



## RELATED PARTY TRANSACTIONS AND TRANSFER PRICING: A BRIEF INTRODUCTION

*Angelique Bart*

**T**he issue of transfer pricing is pertinent for multinational enterprises (“MNE’s) i.e. companies which operate in one or more countries at a time. Globally recognized MNE’s include Google, Amazon, and Facebook, but transfer pricing can also impact many local companies that carry on business in other jurisdictions.

From a tax perspective, MNE’s pose a particular challenge as a country would need to ensure that the entity is compliant with its tax laws, while ensuring that laws are not so stringent as to be viewed as a significant impediment to the commercial objectives of the enterprise and/or cause the jurisdiction to be viewed as unattractive for investment purposes.

In striking this delicate balance, countries are often faced with greater challenges when cross border transactions occur within a group of companies operating in various jurisdictions. Most states are concerned that a MNE may identify and exploit lacunas in the varying laws to maximize its profit but distort its tax base by inter alia, utilizing artificial or fictitious transactions which lack commercial purpose. In these difficult economic times, tension has increased between MNE’s and the Tax Authorities and the countries in which they conduct business. The recent appearance of Starbucks, Google and Amazon (U.S. incorporated companies) before the UK Public Accounts Committee on the issue of taxation highlights how concerned each country is with whether MNE’s are paying their fair share of tax in the respective countries in which they operate, or whether they are manipulating laws to avoid taxation. The UK attributes these MNEs’ ‘low or no tax’ reporting status to complex intercompany transactions which erode the tax base.

The transparency aspect in “inter-company” cross border transactions has propelled this issue onto the world stage. In this regard, the Organization for Economic Cooperation and Development (OECD) developed Transfer Pricing Guidelines which are codified and used in member countries. The OECD consistently amends/updates the guidelines to reflect best practice, and the most recent of those amendments were made in 2010. Transfer pricing is

amongst the top tax issues of concern to MNE’s and Governments alike since Countries would like to ensure that they collect their fair share of taxes while MNE’s wish to ensure they are not unduly taxed and burdened so as to impede profitability.

Trinidad and Tobago (T&T) also faces the taxation issue regarding inter-company and other cross border transactions. Accordingly, it was no surprise when the Minister of Finance announced in the 2010 National Budget that the Government proposed to introduce transfer pricing rules based on the OECD Transfer Pricing guidelines. Although local transfer pricing legislation has not been passed to date, in recent years we have encountered several instances in which discussions between taxpayers and Tax Authorities include references to the OECD Transfer Pricing Guidelines as a highly persuasive authority in resolving tax disputes.

### What is Transfer Pricing?

The OECD Glossary of Statistical terms defines a ‘transfer price’ as:

*“A price, adopted for book-keeping purposes, which is used to value transactions between affiliated enterprises integrated under the same management at artificially high or low levels to effect an unspecified income payment or capital transfer between those enterprises.”*

For clarity, it is not transfer pricing *per se* that is unacceptable, it is transfer [mis]pricing which is strongly frowned upon! In transfer [mis]pricing, two related parties

*(cont’d on page 3)*

## C O N T E N T S

- Related Party Transactions and Transfer Pricing: A Brief Introduction
- Get Those Goods Moving Out of Trinidad & Tobago: The Ins and Outs of Regional Trade

# GET THOSE GOODS MOVING OUT OF T&T:

## The Ins and Outs of Regional Trade

*Aisha Peters*



It is no secret that trade with our Caribbean neighbours represents a significant source of revenue for local businesses. The emergence of the Caribbean Single Market and Economy (CSME), while not yet fully implemented, has facilitated improvements in our regional trading ability, particularly in the movement of labour. In addition to the CSME, bilateral agreements between CARICOM and Caribbean countries such as Cuba and the Dominican Republic are designed to promote and expand the trade of goods and services amongst all the participating territories.

Despite the growing importance of regional trade, some local businesses are reluctant to navigate their entrepreneurial skills and resources outside of Trinidad and Tobago (T&T) because they do not understand the requirements for the movement of goods and services in and out of our shores. This article provides an overview of the legal requirements of which businesses in T&T should be aware if they wish to conduct trade within the region. It also highlights the local authorities responsible for the regulation and enforcement of these laws.

### **Movement of Labour in the Caribbean**

A key pillar of enterprise is the ability to select quality labour from as wide a pool as possible to ensure that the best persons are recruited. This might involve looking outside of T&T, especially if unique skills are required. If you are a 'one-man' enterprise or a self-employed professional, you will want to provide your services to as large a market as possible. In both instances, the common denominator for success will be the free movement of labour in and out of the country.

One of the main goals/benefits of the CSME has been the implementation of the Certificate of Recognition of Caribbean Community Skills Qualification ("Certificate of Recognition"), which has removed the need for work permits to be obtained for certain categories of workers who are nationals of participating member States. According to the Immigration (Caribbean Community Skilled Nationals) Act the following persons can move and work freely within the Community: university graduates, artistes, media workers, musicians and sports persons.

If the foreign worker does not fall into any of these categories, and the person's duration of employment will exceed a single period of thirty (30) days in any twelve consecutive months, the employer will need to apply for a work permit on behalf of the worker. The major differences between the Certificate of Recognition and the work permit are the cost and period of stay permitted in Trinidad and Tobago by the respective documents. There are no fees for the application or issue of a Certificate of Recognition, which is processed by the Ministry of Foreign Affairs, and once approved the foreign worker could be granted indefinite entry, whereas work permits, which are processed by the

Ministry of National Security, are typically granted for no more than three years and are subject to renewal at the discretion of the Government of Trinidad and Tobago. There is also an application fee and a monthly fee to be paid for the term of the work permit.

### **Export and Import of Goods**

In Trinidad and Tobago, an Open General Licence allows the general exportation and importation of most goods without a special licence except goods identified in the "Negative Lists" published by Legal Notice for exports and imports respectively. Examples of some goods requiring a licence to export are endangered species; works of art, artefacts and archaeological findings. Items requiring licences to import from the Caribbean include coconut oil, copra and animal oils. Businesses wishing to export and import goods should always consult with the Ministry of Trade, Industry and Investment to confirm whether the particular item requires a licence in accordance with the respective Negative List. The Customs and Excise Division of the Ministry of Finance and the Economy is also responsible for approving all imports and exports from T&T and the enforcement of duties.

### **Standard of Goods**

Certain goods imported into T&T are required to meet specific standards before being distributed to consumers. The Trinidad and Tobago Bureau of Standards (TTBS) (governed by the Standards Act) is the statutory authority responsible for the development and maintenance of standards for goods and services produced or used in T&T, except food, drugs, cosmetics and medical devices. The TTBS, as part of its mandate, is authorized to inspect goods entering the country for purposes of trade to ensure compliance with any published standards. All businesses desirous of importing goods should consult with the TTBS to determine what compulsory standards, if any, apply to such goods.

The Chemistry, Food and Drugs Division (CFDD) of the Ministry of Health is responsible for ensuring the safe quality and proper standards for food, drugs, cosmetics and medical devices in accordance with the Food and Drugs Act and Regulations; and the Pesticides and Toxic Chemicals Act and Regulations. Any person, broker or business wishing to import, manufacture or sell food or drugs in Trinidad and Tobago must have these inspected and approved by the CFDD.

### **Anti-Dumping**

Importers of subsidized goods should be aware of legislation controlling the importation of subsidized products. The Anti-Dumping Authority was established under the Anti-Dumping and Countervailing Act to investigate complaints and impose anti-dumping or countervailing duties in order to eliminate the dumping or subsidising of imported products.

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## GET THOSE GOODS MOVING OUT OF T&T: Regional Trade (cont'd)

(cont'd from page 2)

The Anti-Dumping Authority has the power to:

- Investigate the existence, degree and effect of alleged dumping or grant of subsidy of any goods;
- Ascertain whether the goods imported into T&T cause or threaten to cause injury to any local industry or to retard the establishment of a new industry in Trinidad and Tobago;
- Identify goods liable for any duty or additional duty to be chargeable under the Anti-Dumping legislation;
- Submit to the Minister findings as to the margin of dumping or the nature and amount of subsidy relative to such goods; and
- Make recommendations to the Minister.

### Conclusion

The ability to trade outside one's domestic economy is essential for economic development. There has been considerable discussion in recent times on the need for trade liberalization and improving the free access to goods and services particularly within the Caribbean. It is critical for businesses desirous of expanding their enterprise to understand the legal framework currently available for facilitating intra-regional trade, and to use this as their compass to steer their business towards prosperity.

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## RELATED PARTY TRANSACTIONS AND TRANSFER PRICING (cont'd)

(cont'd from page 1)

utilize artificial transactions between themselves to distort income payments or capital transfers so as to erode their taxable base. Thus, transfer pricing regulations effectively force two related parties to deal at arm's length with each other, and in the absence of the parties dealing with each other on an arm's length basis, most Tax Authorities are empowered by law to disregard or re-adjust the transaction to reflect what it considers "arms' length". Essentially, these regulations are considered anti-tax avoidance provisions.

### Existing T&T Tax Laws

The existing tax laws have generic anti-avoidance provisions which encapsulate the 'arms length principle'. These are: Section 10(1) (b) of the Income Tax Act, Chap. 75:01 arbitrarily imposes a 2% limitation on the deductibility of outgoing and expenses in respect of management charges; and Section 67 of the Income Tax Act, Chap. 75:01 which allows the Tax Authority to set aside artificial or fictitious transactions.

**Section 10(1)(b):** Interestingly, the restriction on deductibility of management charges applies only where the payments are made to non-resident T&T companies, whether or not related to the paying company. Further, the Finance Act 2006 attempts to reduce the deductibility of allowable expenditure by broadening the definition of "management charges" to include an array of "shared costs" payments. This provision alludes to the difficulty of determining the arms' length pricing between related parties but, more importantly, the legislative provision has limited the deductibility of genuine business expenditure even where the parties are unrelated. Such a provision arguably flies in the face of non-discrimination of applicability to tax laws between resident and non-resident persons.

**Section 67:** This provision is largely governed by the words "artificial" or "fictitious". While there are no legislative

definitions for these words, there has been an abundance of case law to assist in defining the terms. Analysis of case law has shown that "fictitious" refers to a sham or ruse while, "artificial" is seen as having a much wider interpretation than "fictitious". Case law has further shown that a transaction is in the realm of "artificiality" where it takes place between related parties; it lacks commercial sense so that it does not represent what unrelated parties would do; the price of the transaction is not in keeping with the fair market value; and the transaction was essentially designed to reduce or defer taxes.

There is a high level of subjectivity in assessing whether a transaction qualifies as "artificial" or "fictitious" so that it becomes a question of fact as to whether a transaction will be captured by Section 67. However, section 67 is arguably deficient as it does not address how to ascertain the arms' length value of a transaction, in that there are no specific guidelines or accepted methodologies to address this. As a result, there have been many disagreements between the taxpayers and the Tax Authorities in respect of the arms' length nature of related party transactions. On the face of it, the OECD Guidelines on transfer pricing, as tedious and cumbersome as the rules may appear, presents the most internationally accepted alternative for determining the value of an arms' length transaction between related parties. Presumably, the introduction of these rules will pave the way for Parliament to remove the provision restricting the deductibility of genuine expenses between unrelated parties.

In our next article, we will review the OECD Guidelines on Transfer Pricing.

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