was rejected because characteristics of property was different. SARS: territory was listed as a factor that could materially influence royalty rate. Dr S: Canada rich country vs African countries' are low-income countries its classification of World Bank are different. Agreed: Cyprus and Canada are also high-income country its classification.	
18-1098(1) / 6409(1)	18-1101(9) / 6412(9)	<i>Dr S Report</i>	EX 1.3 at 07-849 / 1249			SARS: Exhibit 1.3 (Population and per Capita income) of your report was used to criticise Dr Fügemann and to illustrate fundamental differences between OpCos. Contradiction in your evidence.	
18-1099(6) / 6410(6)						Dr S: No contradiction, we are analysing different things. Dr F analyses perceptions of prices and I am comparing royalty rates.	
18-1099(19) / 6410(19)						My research done after 2014 shows that territory has a tenuous effect on royalty rates.	
18-1102(4)						Territory important when applying a profit method.	

/ 6413(4)							
18-1102(9) / 6413(9)		Dr S Report	EX 1.3 at 07-849 / 1249			SARS questions, based on Ex 1.3, whether he considers Cyprus to be a comparable agreement if one considers the gross domestic product in comparison to other African countries.	
18-1103(1 6) / 6414(1 6)						Cannot just look at per Capita. Have to look at population as well. Cyprus has significant GDP but miniscule population.	
18-1103(2 1) / 6414(2 1)						Put: Dr S did not consider Ex 1.3 as part of comparability analysis because considered to be irrelevant whereas in 2014 Report it was considered to be a factor that could materially affect the comparability in applying the CUP method.	
18-1104(1 1) / 6415(1 1)	18-1105(24) / 6416(24)					Dr S: I learned from research after 2014, looking at many industries that territory among high income countries has little effect on royalty rates.	
Effective Date: Finding in 2014 BF Report contradicts finding in 2022 Report							
18-1106(1) / 6417(1)		2014 BF Report	03-210 / 680, para d)			SARS: In Hudson Bay CUP (2014 Report) effective date was listed as a factor that could materially influence royalty rate	
18-1106(7) / 6417(7)						Cyprus (2018) not contemporaneous to the 2005 ABD agreements.	
18-1107(8) / 6418(8)						I learned from research after 2014 that duration has a tenuous effect on royalty rates.	
18-1108(5) / 6419(5)						SARS: we are not talking about duration, we are talking about effective date.	

Duration: Finding in 2014 BF Report contradicts finding in 2022 Report							
18-1109(2) / 6420(2)		2014 BF Report	03-210 / 680, para e)			SARS: In Hudson Bay CUP (2014 Report) duration was listed as a factor that could materially influence royalty rate	
18-1109(15) / 6420(15)						SARS: obvious difference between Cyprus and Opco agreements is that Cyprus has a 3-yr duration with no renewal option	
	18-1112(3) / 6423(3)					Dr S persists that it has no impact on the royalty rates.	
BF 2014 Report - fn 26 refers to key contractual terms							
18-1112(4) / 6423(4)		2014 BF Report	03-211 / 681			Hudson Bay CUP (and other agreements) rejected as "[t]hese agreements contain differences from the ABD Agreements in contractual terms and other comparability factors for which no adjustments were proposed."	
18-1112(15) / 6423(15)		2014 BF Report	03-211 / 681, fn 26	1.54 (does not correspond with guidelines)	14-713 and 14-1319 / 3615 and 3999	SARS says Dr S references para 1.54 of OECD and then quotes a portion from fn 26 which indicates that key contractual terms duration, geographical area, exclusivity can be assumed to be crucial. <i>Note: Para 1.54 not in 2022 OECD TPG - Refer to redress at 18-1307(18) / 6618(18).</i>	
18-1113(9) / 6424(9)						Dr S: BF was unfamiliar with TP regulations, so I quoted extensively. One factor alone which led to reject Hudson Bay and that was the characteristics of the property.	

	18-1114(8) / 6425(8)					My 2022 report is based on empirical research.	
BF 2014 - fn 20 typo in wording on differences							
18-1115(3) / 6426(3)		2014 BF Report	03-210 / 681, fn 20			fn 20 states: "If differences cannot be ascertained, then the agreement cannot be used as a CUP."	
18-1116(10) / 6427(10)	18-1119(6) / 6430(6)					Dr S: it is a typo. It should read If differences 'can' and not 'cannot'.	
Empirical Study in fn 30 of Dr S's Report do not support his conclusion on Duration							1.28;1.1
18-1119(7) / 6430(7)	18-1125(18) / 6436(18)	Dr S Report	07-814 / 1214, para 43, fn 30			SARS refer Dr S to fn 30 of his Report which contains the empirical study that support the conclusion that duration has a tenuous effect on royalties. SARS contends that this particular study contains nothing on duration. Dr S agrees and says it supports exclusivity - he has other studies that support duration which are not listed in the fn.	
Empirical Study in fn 30 - Discrepancy between article and Dr S's Report on the effect of additional payments on royalties							
18-1125(18) / 6436(18)		Dr S Report	07-815 / 1215, para 44, fn 30			Statement in Dr S's article referred to in fn30 "The presence or absence of additional payments does not appear to have an effect on the royalty rates..." is inconsistent with statement in para 44 of Dr S's report "The empirical factors that most influence royalty rates are additional payments..."	
		Dr S Report	07-815 / 1215, para 44, fn 30			Dr S explains additional payment not factor that differentiates the CUP agreement with the Opco agreement. Additional payment not factor in patterned licence agreement that I analysed.	

1128 (13) / 6439 (13)	18- 1129(2) / 6440(2)					Put: not credible, not believable, not an honest explanation for obvious discrepancy between source of empirical study and statement in report.	
Not Independent - Dr S failed to look beyond the Cyprus Agreement to the actual facts and conduct of the parties							
18- 1129 (3) / 6440 (3)						SARS: Right to early termination and intention to rebrand is part of business strategies and economic circumstances that is material to the transaction.	
18- 1134 (20) / 6445 (2)						SARS: Agreement is only starting point. One must look outside agreement at conduct that is indicative of business strategy.	
18- 1135 (2) / 6446 (2)	18- 1135(17) / 6446(17)					Dr S contends that early termination affects the value of the intangible and not the royalty rate.	1.26, 1.20, 1.32
18- 1138 (1) / 6449 (1)						SARS: No significant negotiations could have taken place between the parties under these circumstances. Dr S says he can't speculate.	
18- 1138 (20) / 6449 (20)						In applying the CUP method, Dr S was required to go beyond the letter of the agreement and establish the actual facts and conduct of the parties. Fundamental flaw in applying the CUP.	
18- 1140 (13) / 6451 (13)						SARS: Dr S failed to make any enquiries to establish business strategy or any other relevant circumstance that may inform the true intention.	
18- 1141 (7) / 6452 (7)						Dr S: sufficient for me to establish that the licensor and the licensee are independent and that they had agreed to a royalty rate of 1%	
18- 1143 (12) /						SARS: Cyprus Agreement not independent and not comparable. Dr S's	

6454 (12)						application of the CUP is non-compliant with OECD.	
18-1146 (1) / 6457 (1)	18-1146(6) / 6457(6)					SARS: Dr S's Report and evidence should be disregarded as not credible and not of independent expert.	
Comparables cannot exist when both parties make unique and valuable contributions							
18-1157 (19) / 6468 (19)						Debate that unique and valuable contributions are made between ABD and OpCos is common cause.	
18-1177 (12) / 6488 (12)				6.209	14-1582 / 4258	SARS: It is common cause between the parties that unique and valuable contributions are made by both parties. There is no reliable uncontrolled transaction. Therefore, the TPSM is the appropriate method.	1.21.3
18-1179 (1) / 6490 (1)						Dr S: Dr F has 2 burdens. 1. that the internal CUP is not identified and 2 that that no external CUP exist.	
1190 (2) / 6501 (2)				6.203	14-1581 / 4257	SARS: OECD says that comparability analysis will fail often as a result of the use by one or both parties to the transaction of unique and valuable contributions.	
1191 (7) / 6502 (7), 1194 (11) / 6505 (11)	1197(5) / 6508(5)			6.212	14-1582 / 4258	SARS: TPSM not dependent on identifying comparables. Therefore, reliable comparable uncontrolled transactions is not a <i>sine qua non</i> of OECD. Dr F will rely on para 6.212 in support of his argument that TPSM is not dependent on the identification of comparables.	
1197 (6) / 6508 (6)				3.39	14-1432 / 4111	SARS: para 3.39 indicative that comparability not <i>sine qua non</i> . Especially where both parties make unique and valuable contributions.	

1200 (9) / 6511 (9)						Dr S: A tax authority that wants to use a method without comparables applying to a special circumstance has a burden to demonstrate that comparables do not exist.	
1200 (13) / 6511 (13)						SARS; No burden in OECD. The quest is for the most appropriate method and does not require the dismissal of a CUP method as a precondition to pursue alternative method.	
1200 (19) / 6511 (19)						Dr S disagrees - CUP takes precedence over any other method.	
1201 (2) / 6512 (2)	1201(12) / 6512(12)					SARS: where unique and valuable contributions exist, the OECD suggests that TPSM is preferred method.	
Most appropriate method							
1180 (1) / 6491 (1)				2.2	14-1365 / 4044	SARS: Selection of method aims at finding the most appropriate method. Enquiry is ultimately what is the most appropriate method - it is not for Dr F to refute the CUP.	
1181 (4) / 6492 (4)						DR F's WTP method is not a recognised method. Multinational and tax authority incur great risk to use an unorthodox method. Novel method is vulnerable to the attack that the method is arbitrary, and arbitrary methods cannot produce arm's length results. Mr F's method not recognised in para 2.2 and cannot be the most appropriate method.	1.43
1183 -(11) / 6494 (11)	1185(11) / 6496(11)					SARS: WTP is not a method but simply a data input. What Dr F does is he arrives at brand related profit by deducting brand related cost from brand related revenue and therefore employs the TPSM.	1.43

1187 (12) / 6498 (12)						Dr S: the statement is not reflective of what Dr F did. (rest of the debate is about Dr F's method)	

NOTE: It is difficult and imprudent to reject internal comparables when you do not have an external comparable to offer as corroborating counter evidence. Similarly, you cannot deny the internal comparables with hearsay statements in the absence of corroborating support.

RE-EXAMINATION OF DR S ON CUP (18-1295 to 18-1311(12) / 6606 to 6622)							
18-1295(1) / 6606(1)	18-1297(2) / 6608(2)			1.13	14-1305 / 3985	Transfer pricing not an exact science. Requires exercise of judgment. Professional judgment must not be arbitrary but based on principles.	
18-1297(3) / 6608(3)	18-1298(20) / 6609(20)			2.3	14-1366 / 4045	CUP and another method can be applied in an equally reliable manner, but CUP is the preferred method.	
18-1298(21) / 6609(21)	18-1299(19) / 6610(19)			2.11	14-1367 / 4046	Transactions need not be identical or exact, for example with contractual terms, one cannot dismiss the information because of some rigid standard of comparability or the standard that applied in the abstract not recognising that reality does not confirm to ideals.	
18-1299(20) / 6610(20)	18-1301(11) / 6612(11)			2.15	14-1369 / 4048	First step is to identify any differences. Second step is to determine whether the differences have a material effect on price. If one knows from experience that the difference does not have a material effect on price one can benefit from that learning and apply it by not further establish comparability.	
18-1301(12) / 6612(12)	18-1302(8) / 6613(8)			2.15	14-1369 / 4048	CUP is preferred method because it is more reliant.	
18-1302(9) / 6613(9)	18-1303(8) / 6614(8)			2.17	14-1370 / 4049	Para 2.17 suggests a level of pragmatism and flexibility and one should not impose rigid standards.	
18-1303(9) / 6614(9)	18-1304(15) / 6615(15)			3.27	14-1429 / 4108	Better to support CUP with Internal comparables. ABD is party and independent party is counterparty. As opposed to comparables obtained from database. There you have a challenge to match a number of attributes to establish comparability. In internal CUP many attributes are similar or identical.	
18-1304(16) / 6615(16)	18-1304(18) / 6615(18)					I did consider the functions performed by the licensee and concluded that they were similar to the Cyprus agreement.	

18-1304(19) / 6615(19)	18-1305(16) / 6616(16)					Difficult and imprudent to reject internal comparable when you do not have an external comparable to offer as counter evidence. Cannot be denied by hearsay, statements or counter statements without support.	
18-1305(17) / 6616(17)	18-1307(1) / 6618(1)			3.29	14-1430 / 4109	When one has an internal CUP that satisfies the primary criterion of comparability, which is the characteristics of the property, one does not need to look for external comparables.	
18-1307(2) / 6618(2)	18-1307(17) / 6618(17)			3.38	14-1432 / 4111	Data need not be perfect. Must apply the principle of reliability. To determine more comparables with imperfect information, one selects the method that is less subject to accounting manipulation, such as the CUP.	
18-1307(18) / 6618(18)		2014 BF Report	fn 26 at 03-211 / 681	1.54	14-2100ax / 4570	Quote in para 1.54 of 2010 OECD not carried forward to 2017 and 2022.	
18-1309(9) / 6620(9)	18-1311(10) / 6622(10)					Your evidence was that per capita income has tenuous effect on royalty rate, would it increase or decrease the royalty rate? Dr S: has effect on value of intangible and not the rate and explanation why.	

APPENDIX N3

DR F – ANALYSIS ON EVIDENCE ON CUP

Transcript		Evidence referred to		OECD		Evidence	Ground of Appeal
From	To	Document	Reference	Para	Reference		

DR F'S OWN EVIDENCE ON CUP (18-1328 – 18-1494 / 6639 – 6805)							
18-1344(20) / 6655(20)	18-1360(10) / 6671(10)	EX 8	16-149v-al / 4985 - 5001			Functional Analysis (Ex 8 Section 2.4 Functional Analysis at 16-149v / 4985)	
18-1345(9) / 6656(9)	18-1345(20) / 6656(20)					Need to do a functional analysis to determine whether the transaction is comparable to any uncontrolled transaction.	
18-1345(21) / 6656(21)	18-1346(4) / 6657(4)	EX 8	16-149x / 4987	2.2	14-1365 / 4044	Selection of method. Most appropriate method determined through functional analysis.	
18-1346(5) / 6657(5)	18-1358(12) / 6669(12)	EX 8	16-149y / 4988			Dr F's evidence on the functional analysis forms the basis of his conclusion that both parties perform DEMPE functions which are unique and valuable contributions and the contention that the CUP is not appropriate.	

Unique and valuable contributions							
18-1358(21) / 6669(21)	18-1360(10) / 6671(10)	EX 8	16-149al / 5001	2.130	14-1404 / 4083	He says that it is acknowledged by both parties that ABD and the OpCos perform the DEMPE functions which are unique and valuable contributions. Unique by its very nature tells us they are not comparable in essence to any contributions anyone else does in developing its own brand.	1.21.3; 1.33, 1.34
18-1360(23) / 6671(23)	18-1378(5) / 6689(5)	EX 8	16-149am / 5002			Transfer Pricing Methods (Ex 8 Section 3 Transfer Pricing Methods at 16-149am / 5002)	
Selection of the most appropriate method							
18-1363(13) / 6674(13)	18-1366(14) / 6677(14)	EX 8	16-149aq-at / 5006 - 5009	2.118, 2.2, 6.145	14-1401, 14-1365, 14-1562 / 4080, 4044, 4238	No requirement in OECD to test every method. OECD prescribes the most appropriate method and not a hierarchy of methods. TP methods likely to be useful in transfer of intangibles are the CUP and TPSM.	1.19.3
18-1366(15) / 6677(15)	18-1367(22) / 6678(22)	EX 8	16-149au / 5010	2.18	14-1370 / 4049	CUP is generally appropriate for establishing ALP for transfer of commodities. Used for homogenous goods for example sugar and wood. Vast difference between method which requires strictest comparability criteria (CUP) and intangibles which are by definition unique.	

18-1367(23) / 5578(23)	18-1368(19) / 6679(19)	EX 8	16-149av / 5011	6.131, 2.1 to 2.12	14-1559, 14-1365 to 14-1368 / 4235, 4044 to 4047	Selection of most appropriate method. Although CUP can be used in certain circumstances for transfer of rights in intangibles, it is restrictive and difficult to identify comparables.	1.19.4
18-1368(20) / 6679(20)	18-1369(12) / 6680(12)	EX 8	16-149aw / 5012	6.209, 2.126	14-1582, 14-1403 / 4258, 4082	On the other hand, the TPSP is appropriate where no reliable comparable exists and both parties make unique and valuable contributions. The existence of unique and valuable contributions by each party in the controlled transaction is the clearest indicator that TPSP may be appropriate.	
18-1369(12) / 6680(12)	18-1371(6) / 6682(6)	EX 8	16-149ax / 5013	2.119	14-1401 / 4080	Industry analysis important to determine contributions and whether unique and valuable. In this regard, a functional analysis needs to be done, and profits be shared accordingly. It is common cause that unique and valuable contributions are made. Put differently, the CUP is not appropriate: (a) there are no comparables and (b) both parties make unique and valuable contributions.	

18-1371(6) / 6682(6)	18-1372(11) / 6683(11)	EX 8	16-149ay-az / 5014 - 5015	6.212, 3.39, 2,120, 2.126	14-1582, 14-1432, 14-1401, 14-1403 / 4258, 4111, 4080, 4082	Reasons why TPSM is appropriate in terms of OECD Guidelines: TPSM not dependable on comparables. Relevant were highly integrated operations.	
18-1372(12) / 6683(12)	18-1374(13) / 6685(13)	EX 8	16-149ba / 5016	6.146, 2.14 to 2.26, D.2.1 to D.2.4	14-1563, 14-1369 to 14-1373, 14-1554 to 14-1559 / 4239, 4048 to 4057, 4230 to 4235	Qualification in using CUP: reliable CUP must be identified. General principles in paras 2.14 to 2.26 must be applied when CUP is used. In this regard, the comparability factors in Sections D.2.1 to D.2.4 should be considered in evaluating comparability and in making adjustments. Therefore, need to consider both para 1.36 factors and additional comparability factors in D.2.1 to D.2.4. Should be noted that it may be difficult or impossible.	1.19.4, 1.21.3 1.24
18-1374(14) / 6685(14)	18-1375(6) / 6686(6)	EX 8	16-149bb-bc / 5017 - 5017	6.205, 6.141	14-1482, 14-1561 / 4160, 4237	CUP is one-sided method which method generally not reliable for valuing intangibles or rights in intangibles.	
18-1375(7) / 6686(7)	18-1376(2) / 6687(2)	EX 8	16-149bd / 5019		Comparison CUP vs TPSM:		
					1. Routine assets vs Unique and Valuable contributions Is this saying the CUP is for routine assets?		
					2. Separate Operations (e.g. commodities) vs Highly Integrated Operations		
					3. Market data from independent parties available (e.g. commodities) vs Not performed between independent parties.		
					4. Identify available comparable intangibles vs Identify value (profit) attributable to intangible.		

						5. One sided vs Two sided.	
18-1376(2) / 6687(2)	18-1376(13) / 6687(13)	EX 8	16-149be / 5020			Conclusion: TPSM is most appropriate method. 1. It looks at both sides of the transaction. 2. Considers the integrated functions of the parties. 3. Accounts for unique and valuable contributions made by both parties. 4. Not dependent on comparables.	
18-1376(14) / 6687(14)	18-1378(5) / 6689(5)	EX 8 Ms N Report para 109 MR Report Para 23 MR Report para 147	16-149bf / 5021 07-770 / 1170 07-685 / 1186 07-719 / 1120			Common cause that both parties make unique and valuable contributions. Dr F relies on paras 23 and 147 of MR's witness statement and para 109 of Ms N's witness statement in support.	1.21.3; 1.33, 1.34
18-1458(3) / 6769(3)	18-1473(16) / 6784(16)	EX 10	16-36m - ad / 5155 - 5172			CUP (Ex 10 Section 6.1 The CUP at 16-36m / 5155)	
Factual evidence on Cyprus Agreement							
18-1458(7) / 6769(7)	18-1458(17) / 6769(17)	EX 10	16-36n / 5156			ABD Cyprus was part of ABD Group and operated under ABD Brand from 2007 to 2018. Divested in 2018. As part of divestment, parties entered into brand licence agreement until its rebranding. The brand licence agreement constitutes the alleged internal CUP.	
CUP is used for commodities and where quoted prices exist							
18-1458(18) / 6769(18)	18-1458(25) / 6769(25)	EX 10	16-36o / 5157	2.18	14-1370 / 4049	CUP is generally appropriate for establishing ALP for transfer of commodities . Reference to commodities means physical products with a quoted price.	

CUP has strictest comparability criteria							
18-1459(1) / 6770(1)	18-1459(7) / 6770(7)	Ex 10	16-36p / 5158	2.15	14-1369 / 4048	CUP has strictest comparability criteria. One of two conditions to be met.	1.21
18-1459(8) / 6770(8)	18-1459(23) / 6770(23)	Ex 10	16-36p / 5158	2.15	14-1369 / 4048	Condition 1. None of the Differences, if any, could materially affect the price. Firstly, the differences should be identified before you can move to Condition 2. If you cannot, you cannot go to Condition 2.	1.19.2; 1.21.1, 1.25
18-1459(24) / 6770(24)	18-1460(5) / 6771(5)	Ex 10	16-36p / 5158	2.17	14-1370 / 4049	In comparability analysis regard should be had to the effect on price of broader business functions other than just comparability. One need to look broader business functions beyond the IP granted.	
18-1460(6) / 6771(6)	18-1462(2) / 6773(2)	Ex 10	16-36q / 5159	3.27 - 3.29	14-1429 / 4108	Internal Comparables, where they exist, must satisfy the 5 comparability factors in the same way as external comparables.	1.22
18-1461(5) / 6772(5)	18-1462(2) / 6773(2)	Ex 10	16-36r / 5160	1.36	14-1312 / 3992	All 5 Comparability criteria must be satisfied: 1. contractual terms, 2. functions performed, assets used, and risks assumed, 3. characteristics of the property, 4. economic circumstances, 5. business strategies.	
TWO conditions must be present to use CUP:							
1462(3) / 6773(3)	1462(8) / 6773(8)	EX 10	16-36s / 5161			In order to apply the CUP, it must be (A) the most appropriate method and (B) the agreement must be between external and unrelated parties and be comparable.	
1462(9) / 6773(9)	1462(20) / 6773(20)	EX 10	16-36s / 5161			Neither is the case for the following reasons: (1) CUP inappropriate due to unique and valuable contributions, (2) lack of uniform contributions (3) not agreement between unrelated parties in terms of the commercial and financial relations and (4) does not meet the comparability factors.	
A. CUP Method not Appropriate:							
18-1462(21) / 6773(21)	18-1463(8) / 6774(8)	Ex 10	16-36t / 5162	3.39; 2.65	14-1432, 14-1386 / 4111, 4065	1. Unique and valuable contributions made by both parties. Dr F accepts this as common cause fact (18-1463(6)-(8), 18-1358(24) / 6774(6) – (8), 6669(24))	1.21.3; 1.33, 1.34

18-1463(9) / 6774(9)	18-1464(9) / 6775(9)	Ex 10	16-36u / 5163			2. Lack of uniformed contributions made by both parties. Multiple parties that contribute in different ways. Contributions differ between OpCos and from year to year. One must measure contributions with DEMPE functions. Use this as contributions split. ABD accepted this split.	
						B. CUP does not meet comparability requirement:	
18-1464(10) / 6775(10)	18-1467(13) / 6778(13)	Ex 10	16-36w / 5165			1. Agreement must be between external and unrelated party – Cyprus Agreement was not negotiated under full market forces	1.11, 1.20, 1.32
18-1464(21) / 6775(21)	18-1465(12) / 6776(12)	Ex 10	16-36w / 5165			a. Made on the back of intercompany agreements which existed. Intercompany agreement informed the 3rd party agreement. In internal CUP, the 3rd party agreement should inform the intercompany agreement.	1.20.1, 1.32.1
18-1465(13) / 6776(13)	18-1466(1) / 6777(1)	Ex 10	16-36w / 5165			b. limited to the event of rebranding.	1.20.1, 2, 1.20.1, 3, 1.32.2, 1.32.3
18-1466(2) / 6777(2)	18-1466(8) / 6777(8)	Ex 10	16-36w / 5165			c. neither party had incentive to invest in the ABD brand.	1.20.1, 4, 1.32.4
18-1466(9) / 6777(9)	18-1467(3) / 6778(3)	Ex 10	16-36w / 5165			d. no commercial or financial incentive for licensee to question 1%	1.20.1, 5, 1.32.5
18-1467(4) / 6778(4)	18-1467(13) / 6778(13)	Ex 10	16-36w / 5165			e. not possible to isolate the royalty rate transaction from overall disinvestment transaction.	1.20.1, 6, 1.32.6
18-1467(14) / 6778(14)	18-1468(20) / 6779(20)	Ex 10	16-36x / 5166			2. Agreement does not meet the comparability factors mandated by OECD (Table at 16-36x / 5166 NB)	1.20.4
18-1467(17) / 6778(17)	18-1467(22) / 6778(22)	Ex 10	16-36x / 5166			a. Business Strategies not the same. Cyprus in divested market and OpCos incentive to enhance brand.	1.20.4, 1; 1.24.2
18-1467(22) / 6778(22)	18-1468(3) / 6779(3)	Ex 10	16-36x / 5166	D.2.1. 7 para 6.127	14-1557 / 4233	b. Expected Future Benefits not the same. Cyprus covers short and limited period with no incentive to invest in brand = low expected benefit. OpCos has long term focus to increase value.	1.20.4, 2; 1.24.2

18-1468(3) / 6779(3)	18-1468(4) / 6779(4)	Ex 10	16-36x / 5166			c. Commencement Date not the same. Cyprus 2018 v OpCos 1999 - 2010.	1.20.4.3, 1.24.2
18-1468(5) / 6779(5)	18-1468(7) / 6779(7)	Ex 10	16-36x / 5166			d. Duration. Cyprus max 3 yrs and OpCos 9 - 15 yrs.	
18-1468(7) / 6779(7)	18-1468(9) / 6779(9)	Ex 10	16-36x / 5166			e. Expiration / Renewal. Expires automatically vs renewal period	1.20.4.4, 1.24.2
18-1468(10) / 6779(10)	18-1468(12) / 6779(12)	Ex 10	16-36x / 5166	D.2.1.1 para 6.118	14-1555 / 4231	f. Exclusivity. Exclusive vs non-exclusive	1.20.4.5, 1.24.2
18-1468(12) / 6779(12)	18-1468(14) / 6779(14)	Ex 10	16-36x / 5166			g. Right to sublicense. None vs some	1.20.4.6, 1.24.2
18-1468(14) / 6779(14)	18-1468(19) / 6779(19)	Ex 10	16-36x / 5166	D2.2 para 6.128	14-1557 / 4233	h. Infringements. No obligation to support ABD infringements vs obligation to support.	1.20.4.7, 1.24.2
18-1468(20) / 6779(20)	18-1468(20) / 6779(20)	Ex 10	16-36x / 5166			i. Payment period. Quarterly v 6-months	1.20.4.8, 1.24.2
18-1470(17) / 6781(17)	18-1471(24) / 6782(24)	Ex 10	16-36aa / 5169			Agreement is a transitional agreement. This in itself affects the financial and commercial relations between the parties.	
Adjustments not made:							
18-1471(25) / 6782(25)	18-1473(16) / 6784(16)	Ex 10	16-36ab / 5170	2.15	14-1369 / 4048	Adjustments need to be made for each comparability factor which materially affects the price.	1.25

APPENDIX N4

DR F – CRITICISM OF THE EXPERTS

In the ABD trial expert witness Dr F gave evidence in the trial for the revenue authority supporting his critique of the ABD expert witnesses, and evidence supporting his unique PSM methodology in contradistinction to the taxpayer's PSM. The first column reflects the page numbers in the court record of the evidence given by him in the court evidence transcript. The "Evidence" column sets out a summary of the evidence given. This type of summary is provided as an example of the detailed evidence given and is used to support the final closing arguments to the tax court.

Transcript		Evidence referred to		OECD		Evidence	Ground of Appeal
From	To	Document	Reference	Para	Reference		

DR F'S CRITICISMS OF ABD EXPERTS							
Dr S considers Comparability Factors incorrectly						Two reasons:	
18-1468(21) / 6779(21)	18-1468(25) / 6779(25)	EX 10	16-36y / 5167			1. Dr S concludes that the factors (Duration, Exclusivity & Geographic Scope) have a tenuous effect without evidence of this assertion.	1.28.1.1
18-1468(25) / 6779(25)	18-1469(17) / 6780(17)	EX 10	16-36y / 5167	D2.1	14-1554 to 14-1557 / 4230 to 4233	2. Dr S failed to consider all the comparability factors set out by OECD (general ones and intangibles ones in Chapter 6). Instead, he looked at Tiered Structure and Additional Payments.	
Ms N considers Comparability Factors incorrectly						Two reasons:	
18-1469(18) / 6780(18)	18-1470(5) / 6781(5)	EX 10	16-36z / 5168			1. Authorized geographical Location. Simply because each market has a licence does not make it comparable.	
18-1470(6) / 6781(6)	18-1470(17) / 6781(17)	EX 10	16-36z / 5168			2. Pricing. Price itself cannot be a comparable factor. It is the result of the analysis.	
Ms N's definition of a transitional agreement is wrong							
18-1470(17) / 6781(17)	18-1470(24) / 6781(24)	EX 10 Ms N Report para 145	16-36aa / 5169 07-780 / 1180			Ms N conflates the transition of legal ownership with a transitional agreement. Transitional agreement relates to period after sale when the divested entity may still need operation support to ensure smooth transition.	
Dr S and Ms N makes no adjustments for the differences in comparability							
18-1471(25) / 6782(25)	18-1473(16) / 6784(16)	EX 10	16-36ab / 5170	2.15		Adjustments need to be made for each comparability factor which materially affects the price.	
		EX 10	16-36ac / 5171			Dr S & Ms N fails to make adjustments for the differences. Two things must be done:	
						A. Analyse each ABD intercompany licence agreement against the Cyprus Agreement	
		EX 10	16-36ad / 5172	D2.1 para 6.116	14-1554 / 4230	B. Determine the profit potential given the differences in each comparability factor in each ABD market.	

APPENDIX N5

DR F – CROSS-EXAMINATION

In the ABD trial expert witness Dr F gave evidence for the revenue authority in the trial supporting his critique of the ABD expert witnesses, and evidence supporting his unique PSM methodology in contradistinction to the taxpayer's PSM. After he gave his evidence, he was cross-examined by the ABD lead advocate. The first column reflects the page numbers in the court record of the evidence given by him in the court evidence transcript. The "Evidence" column sets out a summary of the evidence given. This type of summary is provided as an example of the detailed evidence given and is used to support the final closing arguments to the tax court.

Transcript		Evidence referred to		OECD		Evidence	Ground of Appeal
From	To	Document	Reference	Para	Reference		
DR F'S CRITICISMS OF MTN EXPERTS							
Dr S considers Comparability Factors incorrectly						Two reasons:	
18-1468(21) / 6779(21)	18-1468(25) / 6779(25)	EX 10	16-36y / 5167			1. Dr S concludes that the factors (Duration, Exclusivity & Geographic Scope) have a tenuous effect without evidence of this assertion.	1.28.1.1
18-1468(25) / 6779(25)	18-1469(17) / 6780(17)	EX 10	16-36y / 5167	D2.1	14-1554 to 14-1557 / 4230 to 4233	2. Dr S failed to consider all the comparability factors set out by OECD (general ones and intangibles ones in Chapter 6). Instead, he looked at Tiered Structure and Additional Payments.	
Ms N considers Comparability Factors incorrectly						Two reasons:	
18-1469(18) / 6780(18)	18-1470(5) / 6781(5)	EX 10	16-36z / 5168			1. Authorized geographical Location. Simply because each market has a telecom licence does not make it comparable.	
18-1470(6) / 6781(6)	18-1470(17) / 6781(17)	EX 10	16-36z / 5168			2. Pricing. Price itself cannot be a comparable factor. It is the result of the analysis.	
Ms N's definition of a transitional agreement is wrong							
18-1470(17) / 6781(17)	18-1470(24) / 6781(24)	EX 10 Ms N Report para 145	16-36aa / 5169 07-780 / 1180			Ms N conflates the transition of legal ownership with a transitional agreement. Transitional agreement relates to period after sale when the divested entity may still need operation support to ensure smooth transition.	
Dr S and Ms N makes no adjustments for the differences in comparability							
18-1471(25) / 6782(25)	18-1473(16) / 6784(16)	EX 10	16-36ab / 5170	2.15		Adjustments need to be made for each comparability factor which materially affects the price.	
		EX 10	16-36ac / 5171			Dr S & Ms N fails to make adjustments for the differences. Two things must be done:	
						A. Analyse each ABD intercompany licence agreement against the Cyprus Agreement	
		EX 10	16-36ad / 5172	D2.1 para 6.116	14-1554 / 4230	B. Determine the profit potential given the differences in each comparability factor in each ABD market.	

APPENDIX O

DISPUTES, ADJUSTMENTS AND CASES

A very practical and useful presentation is “**Transfer Pricing: Disputes, Adjustments and Cases**” by Hugo Vollebregt (formerly as senior partner at PWC) as part of his lecture series for the Postgraduate Programmes in Transfer Pricing delivered by the Academy of Tax Law and validated by Middlesex University, London (for more information on this programme visit www.academyoftaxlaw.com/transfer-pricing). This presentation aims to enhance understanding of conflicts between taxpayers and revenue authorities regarding transfer pricing, exploring various types of adjustments and notable cases

THE DRIVER OF TRANSFER PRICING DISPUTES

This is really relevant and important. And the accountants among you, and the economists among you will understand it immediately. And I guess my experience is that the people having a legal training, a legal background need some explanation and some help here in understanding it. The traditional disputes between taxpayers and tax administrations are around what we call timing differences. And an important example are depreciation adjustments.

Just assume for a moment that a company has bought a piece of equipment of a 100 and it depreciates this piece of equipment in 5 years' time. So, it will have a 20 depreciation expense every year. Now during a tax audit, the tax administration to find a depreciation period should not be 5 years but 10 years. It means that the expense per year goes down from 20 to 10, but overall over the 10 year period, the tax administration will still be confronted with the full 100 of expenses. So, the adjustments that a tax administration applies commonly results in a timing of when the company can deduct the expenses for tax purposes.

Now in more modern disputes, the tax administration, more or less forgets about depreciation and inventory valuation and all that stuff and focuses on what they call permanent differences. Now, a transfer pricing adjustment by the tax administration is one of these permanent differences. If the tax administration applies an adjustment in one year, it does not mean that there will be more expenses or some compensation in another year. It is a permanent difference. Now add to that, that 70% of the world trade is intra- group. So, the amounts and the stakes are very high. And you will understand why it is so attractive for tax administrations to focus on transfer price.

ARE ALL SOURCES ALIGNED?

These days, the arm's length standard or the arm's length principle is the heart of any transfer pricing analysis. The difficulty though with the arm's length standard is that, well, we do not have the same interpretation and we do not have the same application and implementation of the arm's length standard. Although we all mean the same and although we all use the same language.

So even among the OECD members in practice, there is already a difference on how it is to be applied. Now, non-OECD countries also use the arm's length standard but have a different interpretation. Well, sometimes altogether, especially Brazil, Russia, India in China. Add to that the recent UN Manual on transfer pricing, the starting point again, with the arm's length principle. But the UN believes that with applying the arm's length standard, we should make sure that more tax rights go to the source countries. So, to the developing countries, more rights to those countries than to the richer countries.

Imagine a transaction between an OECD member country and a non-OECD member country. If that is an intercompany transaction, you are almost bound to have a problem on one side, opposite transaction. And you can choose what the Americans say "between a rock and a hard place".

THE ISSUES OVER WHICH DISPUTES ARISE

Non-Technical

Tax audits and transfer pricing audits are quite often quite emotional processes. And there are some non-technical issues over which we have had many emotional debates with tax administrations around the world. The first one is a point which is quite often overlooked by many transfer pricing experts and it is when the tax administration raises the question on the effects and circumstances behind a transfer pricing transaction. If they have questions on functions and risks, and facts and circumstances to whom do they raise the question? Do they raise the question to the company and is it the company who determines who will give the answer, and that usually will be tax director, or can the tax administration interview employees of the local subsidiary? Now that is a big difference. And companies quite often want to be in control of the tax audit process. Well in control as much as possible. So, the companies ought to determine who will get to answer. Each country has in its law these days that there must be some transfer pricing documentation, but there is a huge difference between the various types of requirements in the various countries and it is for the companies, very difficult to meet all the requirements of all countries in the world.

Another source of conflict is the language of documentation. If you have seen transfer pricing documentation in most situations, it will be in English and for most companies, that is the most obvious language. It is the business language these days. So let us have the documentation in English. From a local tax administration perspective English is not the most logical choice. The most logical choice from their perspective is the local language.

Just imagine for instance, a transaction between Apple China and Apple France. Which language should they choose Chinese, French, English? That is already a dispute that gets very, very emotional. Under the laws of many countries, if the documentation is not in the local language, the position of the tax administration may be that there is no documentation. Some tax authorities do accept documentation in another language. And if there is no documentation, you end up in the reversal of the burden approval and you can understand where the conflict goes from there. So, language is really a big issue. Again, from the perspective of the local country, it is fair that they require that the transfer pricing documentation is in the local language. From the perspective of an international company, let us go back to the Apple example again, can tax administrations really require from Apple that they have transfer pricing documentation in all languages over the world.

Another point of disputes has to do with the access to foreign information. Let us assume that Apple Kenya buys product from Apple China and what you would usually do is do a transfer pricing analysis at Apple Kenya and find out whether Apple Kenya earns sufficient money on those transactions. The accounts and records of Apple Kenya of course are in Kenya and they must be handed over to the Kenyan tax administration. Now, in my example, can the Kenyan tax administration also require that Apple Kenya hands over the accounts of Apple China, because it wants to know

how much profit Apple China is making on this transaction, which is a pretty fair requirement from the Kenyan tax administration. Although the laws of many countries, I do not know what the position in Kenya is, but the laws of many countries do not oblige the local subsidiary to provide information on foreign subsidiaries. So again, a dilemma, it is a fair question for the local tax administration. And it is a fair point of the analysis, but there is no obligation on the local subsidiary to hand over this information.

Compare a controlled transaction (profit) to an uncontrolled transaction (profit)

Now, some more issues. Now you have heard by now that in transfer pricing a lot of the work we do is compare the related transaction to an unrelated transaction. And the question is, are the transactions and our companies to which we compare our target company, are they truly sufficiently comparable? It is important that you realize and let us go back to the example of Apple Kenya, that if we want to compare the profitability of Apple Kenya to the profitability of some non-related company of an independent company, we should find a number of independent wholesalers of high quality mobile phones. And how many of those companies are there in Kenya? How many of those companies are there in the Netherlands? There might be two or three only. So the companies to which we compare Apple Kenya, their number is very low. And therefore the outcome of our statistical analysis is relevant because we have so few observations in our sample.

If we want to have more observations in our sample, so more companies in our samples, to compare Apple Kenya with, we might want to look to companies that sell electronic appliances. There will be more companies selling electronic appliances in Kenya. So we have more companies in our sample by now. But are our companies who sell electronic appliances really comparable to Apple Kenya? So you understand the dilemma here and it is almost companies are always exposed to a problem here, because if they truly have high comparability standards, the dispute will be around there are so few companies in your sample, the statistical analysis is irrelevant. And if the company wants to have more companies in the sample, the argument with the local tax administration will be that Apple Kenya is not truly comparable to the companies in the sample.

I urge you for this discussion to have a look at the five comparability factors of the OECD Transfer Pricing Guidelines. You will find them in the guidelines and there are also disputes on databases, which databases to use, but I want to skip it now for this moment.

True Ups

If Apple Kenya incurs losses during a number of years, that is highly suspicious and highly illogical, that it might be a source for disputes. If Apple Kenya earns a margin of 5%, while Apple US or globally earns a margin of 20% that might be a trigger for the local tax administration Kenya to have a closer look to Apple Kenya. Other sources of conflicts are royalties, management charges, and service charges. And there are many disputes around service charges and management charges in many countries.

Some other issues which are so often overlooked in a transfer price analysis and in pricing documentation. Now let us assume for a moment that we have done some relevant statistical analysis, and we all believe that Apple Kenya should be earning a margin of 5%. If Apple Kenya earns a margin of 5%, the transfer pricing charged by Apple China for all the products are fair and medium arm's length standards. But what do we mean by a margin of 5%? Is that a margin of 5% in the budget? So we assume a particular transfer price during the budget process. In the budget process, Apple Kenya earns a margin of 5% end of discussion, or do we mean that Apple Kenya by the end of the year should be earning a margin of 5%. Now assume for a moment that Apple Kenya is not earning in real life the margin of 5%. That in December 2013, a few days before the financial year ends, we find out that Apple Kenya only earns a margin of 1% and it is outside of the range and it means that it is not earning a fair reward.

Now there are various ways to resolve this. And one of the ways to resolve this is that Apple China sends a credit invoice for the product it has supplied earlier to Apple Kenya and that is called a true up invoice. So Apple Kenya basically gets a credit invoice for 4% so that by the end of the year, it earns now the 1% percent on the actual basis, plus 4% under the true up. So yes, it earns now the targeted 5%. The Kenyan tax administration will be very happy. But how about the

Chinese tax administration? The Chinese tax administration will argue well that by the end of the year, you find that the counterparty of your transaction is earning too little profit and you adjust it.

Do you also do this with third parties. Now, let us assume that you have a cell phone. Let's assume you have an Apple cell phone or an iPhone. You bought it seven months ago. And we are now in December 2013, and Apple Kenya sends you a small letter and explains to you, our profits are a bit low for last year so please, would you pay another \$50 for your iPhone? It would be an absurd request. So the mechanism of the truer invoice is not third party behavior. So the tax administration in China could argue that the credit invoice is not third party behavior and therefore it will disallow this invoice as a tax deduction at Apple China.

That is a big issue. The way to resolve this is that Apple in my example, after three months in 2013, should have checked whether Apple Kenya was earning more or less 5%. And if it was earning far more or far less than the 5%, it should reestablish the transfer prices for the next nine months to make sure that overall Apple Kenya would be ending around the 5%. And by six months after six months, it should do the same analysis again and perhaps adjust the transfer price again. So during the year, it must change the culture price for a common period in effect that by the end of the year, Apple Kenya will be earning around a 5% margin without the mechanism of the true up. But many, many companies forget this frequent adjustment and therefore end up in big troubles with the true up mechanism.

The cost plus method

Let us assume for a moment, Apple China sells the products to Apple Kenya at cost plus 5 which in your view is a fair transfer pricing mechanism and reward. Now many transfer pricing specialists believe that in an audit, the tax administration will focus on whether it should be cost plus 5 or cost plus 7 or cost plus 10 or whatever. And the tax administrations, indeed they focus again on whether it should be 5 or 10, that it is far more interesting to have a look at the cost basis because the margin is only the margin and the cost base is 100%. The question is whether we looking to an estimated cost or to an actual cost price.

Let us assume that Apple China builds it at a cost price of 100 and let us assume there is a component for plastic of, let us say, 90 in the cost price. There is a cost of 10 incurred on other costs, such as salaries and general administrative expenses. Total cost 100 and mark up of 5. So the transfer price is 105. Now let us also assume that due to market circumstances, the price for plastic goes up dramatically by 10%. So after 6 months Apple China has an actual cost price of 99 plastic, 10 other expenses. So that is already 109, while their transfer price is only 105. Again, should they adjust or should they not? It is the same discussion we just had a moment to go on the true up. So frequency of adjustments for prices of raw materials is important and quite overlooked.

And another big question is what do we mean by cost price? And whenever you do transfer pricing documentation, and your conclusion is you should be using the cost plus mechanism. The question is, and add that to your transfer pricing documentation, what do we mean by cost price? Under the GAP of which country do we determine the cost price? Now let us go back to Apple. Are we using Chinese GAAP? Are we using French GAAP? Are we using US GAAP? That is really a very important question. Most of the time companies would be using the accounting principles of the parent company to make sure that all phones and all products have the same cost price basis and, the same cost price methodology. that is important. But if in this example, US GAAP differs from Chinese GAAP and Apple China would be using US GAAP. It means that in the accounts and records in the financial statements of Apple China, if Apple China would be using cost plus 5 and would determine cost on US basis in the local statutory accounts, you will never be able to find the cost plus 5 back in the accounts of Apple China. And that in itself is a source of conflict. This example highlights the potential issues that can arise from using different accounting standards in multinational companies. Ensuring consistency in accounting practices is essential to avoid misunderstandings and conflicts in financial reporting. It underscores the importance of harmonizing accounting standards to maintain transparency and accuracy in financial statements. An added challenge is that the local tax authority may only accept a tax return in its local accounting standard. In that situation, the taxpayer has to navigate getting to the right transfer price for the accounting standard used by the group and the local accounting standard. This can be managed by a flexible transfer pricing policy which makes true up adjustments within the interquartile range; i.e. the interquartile range could be between 2% and 7% and thus allow the taxpayer to adjust anywhere within that range, subject to local rules. There are some jurisdictions which dictate that the adjustment must be the mean or median. It is prudent to always check the local tax law requirements.

Resale price method (RPM)

The application of the RPM also has its challenges. The Resale Price Method (RPM) determines the transfer price based on the resale price of a product to an independent party, minus an appropriate gross margin. This method can be challenging to apply. Now let us assume for a moment, we apply the RPM between Apple China and Apple Kenya and that we argue that Apple Kenya must be earning a margin of 10%. It is selling a product at 100. It should be earning a margin of 10%. So the transfer price is 90. The invoice from Apple China to Apple Kenya, however, is printed and prepared at the very moment the product is being shipped from Apple China to Apple Kenya and at that moment Apple Kenya has not yet sold the phone. So Apple Kenya does not know whether it will sell the product at a 100 or 110 or at 90 or at perhaps 80. So again, are we using actuals or budgets. Typically the taxpayer will use a forecast or budget to determine related party transactions, which is not how third parties operate. Should we frequently adjust the transfer prices? So this is all very important practical stuff, which you should bear in mind while developing and designing the transfer pricing analysis and preparing transfer pricing documentation. And I can tell you for my very long experience that these factors are quite often overlooked in transfer pricing documentation, but they are not overlooked during transfer pricing audits. The tax administrations in this area are quite often more proactive, knowledgeable and vigilant in this area consultant companies.

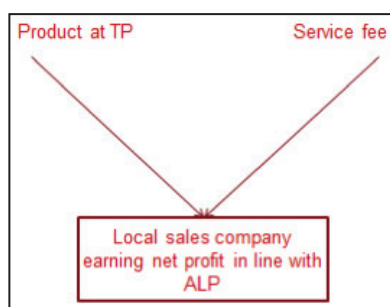
The challenges of the RPM include the fact that it is difficult to find comparables with very similar products, market conditions and business functions. Resale prices are subject to market conditions and thus may fluctuate. The timing of sales and purchases do necessarily align and thus there can be discrepancies in the data used for analysis. Costs have to be properly documented and allocated. Foreign currency fluctuations will also impact the outcome of the transfer prices.

Transactional or Transactional Profit Method

In transfer pricing, the difference between using a transactional method and testing the entity as a whole is often referred to as the distinction between traditional transactional methods and transactional profit methods. This is another nice conflict.

It is a dispute I was involved in between Uganda and South Africa. And it is a problem which we often come across.. Now, let us assume again, that the local sales company is Apple Kenya and Apple Kenya earns a margin of 5% and we all believe that Apple Kenya should be earning a margin of 5%. So it is earning an appropriate margin and it buys the product from Apple, China at a transfer price. And it also gets a service fee from Apple US and overall, at an entity level, it still earns the margin of 5% and the margin is arm's length. Let us assume that in analysis, we found out that the price charged by Apple US to Apple Kenya is too high. It does not meet the arm's length standard, nonetheless, overall Apple Kenya earns an arm's lengths reward. And the question is can the Kenyan tax administration adjust the service fee from Apple US? And again, there are two answers.

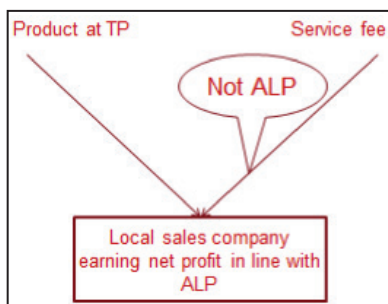
One answer is a transactional approach. You will hear this quite often in transfer pricing. There are two views on transfer pricing. One is a transactional approach and a transactional approach says this service fee is too high, so of course the Kenyan tax administration can adjust. End of the discussion.



The other approach in transfer pricing is more a profit oriented approach. And the profit oriented approach will say, well, whatever the service fee overall Apple Kenya earns a fair reward so there is no scope for adjustment. Because what should happen is if Apple Kenya feels dis-adjusted on the service fee, that tax administration in Kenya should also allow

an adjustment on the product at the transfer price. So overall it balances out again. So a profit approach of transfer pricing versus a transactional approach.

See diagram on page 406...



SOURCES: INTERNATIONAL TRANSFER PRICING CASE LAW

- There are some famous international cases.
- Bausch & Lomb, US, 1991, tax haven
- Compaq, US, 1999, products
- DHL, US, 2002, trade mark valuation
- GSK, US, 2006 (settlement)
- Roche, Australia, 2008, comparables
- There are some famous international cases.

SOURCES: INTERNATIONAL TRANSFER PRICING CASE LAW

- Bausch & Lomb, US, 1991, tax haven
- Compaq, US, 1999, products
- DHL, US, 2002, trade mark valuation
- GSK, US, 2006 (settlement)
- Roche, Australia, 2008, comparables
- Xilinx, US, 2010, stock options
- GSK, Canada, 2010, CUPs
- GE Capital, Canada, 2010, guarantee
- Veritas, US, 2010, buy in payment
- Rolls Royce, India, 2011, PE
- Velcro, Canada, 2012, ownership of IP

The case law is mainly from Australia, Canada, India and the US. It is an urban legend that India is good for something like 80% of all transfer pricing litigation in the world. There many cases and the question is why is foreign case law relevant? And I can explain it very briefly to you. Whenever a tax administration takes a smart view on transfer pricing, and quite often there will be articles on these many cases. In the US and in Canada a lot of the documents around the court case are being published even when the court case is still pending. So there is a lot of noise in the international transfer pricing community on pending transfer pricing cases. So your tax administration will also listen to the noise and will start to use the same arguments as the Indian tax administration or as the US tax administration. When the US IRS had this big debate on GSK on the Glaxo Pharma company, the Dutch tax administrations started to use the same arguments. Thus, in transfer pricing, foreign cases are relevant to you in your countries as well.

In conclusion, you have heard that transfer pricing is not exact science and requires the exercise of good judgment. That is what the OECD says. And quite often a very relevant test is, would the proven business manager have done the same as the local manager of the local subsidiary of the group, or if the local subsidiary is only agreeing to the transfer prices because it is part of the group.

My favourite quote is from an Indian court case, the judge in the court said that transfer pricing is an art. So the good news is by the end of this session, and by end of this course in transfer pricing, you are all artists like we are also just artists.

FAIRNESS AS THE NEW STANDARD?

My personal view is in the end, it is all about fairness - which country may tax which share of the group's total profits. You can look to transfer pricing from a strictly mutual perspective but in the Netherlands, we will look at more and more cases, which country, which of the group's total profit are really a profit-oriented approach. And quite often we believe in my country that this is quite often the only way to get around a very complicated and long and legal battle on transfer pricing.

To show to you how companies are in the news with their transfer pricing strategies, and that there is something going on in the world. We have developed a transfer pricing doctrine in the arm's length of things, and we truly believe this is utterly great and utterly brilliant. And as long as we stick to the transfer pricing analysis in the arm's length principle companies are meeting their, let's say, their obligations to society. In 2010, the UK Guardian newspaper had a big attack on SABMiller for its transfer pricing strategies in India and African countries. The story was that SABMiller was extracting profits from African countries through a web of tax haven subsidiaries and if it would not do so it could send a quarter of million children to school in Africa. That is a difficult discussion. Of course it is following the arm's length principle. I do not know whether they are aggressive in their tax planning or not, but this shows the importance of managing reputational risk in how transfer pricing policies are viewed. We often see this media coverage on MNEs not paying adequate taxes.

There have been parliamentary inquiries into Amazon, Google and Starbucks, in the US, Australia and the UK? If you have not done so, I really urge you to Google it. No doubt it is on YouTube. The CFOs or the CEOs of the subsidiaries in the UK of Amazon, Google and Starbucks were interviewed in parliament on their transfer pricing strategies. And basically, they are beaten to death by the members of parliament on their transfer pricing strategies. This is not about compliance or tax evasion but rather about public perceptions of how much tax these companies should be paying. They apply an acceptable version of the arm's length standard. Their transfer pricing policies and tax planning may be viewed to be aggressive..

BEPS AND TRANSFER PRICING

The OECD has maintained the arm's length principle, which requires related enterprises to transact as if they were unrelated parties, ensuring fair pricing and conditions. However, in response to the challenges posed by base erosion and profit shifting (BEPS), the OECD introduced the BEPS project to address tax avoidance strategies that exploit gaps and mismatches in tax rules. Additionally, the OECD has implemented Pillar 2 of the BEPS framework, a minimum tax known as the Global Anti-Base Erosion (GloBE) Model Rules, which aims to ensure that large multinational enterprises pay a minimum level of tax on income arising in each jurisdiction where they operate.

They are supplementing but not changing the arm's length standard, and the objective is to encourage companies to change their behaviour and steer away from base erosion and profit shifting. So that is a very interesting momentum where we are living.

TRANSFER PRICING ADJUSTMENTS

We distinguish in transfer pricing various types of adjustments and they are often confused by students therefore I thought it's a good idea to explain them. We have a primary adjustment, a secondary adjustment and a corresponding adjustment.

PRIMARY ADJUSTMENT

The primary adjustment is just the adjustment where the tax administration adjusts the transfer prices and increases taxable profit. That is very simple. The complicating fact in primary adjustment is what are the facts on which the tax administration bases its adjustment. Now, if the tax administration is doing a tax audit right now or let us on say 2009 year. The company had to implement a transfer pricing strategy in 2009, so only had at its disposal the facts and circumstances, which it expected in 2009. Whilst the tax administration now looks to the present day actuals and the actuals might be totally different from the expectations which the company had in 2009. Now, what is more relevant for the transfer pricing analysis?

The fair expectation of the company in 2009 or the actuals as the tax administration sees them now in 2014. This is the problem of hindsight. The OECD argues that the tax administration is not allowed to use hindsight, but it is very difficult for tax administrations, of course, to totally ignore the real, the actual facts and circumstances. So there is always a big issue for debate, and it really also relates to the issue of actuals and budgets, which we discussed a moment ago.

SECONDARY ADJUSTMENT

And let me explain this also. I do not know whether you have a legal background or more an accounting background. Let me explain this using issue, balance sheets. This is a hypothetical balance sheet of Apple Kenya.

Balance sheet			
Assets	100	Capital	60
		Reserves	10
		Profit	30
Total	100	Total	100

It has assets of 100. It has share capital of 60. It has retained earnings of 10 and profit of this year was 30 and it is balance - left than right, should be in balance and they are above a hundred. Now the tax administration has increased taxable income. So it has applied an adjustment of 20.

Accounting for the Transfer Pricing Adjustment Transfer Pricing Expense

1. Debit: Transfer Pricing Adjustment Expense (Income Statement) - 20
2. Credit: Accounts Payable (Liabilities) - 20

This adjustment reflects the additional expense incurred due to the transfer pricing adjustment, which increases your liabilities and reduces your profit. The profit was 30 but is now reduced to 10, the original 30 minus the TP adjustment of 20.

The adjusted balance sheet is

- Assets 100
- Liabilities 100
- Capital 60
- Reserves 10
- Current liability (accounts payable) 20
- Profit 10

Transfer Pricing Income Adjustment

1. Debit: Accounts Receivable (Assets) - 20
2. Credit: Transfer Pricing Adjustment Income (Income Statement) - 20

This adjustment reflects the additional income received due to the transfer pricing adjustment, which increases your assets and profit.

Adjusted Balance Sheet

Assets 120

- Original assets 100
- Current assets (accounts receivable) 20

Liabilities 120

- Capital 60
- Reserves 10
- Profit 50 (original 30 plus 20 from TP adjustment)

So profit of this year has gone up to 50. And what you will see on this balance sheet is on the left hand side, there is a hundred and the right hand side, the balance sheet total is 120.

It has been debated whether you can recharacterize the TP Adjustment as a dividend where you have an accounts receivable created and it is unlikely that the related party will get a corresponding adjustment in their jurisdiction and pay the extra 20 TP adjustment. Recharacterizing a transfer pricing adjustment as a dividend is generally not allowed under accounting standards and tax law. Transfer pricing adjustments are meant to reflect the arm's length principle, ensuring that transactions between related parties are conducted as if they were unrelated parties. Recharacterizing these adjustments as dividends could misrepresent the true nature of the transactions and lead to inaccurate financial reporting.

From a tax perspective, transfer pricing adjustments and dividends have different implications. Transfer pricing adjustments affect the allocation of income and expenses between related entities, while dividends are distributions of profits to shareholders. Recharacterizing a transfer pricing adjustment as a dividend could result in tax consequences, such as withholding taxes on dividends, which may not align with the original intent of the transfer pricing adjustment.

CORRESPONDING ADJUSTMENT

	A	B	Group
Profit (R)	100	900	1.000
Primary Adj.	300		
Profit (A)	400	900	1.300

The first corresponding adjustment is totally different. Let us assume we have a group consisting of two companies in A and B earning 100 profit and 900 profit respectively. So in total a 1 000 profit. Now the tax administration of country A applies, a transfer pricing adjustment, a primary adjustment of 300 to subsidiary A. It increases profit to 400 and by now the group is being taxed on income of 1 300, rather than a 1 000. So the company has the phenomenon of economic double tax. The company is being taxed on more income than it actually earns. And frankly it happens quite often.

	A	B	Group
Profit (R)	100	900	1.000
Primary Adj.	300		
Profit (A)	400	900	1.300

So the corresponding adjustment, you find it in article 9.2 of the OECD Model Tax Convention. 9.2

“Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly – profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first mentioned State if the conditions made between two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting State shall if necessary consult each other.”

Basically it says, if you look to the full tax that if country A increases and applies an adjustment, country B should make an appropriate adjustment to the income of subsidiary B.

So it would reduce taxable income of subsidiary B. Will it do so automatically. NO. The commentary to the article 9.2 suggests that. We also read article 25 of the OECD Model Tax Convention. The corresponding adjustment you see it here is minus 300 in the income statement of country B. You want the tax administration in that country to agree to a reduction of taxable income of 300. And it basically says country B should do a corresponding adjustment, but also the tax administration of country A and country B must be able to speak to one another. Article 25 of the OECD Model Tax Convention and article 25 is the mutual agreement procedure.

1. *“Where a person considers that the actions (i.e. the primary adjustment; HV) of one or both of the Contracting States result ... in taxation not in accordance with the provisions of this convention he may ... present his case to the competent authority of the Contracting State of which he is a resident ...*
2. *The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the convention (i.e. the double taxation because of the primary adjustment; HV) ...”*

And basically it says in paragraph two, that the competent authority of country A and country B shall speak to one another and will try to find a solution to resolve to the double tax. So we will need article 9.2 and we will need article 25, and we hope that the countries agree and find a solution on the primary adjustment and also on the secondary adjustment.

	A	B	Group
Profit (R)	100	900	1.000
Primary Adj.	300		
Profit (A)	400	900	1.300
Corresp. Adj.		-300	
Profit (A')	400	600	1.000

SPECIFIC TRANSFER PRICING CASES & TAX AUTHORITY RESPONSES

Unilever Kenya, 2005 - Unilever Kenya Limited vs. Commissioner of Income Tax (Kenya Revenue Authority – KRA)

In the Kenya case of Unilever, the tax administration challenged the transfer prices. They could not reach a settlement or a compromise with the taxpayer. Therefore, they took the company to court and in court the tax administration lost. In response to the tax authority's defeat, the government introduced stricter transfer pricing legislation because the tax administration's position was not supported by existing legislation.

There was a similar response in the Netherlands, where the tax administration lost the

transfer pricing case and immediately the taxation law was changed to stricter transfer pricing rules.

Roche Australia, 2008 - Roche Products Pty Ltd v Commissioner of Taxation [2008] AATA 639

This is an important case for transfer pricing where Roche, a Swiss pharmaceutical company, developed and manufactured pharmaceutical products and sold them to Roche Australia. Roche Australia sold the products in the local Australian market. The tax administration in Australia applied a profit method, the TNMM. Roche Australia had various functions and it concluded that a certain routine profit should be applied to remunerate Roche Australia. Roche used comparable uncontrolled prices, basically market prices at the gross margin level. So it finds that other companies are earning a particular gross margin on certain products, and they apply the same gross margin for Roche Australia. And they do not look to individual products or product groups but they add everything together. They do an aggregation at divisional level. So they do not look to individual products in group but they look to the total division. If this division earns sufficient money. If the answer is, yes, the transfer prices for all products must have been right or average, they must have been right. And we are not going to specify for product A and product B whether they meet the arm's length standard. Overall the division earns an arm's length profit, and therefore the analysis can stop there. And what they also do and that is very much an OECD approach., they do not do analysis for a particular financial year, but they look to various years, they aggregate the results of various years. So they do what is called a multiple year analysis. So basically in the periods, whatever, 2008, 2009, 2010 overall, is this company earning sufficient money in those three particular years. And it could be very well that one year earns too little and the other two enough.

First, if you read the court case, the court says, well, it is very complicated to find comparables, and they do not necessarily agree to the approach of the company and they do not necessarily agree to the view of the tax administration. Both the tax administration and Roche Australia requested counsel from well-known US economists and they were the big shots, the big names in transfer pricing at that particular moment. They sought the assistance of these economists because the US was highly advanced in transfer pricing at the time, whereas Australia had not yet developed its expertise in this area. The court acknowledged the insights provided by the American economists but noted that their perspectives were influenced by the US experience. Politely, the court indicated that it would disregard their testimony. This was surprising, given that the US was considered a leader in transfer pricing practices. Another jurisdiction in court similarly remarked that while the American viewpoints were interesting, they would be ignored in favour of the country's own perspective.

Now let us go back to my example of Apple again, earlier on. Just assume Apple US is selling product to Apple Australia. Of course, Apple US is looking to this transaction from an US transfer pricing angle and if Australia is going to view this from an Australia transfer pricing angle in applying a different basis for the arm's length standard, how fair this may be from an Australian perspective, do not understand me wrong. You can imagine that the Apple Group by definition is in a big problem, and it is not very helpful for, well, the global economy and for global trade.

The Australian court opted for a transactional method, the CUP method. This was not how Roche had conducted its transfer pricing. The court did not allow a multiple year analysis and looked to 2008 only. This approach is not in line with what the OECD proposes. This was a landmark decision for transfer pricing.

Coca-Cola Japan, 2007 - Coca-Cola (Japan) Co., Ltd. vs. the Japanese National Tax Agency (NTA)

Let me explain that also by the Coca-Cola Japan case, because it all has to do with what we call in the transfer pricing arena marketing intangibles. And there is much to do about these local marketing intangibles. Before the second world war, nobody drank Coca-Cola in Japan. And after the second world war, which ended in 1945 Coca-Cola was imported in Japan. It was heavily promoted and heavily marketed in Japan for many, many years, huge marketing campaigns. Coca-Cola became a very popular soft drink in Japan. Coca-Cola is one of the most valuable brands in the world. So Coca-Cola Japan obviously paid big royalties, significant amount of royalties to Coca-Cola US for many, many years. And it was allowed to deduct these royalties from the taxable base in Japan, obviously until the Japanese tax office said by now, Coca-Cola Japan has done so much promotion and local marketing initiative in Japan we acknowledge that the brand is owned by the US but by now Coca-Cola Japan has built its own local marketing intangible and it is a

kind of Coca-Cola economic ownership of the brand in Japan. And we are going to disallow the royalties being paid to Coca-Cola Japan in the future. This is the dilemma of the local marketing intangible. And that is a very popular debate during transfer pricing tax audits.

Ford India, 2011 - Ford India Pvt. Ltd. (the taxpayer) vs. Deputy Commissioner of Income Tax (TPO – Transfer Pricing Officer)

Ford India Pvt. Ltd., a wholly-owned subsidiary of Ford Motor Company (USA), was involved in the manufacture and sale of passenger cars. The case centered around whether certain advertising, marketing, and promotion (AMP) expenses incurred by Ford India constituted “brand building” on behalf of its foreign associated enterprise (AE), and therefore whether those expenses warranted a transfer pricing adjustment.

If Ford India is using the name Ford there can be two views. One view is Ford India uses a valuable brand, and obviously for India should be paying a royalty to the brand owner for it in the US. That is a fair view, but you could also turn it around and argue that Ford India is performing services that increase the brand value of the brand that is being owned by Ford US and Ford India rather than paying a royalty should be compensated for enhancing the brand value for the benefit of US. And that was the dilemma in the Ford India case. And you will find similar cases in similar countries.

GSK US, 2006 - GlaxoSmithKline Holdings (U.S.) Inc. v. Commissioner of Internal Revenue

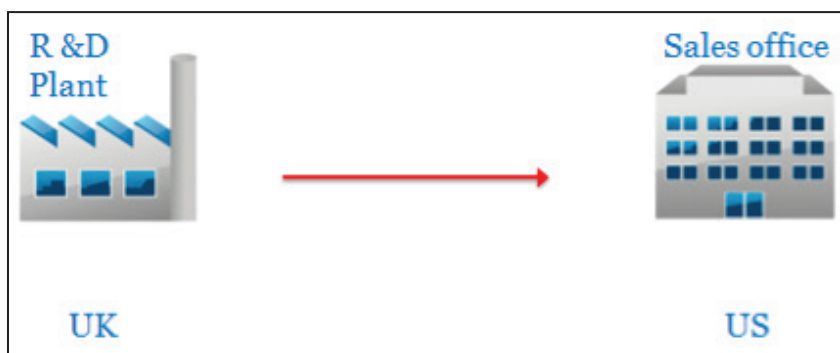
GSK’s U.S. subsidiary marketed and sold key pharmaceutical products—including Zantac (ranitidine), an ulcer and heartburn treatment—developed by its UK parent company.

The IRS challenged the way profits from these products were split between GSK U.S. and its UK affiliate. The core issue was whether GSK’s U.S. subsidiary was appropriately compensated for its role in the marketing, promotion, and brand development of the products in the U.S. market.

If you analyze the intercompany transactions, we usually argue there are two companies engaged in an intercompany transaction, and one, we call the least complex entity and the other one we call the entrepreneur. The entrepreneur has got the key value drivers. It takes the management decisions around these key value drivers and all entrepreneurial risk taking.

So if you look to the Apple group, the entity that mainly develops the Apple brand and technology is Apple US. Those are the key value drivers of Apple. So if you would look to a very simple group structure and let us assume for a moment that the Apple group consists only of Apple US and Apple Kenya and Apple US ships iPhones to Apple Kenya then we would argue that Apple US is the entrepreneur. It owns the key value drivers and if Apple is very successful, Apple US should be earning the big bucks. And if it is not successful, it should be incurring the losses. Apple Kenya, in my example, performs routine activities. It does not own key value drivers. It is what we call the least complex company, and therefore it should be earning a routine reward. And if the product is extremely successful, it still earns a routine reward. And if it not successful at all, it still earns a routine reward.

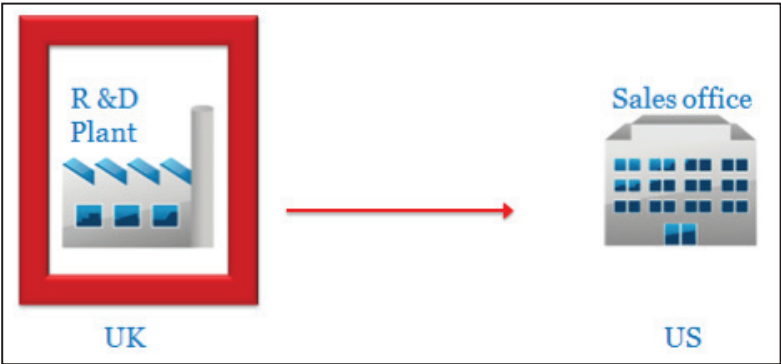
That is the model.



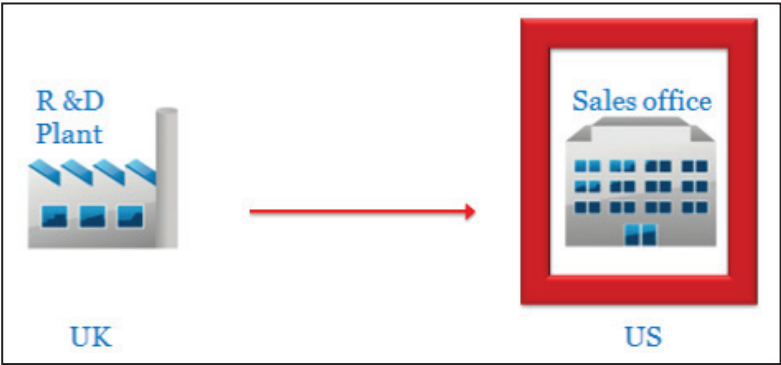
Let us assume that GSK consists of two companies. In the UK, the head office, R& D and in the US there is only a sales

office. Which company should be earning the residual profit.

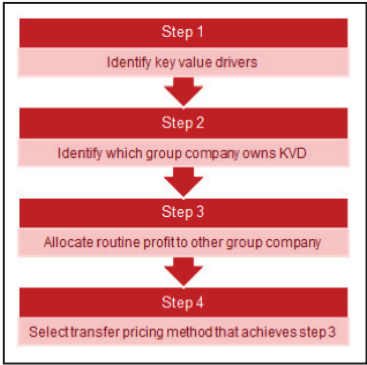
Should it be the UK company



or should it be the sales office in the US?

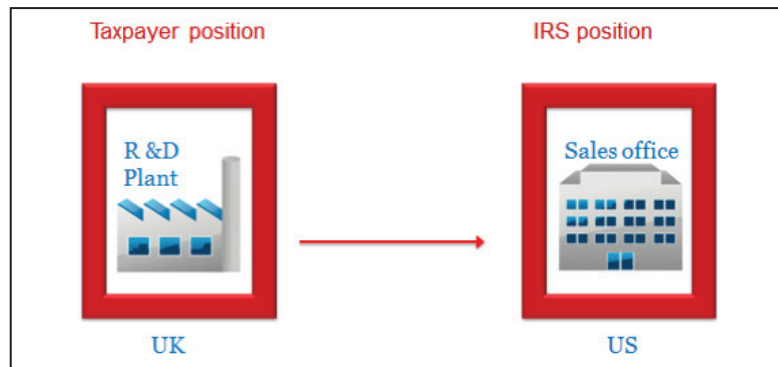


Let us do an analysis.



Step one is you should identify what the key value drivers (KVD) are in the transaction. Then we must identify which group company owns the key value drivers. And then we are going to allocate dual routine profit to the other company, to the routine company. And we going to select a transfer pricing method in such a way that we achieve step three. This is a very interesting and very practical model and it is so simple in magnifying all cases. It will bring you to the answer.

Now GSK said, we are a pharmaceutical company. So R&D and patents and manufacturing. Those are the key value drives. They are in the UK. So the UK is the entrepreneur and should be earning the residual profit. And the US sales office should be getting a routine reward because it is only performing routine activities. Guess what the IRS said, you have got it totally wrong. Marketing and the high prices for pharmaceutical products in the US those are the key value drivers. R&D and manufacturing are protocols for all that stuff that in real life it is complicated, but it is not a key value driver because it is a standardized process. The real key value drivers are marketing in premium markets. Those are in the US. So the US sales office should be getting the residual profit.



So the taxpayer position was on the left hand side, residual profit in the UK and the IRS position was that the residual profit should be in the IRS. So there was the huge double tax.

So the company started a mutual agreement procedure (MAP). But you have seen in article 25, that two tax administrations shall endeavour to resolve the double tax and endeavour means to try. So they have spoken. They have tried and they did not resolve it. And that is why, by the way, the OECD model tax convention was updated later on with the arbitration clause. In the end Glaxo did not resolve the double tax. In the end there was a settlement between Glaxo and the US tax administration. And Glaxo overpaid \$3 billion in additional tax. And it is a shame that we as tax professionals were unable to solve this. Imagine this is just two countries in a disputes on this. There is a bigger challenge when transfer pricing disputes are multilateral.

APPENDIX P

IN-COUNTRY LEGISLATION

This is provided as extra background reading material, an introductory lecture I present in all my TP courses. This sets out important background legal landscape issues.

There are two scenarios that will arise here. Firstly, in many of the instances, you will have specific transfer pricing provisions and then you may have a set of rules or a set of regulations. You need to look out for those and typically those will incorporate or refer to the OECD Transfer Pricing Guidelines or to the United States Practical Guidelines. But in the absence of specific transfer pricing provisions, you would then look at the general anti-avoidance provisions. We come across this in countries such as Malawi, Zimbabwe prior to them creating their own transfer pricing provisions and the Income Tax Act, where reliance is placed on the general anti-avoidance provisions and oftentimes as widely as those provisions are drafted, we find that there is a misapplication by the revenue authorities of those provisions. Therefore, you need to look very carefully. You need to look out for both. Sometimes they will use the general anti-avoidance provisions, even though they have specific transfer pricing provisions. Those are the two things you need to look out for.

Obviously, you need to look out for the associated enterprise or similar definition such as connected persons. You need to look at the arm's length definition and in most cases, you not going to find that so you going to rely on the soft law and the soft laws are the OECD Transfer Pricing Guidelines as well as United Nations Transfer Pricing Practical Guidelines. And remember that transfer pricing affects goods, services, services is considered very broadly. It would typically include intangible properties but it could also affect intangible assets and it will affect all financial transactions where there is a transfer of an amount that might be inflated or understated in the form of interest, loans and the like. It affects a very broad spectrum of assets and rights.

APPENDIX Q

CONSTITUTIONAL LAW AND TREATIES

This is a transcript as part of an introductory lecture I present in all my TP courses. This sets out important background legal landscape issues to identify.

“Besides examining country tax legislation, one needs to look at the Constitution, to assess the rules in that country about the constitutional rights of the taxpayer and administrative law. Looking at South Africa, there are any administrative action and provisions that exist in the South African Constitution. There are specific provisions that attain to the lawfulness, reasonableness and fairness of administrative action. And if that administrative action is not lawful, nor reasonable nor fair, it is invalid and it can be set aside. The reason why this is important is if the revenue authorities conduct an audit and they do not follow the proper administrative action channels, rules and laws, then an opportunity will present itself for you to have that administrative action set aside without even going into the merits of the transfer pricing adjustment. And it gives you a very powerful angle early in the process vis-à-vis the revenue authority. So, it is very important to understand what the Constitution describes as lawful, reasonable and fair conduct on the part of a revenue authority. When interpreting the Constitution, it’s crucial to consider the influence of foreign law, which can provide valuable perspectives and insights. Foreign law often has persuasive value, meaning it can guide and inform decisions without being binding.

In addition to foreign law, it’s essential to look at case precedents to understand how international guidelines, such as those from the OECD and the UN, have been applied and interpreted in various jurisdictions. For instance, the OECD Guidelines for Multinational Enterprises and the UN TP Guidelines have been persuasive in some jurisdictions while in other jurisdictions they are treated as part of the tax law.

When an international treaty is ratified by parliament or congress or the equivalent of parliament or congress, it becomes part and parcel of that country’s laws. When determining whether an international treaty or local law takes precedence, it depends on the legal framework of the country in question. Typically, both laws are considered alongside each other, and efforts are made to reconcile any conflicts between them. If a conflict arises, the legal system of the country will dictate which law takes precedence—

domestic or international. This is often country-specific, requiring an examination of the nation's laws to understand how such conflicts are resolved.

The taxpayer can challenge the tax authority on the constitutionality of their actions and the administrative procedure they follow. Remember once they issue the revised assessments it is at that point in time that they make a decision. What were the facts available to them at that point in time? If they subsequently change their position, should they not issue revised assessments again? It's important to remember that in most legal systems, the revenue authority has a limited period to issue revised assessments. Often, a transfer pricing audit occurs towards the end of this prescribed period. If the authorities issue assessments and later decide to change their methodologies, they would be out of time to issue new revised assessments.

Consequently, they would have to scrap and cancel the original revised assessments they issued.

Those are things that you need to look out for carefully, because if the effect of what they have done means they have actually come up with a new decision then there would be constitutional and administrative law grounds that could be raised in a challenge to have the assessments set aside.

The Constitution flows into administrative law, other than to highlight that when it comes to administrative law, they must give you notice that they are going to audit. They must give you an opportunity to respond, and they must give you proper reasons for what they are going to do in issuing the revised assessments. And if they fail in any one of those, that constitutes an opportunity to challenge their administrative action as being unconstitutional, unlawful, unreasonable, unfair and subject to being set aside by the courts. And you need to establish that quickly, so the moment that it happens you need to review your situation.

We have been very successful with this approach in South Africa. It is a non-technical approach, it is non-technical in the sense that you are not going into the merits of the transfer pricing provisions, but you are tackling the wrongful conduct of the public servants and the revenue authorities in the way in which they conduct their powers.

Do not forget the administrative chapter 4 in the OECD TPGs that deals specifically with the way in which the onus should work and those Guidelines say that it is not right for the different revenue authorities worldwide to stick to their classic onus provisions, they need to approach it differently, because of the complexities of transfer pricing. Look at those particular provisions.

Other relevant treaties and legislation, the Vienna Convention, the bi-lateral investment treaties, the World Trade Organization (GATT & GATTS), just remember with the bi-lateral investment treaties and the World Trade Organization that these are country level fights. Therefore, you would have to convince your country to fight with the other country whose treaty you are in a dis-criminatory point of view but potentially effective."

CASE STUDY 1

TRANSFER PRICING AUDITS

This was an article published giving information about a revenue authority transgressing the taxpayer's rights to a proper letter of findings.

Prof Dr Daniel N Erasmus

Adjunct Professor of Law - Thomas Jefferson School of Law, San Diego, California (USA)

SARS and various revenue authorities within South Africa are increasing their audits of multi-national corporations on transfer pricing issues after sending senior tax officials on a training program in London during 2010. Multi-national corporations according to a recent survey by Ernst & Young conducted worldwide state that MNC's can expect about a 40% chance of being subjected to such a transfer pricing audit. This places transfer pricing as a very high-risk item.

There are a number of issues that Revenue Authorities such as SARS are misapplying in their audit procedures.

It has become practice of SARS to issue a detailed letter of findings at the conclusion of any investigation or audit of a multi-national corporation explaining to them the relevant facts and law in detail that they are going to rely upon in raising additional assessments against the taxpayer. This is in fulfilment of the well-established *audi alterem partem* principle of law in South Africa. Taxpayers on receipt of the letter of findings are then given the opportunity to respond to the detailed findings to give them an opportunity to convince SARS not to raise the additional assessments.

Failure by SARS to adhere to this important procedural step before issuing additional assessments will result in any follow up additional assessments being issued wrongfully and subject to review and being set aside by the High Court in accordance with the Promotion of Administrative Justice Act, 2000 and the Tax Administration Act, 2011.

The writer was successful in acting for and on behalf of a multi-national mining group where SARS issued a letter of findings that was defective. A Court Order was issued against SARS - the effect of which resulted in SARS abandoning its audit and its findings. The benefit to the mining group was some R3.5 billion.

One of the common transfer pricing attacks appears to be around the issue of intra-group service charges. Section

31(2) of the Income Tax Act, 1962 allows the Commissioner to adjust the taxpayer's gross income to compensate for what the Commissioner believes to be an arms-length charge between international group companies. In order for the Commissioner to exercise his discretion he must be satisfied that the charge between these companies is not arm's length. The Commissioner has in practice acknowledged that the exercise of such discretion cannot be based on the estimates and must be supported by evidence to suggest the contrary. A common tactic of SARS is to simply ask the taxpayer to what extent it has complied with the 371 pages of the OECD guidelines on Transfer Pricing, which in itself is an unreasonable question as any such response would take any taxpayer a considerable amount of effort and time to formulate a coherent response. Inevitably the taxpayer gropes in the dark answering the question by usually referring to its transfer pricing policy documents, which contains the manner in which it executes transfer pricing in the group.

What SARS then typically does is not to focus on any comparative analysis done of fair and reasonable service charges compared between the taxpayer and any other intra group relationships set out in a comparable analysis report. Instead, SARS then jumps to the conclusion that the taxpayer has failed to demonstrate that it has received any benefit from the services and in the absence of providing such evidence SARS deems the entire service charge not to be arm's length. This is not bona fide conduct of SARS as, in essence, SARS is suggesting that the taxpayer in question is telling lies about any benefit that may have been received in respect of these services. SARS in effect makes such allegations in the absence of any substantial evidence to support such an allegation.

This type of issue must play itself out in the letter of findings process between SARS and the taxpayer.

For further information on transfer pricing audits please do not hesitate to contact Prof Dr Daniel N. Erasmus (daniel.n.erasmus@me.com).

CASE STUDY 2

FOUNDING AFFIDAVIT ON A REVENUE AUTHORITY FAILING TO FOLLOW THE RULES OF ENGAGEMENT

This application was brought before the Tax Administration Act, 2011 was promulgated in South Africa, where a letter of findings must now be issued by the revenue authority. Thus, parts of this founding affidavit would be changed to reference the relevant sections in that Tax Administration Act, 2011. Do not simply 'copy and paste' this example of an application. Make sure your facts are compelling, and the law in that jurisdiction supports what the draft application attempts to achieve.

The question was asked, is this still relevant? YES – revenue authorities transgress the rules all the time. If this happens at the 'letter of findings' stage, this DRAFT application is useful.

Case Number:

In the matter between:

MNE LIMITED subjected to TRANSFER PRICING audit
and
**COMMISSIONER FOR THE
SOUTH AFRICAN REVENUE SERVICE**

Applicant

Respondent

FOUNDING AFFIDAVIT

I, the undersigned,
NAME OF KEY TAX MANAGER
do hereby make oath and state that:-

1.
 - 1.1. Description of deponent. A resolution confirming authority is annexed as “ANNEX 1”.
 - 1.2. The content of this affidavit is true and correct and falls within my personal knowledge, unless indicated to the contrary. I wish to state that due to my position within the Applicant I have in my possession and under my control all the correspondence, documentation and information relating to the subject matter of the present application.
 - 1.3. Insofar as any submissions are made relating to matters of a legal nature or conclusions, same are done on the basis of the advice of the Applicant’s legal representative and I request the Honourable Court to accept same on such basis.
2. The Applicant is MNE LIMITED details.
3. The Respondent is the COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE of Nr. 299 Bronkhorst Street, Nieuw Muckleneuk, Pretoria, Gauteng.
4.
 - 4.1. The purpose of this application is to seek an order setting aside the additional tax assessment issued by the Respondent on DATE in respect of the DATE tax year of assessment (“the additional assessment”). Applicant will show that the assessment was issued without due process being followed and that it was issued under circumstances where it infringes Applicant’s legitimate expectation of fair administrative action.
 - 4.2. I annex hereto as Annexure “ANNEX 2”, a true copy of the additional assessment raised and issued by the Respondent on DATE. The effect of the additional assessment having been issued is that a substantial portion thereof relates to the Respondent disallowing AMOUNT as an adjustment in terms of Section 31 of the Income Tax Act, No. 58 of 1962 (“the Act”). Accordingly, the Applicant’s taxable income increased by the amount disallowed. I annex hereto as Annexure “ANNEX 3” the original assessment issued by the Respondent in terms of the DATE year of assessment, dated DATE.
 - 4.3. Due to the importance of Section 31 in the understanding of what transpired in the present matter, I herewith quote the section for ease of convenience for the Honourable Court:-
“31(2) Where any goods or services are supplied or acquired in terms of an international agreement and -
(a) the acquirer is a connected person in relation to the supplier; and
(b) the goods or services are supplied or acquired at a price which is either-
(i) less than the price which such goods or services might have been expected to fetch if the parties to the

- transaction had been independent persons dealing at arm's length (such price being the arm's length price); or*
- (ii) *greater than the arm's length price, then, for the purposes of this Act in relation to either the acquirer or supplier, the Commissioner may, in the determination of the taxable income of either the acquirer or supplier, adjust the consideration in respect of the transaction to reflect an arm's length price for the goods or services.* (my own underlining)

5.

- 5.1. In order for the Honourable Court to appreciate why the Applicant felt it necessary to approach the Court for the relief that it seeks, I have been advised that it is necessary to give the Court some background and historical information as to the relationship between the Applicant and the Respondent in general and in particular in respect of the Section 31 issue, which is colloquially referred to as "TRANSFER PRICING" in the correspondence between the parties.
- 5.2. The Applicant is, through a number of other intermediaries, a 100% subsidiary of DESCRIBE WHERE THE APPLICANT FITS INTO THE INTERNATIONAL GROUP STRUCTURE. The background history will demonstrate to the Honourable Court that the Applicant used its best endeavours possible to be open and transparent with the Respondent and deal properly and fully with all issues that have been raised by the Respondent.
- 5.3. Unfortunately the actions of the Respondent in issuing the additional assessment, and the actions thereafter, have led thereto that the Applicant has no choice but to approach the Honourable Court for the relief that it seeks. It has done everything possible in an effort to avoid this scenario, but unfortunately at this point it has no option but to approach the Honourable Court. The issuing of this application is also a last resort and necessary at this point because the 180 (one hundred and eighty) day period within which a review application must be launched under the Promotion of Administrative Justice Act, No. 3 of 2000 ("PAJA") prescribes on DATE.
- 5.4. In the paragraphs below I intend to briefly sketch the background events. I believe that the exchanges and meetings are all common cause and refer to them on such basis to show the exchanges rather than the substantive merits contained therein. As advised, and because this application is of an administrative nature, I shall not dwell on the "merits" of the tax aspects.
- 5.5. During DATE representatives of the Applicant made USUALLY THERE ARE MANY HISTORICAL INTERACTIONS WHICH SHOULD BE DESCRIBED. I annex hereto as Annexure "ANNEX4" a copy of the ATTACH MATERIAL COPIES OF HISTORICAL DOCUMENTS GIVEN TO SARS. To avoid attaching a multitude of documents, we simply attach the index of the lever arch files where the documentation is identified and set-out as Annexure "ANNEX5". I wish to draw the attention of the Honourable Court to key documents, namely DESCRIBE. As part of the presentation Applicant also provided the Respondent with a document titled "Analysis of Comparative Data". This is a report compiled by NAME at the request of the PARENT COMPANY doing a comparative study on service charges as customarily required by Respondent, as part of Applicant's TRANSFER PRICING documentation, to justify service charges paid by the Applicant. In terms of the report a search was performed to identify a set of independent companies that could be used as a benchmark for the provision of comparative services. In Practice Note 7 published by the Respondent in relation to TRANSFER PRICING the Respondent states that it will be guided and influenced by such international comparative studies. The relevant extract from Practice Note 7 states as follows:
- "11.2 The availability of information*
- 11.2.1 In the light of the difficulties which may be encountered in obtaining information on uncontrolled transactions in South Africa, the Commissioner will accept the use of foreign country comparables (e.g., data from the Australian, United Kingdom and United States markets) in taxpayers' transfer pricing analyses. However, taxpayers using such comparables would be expected to assess the expected impact of geographic differences and other factors on the price."*
- 5.6. NAME used the NAME commercial database of United Kingdom company information as the basis for its research in order to find a suitable benchmark for the provision of management services. They identified hundreds of comparable independent companies. The result was a median average full cost markup of X% for such service charges.
- 5.7. SET OUT THE HISTORICAL CORRESPONDENCE EXCHANGED BETWEEN THE PARTIES CULMINATING IN THE ADDITIONAL ASSESSMENT. I annex a true copy of the aforementioned letter hereto as Annexure "ANNEX6".

This was after a DATE year hiatus between the presentation and “ANNEX6”. HIGHLIGHT TIME GAPS BETWEEN INTERACTIONS.

5.8. ...

5.14. On DATE, a conference call took place between the representatives of the Applicant, including myself, and the Respondent where the looming prescription date was discussed. During such conference call, the Respondent’s representatives indicated that in the event that the Applicant should not be prepared to grant the required extension of the prescription period, as requested by the Respondent, the Respondent would simply issue an additional assessment disallowing the full amount claimed for the DATE tax year. In fact, it appeared that the Respondent was making a very thinly veiled threat against the Applicant. Such threat, as appears hereunder, was later given effect to.

5.15. 5.15 ...

5.16. It is clear from this letter that the Respondent was of the view that it still did not have sufficient information to be able to properly judge and appreciate the Applicant’s position. Considering the massive input of information that had been delivered by the Applicant to the Respondent over the preceding years, since before DATE, we could not understand the Respondent’s position that it still required further information at this late stage, some PERIOD years after the extensive initial information was supplied to Respondent.

5.17. In the Applicant’s letter of DATE (“ANNEX13”), this fact was pointed out to the Respondent’s offices and, because certainty now had to be reached, we declined to extend the prescription period. The following is stated in the letter:-

“As to your request that we extend the date of prescription for the DATE transfer pricing review, (against a suggestion that you may elect to disallow a deduction of approximately RXXX million if we do not consent to an extension), we advise that we cannot accede to your request in view of the history of this matter.”

5.18. The next event was that on DATE, a further letter was received headed “TRANSFER PRICING – LETTER OF ASSESSMENT, YEAR OF ASSESSMENT DATE” to which the actual additional assessment annexed hereto as Annexure “ANNEX2” was attached. I annex a true copy of the aforementioned letter hereto as Annexure “ANNEX14”. In this letter, the Respondent purports to disallow the expenditure and to raise the additional assessment on the basis that they purport not to have the information necessary to be able to make a determination. As shall be dealt with hereunder, this purported lack of knowledge and inability to make a proper assessment is contrived and what the Respondent simply did, was issue the additional assessment on the last day it believed it could do so, just prior to the relevant period prescribing (in Respondent’s view), and disallowed the entire claim in respect of what is known as “TRANSFER PRICING”. It shall be submitted and argued to the Honourable Court that what the Respondent did was not bona fide; it did not follow fair, proper and transparent administrative process and this in itself makes the decision to issue the additional assessment reviewable and capable of being set aside. It is incomprehensible, when one considers the ambit of the discretion awarded in terms of Section 31(2), that the Respondent when faced with the discretion of determining what amount constitutes an “arm’s length transaction” could not allocate even a single cent in value to the transactions.

5.19. There is, however, a further extremely important issue that comes to the fore. It is now trite procedure that the Respondent is under an obligation before it issues any additional assessments, after a review and audit process by its offices, to issue a document that is known as a “letter of findings”, in terms whereof a taxpayer is given an opportunity to respond to and deal with the detailed findings that the Respondent has made and upon which the Respondent proposes to take a certain course of action, including the issuing of additional assessments for the payment of further taxes. Such letter of findings satisfies the requirement of audi alteram partem and ensures a fair, transparent and lawful administrative process in a democratic society.

5.20. In the present instance, the Respondent failed to issue any such letter of findings and failed to give the Applicant the opportunity to respond to such a letter of findings before the additional assessment was issued. This legitimate expectation that the Applicant has to be treated fairly and properly in such manner was not met and, accordingly, the additional assessment is fatally defective due to the failure of the Respondent to meet this legitimate expectation. This aspect constitutes but one of the defective administrative processes dealt with in this application. The importance of this legitimate expectation cannot be overstated and I am advised that full argument on this aspect shall be addressed before the Honourable Court.

-
- 5.21. In fact, when one considers the further actions by the Respondent it becomes quite clear that what the Respondent did, was to avoid its perceived problem that it would have in respect of prescription in respect of the DATE tax year, namely; that it simply, without due and proper consideration, and in a mala fide manner and in contravention of the legitimate expectation to deliver a proper, or in fact any, letter of findings, issued an additional assessment so as to beat the perceived prescription date of DATE.
- 5.22. The importance of the “letter of findings” can be emphasized by giving one simple example with reference to the letter of assessment, “ANNEX14”. In such letter the Respondent now, out of the blue, disallows the amount set out above on the basis that there is “no benefit” for the Applicant from these transactions. This completely new reason given by the Respondent had never been suggested before and came as a complete surprise. Should the Respondent have issued a “letter of findings”, as it is required to do, to the Applicant with the reasons that appear in “ANNEX14”, the Applicant could and would have responded thereto, as it legitimately expected and had the administrative right to do and would have explained why the Respondent’s disallowance of all the service charges was not bona fide and wrong in the absence of the Respondent producing any evidence that Applicant’s deduction was contrived in toto. Instead the Applicant is faced with a fait accompli necessitating the launch of this application.
- 5.23. Furthermore the present application, as has been stated above, is an application based upon the tenets of administrative and constitutional law and stands separate and apart of the process that can be followed by the Applicant in terms of the Act.
- 5.24. Subsequent to the issuing of the additional assessment, the Respondent has directed further enquiries to the Applicant in respect of the very same DATE tax year. The Respondent has sought responses to a multitude of questions and further information. The Applicant has done its best to engage with the Respondent in the hope that the Respondent would see reason and withdraw its additional assessment. The Respondent, however, has not done so and the Applicant has been left in the invidious position that it has now become necessary to approach the Honourable Court for the relief that it seeks in order to protect its rights.
- 5.25. ...
- 5.30. Subsequent to various meetings and during discussions with some of the Applicant’s other legal representatives it became apparent that the decision taken by the Respondent on DATE was capable of being reviewed but that the 180 (one hundred and eighty) days time limit prescribed in PAJA expires on DATE. Accordingly the Applicant was advised that the application would have to be launched and served by DATE.
- 5.31. As indicated previously the Applicant was reluctant to enter into unnecessary litigation and as such contact was made with X of the Respondent to determine if there was any prospect of avoiding this litigation and to inform him of such possibility. In a telephonic conversation between X and I on the afternoon of DATE X indicated to me that he was fully satisfied with the work done by the Transfer Pricing division and that the Respondent stood by its decision to issue the additional assessment. On such basis the Applicant has proceeded to bring this application. A letter was also sent to X dealing with the above. A true copy of the letter is annexed as “ANNEX18”.

6.

- 6.1. As indicated and alluded to previously, the Applicant has been extremely reluctant to engage in litigation with the Respondent. I now feel it necessary to explain to the Honourable Court why this statement has been made.
- 6.2. BACKGROUND TO THE MNE.
- 6.3. The Respondent cannot dispute the levels of co-operation that the Applicant has at all times shown towards the Respondent and its obligations.
- 6.4. The Applicant views the actions of the Respondent, in not dealing in a fair administrative manner with the Applicant, in an extremely serious light. Obviously, the additional amount of taxation that has become payable due to the additional assessment, plus any interest and penalties that may yet still be imposed, affects the financial position of the Applicant. In this regard, the Applicant has to report to its shareholders and file audited reports, which indicate what its obligations and liabilities are. Due to the fact that the amount is now payable in terms of the ‘pay now argue later’ rule, it is a current liability of the Applicant until the position has been altered.

7.

- 7.1. The Applicant is advised that in the circumstances above, the decision by the Respondent to issue the additional assessment stands to be challenged on an administrative basis for all the reasons as set out above.
- 7.2. It is clear when one has an overview of all the correspondence that we have referred the Honourable Court to that the Respondent failed to exercise the discretion that is afforded to him in terms of Section 31 of the Act. The failure to properly apply his mind to the issues, we submit, appears clearly from the correspondence that took place after the decision had been taken, which resulted after all the correspondence and excessive delays and time periods that preceded the decision. To put it simply for the Respondent, due to self-created time constraints to then issue an additional assessment for the purported reasons given, does not constitute fair and lawful administrative process.
- 7.3. Numerous requests were responded to, meetings held, presentations made and vast quantities of information and documentation supplied to the Respondent. Notwithstanding same, the Respondent appeared to keep reverting with the similar questions. Years passed between the questions. This fact is amply demonstrated by the fact that the Respondent simply disallowed the entire amount, without considering and properly applying his mind to the appropriate allocation of the amounts claimed. As such, it appears that the Respondent did not properly consider the matter and apply his mind thereto and/or in excess of a period of PERIOD years which culminated in the additional assessment being issued without a letter of findings.
- 7.4. Furthermore, as indicated above, the fact that prescription was due to occur in respect of the DATE tax year on DATE (which date was erroneously calculated by the Respondent) led thereto that the disallowing of the amount and the issuing of the assessment was done for an ulterior purpose other than a proper exercise of the discretion allocated or allowed for in terms of Section 31. The ulterior purpose was to escape the consequences of the Respondent's inaction and the failure to have properly considered all matters and information supplied over many years to the Respondent. To avoid these consequences, the Respondent simply issued the additional assessment disallowing the entire amount. It shall be argued that this constitutes a mala fide purpose or an ulterior purpose other than the proper application of the Act.
- 7.5. Lastly, the doctrine of legitimate expectation is an important issue in the present matter. As clearly indicated above, the Applicant, as well as all other taxpayers, has a legitimate expectation when its returns or assessments are reconsidered and reviewed by a process such as that carried out by the Respondent, that prior to the issuing of any additional assessments, a letter of findings has to be prepared and presented to the taxpayer, in this case the Applicant, for its consideration and response.
- 7.6. This legitimate expectation of a letter of findings was confirmed by former Commissioner Mr. Pravin Gordhan when he stated under oath in unreported case number 4594 / 02 that:
"... upon conclusion of the audit, the view is held that there is additional income not declared by the applicant for which it should be assessed, the applicant will be informed of the basis of such conclusions. The applicant will be given an opportunity to respond to such views ... prior to the issue of the assessment."
(my own underlining)
This letter of findings has become common practice followed by the Respondent upon conclusion of an investigation or an audit before issuing any form of assessments. In the event that the Respondent should challenge same, which I am advised would be extremely surprising, I annex hereto as Annexure "ANNEX19" the relevant extracts of the affidavit.
- 7.7. In the present instance, as clearly evidenced above, no such letter of findings was ever prepared and presented to the Applicant, due obviously to the fact that the Respondent simply ran out of time before the assumed prescription date, and that same constitutes a serious breach of the legitimate expectation that the Applicant has to fair, transparent and lawful administrative process.
- 7.8. I am advised that the Respondent's decision to issue the additional assessment is subject to review and of being set aside in terms of the Promotion of Administrative Justice Act, No. 3 of 2000 and in particular Section 6 thereof in that the taking of the decision was:
 - 7.8.1. procedurally unfair;
 - 7.8.2. taken for an ulterior motive or purpose;
 - 7.8.3. taken after relevant considerations were not considered;
 - 7.8.4. in bad faith;

-
- 7.8.5. taken arbitrarily or capriciously;
 - 7.8.6. not rationally connected to the purpose of the empowering provision or the information before the Respondent or the purported reasons given for it by the Respondent;
 - 7.8.7. otherwise unconstitutional or unlawful.

8.

Even at this very late stage, should the Respondent decide not to oppose this application the Applicant shall not seek a cost order against the Respondent. Should the Respondent however oppose this application the Applicant will seek a cost order, such costs to include the costs occasioned by the employment of two counsel.

9.

In these circumstances and for the reasons set out above, the decision by the Respondent to issue the additional assessment on DATE stands to be reviewed and set aside. As such the Applicant prays for an order as detailed in its Notice of Motion.

DEPONENT

THUS SWORN TO AND SIGNED BEFORE ME AT _____ ON THIS, THE _____ DAY OF ____ 20____,
THE DEPONENT HAVING ACKNOWLEDGED THAT HE UNDERSTANDS THE CONTENTS OF THIS AFFIDAVIT, AND THAT THE
CONTENTS THEREOF ARE TRUE, THAT HE HAS NO OBJECTION TO THE TAKING OF THE OATH AND THAT HE CONSIDERS
THIS OATH TO BE BINDING ON HIS CONSCIENCE.

COMMISSIONER OF OATHS

FULL NAME:

CAPACITY:

ADDRESS:

CASE STUDY 3

HIGH COURT OF ZIMBABWE JUDGMENT ON MANAGEMENT FEES: *X V ZIMBABWE REVENUE AUTHORITY (HH 32-22, ITC 17/17)*

Read this case in contradistinction to the content of **Appendix C6**. As stated previously, this was a management fees case argued by me in Zimbabwe, where we presented similar evidence to what is set out below. The court found against us. Yet in the extracts below setting out evidence arguments, the similar evidence presented by the taxpayer in the tax trial was considered convincing. The judge in our tax trial in **Case Study 3** was a retired magistrate with no tax trial experience. Was that the reason for the difference? Be that as it may, we approached the tax trial on the basis we would most likely lose, and made sure the evidence was carefully recorded for the purposes of going on appeal to the Supreme Court. The matter is currently on appeal.

This redacted case illustrates how a tax court will favour the revenue authority despite extensive evidence presented to prove the management fee charges paid by the taxpayer. This case was lost at trial but has proceeded to an appeal to the Zimbabwean Supreme Court.

Pay careful attention to the BOLD portions of the redacted judgment and the rejection by the tax court of secondary evidence provided to justify that the management services were in fact provided.

Furthermore, this case must be read in conjunction with another similar case set out in **Appendix C6**.

The case can be summarised as follows:

BACKGROUND

The appellant, a Zimbabwean bread manufacturing company, was audited by ZIMRA for tax years 2010–2015.

The appellant, a Zimbabwean bread manufacturing company, was audited by ZIMRA for tax years 2010–2015. The company is a subsidiary of a listed Zimbabwean conglomerate (XX) and part of a shared services structure.

ZIMRA raised assessments on several grounds, including:

- Unreported fringe benefits (bread and canteen meals);

-
- Questionable management fee deductions;
 - Improper VAT claims;
 - Lack of withholding on payments to foreign technicians; and
 - Disallowed capital allowances on a power feeder.

KEY ISSUES IN DISPUTE

- Whether the 2010 tax year could be reassessed after the 6-year limitation period;
- Whether management fees paid to the parent company were deductible;
- Whether canteen meals provided to factory workers constituted taxable employee benefits;
- Whether those canteen expenses were deductible for the employer; and
- Validity of a 30% penalty imposed by the tax authority.

TAX COURT RULINGS

Reopening of 2010 Assessment:

Upheld ZIMRA's right to reassess 2010 based on misrepresentation and non-disclosure, in terms of Section 47 of the Income Tax Act.

Management Fees:

Disallowed. While contracts existed between the parent and the appellant, no sufficient evidence (timesheets, cost build-ups, specific proof of services rendered) was provided. The tax court ignored the extensive corroborating evidence provided by the taxpayer's witnesses in this regard. The court held that invoices were vague and non-compliant with VAT Act standards. The tax court held that a contract alone does not prove services were actually rendered.

Canteen Meals (Taxable Benefit):

For factory workers, the meals were not taxable fringe benefits.

The meals were deemed necessary for operational continuity (24/7 shifts), and not for hospitality or employee compensation.

Hence, meals did not constitute gross income under Section 8(1)(f).

Canteen Expenses (Deductibility):

Allowed as a deductible business expense under Section 15(2)(a).

The primary benefit was to the employer's operations, not the employees.

Penalty:

Reduced from 30% to 20%.

While the taxpayer acted on legal advice, it failed to meet legal invoice requirements and provide adequate documentation.

FINAL ORDERS

- The appeal was allowed in part.
- ZIMRA's assessments on management fees were upheld.

-
- Assessments on canteen meal benefits were reversed.
 - Penalty reduced to 20%.
 - Case remitted to ZIMRA to issue revised assessments.

LESSONS LEARNED

Burden of Proof Rests on the Taxpayer

Legal Principle:

Under section 63 of the Income Tax Act, the taxpayer bears the onus of proof to demonstrate that ZIMRA's assessment was incorrect.

Key Takeaway

Taxpayers must provide substantial, detailed, and reliable evidence to support their claims, especially when claiming deductions, exemptions, or adjustments.

Mere assertions, assumptions, or incomplete documentation will not suffice to discharge this burden.

Importance of Proper Documentation for Deductions

Legal Principle

For deductions under section 15(2)(a) of the Act, the taxpayer must prove that expenses were incurred for the purposes of trade or income production.

Key Takeaway

Taxpayers should maintain accurate and comprehensive records to substantiate:

Actual services rendered;

Cost build-up of fees; and

Evidence that claimed expenses are directly related to income production.

Invoices and Service Level Agreements (SLAs) must meet statutory requirements. Failure to comply can result in disallowed deductions.

Mere Existence of a Contract Does Not Prove Services Were Rendered

Legal Principle

The signing of an SLA or contract does not automatically create a legal obligation for tax deduction.

A taxpayer must show that services were actually rendered and that the fees claimed are commensurate with the services provided.

Key Takeaway

Pre-determined or subscription-based fees (like DSTV subscriptions) are not deductible without proof that actual services were provided.

Payments made without evidence of services rendered will not be deductible.

Valid Invoices Are Mandatory for Deductions

Legal Principle

Section 20(4) of the VAT Act requires that tax invoices must contain key information such as:

- Description of goods or services.
- Quantity or volume of goods or services supplied.

Key Takeaway

Non-compliance with invoice requirements renders the claim invalid, and erroneous acceptance of invalid invoices by

ZIMRA officials does not validate them.

Taxpayers should ensure that all invoices meet legal standards to avoid disallowance of claims.

Penalties Are Linked to Intent and Compliance

Legal Principle

Penalties under tax laws are imposed based on intent and degree of non-compliance.

A penalty of 30% was reduced to 20% in this case because X was found to have misunderstood the law rather than intentionally evading tax.

Key Takeaway

Good faith mistakes may result in a reduction of penalties.

However, taxpayers with professional expertise should take extra precautions to comply with legal requirements, as ignorance of the law is not a defense.

Revenue Authorities Cannot Dictate Business Decisions

Legal Principle

Revenue authorities are not able to dictate business decisions or impose hindsight judgments about what is reasonable for a business.

Key Takeaway

Courts will uphold the taxpayer's decisions where they are made in the ordinary course of business and not for the purpose of avoiding tax.

Taxpayers have discretion to choose their business strategies, and authorities should not substitute their own views.

Application of OECD Transfer Pricing Guidelines

Legal Principle

Transfer pricing adjustments should follow OECD Transfer Pricing Guidelines when determining the arm's length nature of intercompany transactions.

Key Takeaway

Multinational companies must ensure that intercompany transactions meet the arm's length standard and are properly documented.

Inconsistent or arbitrary application of transfer pricing methods can be challenged.

Consistency in Evidence and Witness Testimony

Legal Principle

Contradictory witness testimonies weaken a taxpayer's case.

Key Takeaway

Witnesses must be consistent and demonstrate first-hand knowledge of the facts.

Inconsistent testimonies can lead to adverse findings.

Final Lessons for Taxpayers

Maintain comprehensive records and comply with documentation requirements.

Ensure that all claimed expenses are verifiable and incurred for the purpose of trade.

Avoid pre-determined fees without verifying services rendered.

Be cautious of inconsistencies in witness testimony that may harm the taxpayer's credibility.

By following these lessons, taxpayers can reduce the risk of adverse findings in tax audits and litigation.

On Appeal

The tax court decision has gone on appeal and a Supreme Court decision from Zimbabwe is awaited as of March 2025.

A similar judgment that went in favour of the taxpayer

In a similar matter that went on appeal, between the Zimbabwe Revenue Authority (ZIMRA) and Nestlé Zimbabwe over tax deductions totaling US\$15.9 million, the Supreme Court dismissed ZIMRA's appeal, upholding the High Court's ruling in favour of Nestlé. The court found that the tax assessments issued by ZIMRA for the years 2009 to 2013 were invalid, as they did not conform to the requirements of the Income Tax Act.

The following is an extract from that judgment relevant to this case study. Note the acceptance by the court of the evidence presented by the taxpayer, contrary to what happened in the tax court in **Case Study 3**, where the evidence, as presented in detail, was not accepted as convincing by the tax court.

This extract is followed by a summary of at the end of this case study is a summary of lessons learned:

[c] Shared services

- [30] ZRA disallowed the amount Nestle paid to Nestle Central and West Africa's Nestle Business Services [NBS] allegedly for accounting and human resources functions on the basis that such functions are materially performed by Nestle's locally based personnel. In the course of its audit, ZIMRA held interviews with certain of Nestle's employees in accounts and human resources and came to the conclusion that their functions were substantially the same as those performed by NBS.
- [31] During her evidence, Ngare took the court through the agreement on shared services, the employee interviews, the relevant job descriptions, graphs, pictures and so on, and concluded that there was no such duplication of services as claimed by ZRA. She said the local functions were dissimilar to those rendered from abroad.
- [32] The whole of this appeal presents issues that dog the courts from time to time in ZRA's relations with multinationals. On the one hand ZRA is entitled to scrutinize and question intragroup business models that may appear to be mere tax evasion schemes. It has the statutory mandate to collect taxes and protect the fiscus from errant tax planning schemes. On the other hand, businesses are entitled to adopt models or concepts that offer the best advantage in the reduction of the cost of doing business for optimum profitability. The position is settled that the central revenue collector cannot assume an armchair position and decide for businesses how to run their operations: see *IAB Co v ZRA HH 32-22*, at p 12 of the cyclostyled judgment.
- [33] In the instant case, having scrutinised the relevant documents on the shared services, the results of the employee interviews and Ngare's evidence, we are satisfied that Nestle has proved on a balance of probabilities that there was no duplication of services in the expenses that were disallowed by ZRA. There are differences, admittedly marginal in some respects, between the functions of Nestle's local personnel and the services that it receives from its affiliates from abroad. But it is too sweeping a conclusion that the services rendered by Nestle's affiliates abroad were the same as those performed by its local personnel here. Consequently, ZRA's decision on this expenditure item should be set aside.

[d] Research services

- [34] In terms of the management services agreement, Nestle also pays service costs which comprise, among others, direct or indirect expenses, charges, overheads and administration costs. ZRA disallowed expenses claimed by Nestle in relation to certain analytical quality tests conducted by an affiliate in a laboratory in Singapore under

the rubric 'research services'.

[35] ZRA's basis for disallowing the deduction for such services was that Nestle could not pay royalties to the owner of the brand, Soci  t   Des Produits Nestle SA, when it was its obligation to account for any research associated with food safety. Ngare testified that each of the Nestle group laboratories is equipped with specialised equipment. She said that any testing is referred to a laboratory with the appropriate equipment; that Nestle laboratory here does not have such capacity; that there had been no laboratory testing in years 2014, 2017 and 2018, and that no research fees had been claimed in respect of those years.

[36] Our findings are that the research or analytical fee was not paid to the owner of the brand but to an affiliate with the appropriate laboratory apparatus. An affiliate tests the products after the manufacture to ensure product compliance with specifications and standards as a guarantee for food safety. We are satisfied that such a cost is classically deductible in terms of s 15[2][a] of the Act in respect of the years in which it was claimed. The High Court had previously ruled in favour of Nestl   on several disputed tax deductions, including royalties, shared services, research services, and canteen meals. The court also set aside a 40% penalty imposed by ZIMRA, finding no evidence of deliberate tax evasion by Nestl  .

The detailed in the judgment available at: <https://zimlil.org/akn/zw/judgment/zwwhc/2024/236/eng@2024-06-11>.

In summary, the Supreme Court's decision affirmed that ZIMRA's assessments were invalid and that Nestl  's tax deductions were legitimate, thereby dismissing ZIMRA's appeal.

THIS IS THE FULL JUDGMENT ON MANAGEMENT FEES – X VS ZIMBABWE REVENUE AUTHORITY IN THE TAX COURT OF ZIMBABWE HH 32-22 ITC 17/17

NDOU AJ

HARARE 20 January 2020, 20 April 2021 & 19 January 2022

Assessors: Ms R. Kangai
Mr W. Mandinde

Income Tax Appeal

D.N. Erasmus with J. Muchada, for the appellant

T. Magwaliba, for the respondent

NDOU AJ: The respondent is a body corporate established in terms of the Revenue authority Act [Chapter 23:11]. It is an administrative authority responsible for revenue collection, inter alia, in terms of the Income Tax Act [Chapter 23:08] (herein referred to as the Act).

The taxation system involves submission of self-assessment returns by certain categories of taxpayers of which the appellant is one of them.

The respondent carries out periodic audits and investigations on taxpayers to ensure full compliance with the Act since it does not have the capacity to scrutinize every self-assessment return submitted by taxpayers.

The respondent embarked on an investigation of the appellant, which is in the business of making and selling bread in the country, to check and confirm if the appellant was compliant with the provisions of the Act.

From these investigations the respondent was concerned by a number of issues. I will revert to these issues later in this judgment.

The appellant, X, is a wholly owned subsidiary of XX, where XX holds all the ordinary shares. XX is a diversified conglomerate operating a management and investment holding company for its subsidiaries and associate companies. XX is incorporated in Zimbabwe and listed in the Zimbabwe Stock Exchange. The XX Group is involved in the manufacturing, procurement, distribution and marketing of commodities for its food manufacturing, supermarket and restaurant divisions and the provision of managerial and entrepreneurial skills. The activities are undertaken through various group operating divisions and companies. As alluded to above, the appellant is a private limited company specializing in the production and distribution of bread. It began operations as a small division of ZZ until 2010, when it was incorporated as a subsidiary in terms of ZIMRA approved scheme of reconstruction. The effective date of the transaction was 1 January 2010, XX comprises of a team of functional experts with experience and technical expertise, working to support the operations of the group companies and divisions, including the appellant, through the provision of management support services in terms of the Service Level Assessment ("SLA"). Through its shared service centre, XX acts as centre of excellence constituting of a team of people that provide collaboration and use of best practice around specific focus areas to drive business results, as reflected in the appellant's overall increased production. XX operates in the following areas:

- (a) Strategy and corporate finance;
- (b) Group corporate affairs executive;
- (c) Financial reporting;
- (d) Procurement;
- (e) Legal;
- (f) Tax;
- (g) Internal audit; and
- (h) Treasury.

Coming back to the investigations carried out on the appellant's tax affairs, the respondent concluded the following:

- (i) The appellant was giving at least three (3) loaves of bread per week to both its factory and administrative

employees. This was a benefit that the employees were getting as a result of the employment relationship. The appellant was not subjecting the bread benefit to taxation in the hands of the employee.

- (j) The appellant operates a canteen where meals are prepared and served to all its employees for free. This was another benefit that the employees were getting. Again the appellant was not subjecting this benefit to tax in the hands of the employees.
- (k) Value Added Tax: In part Tax was being wrongfully claimed by the appellant in respect of duplicate invoices.
- (l) Pre-determined management fees expenses were being claimed as a deduction against income which the appellant failed to ... and submit documentary proof confirming that there were management services actually rendered by its parent company. Neither could they prove the cost build-up of the pre-claimed fee.
- (m) Capital Allowances were being claimed for an electricity deducted feeder, which the respondent believed belonged to ZETDC.
- (n) Non-resident tax on fees was not being withheld on technical fees that were being paid to foreigners who were attending to their bread plant.

The respondent proceeded to tax the bread benefit and canteen meals benefit in the hands of the employees. It also proceeded to disallow the input tax on duplicated invoices from its VAT computations. NRTF was computed and charged. The respondent also disallowed management fees and canteen meals expenditure from the income tax computations. Assessments were duly issued to correct these anomalies on 17 July 2017 in respect of 2010, 2011, 2012, 2013, 2014 and 2015 tax years. The appellant agreed to have the input tax claims disallowed from the VAT returns. The appellant also agreed to have the bread benefit taxed in the hands of the employees. The on-resident tax on fees was not disputed. As for the canteen meals benefit the appellant only agreed to have the administrative staff taxed on such meals.

Four issues have remained in contention between the parties, namely (1) the taxation of meal benefit for factory workers, (2) the deductibility of canteen meals expense against income in the hands of the appellant, (3) the deductibility of the management fees against income and (4) the claiming of capital allowances for the dedicated feeder. On 18 July 2017, the appellant lodged an objection to the amended assessments in terms of s62 of the Act. In that objection, the appellant raised seven (7) grounds of objections as follows:

- (i) Prescription of additional assessment for 2010;
- (ii) Disallowance of management fees;
- (iii) Disallowance of canteen meals;
- (iv) Taxing of canteen meals provided for factory workers;
- (v) Disallowance of capital allowances claimed in respect of the dedicated feeder;
- (vi) Directive to effect some adjustments highlighted under (i) to (v) for 2016 and 2017;
- (vii) Penalty and interest charged.

The Commissioner considered these grounds of objection and disallowed six grounds of objection in full and allowed in full one ground relating to the dedicated feeder after it was proved that the feeder belonged to the appellant. This led to the appellant to lodge the present appeal before this court in terms of s65 of the Act. Despite the voluminous and intimidating documents which have been filed in this appeal, the issues for determination are fairly straight forward and simple.

The issues were set out in a joint pre-hearing minute executed between the parties on 14 January 2020. These are the following:

- (a) Whether the Commissioner of the respondent was entitled to adjust the 2010 tax year assessments in terms of s47 of the Act, after the prescription period of six (6) years had expired?
- (b) Whether the appellant received management services from XX during the period extending from the tax year 2010 to the tax year 2015?
- (c) In the event that the appellant received management services from XX, whether the full amount of the fees or any portion thereof are deductible in computing the income tax liability of the appellant in each of the tax years in issue?
- (d) Whether the value of canteen meals provided by the appellant to its factory workers constituted gross income in the hands of those factory workers in terms of s8(1)(f) of the Act and therefore liability to PAYE.

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- (e) Whether or not the appellant was entitled to deduct the expenditure incurred by it in the provision of canteen meals to its factory workers, in terms of s15 (2)(a) of the Act?
 - (f) Whether in the circumstances, the 30% penalty levied by the respondent was appropriate?

1. The decision by respondent not to lead evidence

It is trite that the onus lies on the taxpayer to show that the Commissioner's opinion or satisfaction was wrong – see s63 of the Act and *CF (Pvt) Ltd v ZIMRA HH-99-18 at p24*. S63 affirms the common law position as set out in *Pillay v Krishna 1946 AD 946 at 951-2* as follows:

“If one person claims something from another in a court of law, he has to satisfy the court that he is entitled to it ... But there is a third rule, which Voet states as follows: ‘He who asserts, proves and not he who denies, since a denial of a fact cannot naturally be proved provided that it is fact that is denied ad that denial is absolute’ ... The onus is on the person who alleges something and not on his opponent who merely denies it.”

In this case the respondent decided not to lead oral evidence. The respondent's position is that the appellant has not discharged the onus upon it notwithstanding the fact that the respondent did not lead evidence. The respondent argues that the appellant's witnesses did not testify as to anything that would have been in the knowledge of the officers of the respondent which could be contradicted by them.

There is no adverse inference which can be drawn on the failure by the respondent to lead evidence. In *Siffman v Knel 1909 TS 536 at 543* it was stated:

“It does not follow, because evidence is uncontradicted, that therefore it is true ... The story told by the person on who the onus rests may be so improbable as not to discharge it.”

It is the respondent's case that the question is not one of the appellant's story being so improbable. It is one where in a large measure, the evidence simply does not measure up to the mark. In other words, the evidence is not sufficient to discharge the onus on a balance of probabilities. Further reliance was placed on the case of *Nelson v Marich 1952 (3) SA 140 (A)* at 149A-D where the rule was stated as follows:

“The fact that there was not evidence to contradict the evidence given by the defendant does not mean that the court is bound to accept the defendant's evidence.”

Further, reference was made to *Sigournay v Gillbanks 1960 (2) SA 552 (A) at 558 H* where it was stated:

“The onus was on the plaintiff and although the defendant could have investigating the matter further by cross-examination it was necessary for the court to consider whether, to quote DE VILLIERS JP, in Union Market Agency Ltd v Glick & Co 1927 OPD 285 at 288, the evidence of M. Fonder on the point was “sufficiently substantial, detailed, reliable and satisfactory” to prove what he deposed to. Uncontradicted evidence, is not necessarily acceptable evidence.”

The appellant contended that the burden of proof stated in s63 must be discharged on a balance of probabilities and all that is required in this regard from the tax payer is to tilt the scales of justice slightly in its favour. The appellant relied on *H Ltd v Commissioner of Taxes 34 SATC 57 1925 TPD* where it was held that when it comes to determining those balance of probabilities that are two main lines of approach, which are not mutually exclusive, namely, credibility and probability. In determining whether a witness is to be believed or not, the court must have regard to the probability of his story. But there may be cases where probability will have to yield to credibility for a court may believe a witness, despite improbabilities in his evidence and where it does so it may find that any burden of proof resting on him has been discharged. Where the probabilities are evenly balances, a finding of credibility might well be the determining factor.

Furthermore, when it comes to weighing up probabilities, it must be remembered that a trial judge is not concerned with what is or is not probable when dealing with abstract businessman or ... men, but he is concerned with what is probable and what is not probable as regards to the particular individual situation in the particular circumstances in which they were.

With this in mind I now propose to deal with the issues articulated above in turn.

2. Prescription in terms of s47 of the Act

The Appellant contends that the respondent was not entitled to adjust the 2010 tax year assessment on account of the provisions of s47 of the Act. The appellant's position is that the 2010 tax year is prescribed in terms of s47 (1) (3) of the Act, which provides as follows:

“47 Additional assessments

- (1) If the Commissioner, having made an assessment on any tax payer, later considers that –
 - (a) an amount of taxable income which should have been charged to tax has not been charged to tax; or
 - (b) in the determination of an assess loss –
 - (i) An amount of income which should have been taken into account has not been taken into account; or
 - (ii) An amount has been allowed as a deduction from income which should not have been allowed; or
 - (c) any sum granted by way of a credit should not have been granted; he shall adjust such assessment so as to charge to tax such amount of taxable income or to reduce such assessed loss or to withdraw or vary such credit, and if any tax is due either additionally, or alternatively, call upon the tax payer to pay the correct amount of tax;

Provided that –

 - (i) No such adjustments or call upon the tax payer shall be made if the assessment was made in accordance with practice generally prevailing at the time the assessment was made;
 - (ii) Subject to proviso (i), no such adjustment or call upon the tax payer shall be made after six years from the end of the relevant year of assessment the, unless the Commissioner is satisfied that the adjustment or call is necessary as a result of fraud, misrepresentation or wilful non-disclosure of facts, in which case the adjustment or call may be made at any time thereafter;
 - (iii) The powers conferred by this subsection shall not be continued so as to permit the Commissioner to vary any decision made by him in terms of subsection (4) of section sixty-two.
- (2) Sections forty-five and forty-six shall apply to any assessments or additional assessments or to a call for the payment of any additional sum in respect of a credit made by the Commissioner under the ... appellants conferred by subsection (1)”.

From these provisions, in order for the Commissioner to raise additional assessments in terms of s47(1) (ii) of the Act, there are two elements in respect of which the Commissioner must be satisfied. Firstly, he must be satisfied that there was fraud, misrepresentation or wilful non-disclosure of material facts.

If he is so satisfied, then secondly, he must also be satisfied that the full amount of tax chargeable which was not assessed, was as a result of such fraud, misrepresentation or non-disclosure of material facts – *SIR v Trow* 43 SATC 189. On the one hand, the appellants posits that a period of more than six years having gone by, in the year 2017, which the adjustment was made by the respondent, the respondent no longer had the power to adjust the assessment rendered by the appellant on account of extinctive prescription.

On the other hand, the respondent while admitting that the period of six years had gone by, relies on s47 (1) (ii) supra, which permits the Commissioner to re-open and assess after the prescriptive period if there existed fraud, misrepresentation or wilful non-disclosure of material facts. This is made clear by the letter that the Commissioner wrote to the appellants on 23 November 201. In the said letter the Commissioner stated the following –

“After a tax investigation was conducted, it was discovered that the client entertainment costs attributed

to the provision of canteen meals and management fees expenses which were not commensurate with the actual work done. Addition, it was observed that employees take (PAYE) payments made to this office excluded canteen meal benefits enjoyed by the client's employees ...

Based on the above observation and comments, your client made misrepresentations in the returns submitted to this office by not making the correct declarations and information that was supposed to be disclosed. This resulted in the underpayment of income tax and payee for the 2010 and other tax years affected.

I am therefore of the view that the prescriptive provisions are not applicable under the circumstances and section 47 (1) (ii) of the Act was correctly applied."

It is trite that the appellant was obliged to subtract self-assessments and did so in terms of s37A of the Act. These returns, however, did not disclose the true position in relation to the canteen meals and management fees. They contained a misrepresentation. It is beyond dispute that the appellant provided meals to both factory workers and administrative employees based at its bread manufacturing factory in Harare. In the evidence led on appeal, the appellant chose to persist with the objection in relation to the meals afforded to factory workers. It abandoned the objection in relation to the administrative staff. Once it is admitted that the appellant claimed as a deduction in terms of s15 (2) (9) of the Act, meals provided to administrative staff which cost the appellant subsequently conceded not to have been properly deducted then the Commissioner was entitled to re-open the assessments in respect of the relevant years. The tax returns and the financial statements contained the concealment of the treatment of management fees and canteen meals. These claimants did not disclose that the appellant was deducting canteen meals where it had no right to do so i.e. in relation to administrative staff. On this admitted misrepresentation along, the respondent was entitled to re-open the 2010 assessment. It is not necessary to deal with the alleged misrepresentation in relation to provision of canteen meals to factory workers and management fees at this juncture. Once there is a misrepresentation, the entire assessment can be opened. The assessment should not be broken into bits and pieces for the purposes of re-opening under s47. Accordingly, in this issue I find in favour of the respondent that the Commissioner correctly re-opened the assessment for the year 2010.

3. The decision to disallow in full the claim of management fees s15 (2) (a)

In the determination, the Commissioner contends that the appellant failed to substantiate and submit proof that the services involved were rendered to the appellant by its holding company hence the management fees were disallowed under the provisions of s15 (2) (a). It is, however, necessary to define the ambit of the inquiry in casu, in view of the agreed issue set out in paragraph 1.3 of the joint minute between the parties. In the event that management services were rendered by XX to the appellant, in terms of issue 1.3, supra I must proceed to determine whether

"... the full amount of any portion thereof of the management fees ... are deductible in computing the income tax liability of the appellant in each of the tax years."

The framing of this issue in this fashion takes into account the wording of s5 (2) (a). s15 (2) (a) reads:

"15 (2) The deductions allowed shall be –

- (a) Expenditure and losses to the extent to which they are incurred for the purposes of trade or in production of income ..." (emphasis added)

This provision requires that the tax payer establishes "the extent" to which any losses or expenditure have been incurred for the purposes of its trade or for the production of income. It is not sufficient for the tax payer to prove that services were rendered. The tax payer must go further to prove that the services were rendered to the full extent for the purposes of its trade or the production of income.

In *Z (Pvt) Ltd v ZIMRA 2014 (2) ZLR 568 (H)* at 575A KUDYA J (as he then was) correctly amplified this test as follows:

In *Commissioner of Taxes v Rendle* 463 (A) in fine 466; 1965 (1) SA 59 (SRA) at 62H – 63D (which was followed by *SMITH J in S (Pvt) Ltd v Commissioner of Taxes* 1985 (4) SA 34 (ZH) at 383 -39D), BEADLE CJ stated that:

“The broad test which is now universally applied was laid down by WATERMEYER AJP in Port Elizabeth Electricity Tramway Co v Commissioner for Inland Revenue 1936 CPD 241 at 246. This test, with slight alteration in the wording was approved by the Appellate Division in Commissioner of Inland Revenue v Gem & Co (Pty) Ltd 1955 (3) SA 293 (A) at 299, and the test as modified by the Appellate Division has subsequently been approved by the Appellate Division in the Commissioner for Inland Revenue v African Oxygen Ltd 1963 (1) SA 681 (A) at 688 and in task, which may now be regarded as the accepted test, is as follows:

All expenses attached to the performing of a business operation bona fide performed for the purposes of any income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the ... performance of such operation provided they are so closely connected with it that it would be proper, natural or reasonable to regard the expenses as part of the cost of performing the operation.”

It is beyond material dispute that during the period under review, the holding company, IAL housed group functions such as Internal Audit, Tax, Legal and Secretarial, Strategy, Operations and Corporate Communication. The appellant provided the respondent with management services contracts in place between the appellant and its holding company, which detail the services provided. It also availed to the respondent invoices relating the management fees including detailed explanation of the nature of the services that are rendered from a group level.

In a nutshell the issue here is whether or not the appellant received management services from its holding company for the tax years 2010 to 2015. **The appellant adduced a considerable amount of evidence during the hearing. It relied on the oral evidence (supported by documents) from the Group Director of XX, the Company Secretary, the XX Group Tax Officer RG and Finance Director of appellant. Most of the testimony of these high profile witnesses evinces the entrepreneurial skills of the highly qualified people of the helm of XX and the impact thereof on the appellant.** From a business point of view of the holding company, XX and the appellant and other subsidiaries are admirably run. The XX is a diversified conglomerate, operating as a management holding company for its subsidiaries and associate companies. XX is incorporated in Zimbabwe and is listed on the Zimbabwe Stock Exchange (“ZSE”). The Group is involved in the manufacture, procurement, distribution and marketing of commodities for its food manufacturing and in the provision of managerial and entrepreneurial skills. These activities are undertaken through various Group operating divisions and companies. The appellant one of such of the subsidiary companies. The appellant’s modus operandi has already been highlighted in the preceding paragraph. Suffice to say that XX comprises of a team of functional experts which vest experience and technical expertise, working to support the operations of the Group companies including the appellant, through the provision of management support services. Through its corporate office, XX acts as a centre of excellence consisting of a team of people that promote collaboration and use of best practices around specific focus areas to drive business results as reflected in the appellant’s overall increase production and financial indicators. The shared service centre arrangement, as adopted by the Group in casu, is common among multinational companies in today’s business environment where a Group can rely on professional in-house expertise while reducing overall cost for the administration and management of the business. It would be expensive from a Group perspective, to duplicate the common functions at each operational subsidiary level. This approach allows the Group entities to access professional support at reasonable expense.

Against this background, I propose to highlight the relevant services for which management fees were invoiced in this matter for this tax period under review.

(a) Strategic support service

These services provide the basis for selecting lines of business, choosing an organization structure and operating procedures, analyzing and undertaking acquisitions and divestitures and responding to competitors and to market forces. XX, according to the testimony adduced, provides strategic advice aimed at growing the business. This resulted in the expansion of the appellant’s production capacity to the current 600 000 loaves per day from 300 000 loaves per

day. This also resulted in the appellant having the most technologically advanced plant in the country. This evidence was given in detail during the hearing with aid of video recording of the bread manufacturing exercise. The appellant also benefited from efficient and economic delivery of its bread because of its fleet identified and serviced at XX level and access to better delivery platforms.

(b) Supplier negotiations

Given XX's long standing suppliers and wider business relationships as it has been active, established and successful in the industry, it leverages from these relationships to provide assistance to the appellant through negotiation of favourable supply terms.

(c) Treasury function

The holding company ensures that the appellant secures cheaper financial facilities, secures long term facilities and provides guaranteed facilities. A cash pool is a banking structure which allows the balances on a number of separate accounts to be treated collectively. The concentration of surplus cash into one account generally managed by the Group treasury improves the company's control over cash. Use of a cash pool can also help a company to improve its liquidity management, as total cash balances are managed centrally rather than locally. Were XX is experiencing cash shortfalls, it is funded from the master account at a cheaper rate than could be obtained locally or from external providers.

(d) Project Management Support

On an individual entity basis, if certain strategic projects are being undertaken XX heavily involved from a strategic and technical perspective, in designing, advising and provision of strategic input. The appellant would be involved in the direct implementation of the projects themselves, however with oversight from the holding company ... as and when required. In the circumstances, the appellant benefits from the extensive senior project management skills and expertise of XX, which enhances its capabilities to implement appropriate strategies and ultimately drive revenue.

(e) Finance and Revenue

XX supports the appellant with various functions that enable the efficient running of the financial function. The support produced by XX leads to economies of scale as well as savings for the appellant as the company does not require a large contingency of finance staff or staff with financial qualifications to perform the functions required.

(f) Legal and regulatory affairs

XX provides advice on company secretarial and legal issues. It also provides legal opinion and legal advice concerning the activities of the appellant. The support from XX leads to economies of scale as well as the savings for the appellant.

(g) Tax services

The appellant is generally responsible for its own tax functions. XX asserts with the review of the tax computations every quarter, VAT returns, input tax claims and documentation. XX also asserts Group companies such as the appellant obtain clearance certificates and attend to any tax queries from the revenue authority. This is a summation of the material aspects of the appellant's evidence alluded to above.

3. Deducting of management fees

The respondent's Commissioner disallowed the management fees primarily on three grounds:

Firstly, there was insufficient evidence of actual services rendered.

Secondly, the appellant did not provide a cost build-up of the pre-determined fees.

Thirdly there was no proof of unique expertise that was available at XX which not available at the appellant, which warranted the supply of such services by to the appellant.

These three grounds relied upon by the Commissioner have been considered in proper context. IT is trite that a parent company can arrange for a wide scope of services to be available to its subsidiaries, in particular, technical, financial and commercial services. In an integrated group, the board of directors and senior management of the parent company make all important decisions concerning the affairs of its subsidiaries and the parent company, or another subsidiary may carry out all marketing, training and treasury functions – OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators at 7.2 and 7.4.

Further the revenue authority cannot place itself in the armchair of a businessman or in the position of the Board of Directors and assume the role of deciding what is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize its profit. The tax authorities must put themselves in the shoes of the tax payer and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman – *SA Builders Ltd v CIT* (2006) 289 ITR 26 (SC). Further, I agree with what was stated by Australia's Full Federal Court on the function of the tax authorities and fiscal legislation. In *FC of T v BHP Billion Finance Ltd* 2010 ATC 20169 at paragraph [18] the said court quoted with approval from *Tweddle v FCT* (1942) 180 CLR at 7 where WILLIAMS J staid that:

"It is not suggested that it is the function of the Income Tax Acts or those who administer them to dictate to tax payers in what business they should engage or how to run their business profitably or economically. The Act must operate upon the result of the tax payer's activities as it finds the. If a tax payer is in fact engaged in two businesses, one profitable and the other showing a loss, the Commissioner is not entitled to say he must close down the unprofitable business and cut his losses even if it might be better in his own interests and although it certainly would be better in the interests of the Commissioner if he did as: Tooley's Ltd v Commissioner of Taxation (NSW) (1922) 22 SR (NSW) 432 at pp 4044, J"

Further, in *Income Tax case number (1847) 73 SATC 126* the court reminded the Commissioner of SARS after the latter had disallowed management and marketing fees paid by a subsidiary to its holding company that:

"it is not for the court or the Commissioner to say, with the benefit of hindsight be disallowed on the basis that it was not strictly 'necessary', or that it was not as effective as it could have been. If the purpose of the expenditure was to produce income, in the course of trade, and the expenditure was not of a capital nature, then that is sufficient. Accordingly, the respondent was wrong in his assessment of these fees."

In this said case the court accepted that, many a time a subsidiary is utterly dependent on its holding company for its effective functioning. The holding company had used its muscle as a long established public company, to raise capital for the tax payer and from the evidence it was clear the tax payer needed the management input of the holding company and received it. It need the global vision and strategic advice of the cosmopolitan, internationally experienced team from the holding company. The management service fees charged by the holding company to the subsidiary were held to be in line with the norm in the industry.

I will now consider the evidence before me in light of the above principles. In this case it is beyond material dispute that the management fees charged by the holding company to the appellant were pre-determined at the beginning of each year and subsequently invoices were then issued in respect of each month in the year whether or not the service was actually supplied. The position of the respondent is corroborated by the evidence of the appellant. The Group Finance Director likened the charges for management fees levied by the XX to subscriptions for DSTV which were pre-determined and prepaid notwithstanding the fact that the customer does not on a particular day choose to watch the programs provided. When the respondent requested the cost build up or the evidence of the services that were rendered by XX to the appellant, no such evidence or cost build up was produced. The only documents produced were the contracts between XX and the appellant. Such contracts did not prove that in fact services had been rendered to the appellant by XX. The best they showed was that XX was available to render the services as and when they were required by the appellant. Even in

the documents produced by the appellant the cost build up could not be established. These documents are secondary evidence, which do not show who authored them, when they were authored and why. They bear no evidence as to when they were presented, if at all, to the respondent. It is trite law in this jurisdiction that in respect of management services, the obligation to pay for such services does not arise upon the signing of a service level agreement between the holding company and its subsidiary. The obligation is incurred when services are actually rendered.

In *CF (Pvt) Ltd*, supra at p39, KUDYA J (as he then was) had this to say:

“The principle of law that LEWIS JP appears to have approved in Commissioner of Tax v A, supra, at 415G-H by reference to two Australian cases of Federal Commissioner of Taxes v James Flood (Pty) Ltd (1953) 88 CLR 493 and Nevill & Co. Ltd v Federal Commissioner of Taxation and the English case of Edward Collins and Son Ltd v IRC 12 TC 773 at 783 was that an expenditure or loss arising from the terms and conditions set out in a contract is incurred when the contracted work is performed. This view is supported by the underlying words by WATERMEYER AJP in Port Elizabeth Electric Tramway Co. Ltd v CIR 85 SATC 13 (1936 CPD 241) who at p15 stated that:

‘But expenses ‘actually incurred’ cannot mean actually paid. So long as the liability to pay them actually has been incurred they may be deductible ... The clear principle arising from these cases is that the unconditional obligation to pay is incurred when the work is done or the services rendered. In my view, the provision made in respect of the audit fees constituted a contingent liability, the performance of which was “impending, threatened or expected” in the future. The appellant wrongly sought to deduct in the years in which the provisions were made.’ In casu, the dispute does not relate to whether the expenditure is “actually incurred” or “actually paid”. The legal dispute concern the determination as to when expenditure is “actually incurred” in circumstances where a payment has already been made on the basis of a contractual document but without evidence that the contracted services was “actually rendered”.

The determination as to whether the appellant is correct or not is two-fold.

Firstly, the determination is whether the conclusion of a contract for service necessarily means that the services have been rendered. Put differently, the question is whether a payment made pursuant to the conclusion of service level contract amounts to incurring expenditure for purposes of deductions permissible in terms of s15 (2)(a) of the Act. In my view, the signing of the service level agreement is not sufficient for the appellant to incur obligation to pay management fees. In the circumstances I have to determine, the second issue i.e. whether in fact any services were rendered by XX, and if so, what the services were and how much was charged in respect of services. This two-stage inquiry is evinced by the splitting of the issues in the joint minute of the parties. The first issue being the question management services were rendered by XX and the second being a determination of the extent of such services.

I am in agreement with the contention of the respondent that the execution of a service level agreement between the appellant and its holding company, XX, does not amount to incurring any legal obligation in respect of management fees. Like any other contract, the incurrance of a legal obligation depends on the performance by the parties of their obligations in terms of the contract. There being no evidence that the appellant received specified services from XX during the tax period under consideration (and if so the extent thereof) no legal obligation was incurred by the appellant in respect to of management fees.

In other words, the appellant succeeded in establishing the existence of contractual relationship between it and its holding company. **It, however, did lead evidence to establish that services were rendered to it by the holding company pursuant to the service level contract and the extent of such service. It failed to prove a cost build-up of the pre-determined fees when required to do so by the respondent.** The evidence of the Group Finance Director, supra, was not helpful in this regard. He was not employed by XX in this between 2010 and 2011 i.e. the relevant tax period in *casu*. His testimony primarily comprises a rationalization of facts as gathered from company documents. He conceded that there were people who could competently speak to the activities undertaken by XX in so far as they related to appellant between the years 2010 and 2011. It is trite that not every employee can give evidence on behalf

of a corporate body such as the appellant. Any such employee must have been at the relevant time, been placed within the corporate governance structure of the corporate entity so as to enable him or her to have knowledge of the facts which he or she testifies to. Such knowledge must be derived from the employee's personal contact with the transactions in issue or from their position in the company which allows him or her access to the relevant information – *Antonio v Ashanti Goldfields Zimbabwe & Anor 2009 (2) ZLR 272 (H) at 384D-E*. The position of this witness at the relevant time did not allow him to personally deal with the interaction between the appellant and XX. In any event his evidence is harmless to the case of the respondent. In most respects it constitutes nothing more than a restatement of common cause facts or a ... of the respondent's position. From his evidence it can be gleaned that the strategic decision to unbundle the bread making business commenced in 2010 and was completed in 2015. It is not clear what fees were chargeable under the service level agreement for the tax period 2010 – 2011. **He gave detailed evidence of expertise and experience of management of XX at the disposal of the appellant. With due respect, he appellant, in casu, is required to prove that in fact, it received management services from XX. The service legal agreements signed by appellant and XX merely establish the contractual relationship as alluded to above. The invoices issued by XX to the appellant did not provide sufficient evidence to confirm that the services under contention were rendered. Even in court such evidence was not forthcoming from the witness. The witness made detailed reference to a presentation document made to the respondent on 20 November 2018. This is a secondary document. It, however, does not show that in fact any services were rendered by XX to the appellant.** The service documents upon which the summary is based were not produced either to the respondent or this court. The person who prepared it was not identified with any clarity in the appellant's evidence. **No one can therefore vouch for the correctness of the entries in the document. The document does not refer to the service level agreements which it purports to give birth to the numbers set out therein. No minutes, emails or any other documents confirm that in fact the charges related to any services that were in fact actually rendered. The testimony of this witness and indeed that of the Company Secretary was to the effect that the figures were arrived at taking into account what was reasonable on the market.** Reference was made to bench-marking the charges against reputable companies which supplied similar services. There is nothing wrong with bench-marking. Hereunder there must be reliable evidence of such bench-marking. Such reputable companies and their charges should be evinced, otherwise it seems no more than a retrospective rationalization of figures, extrapolated in order to justify the invoices that had been issued between 2010 and 2015. The document does not even state the particular date on which it was made. The witness admitted that it was prepared in order to "access certain information gaps that ZIMRA had identified." It is trite that the performance of the contracted services is a matter of evidence. The appellant failed to produce such evidence. In any event, some of the services would only be rendered once a year. For instance, tax services would be rendered at the time when the submission of tax returns was at hand. The monthly charge therefore did not take into account whether the services were actually rendered in that particular month or not. It was simply a standard charge that was raised. This shows the falsity of the service level agreement contracted between the appellant and XX.

The Company Secretary also testified that he personally drafted the service level agreement between the appellant and XX. He admitted that some of the agreements were replicated with errors for the years 2010 to 2015. He stated that employees, directors or shareholders at XX provided services to appellant. Naturally, because XX was the shareholder in the appellant, in their course of business, these persons dealt with some aspects of the business of the appellant. What, however, did not clearly come out of his testimony is the dichotomy between the said persons, including himself serving XX and serving the appellant. XX existed for its own purposes for which it was not entitled to charge the appellant. He stated that because of the strategic interventions of the XX shared services centre, the appellant made substantial savings in fuel procurement, insurance premiums, legal services, audit services etc. That may be so to some extent. But he confirmed that it was difficult to quantify the time spent by the officers of XX on business of the appellant since none of them kept timesheets. Further the issue was raised with this witness – whether the invoices issued by XX to appellant met the legal requirements of invoice. It is trite that the meaning of the noun "invoice" given in the Shorter Oxford Dictionary is: 'a list of the particular items of goods shipped or sent to a factory, consignee or purchaser, with their value or prices and charges'. And the meaning of the verb 'to invoice' is given as: 'to make an invoice of, to enter in an invoice'. The basic idea at the root of the noun 'invoice' seems to be a list of the things sent away or shipped, not necessarily, to a buyer – *Universal Shipping Co (Pty) Ltd v Weston Distributing Co. 1946 NPD 260 at 263*. Strictly speaking these documents in law were in fact not invoices. They were accepted by the appellant as invoices and paid upon. In the circumstances it is either no services would have been tendered by XX for certain periods but all the same wanted payments to be made to XX or that some services would be rendered but all the same XX wanted to be paid for all the

services. The Group Tax Officer's testimony was essentially an attempt to establish that services were rendered, in respect of tax advice to appellant. There is, however, nothing which evinces exactly when the services were rendered and how much was charged for the services.

The Finance Director for appellant testified and his testimony remarkably contradicted that of the Group Financial Director of XX on the fundamental premise upon which the notices in issue were raised. He contended that the invoices were issued on the basis of services rendered and by implication suggested that if the services were not rendered for any particular portion of the period concerned, the appellant would not be obliged to pay XX. In contradiction the Group Finance Director had testified that the rendering of a service was not a pre-requisite for the charge which XX raised on a monthly basis to the appellant. The evidence of these witnesses was therefore mutually destructive. The appellant's Finance Director stated that the yearly fees were registered and agreed upon the commencement of the year. He however, had not documents as proof of such negotiations on the fees. He did not provide any rational basis for the charge which was raised by XX to the appellant. He also admitted XX exists for its own purposes and does not exist to provide service to the subsidiary only. It was therefore, necessary to separate the functions of the employees, directors and shareholders of XX in pursuant interests of XX as against the interests of the appellant as a subsidiary. He conceded that the invoices were not itemizing the services rendered. The acceptance of an irregular invoice by the respondent does not make the appellant compliant with the law. S20 (4) of the Value Added Tax Act requires that a tax invoice must contain particulars including –

“(e) a description of the goods or services supplied;

(g) The quantity or volume of the goods, or services supplied” These provisions are mandatory and anything done in contravention thereof is a nullity – *Schirhout v Minister of Justice* 1926 AD 99 at 109; *X-tend-A-Home (Pty) Ltd v Hoselaw Investments (Pvt) Ltd* 2000 (2) ZLR 48 (S); *Manning v Manning* 1986 (2) ZLR 1 (S).

In any event erroneous acceptance of invalid invoices by the respondent's officials would not validate them – *R v Board of Inland Revenue XP. MFK Underwriting Agencies Ltd & Ors* [1997] ALL ER 91 at 100d-j; AG exp – *Imperial Chemical Industries PLC* (1986) 60 TCI at 64; *Vestcy v ICR (No. 1)* [1977] 3 ALL ER 1075 at 1098 [1979] ch ITI 177 and *Commissioner of Taxes v Astra Holding (Pvt) Ltd* 2003 (1) ZLR 417 (S).

From these authorities it is trite that “one should be taxed by laws, and not untaxed by commissions” or errors of revenue officers.

From the foregoing it is clear that the appellant's case on the issue of management fees must fail.

4. Whether canteen meals provided to factory workers are taxable

The evidence of the appellant on canteen meals was primarily from three witnesses. What the evidence showed is that factory workers based at appellant's factory were supplied with meals. Such meals were not supplied in the factory and at the post of duty. The workers exited the factory floor and had a break from work for about fifteen (15) minutes and consumed the meal in a canteen outside the factory. *In casu*, the appellant's employees do not continue with their duties while having the meal. They exit the factory to the canteen and are relieved of their duties and re-enter to resume their duties after they have had their meal. The respondent relies on the decision of this court in *ITC 1934 (1938) SATC 119 (Z)*. In this case the court ruled that the provisions of meals to employees constitutes entertainment where the employees are not required to continue with their duties during the meal. It only constitutes an allowable deduction in the production of income of the taxpayer – if the employees are required to continue with their duties. *In casu*, the factory workers do not continue with their duties while having the meal. The respondent on the one hand contends that there is a taxable benefit on the canteen meals provided by the appellant. The respondent relies on s8 (1) (f) of the Act. The appellant, on the other hand submits that the employees are not deriving any benefits from the canteen meals as this provision is purely designed to meet the employment conditions. In terms of s8 (1) (f) of the Act, the taxable benefit only arises in cases where the employees derive some benefit therefrom. The legislature, under s8 (1) (f), *supra*, excludes from taxation any advantage or benefit in so far as it is used, consumed or enjoyed for the purposes of the business transactions of the employer. The “employee's business purpose”, test should be applied to the meals in order to determine whether they are taxable or not.

My understanding is that as general rule the provision of a meal to an employee may well constitute “entertainment” as envisaged in s16 (1) (m) of the Act. The scenario in *ITC 1394 (1984) 47 SATC*, supra is an exception to the said general i.e. lunch for bank tellers that were required to work through lunch to continue with their duties during the meal ...” This is, however, not the only exception. The facts of this case present another exception. The meals here are provided more beneficial to the employer as they are designed to primarily meet the business objectives of the employers rather than to create an advantage or benefit in the hands of the employee i.e. they are non-compensatory. There is a clear link to the business objectives than to a supposed benefit in the hands of the employees. This is akin to the “employer business purpose test in the United States jurisprudence – *Commissioner v Kawalsk* 434 U.S. 77 (1977); *Caratan v Commissioner* 442 F 2d 606 (1971) and *Boyd Gaming Corp. v Commissioner* 177F 3d 1096 (9th Cir 1999). In this case should the employer not have provided the employees with meals this would introduce additional business risk in the form of increased monitoring of employee movements in and out of their work location, additional disruptions to business continuity including the potential of increased tardiness as well as health and safety risks should employees not in fact eat meals.

Accordingly, the meals are provided to employees in the interest of the appellant's business. The canteen meals provided to employees cannot be classified as entertainment. The primary purpose of the meals is not to be hospitable. The hospitality aspect is absent in this scenario as the primary purpose of providing the meals is to ensure minimal business disruption and continuity given the appellant operates continuously 24 hours a day and every day of the year. The expenditure is closely connected with the production of income and would be allowable under s15 (2) (a) of the Act – *Port Elizabeth Electric Tramway Co. Ltd v CIR*, supra, and *ITC 81820 SATC 507*. S16 of the Act which enlists the prohibited deductions is not an absolute prohibition, but is subject to the Act. The preamble to s16 (1) states that “save as is otherwise expressly provided in this Act, no deductions shall be made in respect of the following matters.” Thus, if there are any provisions in this Act, which provides otherwise, in respect of any of the prohibited deductions that provision will prevail over s16. In other words, s16 of the Act is subservient to the other provisions of the Act which provide otherwise. S15 (2) (a) sets out the general deduction formula, such that any business expenses that meets the prescribed formula is deductible. While a canteen meal expense may fit under the ordinary grammatical meaning of entertainment that should not be the end of the enquiry for deductibility of such expense. The next enquiry is whether, it qualifies for deduction under s15 or any other provision of the Act which provides for deductions. The legislature never intended all entertainment expenses to be prohibited from deduction, because if that was the intention they could have adopted a provision which absolutely prohibits the expenses. However, the legislature was alive that while some expense may fall under the ordinary meaning of entertainment, they will still be deductible if they were incurred under the criteria set for deduction in terms of s15 or any other provision of the Act.

Before I conclude on the issue I wish to highlight the contention by the appellant on why the employees have to have meals at a canteen just on periphery of their work site. The alternative is to allow them to bring their home prepared food, the risk of contaminating the bread being manufactured is very high. In the event the Council Health Regulations would not allow such consumption of food brought from outside in the factory baking site. On the issue of canteen meals for factory workers the appeal should be allowed.

Penalty

The penalty is now only applicable to the issue of management fees. On this issue the appeal is unsuccessful in its entirety. In the case of Income tax case No. 1725. 64 SATC 223, the court held that the penalizing section enjoins the Commissioner or the court to conduct an inquiry on the intention of the taxpayer. The respondent is enjoined to inquire whether in defaulting the taxpayer had the intention of evading tax. Where no such intention exists there is no justification for a penalty – Income Tax case No. 1725, 64, supra. In this case the appellant believed in its interpretation of the law. But with the expertise at its disposal, the appellant should have used proper invoices which meet the minimum requirements of the law. While a case has been made for the reduction of the penalty, I am not persuaded that I should reduce it in its entirety. I will accordingly reduce it to 20%.

Disposition

In light of the foregoing I accordingly order that:

1. The appeal is allowed in part.

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2. On the issue of management fees, the appeal is dismissed and assessments issued on 17 July 2017 are hereby confirmed.
 3. On the issue of canteen meals for factory worker the appeal is allowed and the resultant assessment issued by the respondent set aside.
 4. The matter is remitted to the respondent for the issuance of a revised assessment in keeping with the terms of this judgment stated in paragraph 3, above.
 5. The penalty is reduced to 20% in respect of the contents of paragraph 2 above.
 6. Each party shall bear its own costs.

More key Lessons Learned in X v Zimbabwe Revenue Authority

Substance over Form

Tax deductibility depends not just on having a contract, but on actual performance of services and proof thereof.

Documentation is Everything

- Maintain detailed records, including:
- Timesheets,
- Service descriptions,
- Benchmarking reports, and
- Properly itemised invoices.

Cost Allocation Matters

Shared services from a holding company must show clear benefit and cost allocation to the subsidiary.

Burden of Proof is on the Taxpayer

Especially in self-assessment systems, the taxpayer must prove deductions on a balance of probabilities.

Avoid Blanket Charges

Fixed monthly charges (like DSTV-style subscriptions) not tied to actual services are not deductible.

Tax Planning Must Align with Compliance

Business efficiency (shared services) must still align with tax law requirements, or risk disallowances.

Re-opening of Past Assessments

Misrepresentation, even if unintentional, gives tax authorities power to revisit older years under s47.

CASE STUDY 4

MY FIRST 3-WEEK TP TAX TRIAL

This was my first 3-week TP tax trial in front of a judge who consistently found in favour of ZIMRA. We knew we would lose the tax court trial but were meticulous in the presentation of the evidence to present a complete record of the evidence to the Supreme Court in Zimbabwe.

Unfortunately, the taxpayer decided not to persist with the appeal, as the amount of tax in the Zimbabwean currency devalued to such an extent against the US\$ it was easier simply to pay the tax. The group had also restructured to eliminate the problems encountered in Zimbabwe.

The main issue that we argued was that prior to the introduction of specific TP adjustment legislation in Zimbabwe, the general anti-avoidance provisions could not be relied upon to make TP adjustments by ZIMRA.

Here is a summary of the case:

BACKGROUND

The appellant was a Zimbabwe Stock Exchange-listed multinational enterprise in the hybrid seed industry. It underwent an internal reorganization in 2005, creating a flagship subsidiary to manage operations while the parent company became a non-operational investment holding company. Between 2009–2012, ZIMRA audited the group. Based on intra-group transactions (management fees and royalties), ZIMRA raised assessments totaling over US\$5.7 million, citing s 98 (the general anti-avoidance provision) of the Income Tax Act. The appellant objected and then appealed the Commissioner's decisions.

KEY ISSUES ON APPEAL IN THE TAX COURT

- Applicability of OECD Transfer Pricing Guidelines (TPGs) in Zimbabwe during 2009–2012.
- Whether ZIMRA lawfully applied s 98 in imputing management fees and royalties.
- Whether ZIMRA correctly computed taxable income.
- Whether the penalties imposed were appropriate.

KEY FINDINGS

OECD Guidelines Not Applicable in Zimbabwe, before TP legislation was introduced to Zimbabwe

The court found that OECD TPGs were not legislated in Zimbabwe and had not achieved customary international law status¹.

Section 326 of the Constitution allows for application of customary international law, but the OECD guidelines did not meet the consistency and universality tests.

Therefore, the Commissioner was correct in not applying the OECD guidelines.

MANAGEMENT FEES

The court found that the appellant was the true employer of group personnel who provided services to all subsidiaries.

Although the flagship company received management fees at cost, this was deemed a “transaction, operation or scheme” (TOS) under s 98 designed to divert income and reduce tax liability.

Charging at cost (with no mark-up) was found to be non-arm’s length and abnormal.

The Commissioner was justified in imputing a mark-up of 25% based on group profitability and in taxing the imputed management fees to the appellant.

ROYALTIES

Five trademarks were legally owned by the appellant. These were used across the group and even transferred to the Botswana subsidiary without legal backing.

Royalties paid by foreign subsidiaries for research and marketing were deemed to have accrued in Zimbabwe, as the intellectual property (e.g., germplasm and know-how) originated there.

The use of the appellant’s trademarks constituted royalty-generating events. Attempts to divert that income to the Botswana subsidiary were invalid.

The Commissioner correctly applied s 98 and imputed royalties to the appellant based on an industry rate of 3.5% of sales.

This finding was disputed in the draft appeal, on the basis that the general anti-avoidance provision could not be relied upon to make TP adjustments.

PENALTIES

The Commissioner initially imposed a 60% penalty, later increasing it to 100% due to the appellant’s misconduct, which included withholding documents and misleading ZIMRA.

The court upheld the 100% penalty, noting deliberate attempts to mislead the tax authority.

1 See OECD TPG 2022, Preface, para 17

LESSONS LEARNED IN CONDUCTING A TRANSFER PRICING TRIAL IN X VERSUS THE COMMISSIONER-GENERAL ZIMBABWE REVENUE AUTHORITY

Substance Over Form

Courts look beyond legal structuring to the economic substance and control of functions, assets, and risks. Simply transferring operations to a subsidiary doesn't absolve the parent of tax obligations if it still performs core functions.

Inconsistent or Incomplete Documentation Harms Credibility

The appellant's failure to maintain consistent employment records, misleading emails, and withholding of agreements undermined its case.

OECD TPGs Must Be Legislated to Be Binding

Unless explicitly incorporated into local law, international guidelines like the OECD TPGs do not override domestic tax provisions.

Expert Evidence Must Be Unbiased and Thorough

The court was critical of the appellant's expert, calling her testimony biased and noting flaws in her analysis, such as selective data use and failure to account for relevant legal distinctions. This finding was disputed in the draft appeal.

The Burden of Proof Lies with the Taxpayer

Since the appellant challenged ZIMRA's assessments, it bore the burden of proving them incorrect, which it failed to do.

Outcome

- The tax court appeal was dismissed in its entirety;
- ZIMRA's amended assessments for management fees and royalties were upheld;
- A 100% penalty was confirmed; and
- Each party was ordered to bear its own costs.

THIS IS THE FULL JUDGMENT ON ROYALTIES – X VERSUS THE COMMISSIONER-GENERAL ZIMBABWE REVENUE AUTHORITY

THE SPECIAL COURT FOR INCOME TAX APPEALS

KUDYA J

HARARE, 4, 5, 6, 7, 8, 11, 12, 13, 14, 18, 19, 21 March 2019 and 30 June 2021

This judgment followed a previous case, *X v Commissioner General-Zimbabwe Revenue authority* HH 648/18, which dismissed the appellant's preliminary points. The main issues in this appeal are the applicability of OECD Transfer Pricing Guidelines in Zimbabwe from 2009 to 2012, the lawful application of the general anti-avoidance provision, the correct computation of income tax, and the appropriateness of penalties imposed.

The appellant, a major player in the hybrid seed industry listed on the Zimbabwe Stock Exchange, controlled a network of foreign subsidiaries in over 15 countries. The respondent, Zimbabwe's tax authority, audited the appellant's flagship local subsidiary for the 2009 to 2012 tax years, revealing that the appellant had not submitted tax returns for this period. The audit focused on transactions involving management fees and royalties, leading to a tax review and issuance of notices of assessment in November 2013. The appellant objected to these assessments, but the Commissioner disallowed the objections and increased the penalty to 100%. The appellant then filed an appeal against the Commissioner's decision.

The appellant argued that the Commissioner erred by not applying the OECD Transfer Pricing Guidelines and incorrectly imposed royalties, management fees, and penalties under s 98 of the Income Tax Act. The respondent countered that the Commissioner correctly used her discretion under s 98, appropriately calculated the royalties and fees, and imposed a reduced penalty of 75%. Additionally, the respondent maintained that the OECD guidelines were not mandatory for the assessment.

An expert in OECD Transfer Pricing Guidelines, reviewed 12 Royaltystat databases on transfer pricing agreements in the agricultural industry. She found that royalties were generally charged along with other intangibles like patents and technology, but not separately for trademarks in the hybrid seed industry. The respondent calculated the appellant's net profit margin and reworked it to a cost-plus 25% mark-up, which the expert criticized as flawed. The expert also noted that the OECD guidelines were not law in Zimbabwe and that the appellant's management fees were higher than they should have been. The court found that the expert's testimony was biased and failed to establish the applicability of the OECD guidelines in Zimbabwe. The expert's review of agreements was insufficient to support the claim that trademarks in the hybrid seed industry had no independent value. The court also noted that the expert failed to demonstrate the propriety of housing head office functions in a subsidiary. The expert's computations did not apply the OECD guidelines consistently. The court concluded that the expert's testimony was unreliable and that the appellant's management services were not limited to maize sales. Lastly, the court found that the expert's review of Royaltystat agreements was incomplete and biased.

The appellant argued that the OECD Transfer Pricing Guidelines (TPGs) were applicable in Zimbabwe as customary international law, but the Commissioner disagreed, stating they had not achieved such status. The Commissioner argued that the guidelines could only be considered customary international norms. Sections 46(1)(c) and 327 of the Zimbabwean Constitution exclude the application of international conventions, treaties, and agreements not domesticated into Zimbabwean law, while section 326 allows for the use of customary international law if consistent with the Constitution and local legislation. Jens Wittendorff's book supports the view that the OECD TPGs do not qualify as customary international law. The court found that the guidelines are not binding in Zimbabwe and remain subject to periodic reviews, lacking the consistency required for customary international law. The appellant failed to prove that the guidelines had the force of law in Zimbabwe. The Commissioner correctly disregarded the guidelines in raising the assessments. The court concluded that the appellant's use of the guidelines was unjustified. The Commissioner's decision to ignore the guidelines was upheld.

KUDYA J: This judgment on the merits is a sequel to *X v Commissioner General-Zimbabwe Revenue authority HH 648/18*, which dismissed all the preliminary points raised by the appellant in this appeal. The real questions for determination in this appeal are firstly, whether the Organisation for Economic Cooperation and Development Transfer Pricing Guidelines for Multi-National Enterprises and Tax Administrations (OECD TPGs) were applicable in Zimbabwe during the 2009 to 2012 tax years, secondly whether the respondent Commissioner lawfully applied the general anti-avoidance provision (GAAP), s 98 of the Income Tax Act [Chapter 23:06] against the appellant by imputing royalties for the purported intragroup use of the appellant's five locally registered trademarks and management fees on the intragroup services rendered by the senior management team of the group to the appellant; thirdly, whether she correctly computed the income tax payable and lastly, whether the imposition of a penalty in any amount was appropriate, for these tax years.

The background facts

The appellant is a local multinational public company and a major player in the hybrid seed industry that is listed on the Zimbabwe Stock Exchange (ZSE or local bourse). It controls a network of foreign-based subsidiary companies in which it either owns the entire or majority shareholding. These subsidiaries are incorporated in over 15 countries in SADC, COMESA and ECOWAS and South Sudan and Egypt.

The respondent is the statutory authority charged with the responsibility of collecting taxes from all eligible taxpayers in Zimbabwe. The key operatives who acted on its behalf in the present matter were a team of field investigators who worked under the command of a case manager in charge of the compliance section of complex multinational enterprises transactions, who in turn reported to the Commissioner for Investigations and International Affairs, I will, in this judgment, impute the conduct of the investigators to the case manager.

In 2012, the case manager audited the tax affairs of the appellant's flagship local subsidiary- the flagship for the 2009 to 2012 tax years. A series of transactions covering management fees and royalties between the flagship and some of the foreign subsidiaries in the same period activated the tax review of the appellant in October 2012.² It was common cause that the appellant had not been submitting any tax returns for the 2009 to 2012 tax years.

The appellant and the case manager held various meetings and exchanged numerous documents, correspondence and e-mails during the course of the investigations, which culminated in the issuance of the notices of assessment on 25 November 2013. The appellant was represented by its public officer and Group Financial Director, who was accompanied either by the Group Chief Executive Officer (GCEO), or representatives of either of its two tax consulting firms (the consultants). The interactions between the parties however, continued into the objection and appeal stages.

The case manager attached to the notices of assessment of 25 November 2013, schedules of his computations of the cumulative income tax due, interest and penalty at the rate of 60% in the aggregate sum of US\$5 726 090.02, for the period in question.

By e-mail of 23 December 2013, the appellant objected to the notices of assessment to the Commissioner. The objection was predicated upon the application of the OECD TPGs to the jurisdictional facts in s 98 of the Income Tax Act. On 7 May 2014, the Commissioner disallowed the seven general and two specific objections raised in respect of income tax in their entirety and increased the penalty, imposed by the case manager to 100%.

She held that s 98 of the Income Tax Act was correctly invoked on the adjustments to management fees and royalties. She characterized the housing of the head office function in the flagship to be a transaction, operation or scheme (TOS), which, firstly, had the effect of either avoiding or reducing the appellant's tax liability, secondly, created abnormal rights and obligations not usually created between independent parties in comparable circumstances, thirdly, notwithstanding the purported divestiture of all operations to the flagship on 1 April 2005, the appellant continued to employ for its own account the senior management corps who provided management services to all the subsidiaries in

² E-mail of 10 October 2012 p. 105 of respondent's bundle of documents.

compliance with the listing rules of the local bourse, and not only charged management fees at cost but further diverted them to the flagship. She regarded the failure to gross up these fees and the no-employees assertion as abnormal in both the alternative respects set out in s 98.

- In regard to royalties she invoked the provisions of s 98 on the following basis: Firstly, the purported transfer of the five trademarks legally owned by the appellant to the flagship, who in turn assigned them to the Botswana subsidiary was invalid because it was done contrary to the provisions of the Trade Marks Act [Chapter 26:04], and by a signatory who was neither authorised to do so by the board of directors nor a member thereof.
- Secondly, the appellant's group research manager (ORM or the scientist) and Maize Consultant in Zimbabwe were responsible for the development and monitoring of regional trials from which royalties accrued but paid to the Botswana subsidiary in place of the appellant. She held that these researchers employed their wits, labour and intellect in or from Zimbabwe to breed the germplasm used to create the hybrid seed developed and registered in the territories in which the subsidiaries were based.

In regards to the OECD TPG's, she held that they were not legislated and were therefore ineligible for use in Zimbabwe. She regarded the royalty rate applied by two of the appellant's subsidiaries of 3.5%, rather than the 1% offered by the appellant, to be arm's length and used it to compute the royalty that accrued to the appellant from the use of its trademarks by all its subsidiaries.

Lastly, she increased the penalty to 100% on the ground that the failure to render an income tax return was a grave contravention of s 46 (1) (a) of the Act. The gravity was accentuated by various e-mails that, she reasoned, tended to show the appellant's propensity to avoid payment of the correct tax due by hiding information from the case manager, altering records and failing to heed the advice rendered by its transfer pricing consultant on the dangers of charging management fees at cost.

Aggrieved by the dismissal of the objection, the appellant filed its notice of appeal on 22 May 2014, and grounds of appeal and case on 18 August 2014. The respondent filed the Commissioner's case on 11 November 2014.

By consent of the parties, I granted the substitution of the appellant for the flagship and consequent condonation and extension of time within which to note the appeal on 25 November 2014.

The appellant contended that the Commissioner erred and misdirected herself at law and on the facts in ignoring the OECD TPG's in invoking the provisions of s 98 of the Income Tax Act, imputing and computing royalties and management fees to the appellant for the intragroup use of 5 of the appellant's trademarks and management services rendered by members of the group's senior management, respectively and imposing a penalty in any amount. The respondent made the contrary contentions that the Commissioner judiciously exercised her discretion in invoking the provisions of s 98 of the Income Tax Act, imputing and computing royalties and management fees to the appellant and imposing the reduced penalty of 75%. She further disputed that she was required to apply the OECD TPGs in assessing the appellant to income tax under s 98.

The Issues

The following 10 issues were referred to on appeal at the pre-trial hearing of 30 July 2015.

1. Whether or not there was a transaction, operation or scheme and whether such transaction, operation or scheme had the effect of avoiding or reducing tax and was abnormal in the sense prescribed under s 98 of the Act.
2. Whether or not royalties and management fees are from a source within Zimbabwe.
3. Whether or not the Commissioner exercised his powers under s 98 in accordance with the Constitution and the rule of law.
4. Whether or not the assessments raised by the Commissioner were wrong in law and in fact.
5. Whether or not applying no mark-up on management fees by the appellant and or its flagship is under these circumstances arm's length.
6. Whether or not the group employees who carry out the head office functions are employees of the appellant's subsidiary.
7. Whether or not it is abnormal to house the head office function in the flagship where the appellant does not

operate as a head office.

8. Whether or not the transactions, operations or schemes were entered into with the sole purpose or with one of their main purposes being to avoid or reduce the amount of its taxability.
9. Whether or not the Commissioner was correct to levy a penalty in terms of s 46 of the Income Tax Act.
10. Whether or not the penalty of 100% was warranted.

At the appeal hearing, counsel for the parties reduced the issues to the four that I set out at the commencement of this judgment.

The appeal hearing proceeded by way of oral evidence and the production of documentary evidence. The duty to begin and the incidence of onus to establish on a balance of probabilities all the issues lies on the appellant. This is because it is the one that made positive assertions that the decision of the Commissioner to the objection was either a misdirection of the facts or law. It is trite that he who makes positive assertions bears the onus.

See *Astra Industries Ltd v Chamburuka SC 258/11*; *Zupco v Parkhouse Services (Pvt) Ltd SC 13/17*.

The oral evidence

The appellant called the evidence of its former GCEO, Group Financial Director and Public Officer, Group Research Manager, and a purported expert in the OECD TPGs and the United Nations Practical Manual on Transfer Pricing for Developing Countries, UN Manual (the expert), who between them produced 11 documentary exhibits. The respondent relied on the testimony of its field team leader, Chief Investigations Officer, and its 305 paged bundle of documents filed on 27 July 2015

The Common Cause Facts

The appellant company was formed in 1940 and floated as a public company in July 1996. The annual report for the year ended 29 February 2004, portrayed the appellant as a dominant multinational enterprise in the business of developing and marketing certified crop seeds through its own operations in Zimbabwe and other SADC countries and Kenya. It undertook an internal reorganization programme, referred to by the GCEO and GFD in oral evidence, as a reconstruction scheme. The purpose, captured in the Chairman's circular to shareholders and notice convening an extraordinary general meeting (EGM) of 27 January 2005, was to best serve the interests of the appellant by placing its Zimbabwean operations, exclusive of its investments in local companies and Africa, under an as yet to be formed single wholly owned subsidiary company to be called the flagship, leaving the appellant as a nonoperational holding company and allowing the Board more latitude to superintend over the all group operations more efficiently.

At the EGM of 28 February 2005, the shareholders unanimously approved the disposal of the appellant's fixed assets for ZW\$ 35 643 437 113, and current assets and liabilities as at 28 February 2005 at the net valuation of the directors to the flagship subsidiary for 19 900 ordinary one dollar shares in the flagship at a premium to beset by the directors, with any credit balance appropriated to the appellant's loan account.

The investigations by the case manager revealed the following conduct of the appellant subsequent to the resolution of 28 February 2005. In the financial statements for the financial year ended 28 February 2006 to 28 February 2013, the appellant was treated as an investment company, whose sole income consisted of dividends receivable.

On 1 April 2005, the appellant, represented by GFD, in the purported capacity of a director and secretary, assigned 5 trademarks to the flagship subsidiary for the princely sum of ZW\$1.00, which in turn for a similar amount under the hand of GFD simultaneously transferred them to SCI, the Botswana subsidiary, formed in 2000 to spearhead the appellant's foray into Africa. The appellant summarised the 2005 resolution in note 8.2.1 to its 2006 financial statements and produced consolidated group accounts of itself and all its subsidiaries, which did not relate to any identifiable juristic corporate entity. It further specially profiled and projected itself in the 2007 and 2008 annual reports as the proprietor and marketer of most of the seed varieties, and the research stations where they were researched, developed and bred. It also identified itself by its highly popularized acronym SDC.

In addition, the appellant engaged senior management members in various posts between 1 September 2006 and 8 July 2012 under the hand of either the GCEO or the GFD for and on behalf of the appellant. These were the scientist on 1 September 2006, the GFD on 19 December 2006, the GCEO on 4 January 2016, the group accounting manager on 15 March 2010, the group technical services executive on 23 August 2010, the group marketing manager on 22 October 2010, the group public relations manager on 1 July 2011, who reported to the MD of the flagship and GCEO of the appellant, the personal assistant to GCEO and GFD on 18 February 2011, the group business development executive on 15 December 2011, and group treasurer, SR, on 8 July 2012. Other than the PA and group public relations manager, GPRM, all the other appointees were eligible to participate in the Group share option scheme. Some of the letters bore the list of the directors of the flagship while others carried the names of the directors of the appellant.

The job descriptions and key result areas of all these group employees covered all the subsidiaries and were the basis upon which management fees were paid to their putative employer, the flagship. The mandatory PAYE remittances and cost by code reports disclosed that all the senior managers' salaries were met by the flagship and not the appellant. The PAYE remittances for the months of November and December 2009 and January 2012 and cost by code reports for 21 senior managers of July 2006, October 2007, December 2008 and February 2009, identified the taxpayer as the appellant but reflected the business partner and PAYE numbers and date stamp of the flagship.

It was common cause that these senior managers rendered management services to all the subsidiaries for which management fees were paid to the flagship at cost. The services related to specialised services in strategic, technical, production, agronomy, research, finance, internal audit and marketing and included approval of foreign currency purchases, salary increments of middle managers, approval of purchases and disposals of assets, discipline of all employees, preparation and implementation of the group human resources policy and loan guarantees and allocation of funds to all the subsidiaries. The fees were based on turnover of each subsidiary and not on a charge out rate for the service rendered.

It was also common cause that the foreign subsidiaries paid research and marketing development fees to SCI. It was further common cause that the 5 trademarks, which are the subject of this appeal on royalties, were registered in the name of the appellant with the Zimbabwe Trademarks Office on 2 October 2000, and ARIPO on 12 January 2004, and continued to be so registered during the period under investigation.³ One of these is a general trademark with the trade name and distinctive icon of the appellant while the others have unique marks with an animal device and a product variety number indicating early, medium and long maturity levels and colour of the seed product.

On 1 April 2008, SCI executed two separate Research and Marketing Development Agreements with the Malawi and Zambian subsidiaries, respectively.

The investigations also revealed that GFD had dispatched a treasure trove of e-mails, during the investigations on 15 and 17 July 2013, 27 January and -31 March 2014 to the managing directors and finance managers of the various subsidiaries inciting them to bury and withhold information from the respondent.⁴ By e-mail of 26 June 2013, he instigated the ex post facto replacement of the first two pages of the SCI-Malawi agreement, purportedly to provide the Botswana taxman with the correct documents that were in tandem with the Malawi Exchange Control requirements. By e-mail of 5 August 2013 GFD procured an employee of the tax consultant from providing unsolicited information to the case manager. On 10 January 2014, he requested the flagship's finance director to issue the 2005 share certificates due to the appellant. On 24 and 27 January 2014 and 17 February 2014, GFD disclosed entrenched pattern of using the Zambian subsidiary to redirect royalty income due to the flagship from the Tanzanian subsidiary. He directed the Tanzanian country manager E to redirect the payment due to the flagship from the Tanzanian subsidiary to the Zambian subsidiary and the latter to overcharge Tanzania by US\$26 500 per tonne for the 20 metric tonnes of parent seed sold to the latter. The sworn purpose being to "bury reversal of research costs credited" to Zambia in either overheads or costs of sales and "minimize the taxes that arise from paying direct royalties to Zimbabwe". The flagship finance executive was instructed, on 14 February 2014, to include recoveries in other income and not under apportionments and debit research costs due to the flagship to confound the Zimbabwe case manager. It would also minimize the withholding tax

³ The trademarks were registered in Botswana, Malawi, Zambia, Kenya, Zimbabwe, South Africa, Lesotho, Swaziland, Namibia, Uganda, Egypt and Mozambique.

⁴ P47, 57-58 of the appellant's bundle and p92-93 of the respondent's bundle.

due to the Tanzanian revenue authority and create fictitious withholding tax for the Zambian revenue authority from the sale originating from Zimbabwe. Some of the e-mails showed that germplasm was being dispatched to the other subsidiaries from Zimbabwe for testing, trials, development of ecologically adaptable seed, and registration of plant breeder rights, PBRs, and marketing of the developed hybrid seed.

At no time during the investigations did the appellant ever dispute that the technical and research fees payable under the Research and Marketing Development Agreements were royalties. In fact, in the tax consultant's letter of 6 November 2012, the appellant equated technical fees to royalties. It proceeded to confirm this position in the letter of 25 June 2013. GFD conceded that the general trademark in issue appeared on every maize seed variety sold by all the subsidiaries while two of the distinct trademarks were sold in Kenya, Malawi, Tanzania, Zambia and Zimbabwe. According to the tax consultant's letter to the respondent of 18 January 2012, the early maturity distinct trademark product was approved for sale in Zambia. In the objection letter the appellant conceded that the two medium maturity trademarked products were predominantly sold "by the Group" in Zimbabwe and Malawi.

The without prejudice letters of case of 28 May, 1 and 11 June and 19 August 2013 and 27 February and 10 March 2014 did not exclude liability but merely the taxable percentage. The efficacy of the "without prejudice" principle appears to me to be tenuous in tax related matters in view of the strong sentiments propounded by MALABA JA, as he then was, in the *Commissioner of Taxes v Astra Holdings (Pvt) Ltd* 2003 (1) ZLR 417 (S) at 428B that the duty of the Commissioner is to tax and not untax an eligible taxpayer. Again, in the minutes between the parties of 22 July 2012, the appellant conceded that the fees were royalties.

The respondent imputed management fees to the appellant on the basis that:

1. The ZSE listing rules require employees to have certain experience;
2. The GCEO and GFD were executive directors of the appellant;
3. The annual financial statements indicated that the appellant was operational;
4. The appellant employed group employees, who had extant contracts with it;
5. It had a physical head office from which it rendered administrative, technical, financial and commercial management services through the group employees to its subsidiaries, which negated the assertion that it was an investment holding company holding shares with no employees and other business activities.

In the absence of any comparables from the appellant, the respondent imputed management fees to the appellant of US\$832,155.00 for 2009, US\$1,882,819.55 for 2010; US\$ 2,967,647.50 for 2011 and US\$2,680,158.75 for 2012 tax year. These amounts constituted a transfer price of cost plus 25%, translated as a gross profit percentage of 20%. The "cost" was derived from the general head office expenses disclosed in the audited financial statements of the flagship. These were marked-up by 25% and then allowed as a deduction, thus effectively taxing only the mark-up on the deemed expense.

She also attributed royalties for the use of the 5 trademarks to the appellant of US\$1,998,824.55; US\$ 2,215,841.00; US\$ 2,700,651.05 and US\$2,505,374.04, for each respective tax year.

The Testimony of GFD

GFD joined the appellant before the reorganisation after which he was appointed the financial director of the flagship on 19 December 2006 and the GFD, company secretary and public officer of the appellant from 1 January 2007. He served as the Group Treasurer until 1 September 2012. He was also a member of each subsidiary's board of directors. The pith of his testimony was that the appellant transferred its head office functions and all operations lock, stock and barrel to the flagship on 1 April 2005, from which date it became an investment holding company. It ceased to have employees, other than the GCEO and GFD, on that date. It further cast the responsibility of managing the subsidiaries on the flagship, which employed group employees who provided management services at cost from which management fees were payable.

On 1 April 2005, the appellant transferred 5 trademarks to the flagship which in turn simultaneously transferred them to

the Botswana subsidiary. The effect of the transfer was that the seed varieties pertaining to these trademarks constituted the genetic material that was used to breed ecologically adaptable in country seed varieties from which each subsidiary derived and owned in country PBRs.

He produced exhibits 4A and 4B, the audited consolidated income statements for the financial year ended 31 March 2010, to prove that the appellant only earned dividend income from the subsidiaries and not any other income from the sale of maize, management fees or royalties. He ascribed the technical fees paid by the in-country subsidiaries to SCI, to the funding for research and marketing activities conducted by SCI in the breeding, testing, trials and registration of PBRs during the incubation years of each subsidiary, which were underscored in the Research and Marketing Development Agreements executed with these subsidiaries. The incubation costs for which royalties were paid were highlighted in exh 6A and 6B. To his knowledge and experience, trademarks per se were valueless to the owner. Their value was derived from rigorous research and development, trial, testing, field demonstration and marketing in the host countries for a minimum of 3 to 4 years before registration, not as maize seed varieties but as plant breeder rights by either the owners or users or both. In those instances, like the present, where the owner did not undertake such activities and the seed varieties attached to the trademarks were not sold in country by the subsidiaries, no royalty was due the owner. Rather, the subsidiaries owned the PBRs specific to their host markets and were not legally obliged to pay royalties to the appellant.

He also attributed the impression that group employees belonged to the appellant to the inadvertent and erroneous use of old templates and stationery and the failure to distinguish the juridical difference between the appellant and flagship by the PA shared between the GCEO and GFD.

He maintained his evidence in chief until cross examination. He conceded that the failure to charge mark-up for management services was abnormal, that OECD TPGs were at the time inapplicable in Zimbabwe, that the custodial costs sought to be excluded in exhibit 5 were actually paid to the flagship by the other subsidiaries and the question of bad debts was not contemporaneous but prospective and in any event in the discretion of the Commissioner. The computation of 25% was mathematically correct. All seed varieties sold in country bore the generic trademark of the appellant thus making the product inseparable with the trademark.

Assessment of the Witness

He has extensive and intimate knowledge of the operations of the appellant and all its subsidiaries. He found it very difficult to identify the senior managers of the appellant who made it compliant with r 4.6A of the listing requirements of the ZSE. He prevaricated between the GCEO and himself, on the one hand and eight others on the other. His prevarication was motivated by the realization that admitting that appellant had senior management would automatically make it liable for management fees while denial made it in breach of the listing rules. He was on the horns of a dilemma, between the proverbial hard place and a rock. He failed to explain why he and the GCEO, whom he admitted without equivocation to be employees of the appellant were signing engagement letters for Group personnel after the reorganisation of 2005, as agents of the appellant. The caveat subscriptor principle obviously applied to them. He miserably failed to wriggle his way out of the space between the proverbial hard place and rock that he found himself in. He went to the absurd extent of accusing the case manager of forcing appellant to stamp its logo on the extracts where this logo appears. He could neither proffer a reasonable explanation why the group treasurer used the same logo on his internet signature in domestic and external communication, nor why the public relations manager was being engaged to service both the appellant and the flagship. He was unable to explain how such errors could persist to 12 July 2012 when the last of the group employees, the group treasurer, was engaged by the appellant.

It was disingenuous of him to seek to apply the OECD TPG's to management fees in retrospect rather than contemporaneously to the detriment of our own tax legislation. He failed to make full and frank disclosure to the Commissioner and sought to burden the Commissioner with the onus of eliciting the appropriate questions from him contrary to his clear obligation set out in *ITC 15/94 (57 SATC 259)* thus:

'... an obligation rests upon a taxpayer to render; an accurate and full return on which he can be assessed and not to do so in a vague or ambiguous manner casting the onus upon the revenue authorities to elicit

His assertion that trademarks carried no embodied value was demonstrably false. In the assignments they were not transferred for free, but for a dollar,⁵ they were registered at both the Zimbabwe Trademark Office and ARIPO for US\$27 965,⁶ a SCI accounting entry valued them at US\$31 000,⁷ while an e-mail by GFD to Tanzania of 14 February 2014 estimated their value to be US\$530 000. That these trademarks were already known in the subsidiaries host markets exports was unambiguously demonstrated by the 29 February 2004 annual report of the appellant which boasted that exports already abounded before the 2005 reorganisation.

He gave the false impression that his laptop was unlawfully seized when it was taken by consent of his GCEO and tax consultant. The seizure coloured his relationship as a public officer, with the case manager to the detriment of the appellant. I found him to be an insincere and generally untruthful witness who failed to act with integrity in the statutory position of a public officer.

The GCEO

The GCEO was the GCEO of the appellant between 2002 and 2009. The internal reconstruction took place under his watch. He testified that the reorganisation was designed to promote operational efficiency in the group and not the accrual of tax benefits to the appellant. The avoidance, postponement or reduction of the appellant's tax liability was never discussed by the board at the time. He had no recollection of whether the respondent was ever apprised of the process. He, however, studiously declined to comment on the suggestion that the reconstruction was just a tax avoidance scheme. He maintained that the appellant never recruited any employees after the reconstruction. He confirmed that the flagship did not gross up the management costs incurred on behalf of the subsidiaries. He indicated that no royalties were charged for the use of the appellant's trademarks within the group as they were unknown in the new markets. He maintained his evidence in chief during cross examination. He failed to satisfactorily explain why the letters of employment of the group personnel signed by him, his successor and GFD after the reconstruction indicated that they were being employed by the appellant. To the extent that he maintained this aspect of his evidence, he was an untruthful witness whose testimony was affected by the same malady that afflicted GFD's evidence. He, however, conceded that the failure to charge mark-up on management costs was not arm's length.

The Scientist

The scientist was promoted to his position on 1 September 2006. He was in charge of all the research and breeding projects carried out at various research stations and sites within the entire group. He prepared, controlled and monitored the annual budget for research and development within the group. He was responsible for the acquisition and improvement of germplasm by conventional and biotechnical methods. Germplasm constitutes the foundational material for breeding, developing, testing and registering plant breeders' rights in the flagship and subsidiaries outside Zimbabwe. He worked in close liaison with the group marketing manager to promote the varieties emanating from his division. He testified that the know-how used in breeding genetic plant material used in producing seed varieties was carried out in Zimbabwe for and on behalf of all the subsidiary companies. He, however, was unable to quantify the value of such know-how. While he was able to quantify, in exhibit 8, the cost of breeding, testing, releasing and registering new maize varieties at local research stations, he was unable to quantify the value of the distinctive know-how imputed in the breeding process. His testimony in this regard was confirmed in his email to GFD of 11 June 2013. He technical evidence on Value for Cultivation and Use, VCU, and Distinctiveness, Uniformity and Stability tests, DUS, underscored his intimate involvement in the research and development projects undertaken outside Zimbabwe by the appellant's subsidiaries. He maintained under cross examination that he was employed by the flagship and not the appellant. He did not know how the distinctive input of local research stations in breeding seed varieties was compensated for by the other subsidiaries. I formed the distinct impression that his evidence in chief was choreographed to underplay his pivotal role in the research activities of the whole group, a position he seems to have abandoned under cross-examination.

5 In the 2005 assignments.

6 Expended at local trademarks office and ARIPO between 23 February and 18 March 2013 in invoices Annexure E of appellant's case.

7 Para 133 of the appellant's case.

The last witness was not a factual witness but a purported expert in the OECD TPGs. Her claim to expertise was premised on the four years she spent at the South African Revenue Service (SARS), between 2001 and 2005, as the founding head of the cross-border intercompany transaction desk, where she assessed the propriety of management fees and royalties of the kind imputed to the appellant by the respondent in the present matter. She also relied on the 15 years she worked in the private sector for international accounting firms as a transfer pricing advisor to multinational enterprises.

She conducted a desk top review of 12 Royaltystat data bases on transfer pricing agreements between independent parties in the agricultural industry to ascertain whether royalties were charged for the use of trademarks. Six of the agreements were in the fresh produce category and the other six were in the hybrid seed group. She discounted one agreement in the hybrid seed industry, in which royalties were charged, because it was between related parties. She found that only two of the remaining five hybrid seed agreements covered trademarks. These two were concluded between the same parties⁸ and embodied non-exclusive royalty free licences. The remaining three hybrid seed agreements and all the six fresh produce agreements charged royalties together with other intangibles like patents, technology, know how, trade secrets or software between 4% and 6% of the net sales. She concluded, on the basis of these findings, that royalties were not charged separating for trademarks in hybrid seed industry because they had no value independent of other underlying intangibles, that royalties for the sale of trademarked goods were either much reduced or eliminated altogether by the in country production, registration and marketing efforts of the local subsidiary and that housing head office functions in a subsidiary_ as in consonance with OECD TPGs concept of “group service centre” and “shared services centre”.

The respondent calculated the average net profit margin of the appellant by dividing the net profit by sales based on the entire group turnover (being the sales to unrelated parties only) at 20% and reworked the figure to a cost plus 25% mark-up. It was common cause that the figures were mathematically correct.⁹ The expert testified that this methodology was fundamentally flawed as it suggested that management services were solely responsible for the entire sales. She stated that there was no correlation between the profit before tax and maize sales as the profit before tax was a function of all seed sales and interest income. She further stated that the formula did not eliminate shareholder costs and that the mark-up was too high. Her computations, which were based on the tables in exhibit 5, constitute exhibit 11. It is not necessary to reproduce her computation tables. The computations showed that the amounts chargeable in each year were much less than the taxable income figures imputed by the respondent. And even then, the actual management fees charged by the flagship to the subsidiaries were much higher than they should have been had the cost of shareholder activities been discounted. The respondent imputed royalties’ payable, imposed a charge of 3.5% on the gross sales of the seed varieties sold by the Group, without limiting it to the sales generated by these brands, and assessed the appellant to income tax on the imputed amounts.

In assessing her evidence, I am guided by the insightful article that appeared in De Rebus of May 2015¹⁰ entitled “Beware of the Hired Gun-Are expert witness unbiased”. The learned author captures the apt warning regarding the testimony of expert witness given in Lord Arbinger v Ashton (1873) 17 LR Eq 358 at 378 that:

“Undoubtedly there is a natural bias to do something serviceable for those who employ you and adequately remunerate you. It is very natural, and it is so effectual that we constantly see persons, instead of considering themselves as witnesses, rather consider themselves as paid agents of the persons who employ them ... What it all means is this, of an expert is required originality, objectivity and unbiased assistance to the court. The expert opinion should be based on all the facts or assumptions. No expert should be unwilling to make concessions about something either falling within his or her expertise or not known when first expressing the opinion.”

The efficacy of her testimony was undermined by seven factors. Firstly, her review and results were not original but a

8 The two parties were Syngenta on the one hand and Delta & Pine Land Company on the other.

9 The formula was $\text{Gross Sales} - \text{Intra-Group Sales} - \text{Cost of Sales} \div \text{Cost of Sales} \left(\frac{GS - (IGS + CS)}{CS} \right)$

10 36 [2015] DE REBUS 76.

mere regurgitation of an earlier one, apparently conducted by the appellant's lead representative in this appeal, Mr Erasmus and presaged in para B1.3.8.1 of the objection. Secondly, the review of the two non-exclusive royalty free licence agreements failed to read the royalty free clause, clause 3.8, in conjunction with clause 6.2, which specifically mandated Delta to pay a royalty to Syngenta for the right to produce, multiply and sell the seed to which the royalty free trademark licence related. In my view, these two agreements did not fall into the ambit of pure royalty free agreements but of the other nine. Even if they did, a mere two agreements in the whole wide world would not constitute the critical mass to justify the proposition that royalties are not chargeable for the use of trademarks in the hybrid seed industry. The number is just too insignificant to conclusively extrapolate such an earthshattering principle. After all, the link between the non-exclusive royalty free licence to the royalty payable for the production, sale and propagation of the seed to which the royalty relates belies the further proposition that trademarks standing on their own in the hybrid seed industry are valueless. The practical hard fact is that a trademark, which the parties correctly equated to a brand, cannot stand on its own. It is always attached to, and bears testimony to the quality of, some product, manufacturing process or advertising format. See *DEB (Pvt) Ltd v Zimra HH 664/19* at p 7 and "IP Handbook of Best Practices"¹¹ by Tucker and Ross who opines that capital outlay in the creation of a trademark encodes consistent quality and continuous availability and that value is enhanced by marketing and acceptance.

Thirdly, and more importantly, she failed to establish that these guidelines constituted customary international law and to her credit conceded under cross examination that they were not law. They were therefore inapplicable in Zimbabwe which had not domesticated them as had done South Africa in 1995. Fourthly, she swallowed hook, line and sinker the assertion by the appellant that it was not liable for both these fees while cursorily dismissing the bases for the Commissioner's contrary assertions.

Fifthly, she failed to demonstrate by reference to any data base empirical evidence on the propriety of housing head office functions in a subsidiary company and to articulate the juristic nature of a group company. She appeared to treat all the subsidiaries of the appellant as the "Group Company" and the appellant as a "Company"; thereby giving the incorrect impression that the appellant, which was the holding entity, was a subsidiary of the ambiguous Group. This is contrary to the provisions of s 143 (5) and s 144 (1) and 145 (2) of the Companies Act [Chapter 24:03]¹² which categorically equate the Group with the Holding Company.

Sixthly, she portrayed the false impression that the arm's length principle, which measures the conduct between related parties against that of independent parties in comparable transactions undertaken in comparable circumstances, was a progeny of paragraph 1.110 of the OECD TPGs, when in fact is a common sense based universal standard which predated the promulgation of OECD TPGs.

Seventhly, her computations of management fees, record in exhibit 11 and based on the figures in exhibit 5, inter alia, showed that the flagship did not apply the much touted OECD TPGs in levying management fees against the in country subsidiaries. There was therefore no basis for applying these guidelines to the appellant in this appeal. Doing so would make this Court complicit in aiding the appellant circumvent the very mischief s 98 is designed to guard against. She could not dispute the further fact that management services provided by the group employees were not limited to maize sales only but to all income raising activities of the benefitting subsidiaries.

Lastly, Royaltystat agreements had detailed contractual arrangements on ownership rights over improvements derived from collaborative efforts with or solely by the licensee, the terms of which were hidden from the respondent and this Court in the undisclosed agreements between the appellant and its subsidiaries. In the "Group Proposal to Review Transfer Pricing Framework" of 24 October 2013, the international transfer pricing consultant was availed the Intergroup Transaction Framework, 3 flagship Management Fee Agreements, 2 Q Management Fee Agreements, 9 SCI Royalty Agreements, 13 Intercompany trading agreements, 7 Technical Fees Agreements of the flagship and 6 SCI Management Fee Agreements, which GFD no doubt "buried" from the prying eyes of both the respondent and this Court.

In my assessment, she was a hired gun.

¹¹ Chapter 11.6 p1063 at p1 511 of appellant's bundle.

¹² Where group accounts are a combination of the accounts of both the holding company and its subsidiaries.

It was common cause that the Commissioner has an untrammelled discretion to compute royalties chargeable once all the jurisdictional facts in s 98 are met. Her discretion in this case was reinforced by the concession given by the appellant to utilize the template of the SCI-Malawi agreement. The totality of the evidence adduced by the appellant and especially from the scientist showed that the research referenced in that agreement denoted the manipulation of germplasm and propagation of initial hybrid seed from Zimbabwe, which had suitable research stations and not Botswana, which had no research station.¹³

In the present case, the underlying trademarks were fully developed. They consisted of the general trademark with the logo of the owner and distinct trademarks for specified hybrid seed varieties. The general logo was used by all subsidiaries on all the seeds that they sold. Three of the four distinct trademarks were used on the hybrid seeds to which they related, which were sold in Kenya, Malawi, Tanzania, Zambia, and Zimbabwe. The 2010 variety register shows that the early maturity variety trade mark was purportedly registered under SCI in 2001 while the two medium maturity varieties were purportedly registered in 1999.

The suggestion that these trademarks were either unknown in these countries or were popularised by the marketing efforts of the local subsidiaries was contrary to the available documentary evidence. The appellant's annual report for the financial year ended 29 February 2004, showed that the appellant was already selling the trademarked seed varieties in these countries. This was further confirmed by the letter from the appellant's tax consultant to the case manager which categorically stated that the appellant sold trademarked seeds in these countries.¹⁴ And again reinforced by the attempted simultaneous assignments of the trademarks made by the appellant to the flagship and the flagship to SCI purportedly on 1 April 2005. This was consistent with the appellant's desire to create SCI, already in business since 2000, as its major special purpose vehicle for consolidating existing and opening new markets through the use of existing trademarks and the development of new ones, in Africa, outside Zimbabwe. So at the time of the 2005 reorganisation, these trademarks and the products to which they related were known and sold in these markets. The development, enhancement, maintenance, protection and exploitation functions of the trademarks had long been effected by the appellant before the reorganisation exercise. There was no basis for the products which were already on sale to undergo new trials and testing as suggested by all the witnesses called by the appellant. The evidence of the appellant's witnesses related to new trademarks and their related plant breeders' rights or plant intangibles and not the trademarks we are concerned with in this appeal, other than the general trademark, which attaches to all varieties, new and old as the signature mark of the appellant.

The Chief Investigations Officer

He was the point man of the respondent in the interactions with the appellant. He made the key decisions which let to the invocation of s 98 and the imputation of the taxable income from management fees and royalties to the appellant. He confirmed that in minuted discussions, correspondence and official documents between the parties, the appellant referred to the research fees in the SCI-Malawi agreement which covered research, development, trials, testing, registration or plant breeder rights and marketing of the resultant hybrid seed varieties during the first 3 to 4 years performed in conjunction with the subsidarise as royalties. In other correspondence, the appellant disputed the accrual of royalties to SCI from the five trademarks in question maintaining that royalties were not chargeable for the use of trademarks in the seed hybrid industry. The essence of his testimony was that the Commissioner repositioned and corrected the flow of management fees and royalty income to the appellant, to whom such income accrued before it was diverted to the flagship and SCI, respectively. The computations based on the average profit before tax as opposed to 2% of group turnover resulted in additional accrual of US\$ 665 724 instead of US\$ 1 539 807.06.

The Chief Investigation Officer's testimony was factual. It was supported by the documentary evidence at hand. It was not discredited during cross examination. I accept it as the truth of what transpired during his interactions with the appellant.

13 Zimbabwe contributed average research of 77% against Botswana's 3% during these tax years.

14 12 January 2012.

It was common cause that OECD TPGs were not legislated in Zimbabwe at the time the assessments were raised. The appellant established that at the time of the assessments the guidelines had been adopted by 34 members of the OECD, legislated by only 11 African countries and possibly applied by a total of 85 countries in the whole wide world, including Kenya through the case of *Unilever Kenya Ltd v Commissioner of Income Tax* [2006] 2 EA 334 (HCK), which incidentally, the local case of *S v A Juvenile* 1989 (2) ZLR 61 (S) at 72, regarded as a pacesetter in the use and grafting of international soft law to local law, which could only enrich local law rather than side line it. Per contra, the respondent established that Malawi rejected the use of the guidelines to overshadow local law in *The State v Commissioner General of Malawi Revenue authority, Ex part Eastern Produce Malawi Ltd Judicial Review*¹⁵ Number 43/2016 at pp 11 -12.¹⁶

On the basis of the above facts, the appellant submitted that the OECD TPGs were applicable in Zimbabwe because they had achieved the status of customary international law. The Commissioner made the contrary submission that they were inapplicable in Zimbabwe as they had not achieved any such status. She argued that they could at best be regarded as customary international norms.

Section 46 (1) (c) of the Zimbabwean Constitution¹⁷ enjoins the use of international law in conjunction with other factors in interpreting the Declaration of Rights in Chapter 4 thereof and all treaties and conventions to which Zimbabwe is a party. Section 326 declares customary international law, as long as it is consistent with the Constitution and local legislation, to be part of the corpus juris of Zimbabwe and enjoins “every court and tribunal” to “adopt any reasonable interpretation of the legislation that is consistent with customary international law applicable in Zimbabwe, in preference to an alternative interpretation inconsistent with that law.” Lastly, s 327 excludes the incorporation of international conventions, treaties and agreements that have not been domesticated into Zimbabwean law.

The OECD TPGs are a derivative of the OECD Convention. Their application to the interpretation of s 98 of the Income Tax Act is, therefore, specifically excluded by both s 46 (1) (c) and 327 of the Constitution. They can, however, be applied if they meet the requirements of s 326 of the Constitution.

The question of whether they constitute customary international law appears to have been authoritatively answered by Jens Wittendorff in his book entitled “Transfer Pricing and the Arm’s Length Principle in International Law “.¹⁸ He makes the following pertinent observation at p 287:

“The customary international law has an objective element in the form of a uniform and consistent practice among States or at least a majority of them. The objective test is the cornerstone of customary international law. There is also the subjective element according to which States must act out of a sense of obligation to do so.”

And at p 290, he aptly states that:

“At the international level, the OECD has never referred to the arm’s length principle as expressing customary international law. On the basis of the above, the arm’s length principle cannot be assumed to qualify as customary international law. This means that Article 9 does not have a special status in international law since the OECD model and Commentary are not regarded as being customary international law.”

Wittendorff’s conclusion is in consonance with the evidence of the purported expert witness on the point. She readily conceded under cross examination that the guidelines were not rules of law. In my view, the guidelines perpetually remain work-in-progress, being subject to unending and periodic reviews, which eschew their ability to ever achieve the status of customary international law. Being subject to change with each periodic review, they lack the consistency and certainty required of customary international law.

15 See Glossary of terms.

16 I am of the humble view that where local legislation provides for the law, it is always imperative to apply that law and use any international instruments in interpreting that local law. I do not think that using the international instruments while side lining local legislation is allowed. Doing that, in my considered view, will defeat the intention of the framers of the local legislation.”

17 The Constitution of the Zimbabwe Amendment (No. 20) of 2013.

18 2010 Kluwer Law International.

To the same effect was YISRAM J in the Unilever Kenya case, at p 12 where he said:

“Now these guidelines do not form the laws of the countries concerned. They are simply guidelines, guiding the world of business that is business enterprises and the taxing authorities of those countries in arriving at proper transfer pricing policy principles for the purposes of computation of income tax. And especially, because of the absence of any such guidelines in Kenya, we must look elsewhere. I have no doubt in my mind that the relevant guidelines such as the TP principles are not just hear for relaxed reading. These have been evolved in other jurisdictions after considerable debates and taking into account appropriate factors to arrive at results that are equitable to all parties. It would be foolhardy for any court to disregard internationally accepted principles of business as long as these do not conflict with our own law. To do otherwise would be highly short-sighted.” (My underlining for emphasis).

See also the *Glenister*¹⁹ case where MOSENEKE DCJ and CAMERON J said of a kindred OECD Report:

“The OECD Report is not in itself binding in international law but can be used to interpret and give content to the obligations in the Conventions we have described.”

The appellant, thus failed to establish that the OECD TPGs are part of customary international law. It also failed to establish that its preferred application of the guidelines was consistent with s 98 of the Income Tax Act in the light of the apposite and binding interpretation rendered by the Rhodesian Appellate Division, the precursor to our Supreme Court, to s 91, also the precursor to our s 98 of the Income Tax Act in *Commissioner of Taxes v Ferera* 1976 (2) SA 653 (RAD). At 659A, MACDONALD JP, as he then was, said:

“It is equally absurd to suggest that the Legislature could possibly have intended, as has sometimes been suggested, that taxpayers would not be subjected to those powers if the means or the manner employed to avoid, postpone or reduce tax was a means or manner normally employed for this purpose.”

And held at p 659F:

“When by a transaction, operation or scheme income has been prevented from accruing in a way it would “normally and naturally accrue”, it is no answer for the taxpayer to say that quite a normal method of tax avoidance was used to bring about this result. The acceptance of such an answer would defeat the purpose of the section.”

It is my finding that that the use of the guidelines by possibly 85 countries, which regard them as normal, did not justify their adoption by the appellant in the face of a contrary

interpretation rendered by our Supreme Court. In any event, the majority of these countries utilized them by dint of their respective treaty obligations and domestic legislation. I am satisfied that the appellant failed to establish that the guidelines had the force of law in Zimbabwe. The Commissioner correctly disregarded them in raising the assessments and in his determination of the objection.

The relevant legislative provisions

The power of the respondent to levy and collect tax is provided in s 6 of the Income Tax Act [Chapter 23:06], which states:

“6 Levy of income tax

There shall be charged, levied and collected throughout Zimbabwe for the benefit of the Consolidated Revenue Fund an income tax in respect of the taxable income, as defined in this Part, received by or accrued to or in favour of any person during the year of assessment ending the 31st March, 1968, and each succeeding year of assessment thereafter.”

¹⁹ *Glenister v President of the Republic of South Africa & Ors* Case No. CCT 48/10 [2011] ZACC 6 para [187] in reference to *Specialised Anti-corruption Institutions: Review of Models (OECD Report)* and not OECD TPGs

Royalties are charged in terms of s 8 (1) (d) (iii) of the same Act, which provides that:

“8 Interpretation of terms relating to income tax

(l) For the purposes of this Part-

“gross income” means the total amount received by or accrued to or in favour of a person or deemed to have been received by or to have accrued to or in favour of a person in any year of assessment from a source within or deemed to be within Zimbabwe excluding any amount (not being an amount included in “gross income” by virtue of any of the following paragraphs of this definition) so received or accrued which is proved by the taxpayer to be of a capital nature and, without derogation from the generality of the foregoing, includes-

(d) any amount so received or accrued from another person as a premium or like consideration paid by such other person-

(i)

(ii)

(iii) for the right of use of any patent, design, trade mark, copyright, model, plan, secret process or formula or any other property which, in the opinion of the Commissioner is of a similar nature;”

Section 2 (1) of the Income Tax Act incorporates by reference the definition of trademark in the Trade Marks Act [Chapter 26:04] thus:

“trade mark” means a trade mark as defined in subsection (1) of section 2 of the Trade Marks Act [Chapter 26:04].”

The relevant section in the Trade Marks Act states:

“trade mark” means a mark (any graphic sign capable of distinguishing goods/services of one undertaking from those of another undertaking) which is used or proposed to be used in relation to goods or services for the purpose of-

(a) *indicating a connection in the course of trade between the goods or services and some person having the right, either as proprietor or as registered user, to use the mark, whether with or without any indication of the identity of that person; and*

(b) *distinguishing the goods or services in relation to which the mark is used or proposed to be used, from the same kind of goods or services connected in the course of trade with any other person; but does not include a certification mark;”*

Lastly, s 98 stipulates:

Where any transaction, operation or scheme (including a transaction, operation or scheme involving the alienation of property) has been entered into or carried out, which has the effect of avoiding or postponing liability for any tax or of reducing the amount of such liability, and which in the opinion of the Commissioner, having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out –

(a) was entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or

(b) has created rights or obligations which would not normally be created between persons dealing at arm’s length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question;

and the Commissioner is of the opinion that the avoidance or postponement of such liability or the reduction of the amount of such liability was the sole purpose or one of the main purposes of the transaction, operation or scheme, the Commissioner shall determine the liability for any tax and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he considers appropriate for the prevention or diminution of such avoidance, postponement or reduction.”

Application of the law to the facts

The source of the management fees and royalties

It was common cause that the management fees were deemed to be from a source in Zimbabwe. The appellant disputed the source of royalties could be attributed to Zimbabwe. The evidence led by the appellant showed that the scientist was not only the pivot and brains behind all hybrid seed research and development but in conjunction with the group marketing executive centrally managed, controlled and coordinated the skill, wits and labour of the in country employees who partook in the research, development, propagation and marketing of new seed varieties to which the general trademark attached. The appellant was entitled to royalties calculated at an agreed percentage of net sales less the contributions of the non-title holders. The source of the royalties was the country from which the initial skills, wit and labour originated. Coincidentally, the formula specified in the SCI-Malawi agreement for research fees is the one that abounds in all the Royaltystat agreements used by the appellant. The intellectual property attached to these trademarks originated in Zimbabwe in which the seed varieties attached to all the trademarks were sold and from which they were further registered or used as foundation material in developing new varieties registered as PBRs in the host countries. The source requirements prescribed ins 12 (1) (a), (b) and (c) of the Income Tax were therefore met.

The contention advanced by the appellant that the phrase “premium or like consideration” ins 8 (1) (d) of the Income Tax Act connotes a payment in excess of the royalty chargeable and not the royalty itself by reference to a similar phrase embodied in a lease agreement referred to by Silke para 4.56 Lexis Nexis is incorrect. Silke states that:

“the words ‘premium or like consideration’ in so far as they refer to the relations between a lessor and his lessee, refer to a consideration having an ascertainable money value passing from the lessee the lessor, whether in cash or otherwise, distinct from and in addition to rent For example, if a lessor agrees to let to a lessee land for a lump sum payment of R1 000 000 in addition to a monthly rent of R25 000, the R100 000 is a premium since it is a consideration passing from a lessee to a lessor in addition to the rent. CIR v Butcher Bros (Pty) Ltd 1945 AD 301, 13 SATC 21; Turnbull v CIR 1953 (2) SA 573 (A), 18 SATC 336.”

It is incorrect because a royalty chargeable for the use of trademarks is not analogous to rentals charged for the use of property. A royalty constitutes the premium or like consideration paid for the right to use the trademark or other intellectual property based on the value of sales. The royalty payable is in addition to any licence fees that may be charged annually. The rental in a lease agreement is analogous to the licence fees payable. The additional payment of a royalty on top of the licence fees is what constitutes the “premium or like consideration” referred to in s 8 (1) (d) of the Income Tax Act. The construction of that phrase in the manner suggested by the appellant would render nugatory the inclusion of royalties in the taxable income of a taxpayer, emasculate the application of both the general wording of s 8 (1) and the specific wording of sub-para (d) of s 8 (1) and defeat the intention of the Legislature to include royalties in a taxpayer’s taxable income.

I proceed to determine whether the provisions of s 98 were properly invoked in respect of the transfer of the head office function, management fees and royalties.

The Head Office Function

Whether or not there was a transaction, operation or scheme in respect of the head office function and whether such transaction, operation or scheme had the effect of avoiding or reducing tax and was abnormal in the sense prescribed under s 98 of the Act.

The provisions of s 98 have been judicially construed and applied in this country for a considerable length of time. See Commissioner of Taxes v Ferera 1976 (2) SA 653 (RAD), G Bank Zimbabwe Ltd v Zimbabwe Revenue authority 2015 (1) ZLR 348 (H) and H Bank Zimbabwe Ltd v Zimbabwe Revenue authority 2015 (1) ZLR 1007 (H). The section deals with circumstances where there is an avoidance, postponement or reduction in tax liability and the Commissioner forms the opinion that the avoidance, postponement or reduction was the sole or one of the main purposes of the transaction. He may then determine the tax liability by ignoring the offending transaction or reversing or limiting its impact. He is

obliged to consider whether the transaction was conducted in a way (means and manner) that is not normally employed or created rights and obligations not normally created between independent parties dealing at arm's length. The GAAP does not affect legitimate exceptions, deductions and credits but is concerned with the diversion of income by hook or crook, which would have accrued to the taxpayer, to a different entity.

In the instant case, the Commissioner formed the opinion and was thus satisfied that both management fees and royalties accrued to the appellant but by sleight of hand by way of fictionally placing group employees under the flagship and the SCI-Malawi agreement which income was diverted to the flagship and SCI, who in reality had not earned any such income.

This satisfaction connotes his justification for attaching liability to the taxpayer. The Commissioner thus wields an extraordinary and far reaching power, which negates the freedom of contract enjoyed by taxpayers. The appeal attacks this satisfaction.

The respondent assessed the appellant to income tax on the basis that it created three transactions, operations or schemes between 28 February 2005 and 25 November 2013, when the appealed assessments were issued. The first TOS was allegedly created by virtue of the resolution unanimously passed by the appellant's shareholders on 28 February 2005 and implemented on 1 April 2005. The Commissioner found that this TOS involved the formalistic and not substantive transfer of the head office functions of the appellant to the flagship. The second concerned the rendering of management services by the appellant to all its subsidiaries for which the management fees payable were charged at cost and diverted to the flagship. The third was the utilization of the appellant's general trade mark and 4 distinct trademarks by all its subsidiaries without paying any accrued royalties to the appellant, which royalties (compensation for the use of the intangible assets) were, however, diverted to the Botswana subsidiary.

I find that the conduct of the appellant in each of these three respects constituted a TOS, despite its spirited denial during the investigations, objection, on appeal and in argument. In his evidence in chief, GFD described the 2005 events as a "scheme of reconstruction" and "a scheme of internal reorganisation". It was therefore a scheme that was entered into and executed by the appellant, which falls into the ambit of a TOS.

Whether it had the effect of avoiding or postponing liability for any tax or of reducing the amount of such liability.

The scheme of reconstruction undoubtedly had the effect of avoiding or reducing the tax liability of the appellant. This is apparent from the financial statements issued by the appellant for the year ending 28 February 2005 and subsequent years, in which the appellant is designated as the Company and its subsidiaries as the Group. The tax liability of the appellant in those financial statements was, as a hard matter of fact, much reduced than in the year ending and preceding 29 February 2004.

Whether the abnormality opinion (both the way and manner, and the creation of unusual rights or obligations absent between Independent parties) of the Commissioner was correct.

These two jurisdictional factors are disjunctive. The existence of any one of these factors suffice. The Commissioner formed the opinion that the manner in which the reconstruction was effected of completely divesting the head office functions of appellant to the flagship was abnormal. The bases for that finding were that post the divestiture, the appellant continued to directly employ group personnel, who provided management services, which were remunerated at cost by the flagship. Further that it did so in compliance with listing rule 4.6A of the listing rules of the local bourse. The appellant contends that this finding was wrong. It admitted that the letters of employment of group personnel were signed for and on behalf of the appellant and were engaged as its employees. By reference to the divestiture and PAYE remittances and cost code reports of the relevant tax periods, the appellant attributed the "mistakes" to "typing errors" by ignorant personal assistants. It further treated the letters as mere form and the divestiture and tax remittance documents as the substance of the scheme. Lastly, it contended that listing r 4.6A as read with listing r 15.2 (a) did not preclude the divestiture of head office functions.

I do not accept the appellant's explanations for four reasons. Firstly, the letters all emanated from and were signed by

the highest officers of the appellant on its behalf, who were all aware of the true position of the appellant and cannot blame the personnel assistants for their own deliberate actions. The caveat subscriber rule is an adequate antidote to their actions from which they cannot legally and factually resile. Secondly, the divestiture could not and did not stop the appellant from employing group personnel directly. That they were remunerated by the flagship on behalf of the appellant was a separate contractual arrangement between the appellant, the flagship and the group employees. This was analogous to the pithy comparison made by Mr Matinenga that a son who pays his father's cowhand does not become the employer. In my view, the payments and tax remittances by the flagship portrayed a picture, a mere appearance, of the group personnel as employees of the flagship when in reality and substance, they were direct employees of the appellant.

The two contentious listing rules provide that:

"46A: The directors and senior management of an applicant must have collectively appropriate expertise and experience for the management of the group's business. Details of such expertise and experience must be disclosed in any listing particulars prepared by the company (see para 7B1 to 7B3)."

"15.2: In evaluating a list of an investment entity the Committee will have regard to the following fundamental principles:

- (a) Those managing the investment must have adequate experience;*
- (b) ...*
- (c) The investment entity must be a passive investor and neither it nor its management company nor any director or manager of the investment entity or its management company should control, or seek to control, be actively involved in the management of the companies, or other entities in which it invests."*

The preamble to r 4.6 provides that the rule deals with the general conditions for listing that apply to all markets while r 15 deals with additional and alternative requirements specific to investment entities. The preamble to r 15 defines an investment entity as "including investment companies, investment trusts and unit trusts whose principal activity is the investment which for the purpose of this section includes private companies. The entities, by their nature, do not seek to control or be involved in the day-to-day management of their investees and are therefore passive investors."

Other relevant definitions in the listing rules are:

"Applicant: an issuer which is proposing to apply, or is applying, for admission of any of its securities."

"Group: a holding company, not itself being a wholly owned subsidiary, together with all the companies being its subsidiaries"

"Holding company: a company that has one or more subsidiaries"

"investment entities: investment companies, investment trusts and unit trusts whose principal activity is the investment in securities."

What arises from these definitions is that the appellant was the applicant immediately prior to its listing in 1998 and not on 1 April 2005 when it purportedly transformed into an investment entity. It never listed as an investment entity in 1998, so the provisions of r 15 (2) (a) did not and do not apply to it. The rule that applied and applies to it is r 4.6A. That rule governed its listing conditions in perpetuity. The appellant was the applicant. The flagship, formed in March 2005, was not. It could therefore not comply with the requirement to have directors and senior managers who collectively possessed appropriate expertise and experience in the management of its own business and that of its subsidiaries by the proxy of a non-existent subsidiary.

It was remiss of the appellant to rely on para 7.2 of the OECD TPGs that has no application in Zimbabwe. But even if that para applied, the appointment of inter alia a subsidiary to conduct the head office functions would and cannot turn it into the head office. It merely remains an agent of the appointing entity from whom it derives its mandate and

must constantly account for its conduct. The appellant turned the concept of agency on its head by making the flagship the holding company of the group. It further failed to demonstrate the normalcy of its conduct by way of empirical data. The means and manner in which the appellant effected the divestiture was abnormal. I am satisfied that the Commissioner's opinion in this regard was correct.

The alternative disjunctive, para (b) of s 98, is predicated upon the creation of abnormal rights or obligations that would not be created between parties dealing at arm's length. The arm's length principle is a universal one, which is concerned with the comparability of the actions of related parties with those of unrelated parties. Again, reference to para 1.1.1.0 of the guidelines was misplaced as it is not prescriptive but suggestive and is incapable predicting the multifaceted transfer pricing situations that may confront taxpayers and tax administrators.

The Commissioner correctly formed the opinion that the TOS in question created abnormal rights or obligations between the parties in that the appellant foisted its employment obligations on the flagship. This was abnormal in that the relationship would not pass muster comparison with independent parties.

The further opinion that the avoidance, postponement or reduction of tax liability was the sole purpose or one of main purposes of the TOS

The respondent formed the further opinion that the divestiture of HO functions to the flagship had at the very least as one of its main purposes the avoidance or reduction of the appellant's tax liability. The appellant, through the testimony of GFD, the GCEO and the purported expert, asserted that the questions of tax was not in its contemplation. Rather, the main purpose was to free the directors of the appellant from the clutter and reputational risk associated with running an MNE, streamline management and engender growth of the appellant.

A company does not have a soul or body of its own. It operates through its directors in meeting. It is a peremptory requirement of s 138 of the Companies Act [Chapter 24:03], applicable at that time, that the board keep minutes of its deliberations. It was common cause the directors who conceived the divestiture did not keep minutes of their deliberations. It was again common cause that what passed for those minutes in the minute book of that time were the public resolutions flighted by the appellant in the media, which were all produced as exhibit 1A, 1B and 1C.

GFD was not a director nor was he the company secretary of the appellant at the time the divestiture was conceived. The GCEO was an executive director but was unsure whether the question of tax liability arose. Both witnesses conceded that at the time of divestiture the appellant was required to advise the respondent of the tax implications of the scheme, as it did during the 2018 dual listing of the appellant on the Botswana Stock Exchange.

It is therefore highly unlikely that the tax implications of the divestiture would not have entered the mind of the appellant at the conception of the divestiture. I take the uncharacteristic uncertainty of the GCEO as an admission that the implications of the divestiture on the tax liability of the appellant was one of the main reasons why the head office functions were housed in the flagship. In hindsight, the appellant actually avoided and therefore reduced its tax liability through this scheme. The further contention of the appellant that the TOS did not result in avoidance or reduction of tax by the appellant because such liability was absorbed by the flagship is both incorrect and irrelevant. It is incorrect because the flagship did not remit management fees that accrued from the management services rendered to it by the group employees to appellant. That would have altered the overall group tax matrix. It is irrelevant because the appellant and the flagship were and are two separate and distinct taxpayers. See *GC (Pvt) Ltd v C-G Zimra* 2015 (2) ZLR 116 (H) at 133H-134A. The further opinion of the respondent in this regard was justified. It cannot be impugned.

The last leg of s 98 empowers the respondent to assess the appropriate tax liability of the taxpayer whose conduct falls into the purview of these jurisdictional factors. It reposes a very wide discretion on the respondent, which is designed to disgorge the errant taxpayer of the illicit tax gain. The Commissioner proceeded to do so in respect of management fees and royalties.

I proceed to assess the applicability of the s 98 jurisdictional facts to management fees.

Management Fees

It was common ground between the parties that management fees accrued to the employer of the group personnel who rendered the management services. There are four glaring factors that show appellant had employees after 2005. The first was the letters of specific group employees it engaged through the hands of its most senior employees, the GCEO, his successor and GFD. The second was profiling of the directors of the main and subsidiary boards in the post 2005 annual reports that referred to the main board as the group board. The same annual reports listed the GCEO, GFD and all the managing directors of the subsidiaries as group executives and eleven other group senior managers. The third was the formation of the audit, remuneration and nomination board committees, which was inconsistent with a dormant board.

Lastly, compliance with rule 4.6A of the local bourse's listing rules, which mandates that a listed company, such as the applicant, must have collective appropriate senior management expertise to run the group's business, whose expertise and experience must be disclosed in its listing documents. It was further common ground that the management fees were from a Zimbabwean source. It was also agreed that management fees accrued and were paid to the flagship. I have already found that housing the head office function in the flagship was a TOS that had the effect of avoiding or reducing the appellant's tax liability. The management fee income that accrued to the appellant was through this device designedly diverted to the flagship. I, therefore, find the first two jurisdictional facts confirmed. Whether the means and manner of the diversion and recoupment was abnormal.

The flagship charged the management fees that accrued to the appellant at cost. In the Appellant's Group Transfer Pricing Policy 2011/12, annexure B to its case, which attests appellant to be a ZSE listed company that is in business of breeding and marketing certified crop seeds within country subsidiaries the international transfer pricing consultant attributed the management fees to the appellant and warned it that the charges at cost were not compliant with the arm's length principle. In the same vein, the respondent formed the opinion that both the treatment and charge at cost were abnormal. The opinion was premised on the irrefutable fact that independent parties in the shoes of the appellant would have rendered the management services at a margin. The appellant did not dispute that the diversion was abnormal. Rather, it submitted that charging management fees at cost was normal yet curiously conceded that a mark-up is the commonly accepted way of earning a return on investment.

The appellant relied on the OECD TPGs, which preclude the grossing up of management costs, and the levying of duplicated services' costs and shareholder activity costs. The claim for costs for duplicative services and shareholder activities cannot be claimed under the OECD TPGs because they do not create direct commercial and economic benefit to the subsidiary. However, the flagship claimed and the subsidiaries paid the costs apportioned to them, which included the shareholder and duplicative costs. The balance was apportioned to the flagship. GFD testified that the flagship only recovered the actual costs expended by the group employees without marking them up because he feared that in-country revenue authorities would not have allowed the payment of grossed up fees. His fear, which was supported by the purported expert, was not supported by any concrete evidence. He produced no evidence to confirm the disallowance by these revenue authorities. The claimed fees were actual paid albeit to the wrong party. The appellant cannot therefore claim the benefit of OECD TPGS after the horse has bolted. In any event the management fees accrued to the appellant as the legal employer of all head office personnel. I am satisfied that the appellant failed to discharge the onus on it to show on a balance of probabilities that the opinion of the Commissioner that the diversion of income due to the appellant to the flagship and the failure to gross up the management costs incurred by group personnel was either conducted in an abnormal way or created rights or obligations between them that were abnormal was wrong.

Thus even if the OECD TPGs were applicable, the appellant would have failed to discharge the onus on it to show on a balance of probabilities that the purported duplicative and shareholding services did not create any direct commercial or economic benefits for all the subsidiaries in light of the avowed intention of the appellant to improve efficiency and promote growth within the subsidiaries.

The appellant was also entitled to receive management fees from the flagship, as the flagship was the chief beneficiary of the management services rendered by the Group personnel. The inclusion of the apportionment of the flagship in the computation of market related management fees that were re-positioned to the appellant was therefore appropriate.

The further opinion that the avoidance, postponement or reduction of tax liability was the sole purpose or one of main purposes of the TOS

The appellant denied ever diverting income to the flagship. It did not countenance the possibility that the Court would find that it did. It therefore did not address the point. At the very least I find against it that one of the main purposes of the diversion scheme was to avoid or reduce the tax liability of the appellant.

Whether the mark-up was justified

The respondent imposed a mark-up of 25% based on the average profit before tax of the appellant's reconstituted financial statements. The closing words of s 98 give the Commissioner a wide discretion in extirpating the avoidance or reduction. The appellant contended that the method was fundamentally flawed. The Commissioner simply imposed a blanket mark-up on the total head office costs, which included the costs that would have been incurred by the appellant, which was contrary to the OECD TPGs. The appellant relied on exh 11, compiled by the purported expert, which consists of three tables of the computation of management fees. The first shows that the management fees charged by the flagship were 58%, 33%, 27% and 60% higher in each respective tax year, than they should have been under the OECD TPG formula. The second showed that in comparison to those due under the OECD TPGs, the fees imputed to the appellant by the respondent were higher than they should have been had they been imposed on the flagship by 67%, 145%, 129% and 71% in each of the respective tax years. The last showed the total costs attributable to the subsidiaries, exclusive of the flagship after deducting from the total head office costs, the costs pertaining to the flagship and shareholder costs. The tables attempted to show that the notional base amount upon which the respondent imposed the mark-up was too high, such that it produced an inequitable result.

I dismiss the contentions of the appellant for the following reasons. Firstly, the appellant deliberately ignores the purpose of the computation of the notional tax due from the miscreant taxpayer. It is to either correct the avoidance or reduction of its tax liability or to impose the appropriate notional tax.

In my judgment, in view of the provisions of s 143 (5), s 144 (1) and s 145 (1) of the Companies Act supra, I hold the appellant to be synonymous with the Group. The Group achieved a profit before tax of 25% through the efforts of the group employees. The growth and profitability of the Group was the predominant responsibility of the appellant. The Commissioner was therefore entitled to use the average gross profit of the Group to mark-up the management fees. The Group itself was claiming management fees for all head office costs including the OECD TPGs shareholder activities. The Commissioner in the exercise of his extraordinary powers and untrammelled discretion correctly utilized the formula used by the appellant to claim management fees that accrued to the appellant at the mark-up she used in order for her to either collect the correct amount or disgorge the appellant of the illicit benefit. I, therefore find that the appellant failed to show on a balance of probabilities that the Commissioner's quantum of the tax liability was erroneous.

Royalties

Whether or not there was a transaction, operation or scheme and whether such transaction, operation or scheme had the effect of avoiding or reducing tax and was abnormal in the sense prescribed under s 98 of the Act.

The TOS in respect of royalties arose from the purported assignment of the five trademarks in question firstly from the appellant to the flagship and then from the flagship to SCI on the same day, 1 April 2005. GFD represented the assignor and assignee in the first assignment and the assignor in the second in which the country manager represented the assignee. Until the case manager established by third party verification with the Zimbabwe Trademarks Office that the appellant had never legally relinquished ownership, the appellant had maintained that they were owned by SCI. By virtue of ss 26, 28, 29 and 30 of the Trade Marks Act, these trademarks are irrevocably owned by the appellant and protected from use by any competitor. The appellant thereafter took the position that the trademarks had no value on their own. The purported assignments constituted a TOS, the effect of which was to divest income accruing from the use of the trademarks from the appellant to SCI. The purported assignments made SCI and not the appellant the recipient of that income. The appellant divested itself of income due to it as royalties for which it should have been taxed. It therefore had the effect of either avoiding or reducing the tax liability of the appellant.

Whether the Commissioner's opinion that this TOS's way and means was abnormal or created abnormal rights or obligations was wrong.

The substance of the TOS was that SCI, earned income from the other subsidiaries based outside Zimbabwe from the use of the trademarks in question. It was common cause that the appellant characterised this income as royalties during the investigations in correspondence and meetings held with the case manager and in subsequent e-mails between and amongst GFD and the country managers of its subsidiaries. In fact, the appellant never disputed in the 43 paged objection letter of 23 December 2013 that these payments constituted royalties. It only half-heartedly did so in the appellant's case. However, the appellant implicitly conceded that the amounts paid for the use of the trademarks were royalties by accepting that the Research and Marketing Agreement, such as the one consummated between SCI and its Malawi subsidiary was a royalty agreement. In his unguarded moments during his long evidence in chief, GFD also called the fees paid from such agreements royalties. He also explicitly did so in his letter to the case manager of 25 June 2013. Indeed he agreement is in the nature of a royalty agreement in that it requires the Malawi subsidiary to pay fees to SCI for the right to use research and marketing development intangibles of hybrid seed engineered by SCI as a percentage of the net sales of these products.

The appellant asserted during the investigations, in pleadings and oral testimony of GFD and argument that only two agreements were consummated during the tax years in question. Of these two, only one was ever effected. The assertion is contrary to the position portrayed in the "Group Proposal to Review Transfer Pricing Framework" of 24 October 2013 produced by an international transfer pricing consultant fronted by Mr Erasmus, the lead representative of the appellant at the trial. These agreements were not availed to the case manager despite his requests, obviously because GFD instructed his country managers not to cooperate with him as exemplified, firstly, by his e-mail of 26 June 2013 to the SCI country manager and secondly of 27 January 2014 to the managing directors of Tanzania, Zambia and Zimbabwe to fiddle the maize sales transactions between the three countries in order to minimize tax due to Zimbabwe from paying direct royalties of US\$530 000. I can only draw adverse inferences against the appellant for such unbecoming conduct.

It was common cause that only Zimbabwe and Zambia had research stations from which germplasm was engineered and forwarded to the subsidiaries for trials. I understood the highly experienced scientist to have confirmed this position under cross examination. He had overall control and command of all research as demonstrated by his representation of the appellant in the agreement executed with CIMMYT in March and April 2004 for the benefit of SCI and thereafter his job description. That germplasm emanated from Zimbabwe was unwittingly confirmed by GFD in his e-mail to the managing directors of Tanzania, Zambia and Zimbabwe of 27 January 2014. It emerged from the evidence of GFD that the treasury function through which SCI accessed funds used by other subsidiaries outside Zimbabwe, was based at the appellant's Harare Borrowdale head office. It was further common cause that the trademarked varieties and all the unpatented varieties from registered in country PBRs were sold under the general trademark for market recognition, reputation goodwill and quality consistence. It is clear to me that the wit, labour and intellect, and finances required to research, develop and market the two trademarked varieties and the rest of the unpatented PBRs bearing the general trademark originated from the appellant and not from SCI as captured in the SCI Malawi agreement. See *Millin v CIR 1928 AD 207 (3 SATC 170)*.

The assignments and subsequent royalty agreements created abnormal rights and obligations between the true owner of the trademarks the appellant, SCI and the users. The true owner divested itself of the right to receive royalties from the users. The purported assignee was vested with the right to do so. The users were obliged to pay royalties to the purported assignee. These corporate incestuous relationships would not be undertaken by, and were therefore anathema to the conduct between, unrelated parties. Income from the use of trademarks would accrue to the true owner and the user would pay the agreed royalties to the true owner. The sacred rights and obligations conferred by ownership and utilization would be hallowed and not subverted by unrelated parties. It is my finding that the way and manner in which the TOS was consummated by the appellant and its subsidiaries was abnormal. I further find that the TOS also created abnormal rights or obligations between the appellant, SCI and its other in-country subsidiaries.

In the alternative, such an abnormal arrangement created abnormal rights or obligations between SCI and these subsidiaries in that royalties which accrued to the appellant were diverted to SCI. The conduct of the taxpayer fell into

the impermissible second paradigm articulated in CIR v King 1947 (2) SA 196 (AD) at 210 and 216, 14 SATC 184 at 198 and 204” and to which Commissioner of Taxes v Ferera 1976 (2) SA 653 (RAD) at 659D-E cited in approval:

“But the Commissioner would be properly aggrieved if a transaction or operation were entered into which prevented income from accruing to the taxpayer while leaving him in the position of one to whom the income would normally and naturally accrue.

And

Now normally and naturally the owner of an income-producing asset receives the income and the labourer receives the reward for his labour. Any departure from this order of things, if done with the object of prejudicing the fiscus, is the subject of the legitimate objection by the Commissioner, which is met by the machinery of the section.”

I am satisfied that the income that was divested to SCI was in reality the income of the appellant. The Commissioner, therefore, correctly found the ways and means and in the alternative the rights or obligations created by the TOS in respect of royalty fees to have been abnormal.

The further opinion that the avoidance, postponement or reduction of tax liability was the sole purpose or one of the main purposes of the TOS

I am unable to impugn the opinion of the Commissioner that one of the main purposes for embarking on such a TOS was to avoid or reduce the tax liability of the appellant. I, however, accept the other main reason for doing so was to benefit from the favourable investment and capital raising laws in Botswana in 2005. However, that purpose lost its luster in the period of the tax review, which coincided with the introduction of a vibrant multicurrency regime and consequent creation of favourable macroeconomic policies in Zimbabwe.

The cumulative effect of the existence of a TOS and the two separate opinions of the Commissioner inevitably required her to implement the closing words of s 98. She was obliged to ‘determine the liability for any tax and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out, or in such manner as in the circumstances of the case he considers appropriate for the prevention or diminution of such avoidance, postponement or reduction.” The Commissioner could efficaciously do so with the cooperation of the appellant. The cooperation between the parties was exemplified by the Commissioner and appellant’s acceptance to treat and use the SCI-Malawi agreement as the basis for calculating the imputed or notional royalties that were deemed to have accrued to the appellant. The purported “without prejudice” communication from the appellant must therefore be viewed in this light. The without prejudice communication cumulatively related to the computation rates and not to liability. As I have indicated elsewhere in this judgment, the question of liability was never disputed until much later. By then, the horse had bolted. The appellant’s case had been crystallized by the position it adopted in its objection, which in tax disputes is the key pleading which freezes the rights which the Commissioner and later the Special Court for Income Tax Appeals can determine.

The appellant’s fervent belief that the Commissioner was obliged to compute an arm’s length notional royalty is not borne out by the closing words of s 98. All that is required of her is to assess, in her discretion, a figure that totally extirpates the TOS or one that takes away the illicit tax gain. This is Commissioner did by using the profit before tax figure for maize sales provided by the appellant. The appellant criticized it for including sales derived from other hybrid seed varieties. In my view, the criticism was unwarranted. I find the use of that formula to have been eminently sensible. This is because the general trademark was associated with all the hybrid seed varieties sold in country by all the subsidiaries and from which the Commissioner derived the gross profit.

The amended assessments issued by the Commissioner are therefore unimpeachable.

Penalty

The case manager first imposed a penalty of 100%, which he reduced to 75% on 2 August 2013. However, in the assessment letter of 25 November 2013, he further reduced it to 60%. In the exercise of s 62 (4) of the Income Tax powers the Commissioner increased the penalty to 100%.

In argument, Mr Erasmus wrongly contented that the Commissioner was not imbued with the power to alter the penalty imposed in the assessments. He wrongly sought to separate the penalty from the assessment. My view is that the assessment includes the principal amount, penalty and interest, which in any event was what the appellant had objected to. The power to impose a penalty befitting the offender, the offence and the interests of the community is reposed in the Commissioner by the overarching provisions of s 46 of the Income Tax Act, which inter alia hit any taxpayer who, inter alia fails to submit returns or submits incorrect returns as happened in the present matter.

Like the Commissioner, I am satisfied that the conduct of the appellant through its GFD was reprehensible. I am not persuaded that the appellant sought to apply the OECD TPGs in good faith at all. That conduct showed that the failure to render any tax returns on the part of the appellant was deliberately designed to defraud the revenue. In these circumstances the only befitting penalty is the maximum possible penalty provided by s 46, of 100%.

Accordingly I would, as I do hereby do, impose a penalty of 100%.

Costs

The grounds of appeal were not frivolous. I cannot therefore impose an adverse order for costs against the appellant. Rather, each party must bear its own costs.

Disposition

In the premises I make the following order:

1. The appeal be and is hereby dismissed in its entirety.
2. The amended assessments numbers 1/699, 1/698, 1/697 and 1/700 issued by the Commissioner are confirmed.
3. Each party shall bear its own costs.

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