

Transfer pricing risks

TRANSFER PRICING
DEDAN
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As Ugandan businesses expand regionally and globally, transfer pricing has quietly become one of the most scrutinised areas of tax compliance. Transactions between related parties—whether across borders or within a group of companies—are now firmly on the radar of the Uganda Revenue Authority (URA). Business leaders should therefore understand the risks and how to manage potential disputes before they escalate.

Transfer pricing refers to the prices charged for transactions between related entities within the same group of companies. These may include the sale of goods, provision of management services, intellectual property licensing, loans between group companies, or cost-sharing arrangements. Uganda introduced formal transfer pricing regulations in 2011 under the Income Tax Act, requiring related-party transactions to follow the arm's length principle, meaning they should be priced as if the parties were independent entities dealing with each other.

For many businesses, the challenge lies not in the concept itself, but in its practical application.

Risk 1: Mispricing of related-party transactions

One of the most common risks arises when companies price intercompany transactions without benchmarking them against market conditions. For example, a Ugandan subsidiary may purchase goods from a foreign parent company at inflated prices or provide services at artificially low margins. In such cases, URA may conclude that profits are being shifted outside Uganda and adjust the taxable income accordingly.

Consider a practical scenario. A Ugandan distribution company buys products from its related manufacturer abroad and sells them locally. If the purchase price is higher than what independent distributors would pay in similar circumstances, URA may reduce the cost of purchases and increase the taxable profit of the Ugandan entity.

The lesson for businesses is straightforward: intercompany prices must re-

Risks of transfer pricing



fect economic reality, not group convenience.

Risk 2: Weak or missing transfer pricing documentation

Transfer pricing disputes often arise because taxpayers cannot demonstrate how the price was determined. URA requires taxpayers to maintain documentation explaining their transfer pricing policies, including the nature of related-party transactions, the agreements between the parties, and the methodology used to determine arm's-length pricing.

Failure to provide such records when requested can result in penalties and increased scrutiny during audits. In fact, taxpayers may face a penal tax of up to Shs50 million for failing to provide transfer pricing records requested by URA.

A common example is when a company pays management or technical service fees to its parent company without

documenting the services provided or benchmarking the fee against comparable services in the market. When URA asks for supporting documentation, the company struggles to justify the expense.

Risk 3: Intra-Group service charges without economic substance

Many multinational groups allocate regional management costs, technical services, or shared support functions to subsidiaries. While such arrangements are legitimate, they frequently trigger transfer pricing disputes when the benefit to the local entity is unclear.

URA may ask questions such as: What services were provided? Did the Ugandan entity benefit from the services? Would an independent company have paid for such services? For instance, if a Ugandan subsidiary pays substantial "management fees" to its parent company but cannot demonstrate the nature and value of the services, the deduction may be disallowed.

Risk 4: Financing between related parties

Loans between group companies are another area of risk. Companies sometimes receive funding from related parties at interest rates that do not reflect market conditions. If the interest rate is excessively high, URA may adjust the interest deduction or recharacterize part of the payment. Similarly, interest-free loans between related parties may attract scrutiny if they do not reflect commercial reality.

Risk 5: Lack of early transfer pricing planning

Many transfer pricing disputes arise

because companies address the issue only after URA begins an audit. In practice, transfer pricing should be considered when structuring related-party transactions, not when defending them later.

In Uganda, tax authorities are increasingly focusing on international payments and related-party transactions as part of their risk-based compliance programmes. This means companies with cross-border dealings should expect more detailed questions during tax reviews.

Managing transfer pricing disputes

When transfer pricing issues arise, the taxpayer's approach can influence the outcome.

Maintain robust documentation

The first line of defence is a well-prepared transfer pricing study. This should include a clear description of related-party transactions, functional analysis of the parties involved, and benchmarking against comparable independent transactions.

Good documentation not only supports compliance but also demonstrates to URA that the company has taken reasonable steps to follow the arm's length principle.

2. Ensure consistency between contracts and actual conduct

URA often examines whether the written agreements between related entities match the actual conduct of the parties. For example, if a contract states that the parent company provides strategic services, the company should show evidence such as reports, advisory support, or management oversight.

Consistency between documentation and operational reality reduces the likelihood of disputes.

3. Engage early during tax audits

When URA initiates a transfer pricing review, transparency and cooperation are essential. Businesses that proactively explain their pricing policies and provide supporting documents early in the process often resolve issues more efficiently. Recent tribunal decisions have shown that failure to provide information within the requested timelines can result in significant penalties.

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Prices

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