Current Practice and Future Prospects of Transfer Pricing in Bangladesh: An Engagement-Based Study

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Abstract:

The objective of the study is to broaden the understanding of the practice of transfer pricing in Bangladesh as well as to predict the future trend and avenues for future development in Bangladesh. This study has been conducted through a semi-structured interview basis of 18 persons from two different backgrounds of people like consultants of transfer pricing and the management of the business entity of different industry with open-ended question format. Key findings are that the only motivation for Bangladeshi companies to use transfer pricing strategy is compliance with transfer pricing regulation of Bangladesh Income Tax Ordinance and Rules 1984; companies are accelerating the profit erosion through aggressive transfer pricing; management of Bangladeshi companies has much less knowledge regarding transfer pricing; there has not been any specific guideline for liaison office and banks as well as no guideline for using the range concept for income adjustment; and even there have not been any practical cases on transfer pricing. Bangladesh has not any strong own database, and even no guideline for using any specific database for benchmarking. This study will contribute to the literature on transfer pricing especially in the developing countries where there is a strong lack of engagement-based study on transfer pricing.

Keywords: Transfer pricing, arm's length principle, multinational corporations, permanent establishment, Organization for Economic Co-operation and Development (OECD).

Introduction

In this era of technological development, it becomes more and less expensive to transfer different services and goods from one country to another and the impressing matter is that the way of communication is getting easier day by day. So keeping this benefit in mind the enterprises are getting more motivated to expand their businesses across the world with the easiest system by incurring less cost. They want to take the advantage of technical know-how, cheap labor, less tax rate, market penetration and easy access to international trade. Multinational companies (MNCs) stand for the companies which are operated in more than one country and normally do trade among the different groups in different countries like services, goods and intangible assets, which are normally known as related party transactions. When the MNCs do transactions among themselves in cross-border nature, it falls under the rules of transfer pricing regulation.

The importance of transfer pricing is continuously increasing in the era of the cross-border transaction in the areas of tax and economics as there are different rates in tax in different countries. Transfer pricing has got emphasis by the corporate people not only for the avoidance of double taxation but also for the split of corporate profit in the different regions of the world based on the tax rate to facilitate the avoidance of tax.

Kaur (2016) concluded that transfer pricing issued for the optimum segregation of revenues and cost amongst the different divisions in MNCs. Reasons behind the use of transfer pricing in MNCs are tax savings, performance measurement facilitation, trade-off purpose. Transfer pricing provides different information and the decision about goal congruence. Tax authorities give more emphasis on whether the international transactions among related parties is set out arm's length method or not.

A study conducted by UNCTAD showed that developing countries are losing tax revenue of about $100 billion from the international transactions among associated entities. The companies are going for transfer mispricing which is illegal. To fight against the mispricing, developed as well as developing countries have incorporated the transfer pricing regulations in their own countries. More than 75 companies around the world adopted the transfer pricing regulation. (The Daily Star, 2015).

KPMG (2015) published an article on "Global Transfer Pricing Review in Bangladesh" where they said that tax authorities all over the world are more concerned about the cross-border transactions as it makes the avenue for revenue leakage to other countries. That's why NBR of Bangladesh introduced transfer pricing regulation as a new regulation for the first time in the finance Act 2012 and made effective from 1 July 2014. Bangladeshi transfer pricing guidelines are mainly based on "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010" and "Transfer Pricing Legislation- A Suggested Approach 2011 issued by OECD."

In recent years, research on transfer pricing is gaining momentum, especially in the developed countries. In the developed countries, there is much research on transfer pricing by conducting interview-based engagement reporting (Sirikwan Sriausadawutkul, 2013) to explore the actual scenario, which exists at the practice level. In the developing countries, transfer pricing is also a burning issue for a lot of researchers, but the most interesting part is that very few of them are aware of the engagement-based reporting on transfer pricing. This is the main gap in the field of literature of a developing country like Bangladesh.

The current research addresses the gap which is found through the literature review by undertaking an in-depth interview of 18 people from the 2 sectors like transfer pricing consultants and senior managers. The main obective is to explore the real scenario, with an aim to understanding the weakness in practice by identifying then giving appropriate suggestions.

Literature Review

Literature Review from Global Perspective

Eden and Smith (2011) reported that multinational companies have a greater opportunity by expanding their business in more than one country to get the technical know-how, cheap cost of labor, lower tax rate, and market penetration. As MNCs normally operate in more than one country, they make a strategy to get the optimum benefit of cost minimization through producing in one country where labor rate is comparatively low, assembling in a different country, and then warehousing and distribution in different countries for the maximum value addition.

As per Borkowski (1997) MNCs are getting noticed by the tax authorities as they can transfer the capital from one country to another. It will thus not be surprising if the tax authorities begin scrutinizing the transfer pricing mechanism amongst the associated companies.

As MNCs are operating through different countries, they may manipulate the transfer pricing among their associated entities based on the low tax rate to evade tax, Tebogo (2011). They always try to transfer profit to the country where the tax rate is low from the country where the tax rate is significantly high to minimize the overall tax burden of the company.

OECD (2010) published different methods for the determination of arm's length price like profit based and transaction-based methods. Comparable uncontrolled price (CUP), cost plus method (CPM) and resale price method (RPM) are under transaction-based methods. Profit-based methods will be used where the transaction-based method will not apply. Transactional Net Margin Method (TNMM) and Profit split method (PSM) are under profit-based method.

Literature Review from Bangladesh Perspective

According to CPD (2010) in this period of pure globalization, no assessment entity can shield income without the presence of a sound transfer pricing evaluating framework. Bangladesh is a fast developing economy with expanding presentation to the danger of mispricing in cross-border exchanges.

In an article on "Global Transfer Pricing Review in Bangladesh", the author said that tax authorities all over the world are more concerned about the cross-border transaction as it makes the avenue for revenue leakage to other countries. That's why NBR of Bangladesh has introduced transfer pricing regulation as a new regulation for the first time in the Finance Act 2012 which became effective from 1 July 2014. Bangladeshi transfer pricing guidelines are mainly based on "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010" and "Transfer Pricing Legislation- A Suggested Approach 2011 issued by OECD." (KPMG 2015)

Based on the above literature review, the main literature gap is that there exists very little research on engagement-based study, especially in the developing countries. By regarding the above literature gap, a study has been conducted through semi-structured in-depth interviews of Bangladeshi consultants of transfer pricing and senior level managers of companies.

Research Methodology

The prime objectives of this research is to examine the actual perception of chartered accountants (CA) firms which are engaged in the consultancy of transfer pricing of different MNCs as well as the senior level managers of some MNCs in Bangladesh. To fulfill the objectives, the evidence of the study has been collected through the semi-structured interviews of the intended persons of consultants and managers from different industry/sector of Bangladesh (Belal and Owen, 2007). As discussed earlier, the main objective is to critically understand and evaluate (Gray, 2002) the transfer pricing practices by the conversation with the consultants and managers through a predetermined questions of transfer pricing with the motivation to give probable suggestions for the future development of transfer pricing regulation in Bangladesh by which Bangladesh can earn more revenue from the absolute application of this regulations.

Interviewee Selection

Firstly, the motivation was to cover the three parties like consultants, company senior personnel and NBR officers for the sample. A total of 32 persons were approached for the interview: 22 from consultants of one of the best, A-category, CA firms, 7 senior executives of different companies who are responsible for the tax compliance and 3 officers from NBR who are responsible for transfer pricing cell and tax cell. Among them, 18 favorable responses have come where 13 from consultants and 5 from the corporate level. There has not been any favorable response from the NBR officers. Among the 13 consultants, there are 1 senior manager, 3 managers, 5 associates and 4 senior assistants who are responsible for the transfer pricing consultancy of different MNCs in Bangladesh with a high level of experience and understanding. The 5 company-level executives are from 5 different sectors, namely telecommunication, cement, fuel & power, pharmaceutical, and engineering sector.

According to the above procedures, the 18 persons were interviewed from 15 April 2018 to 10 July 2018. The average time of the interview was 30-50 minutes based on open-ended question-answering session. The interview session was fully unbiased as there was not any kind of arguments at the time of taking the interview. Corporate persons are mainly those who are in the position of tax compliance issues of the whole company. The interview questions were on a generic basis so that no one has to disclose their confidential matter and for that reason, all persons were very helpful in the period of interview sessions. Beyond the structured interview questions, there was an option to add important and relevant information which will be helpful for the overall understanding of the current practice as well as future prospects.

Procedures for Interview

The interview process has been done on the premises of the respondent office with duration of 30-50 minutes based on the interest of the respondent and the depth of knowledge of the respondent about transfer pricing. Every interview process was started with a brief description of the transfer pricing and the objectives of the interview through the outline of the interview questions. Throughout the interview session, the summary of the answer has been written with a short form as the recording was not permitted at the time of the interview sessions. There was a promise to every respondent of the interviewee that the name of their organization and their personal name will not be disclosed for the study purpose and will be kept confidential.

The general introductory questions were asked to every respondent at the interview period about the practice of transfer pricing in Bangladesh as well as to predict the future trend and avenue for future development in Bangladesh.

The process was an interview based on an informal manner so that the respondent could feel free to answer the interview questions. The questions were asked in an open-ended manner through a conversation between the interviewee and the interviewer. The answers, suggestions and the comments given by the interviewees were analyzed and summarized thematically.

Analysis and Discussion of Empirical Findings

The primary motivation of Bangladeshi companies for using transfer pricing strategy

According to the interviewees, the main motivation for the compliance of transfer pricing regulations is especially for tax law compliance purpose. MNCs may have objectives to increase the group profit irrespective of focusing on individual associated enterprise profit. But for the demand of transfer pricing regulations in Bangladesh, MNCs are now starting the compliance of transfer pricing regulations.

> Government is now trying to make the transfer pricing regulation mandatory, especially for the neighboring countries' collaboration and for the prevention of base erosion of profit. (Assistant Manager of a renowned Chartered Accountancy Firm).

> The only motivation for Bangladeshi companies to use transfer pricing strategy is to comply with transfer pricing regulations of Bangladesh Income Tax Ordinance and Rules 1984. (Manager of a renowned Chartered Accountancy Firm)

Are transfer pricing methods too complicated to understand? If no, what is the easy method for transfer pricing?

> Explanation and justification for application of transfer pricing methods in Income Tax Ordinance 1984 and Rules 1984 are neither so easy to understand nor so user-friendly to apply. Therefore, the level of information given on the method of application is sufficient to understand but to apply the method in a proper way, another international guideline on transfer pricing is to be studied.

> No method is preferred as easy or best method; method application depends on the transaction circumstances. (Assistant Manager of a renowned Chartered Accountancy Firm)

Most of the consultants said that transfer pricing methods are not basically complicated to understand. Actually, transfer pricing methods are mainly technical in nature. One has to understand the theme of each method and then to expand more knowledge about the methods one can take a look at the verdict of the different transfer pricing related cases in different countries. They also added that the proof of arm's length price is more appropriate and reliable if the comparison of the similar nature can be obtained with invoices or other documents. It is actually called the comparable uncontrolled price (CUP)method. Above all transactional net margin method (TNMM) is used in maximum cases.

Do you think the companies which have cross-border transactions have an opportunity to shift their profit to other countries?

> Yes, through cross-border transactions, every company has a scope for profit shifting. By segregating the business function in different business authorities, companies are accelerating the profit erosion. Profit is shifted in less taxed countries to avail tax benefits for the group as a whole. (Assistant Manager of a renowned Chartered Accountancy Firm)

In response to this question, the consultants said with high emphasis that transfer pricing is such a weapon by which the MNCs can easily transfer their profit from the base country of the generated income to the country where they can maximize their group profit. They have the chance for the capital flight as the tax rates of different countries are different and MNCs try to grab the opportunity.

On the other hand, the corporate persons said that there is a chance to share profit by transfer pricing policy, but it does not necessarily mean that the company will always hold this belief. The company doesn't want to evade the tax of the income of origin country just want to operate their business on a smooth mood and to earn a profit. So, it can't be concluded that corporate will always hold the belief of shifting the profit and capital flight to any other countries.

What is a level of understanding of the personnel of Bangladeshi companies regarding transfer pricing according to your experience?

> Personnel or management of Bangladeshi companieshavemuch less knowledge regarding transfer pricing. The personnel have not acquainted themselves with the transfer pricing compliance and relevant requirements. Only some of the personnel of MNCs have a little knowledge regarding transfer pricing because of group compliance requirement. (Assistant Manager of a renowned Chartered Accountancy Firm)
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> Consultants concluded that the level of understanding about transfer pricing regulations to the corporate persons is below average as this is a new concept for the world especially for Bangladesh as it is introduced in the Income Tax Ordinance in the Finance Act 2014 and all the companies are not started to comply the transfer pricing regulations. Most of them said that government should come forward to organize training and seminar on this issue and make public awareness so that corporate persons can be more experienced about transfer pricing regulation and can start the same in their individual companies.

In this case, the corporate persons also confessed that they actually have not enriched with the new regulation of transfer pricing. They added that it will require some more time to expand their knowledge about the transfer pricing compliance regulation.

Are all Bangladeshi companies (which fall under transfer pricing regulations) following the transfer pricing compliance regulations?

Consultants have the exact and the authentic knowledge about this matter as they give consultancy about transfer pricing to the companies which have a permanent establishment in Bangladesh. In response to this question, the consultant says that all the companies are not complying with the transfer pricing regulation, but it is a matter of satisfaction that a handsome number of companies are following this. Within a few years, there will be added many companies on the list of complying with the transfer pricing regulation. One of them has given a statistic that around 200 companies are complying with the transfer pricing regulation. Then he also added that there should be more than 2000 companies which fall under transfer pricing regulation but the rest of the noncompliant of transfer pricing regulation are not aware because transfer pricing audit has not started yet by the NBR. If the NBR starts the transfer pricing audit, there will be a huge number of compliant of transfer pricing regulation. They also added that Bangladesh Investment Development Authority (BIDA) have the proper information about the MNCs and the liaison offices, which have cross-border transactions. That's why NBR can take help to collect the list of the Permanent Establishment (PE) which has the international transaction to conduct the transfer pricing audit.

> Many of the companies are not complying with the transfer pricing regulation of Income Tax ordinance in 1984, because of their unawareness of relevant compliance. (Assistant Manager of a renowned Chartered Accountancy Firm)

The corporate persons do not have such vast knowledge about this matter as they are only aware of their own companies and their competitive entities. They concluded that they are following the transfer pricing regulations since the very beginning of the 2015 and said that they always showed their proper respect to the government rules and regulation as well as law and order.

Do you think Bangladesh transfer pricing regulation is highly consistent with developed countries? If no, what is missing in Bangladeshi transfer pricing regulation?

> As Bangladesh transfer pricing regulation is at foundation level, it is quite consistent with transfer pricing regulation of developed countries as being of preliminary stage. Nothing concrete is mentioned regarding transfer pricing compliance of liaison office, banks and practical instances regarding the transfer pricing regulation application is not available in Bangladesh. (Assistant Manager of a renowned Chartered Accountancy Firm)

Most of the consultants said that the transfer pricing regulation in Bangladesh is highly aligned with the transfer pricing regulation of developed countries. But Bangladesh has not still been successful to enforce the law properly, even compared to the neighboring country India. India is one of the most transfer pricing aggressive countries as they have a huge number of foreign companies. They suggested that Bangladesh can follow the rules being followed by India.

Is there any adequate database in Bangladesh? If no, do you think there should be a strong database in Bangladesh?

> Consultants said that there is no database owned by Bangladesh whereas India has 2 strong databases namely CapitaLine-2000 (from CapitaLine Market India Private Limited and Prowess from CMIE (Centre for Monitoring of Indian Economy Limited)
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> In Bangladesh, no database has been established regarding transfer pricing. However, a database that Bangladeshi consultants are using is mainly Asia Pacific based to compare related transfer pricing transactions. Sometimes the consultants use public companies' information from DSE. Therefore, there is a strong need for a Bangladesh-based database, as many Bangladeshi companies request to compare and decide upon the arm's length range of their companies with relevant Bangladeshi companies. (Assistant Manager of a renowned Chartered Accountancy Firm)

Most of the consultants highly put emphasis that there should be a database for Bangladesh. To develop a database the government should come forward as it is a highly costly and timely factor. If the government develops a strong database for transfer pricing benchmarking at its own cost, later the government can charge fees from the consultant for the user of that database. The entire consultant will have to follow the database specified by the NBR, as without following that database the consultant could not do the benchmarking, and even if they do by using another database, the NBR may reject the benchmarking if it wants.

Here the corporate persons also agreed with the consultant that there should be a government-owned database, especially for the benchmarking of the transfer pricing for the more transparent and consistent comparison.

Transfer pricing audit has not been started yet. Do you think transfer pricing audit should be started by the NBR?

All consultants said that it is high time the NBR started transfer pricing audit as soon as possible. If the NBR cannot start the transfer pricing audit now, the NBR will be unable to do an audit of any file which has aged more than 3 years in the eye of law. Now it is 2018 and MNCs started their transfer pricing regulation after the Finance Act 2014 in the year 2015. So if the NBR started transfer pricing audit this year, the NBR will be allowed to open any file of 2015. If the NBR starts transfer pricing audit in the next year, the NBR will lose the back 2015 and onwards. The most interesting factor is that if the NBR starts the transfer pricing audit, there will be a huge number of companies, which will start to follow the transfer pricing regulation, which will be a positive sign for the government that there will be a high amount of income adjustment to the income of the companies, which use the transfer mispricing.

> NBR is planning to start the transfer pricing audit within 2018 possibly. They are planning to be very strict in relation to the transfer pricing audit. NBR has also established a separate transfer pricing cell with required individuals. (Assistant Manager of a renowned Chartered Accountancy Firm)

The corporate persons said that we were ready for the audit with all our compliance report. So, the government can start a Transfer Pricing audit at any time.

Do you think if transfer pricing compliance regulation is maintained by companies properly, it will increase the collection of revenue by NBR?

The consultants concluded that Bangladesh has huge potential to collect more revenue through proper compliance of transfer pricing regulation by the Bangladeshi companies, which fall under the transfer pricing regulation. They argued that most of the countries that are strictly following the transfer pricing regulation are adjusting a huge amount of income with the existing income through transfer pricing audit. They also referred to India for the answer of this question as India adjusted thousands of crores of rupees from the very beginning of 2007 till now.

> Yes, as many group companies are draining profit in countries with lower tax rate to gain overall group level benefits, so applying transfer pricing regulation strictly in Bangladesh would help to increase the revenue collection by NBR. (Assistant Manager of a renowned Chartered Accountancy Firm)

What are the limitations of Bangladesh transfer pricing regulation?

Some limitations of the provisions which have not covered in Bangladesh transfer pricing regulation-

a) Nothing concrete is mentioned regarding transfer pricing compliance of liaison office, banks.

b) Practical instances regarding transfer pricing regulation application are not available in Bangladesh.

c) There has not been any specific guidelines regarding the use (which database should be used) of the database for the benchmarking purpose

d) In case of making an adjustment with the income, the inter quartile range has been found but there has not been any specific guideline whether to use the first quartile or third quartile or the average

e) Bangladesh has not adopted the BEPS yet.

Conclusion

The study finds that although the transfer pricing regulation was introduced in the ordinance in 2014, there is still no legal enforcement by the National Board of Revenue (NBR) through transfer pricing audit. Hence, many companies are not following the regulation, as they keep on the existence of flexible environment. Many multinational companies are draining profit in countries with lower tax rate to gain overall group level benefits. It is found that in Bangladesh no database has been established regarding transfer pricing. It is also found that many of the companies are not complying with the transfer pricing regulation of Income Tax Ordinance 1984 because of their unawareness of relevant compliance. Transfer pricing is such an issue on which the researchers have not focused, especially in the developing countries. But this topic is getting high popularity among the international researchers. There are lots of future scope to conduct research on this topic.

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