

TRANSFER PRICING IN TANZANIA: REGULATING FOREIGN INVESTORS' TRANSPARENCY OBLIGATIONS

Research paper for the fulfilment of the requirement of a mini dissertation for the award of Legum Magister (LL.M) in international trade and investment law in Africa at international development law unit, centre for human rights, faculty of law, university of Pretoria.

Declaration

I declare that this Mini-Dissertation which is hereby submitted for the award of Legum Magister (LL.M) in International Trade and Investment Law in Africa at International Development Law Unit, Centre for Human Rights, Faculty of Law, University of Pretoria, is my original work and it has not been previously submitted for the award of a degree at this or any other tertiary institution.

Roselyne Kiluma

Dedication

To Adam Dango Wamunza

Acknowledgement

I thank GOD for getting me to where I am today and for His unfailing love and strength that has enabled me to complete this research paper.

I would like to acknowledge and thank my fiancé Adam Dango and our children, Adam and Andrew for being immensely supportive throughout. You have been my inspiration and the force that encourages me to fight for the best.

My parents and siblings, you are the reason I am where I am today. Thank you for everything.

I thank my friends, Karabo, Andiswa, LLM TILA class of 2017 and anyone else who directly or indirectly participated in this success.

I give special thanks to my supervisor Dr. Femi Oluyeju who supervised and saw me through this research.

I would like to recognize the Centre of Human Rights at the University of Pretoria and every person who has directly or indirectly participated in this research paper.

Last but certainly not least, I thank Saint Augustine University of Tanzania, Arusha Centre; special thanks going to Vivian Deus, Pedro Munisi, Melchizedeck Hekima, Sr. Esther John, Emmanuel Sood and Dr. Kilangi. I would not have succeeded without them.

List of Acronyms

APA	Advance Pricing Agreement
ATAF	African Tax Administration Forum
BEPS	Base erosion and profit shifting
BIT	Bilateral investment treaty
CCA	Cost contribution arrangement
CUP	Comparable uncontrolled price
CPLM	Cost plus method
EITI	Extractive industry transparency initiative
G20	Group of twenty
ICSID	International centre for the settlement of investment disputes
IIA	International investment agreement
IT	Information technology
MAP	Mutual agreement procedure
MNE	Multinational enterprise
OECD	Organisation for Economic Co-operation and Development
OTH	Other method
PSM	Profit split method
RPM	Resale price method
SADC	Southern African development community
TNMM	Transactional net margin method
UN	United Nations
UNCTAD	United Nations conference on trade and development

Directory of cases

Gabon v Sociéte' Serete S.A. In 1978; ICSID Case No ARB/76/1

Government of the Province of East Kalimantan v PT Kaltim Prima Coal and others; ICSID Case No ARB/07/3

Joy Mining Machinery Limited v The Arab Republic of Egypt; ICSID case No. ARB/03/11 (2004)

Salini Costruttori SPA and Otastrade SPA v Kingdom of Morocco; ICSID Case No. ARB/00/4 (2001)

Tanzania Electric Supply Company Limited v Independent Power Tanzania Limited; ICSID Case No ARB/98/8

List of treaties and instruments

OECD *OECD transfer pricing guidelines for multinational enterprises and tax administrations* (OECD guidelines)(2017) 97 at <http://dx.doi.org/10.178/tpg-2017-en>

United Nations *Practical manual on transfer pricing for developing countries* (2017) at www.un.org

Vienna convention on the law of treaties 1969

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CHAPTER 1- INTRODUCTION

1.1 Background

“What curse have we been burdened with? Even the devil must be mocking us”.¹ This was one of the statements made by President Magufuli² after receiving the second presidential probe committee report on the ongoing saga with Accacia Gold Mining. The report from the second presidential probe committee showed “industrial scale plunder of mineral wealth from Tanzania to the tune of 100 trillion shillings in unpaid tax revenue over 20 years through under-declaration of both the export volume and the value of gold and copper concentrates”.³

It all started on Friday 3 March 2017 when Tanzania’s energy and minerals ministry put up an immediate export ban on copper concentrates and mineral sand for processing abroad.⁴ It was a measure put in place to stimulate value addition to minerals in Tanzania before exportation pursuant to the Tanzanian Mineral Policy of 2009 and Mining Act of 2010.⁵ In April 2017 the President Magufuli set up two committees and lodged an investigation on the contents of the containers now piling up at the port and Acacia gold mines.⁶ The committees came back with a report that showed that the containers carried eight times the gold that had been declared by the company.⁷ Basically, the report showed many violations including under declaring and transfer pricing that has been conducted by Acacia Gold Mining for years during their mining activities in Tanzania.⁸

Transfer pricing has created a buzz when it comes to multinational corporations which invest in countries but manage to evade tax responsibility by over declaring their losses. In 2011 the

¹ ‘Even the devil must be mocking us’ *The Guardian* 13 June 2017

² President of the United Republic of Tanzania

³ ‘Even the devil must be mocking us’ *The Guardian* 13 June 2017

⁴ ‘Acacia halts gold, copper exports from Tanzania, shares plunge’ *Reuters Africa* 4 March 2017 at <http://af.reuters.com/article/investingNews/idAFKBN16B06Y> accessed on 8 July 2017

⁵ Press release on export ban of metallic mineral concentrates and ore *The United Republic of Tanzania ministry of energy and minerals* 3 March 2017 at <https://mem.go.tz/press-release-export-ban-of-metallic-mineral-concentrates-and-ore/> accessed on 8 July 2017

⁶ ‘A brutal lesson for multinationals: golden tax deals can come back and bite you’ *The Guardian* 6 July 2017 at <https://www.theguardian.com/global-development-professionals-network/2017/jul/06/a-brutal-lesson-for-multinationals-golden-tax-deals-can-come-back-and-bite-you> accessed on 8 July 2017

⁷ ‘A brutal lesson for multinationals (n 6 above)

⁸ ‘Western Websites Describe Tanzania’s ACACIA Tax Evasion Complaint as ‘Extreme’, ‘Inflated’ *TZ Business News* *Staff* at <file:///C:/Users/Roselyne/Desktop/Western%20Websites%20Describe%20Tanzania%E2%80%99s%20ACACIA%20Tax%20Evasion%20Complaint%20as%20%E2%80%98Extreme%E2%80%99,%20%E2%80%98Inflated%E2%80%99%20-%20TZ%20Business%20News.html> accessed on 8 July 2017

Illicit Financial Flow report⁹ showed that African countries lose over one trillion USD through illicit flows of funds including transfer pricing. Collection of revenue is essential for any state. Tanzania needs this revenue if the state and the people are to develop. Though there is significant growth in the country, Tanzania remains a least developing country with 47% of the population living under 1.90 USD per day and 12 million living under 0.58 USD per day.¹⁰ The state still finds it a challenge stopping the illicit flow of finances through transfer pricing and therefore fails to collect well deserved revenue to provide for the rights of its people and the development of the state. The country would be in a better position if there was no transfer pricing which largely decreases the tax base and the amount of taxable income.

In order to regulate transfer pricing, a proper legal framework needs to be in place.

Tanzania issued its Income Tax (Transfer Pricing) Regulations in 2014. It was the first formal regulation in that area after having only a provision in the Income Tax Act¹¹. These regulations cut across associate transactions between tax payers. Unlike most transfer pricing regulations which focus on cross border transactions, Tanzania's regulations cater for cross border and internal transactions.¹²

1.2 Research problem

The research problem is that tax authorities cannot track transfer pricing activities. The dispute between Acacia and Tanzania arose this year but it uprooted violations of 19 years. This shows that transfer pricing continues to exist regardless of having regulations on it. The punch line is that the tax authorities are unaware that it is happening. This shows that there could be a problem in the flow of information. Therefore Tanzanian tax authorities need a solid system of obtaining information related to controlled transactions from investors. This brings us to the need of regulating foreign investor transparency in transfer pricing matters.

⁹ 'Illicit financial flow report on the high level panel on illicit financial flows from Africa' commissioned by the AU/ECA conference of ministers of finance, planning and economic development (2011)13 (Illicit financial flow report) *citing* Kar and Cartwright-Smith 2010; Kar and Leblanc 2013

¹⁰ 'World Bank official hails Tanzania's economic resilience' *Further Africa* 12 April 2017 at <https://furtherafrica.com/2017/04/12/world-bank-official-hails-tanzanias-economic-resilience/> accessed on 26 July 2017

¹¹ sec 33 Act 11 of 2004, RE 2008

¹²*Tanzania introduces transfer pricing regulations* Deloitte at <https://www2.deloitte.com/za/en/pages/tax/articles/tanzania-introduces-transfer-pricing-regulations.html> accessed on 11 June 2017

The Tanzanian transfer pricing regulation does provide for transparency or disclosure mechanisms for investors.¹³ Regardless, the problem still seems to be slipping through the relevant authority's fingers.

This research seeks to establish a working regulatory framework on transparency obligations of investors to assist tax authorities in identifying transfer pricing conducts.

1.3 Research questions

This research seeks to provide a solution for research problem stated above. Tax authorities need to have a way to track transfer pricing activities so, the major question that this research seeks to answer is.

How can Tanzania establish a concise transfer pricing legal framework that provides for transparency obligations of investors so that it can assist tax authorities in tracking transfer pricing activities?

The following questions will assist in answering the main question:

- a. What is transfer pricing, how is it used to facilitate BEPS and how do legal theories on law and development relate to it?
- b. What are the international transfer pricing legal frameworks that provide for investor transparency obligations?
- c. How does the Tanzanian legal framework provide for transfer pricing and the transparency obligations of investors? Is the framework full proof?
- d. What recommendations can be given on the way forward?

1.4 Thesis statement

Transfer pricing disputes have been unheard of in Tanzania but this year, Tanzania discovered tax violations of different sorts, including transfer pricing. This research argues that the failure of tax authorities to detect abusive transfer pricing conducts going on in their jurisdiction is a result of the authorities not having the requisite information. Therefore, Tanzanian tax authorities need to have a system in place that alerts them on transfer pricing abuse. Having a way to stop it in its tracks is even better. By the conclusion of this research it is expected to be revealed that having more investor based transparency obligations on

¹³ Regulation 7 of the Income Tax (Transfer Pricing) Regulations 2014

transfer pricing is a good thing for a state and they should be expressly incorporated in laws governing investment. Such laws should also focus on the dynamic nature of transfer pricing events and evolve to cope with the situation.

1.5 Significance of the study

This research is necessary because it is evident that transfer pricing measures are overtaking the legal frameworks in place. It seeks to establish an evolving system to assist states in obtaining information on controlled transactions. There is no uniform binding international regulation on transfer pricing measures to date. Therefore, placing an international obligation on investors by using the legal framework governing foreign investment is the best option that states have to curb the transfer pricing problem.

1.6 Literature review

In his book, Sornorajah¹⁴ provides that foreign direct investment normally starts with an agreement between states; a BIT. He provides that they date back to 1959, the first one being between Pakistan and Germany.¹⁵ There has been an increase of BITs to more than 3000 as states believe that foreign direct investment promotes growth. Sornorajah provides that BITs show that states are ready to accept standards of investments.¹⁶ He further elaborates that there are different interests between the home state and the host state. For the home state the primary intention is creating an environment that will protect the investor so that there may be a realisation of profit.¹⁷ The host state on the other hand has the intention is to attract FDI, promote economic growth, create employment and transfer knowledge and technology from the investors to itself.¹⁸ In doing so, the investor is subject to the domestic laws of the host state together with international law. For the purpose of this research, the laws to be considered are those governing transfer pricing.

In their books, Wittendorff,¹⁹ Feinschreiber,²⁰ Makhan,²¹ Paisey,²² Eden²³ and Abdallah²⁴; they describes transfer pricing as the prices used by associate entities when transacting. Both

¹⁴ M Sornorajah *The international law on foreign investment* (2010) 172

¹⁵ Bilateral investment treaties 1959-1999 *United nations conference on trade and development* 1 at <http://unctad.org/en/Docs/poiteiid2.en.pdf> accessed on 10 July 2017

¹⁶ M Sornorajah *The international law on foreign investment* (2010) 172

¹⁷ Sornorajah (n 14 above)

¹⁸ Sornorajah (n 14 above)

¹⁹ J Wittendorff *Transfer pricing and the arm's length principle in international tax law* (2010) 3

²⁰ Feinschreiber, R *Transfer pricing methods: an applications guide* (2004)

Wittendorff and Feinschreiber provide that transfer pricing are methods of pricing used between affiliated companies and they can affect the total income that the parties gain from the transaction in question.²⁵ He states that it is one of the major problems in international tax law²⁶ Tax authorities globally recognise that multi-national corporations can shift income to low tax jurisdictions using transfer pricing²⁷. This ultimately reduces the tax base and facilitates the shifting of profits to those lower tax rated jurisdictions. This is known as base erosion and profit shifting (BEPS). They are process where MNEs repatriate profits out of the host country by using preferential prices with associate MNEs.²⁸ Therefore, tax authorities focus on associate transactions and not independent transactions.²⁹ Transfer pricing has become a major concern for many states especially in the area of intellectual property.³⁰

The Illicit financial flow report provides that transfer pricing are prices used by associate or constituent parts of a company when transacting between themselves in matters of goods and services.³¹ Transfer pricing though in itself not illegal, can be used to facilitate the illicit flow of finances. It can be used by MNEs to escape tax liabilities in the host state. Transfer pricing is said to be a problem when it becomes abusive transfer pricing.³² Abusive transfer pricing is when MNE deliberately use pricing as a way to escape tax liabilities. In this situation, goods or services from a country with a low tax rate are overpriced when sold to an affiliate company in a high tax rate. This facilitates an influx of funds in the state with low tax rates and increases the cost of doing business in the state with the high tax rate thus reducing the tax base. Just like that, a state loses its well deserved revenue.

The OECD provides that transparency obligations for investors were critically addressed in the base erosion and profit shifting (BEPS) action plan which came up with 15 actions to deal with BEPS. Action 13 provides for documentation to be provided by MNEs to assist tax authorities in evaluating compliance. This transparency measure obliges MNEs to provide

²¹ M Makham *the transfer pricing of intangibles* (2005)

²² A Paisey & J Li *Transfer pricing: a diagrammatic and case study introduction with specific reference to China* (2012)

²³ L Eden *Taxing multinationals: transfer pricing and corporate income taxation in North America* (1998)

²⁴ WM Abdallah *Critical concerns on transfer pricing and practice* (2004)

²⁵ R Feinschreiber (n 20 above) 3

²⁶ Wittendorff (n 19 above) 3

²⁷ A Bakker & M Levey (ed) *Transfer pricing and dispute resolution: aligning strategy and execution* (2011) 1

²⁸ Tanzania *Global transfer pricing review* kpmg.com/gtps accessed on 26 May 2017

²⁹ Feinschreiber (n 20 above) 3

³⁰ Markham *The transfer pricing of intangibles* (2005) 7

³¹ GF Mathewson & GD Quirin *Fiscal transfer pricing in multinational corporations* (1979) 5

³² Illicit financial flow report (n 9 above) (2011) 11

information relevant to transfer pricing. The information to be disclosed is the allocation of income on a worldwide basis, the economic activities of the MNE and what taxes it has paid in different states.³³

The UN manual provides for transparency standards in accordance with the OECD/G20 disclosure guideline on documentation. It also provides insight on how developing countries are to implement the global documentation standards. Attention is initially drawn to the fact that the OECD/G20 disclosure guideline was a result of countries that had come up with disclosure mechanisms over time and eventually developed expertise in the area. These states had a major contribution in the OECD/G20 documentation guidelines.³⁴

In Tanzania, there is a legal framework governing transfer pricing. There exists the Income Tax Act Cap 332 (The Act) and The Income Tax (Transfer Pricing) Regulations, 2014 (The Regulations) which regulate transfer pricing. These regulations are also supported by the Tanzania Revenue Authority Transfer Pricing Guidelines which were created having the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines and the United Nations (UN) Practical Manual on Transfer Pricing for Developing Countries as its basis. Though Tanzania may have the laws, it is essential to tighten the knots on these laws and regulations in order to have a system that truly functions in the nation. In his book, Abdallah³⁵ points out why corporations indulge in transfer pricing. They do so to reduce income taxes, reduce tariffs, minimise foreign exchange and to boost competitiveness among others.

The transfer pricing regulation³⁶ provides that the regulations apply to a controlled transaction between parties where one is located in and subject to the tax laws of Tanzania and the other is within or out of the country.³⁷ In this context, a controlled transaction refers to transactions between associate corporations. Tax authorities will endeavour to determine whether such a transaction would be carried out with the same pricings if it had been conducted between businesses that are not associated. This is called a transfer pricing audit.

The question then becomes, what does transfer pricing have to do with transparency?

³³ OECD *Action plan on base erosion and profit shifting* (2013) 23 at <http://dx.doi.org/10.1787/9789264202719-en> accessed on 20 September 2017

³⁴ United Nations *Practical manual on transfer pricing for developing countries* (2017) at www.un.org accessed on 8 August 2017 (UN Manual)

³⁵ W Abdallah *Critical concerns in transfer pricing and practice* (2004) 5

³⁶ Income Tax (Transfer Pricing) Regulations 2014

³⁷ The Regulations section 2

UNCTAD defines transparency as a social entity being prepared to subject itself to public scrutiny and consideration.³⁸ It involves giving out information that will be pertinent for the proper facilitation of the investment and such transparency in investment cuts across the home state, the host state and the investor.³⁹ Though this is the case, international investment agreements (IIAs) have a general tendency of focusing on the view of the foreign investor when it comes to matters of transparency. Seeing things through the lens of the foreign investor, this means that the transparency obligation is one that should be carried out by the host state, resulting in a fertile investment environment for the investor. The other side of the coin that is not usually captured in laws governing investments is that there is a need for transparency obligations to be placed on investors to assist the host state in policy making and regulatory aspects of the investment.⁴⁰ This report further states that a transparency obligation on an investor is also beneficial for the home state in establishing the extent to which the investor is acting in accordance with the laws of the home state.⁴¹ The bottom line is that transparency is an essential aspect of international investment and should be properly articulated in the laws governing investments.

The questions then become, how transparent is transparent? What should be encompassed in a transparency obligation and to what extent? When does it stop being transparency and starts becoming excessive intrusion?

The UNCTAD transparency report provides that the direction of transparency obligations has shifted from one of mere transparency to one of more transparency where entities may be obligated to disclose more information than previously. This creates some tension because MNEs may feel that this increased obligation is more of intrusion than transparency.⁴² However, the extent of what is to be disclosed is provided for in the relevant laws governing the investment. This brings us to the subject of this research, the issue of transparency by MNEs in matters of transfer pricing.

Transparency and transfer pricing cross paths when an investor is obligated to disclose information relating to a controlled transaction. When an entity concludes a controlled transaction; such transaction is documented and subject to audits depending on the laws of

³⁸ United Nations conference on trade and development 'Transparency; United Nations conference on trade and development series on issues in international investment agreements' (2003) UNCTAD/ITE/IIT/2003/4 7 (UNCTAD transparency report)

³⁹ UNCTAD Transparency report (note 26 above) 7

⁴⁰ UNCTAD Transparency report (note 26 above) 7

⁴¹ UNCTAD Transparency report (note 26 above) 7

⁴² UNCTAD Transparency report (note 26 above) 10

the state with jurisdiction. In the Tanzanian transfer pricing regulation, documentation on controlled transactions is to be provided by the investor. One can say that that is being transparent but as stated in the UNCTAD transparency report, the direction is towards more transparency and not mere transparency. Further, transparency is said to deal with both availability and reliability or quality of information given⁴³

So, when a MNE does not fully disclose the benefits of the controlled transaction is that non transparency? When that transaction is preferential, enables the MNE to repatriate profits out of the host country and +ultimately deprives the host state of deserved revenue; is it then non transparency by the MNE? Does the fact that transfer pricing continues to run rampant mean that there are no proper investor transparency obligations in place or is there a need for increased investor transparency obligations?

This research intends to provide answers for these questions.

1.7 Research Methodology

This is a qualitative research and is conducted using secondary and primary documented sources of information such as books, publications, journals, internet sources and news articles. All the information in this research is library based and no interviews were conducted.

Aside from relevant books, journals and news articles, the research examines the OECD transfer pricing guidelines for multinational enterprises and tax administrations of 2017 and the United Nations Practical manual on transfer pricing for developing countries of 2017 to explore the current framework on transfer pricing transparency. It also explores the African Tax Administration Forum (ATAF) on developments in the African context. Finally, discussions and critiques are made on the Tanzanian transfer pricing legal framework.

1.8 Limitations to the study

This study is limited to Tanzania. Research into the international systems on transparency and transfer pricing will be to the extent of obtaining positions in international law that may be relevant to Tanzania. As a library research, it will be limited to secondary and documented primary sources of information and will focus on transfer pricing and transparency

⁴³ RG Gelos & S J Wei *Transparency and international investor behaviour issues 2002-2174* IMF working paper (2002) 9

obligations of investors. No interviews will be conducted in this research. Though transfer pricing has been well written on, the aspect of investor transparency obligations does not have extensive literature. Most of the writings on it are provided for in the UNCTAD, OECD, UN guidelines and individual country legislations.

1.9 Outline of chapters

Chapter 1: this chapter introduces the subject of the research. It provides for the problem and gives an elaboration of the general understanding to transfer pricing and transparency obligations of investors.

Chapter two deals with transfer pricing and its developments internationally. It provides for the legal theories on law and development and links it with transfer pricing exploring how it can be used to conduct BEPS. It provides for the current international legal frameworks in place that govern transfer pricing. Developing trends are explored, in an attempt to establish whether there is an evolving nature and whether transfer pricing regulations are being overtaken by events.

Chapter three examines transparency obligations and how they apply to an investor. It deals with the international developments with this obligation and how they can be linked to matters of transfer pricing. The chapter also discusses the international trends in place that directly or indirectly regulate investor disclosures in transfer pricing.

Chapter four focuses on Tanzania. It examines and critiques the transfer pricing legal framework and the extent of transparency obligations placed on the investor. It seeks with establishing whether international developments have been considered and how the legal framework in place is managing to deal with the transfer pricing problem.

Chapter five provides the conclusion and recommendations on the way forward.

CHAPTER2- TRANSFER PRICING AND THE LEGAL THEORY ON LAW AND DEVELOPMENT

2.1 Introduction

The previous chapter gave a general background to the problem, establishing that the failure of tax authorities to track transfer pricing was a problem in Tanzania. It provided a brief understanding on what transfer pricing is and how it becomes a problem. It also summarised the legal frameworks on matters pertaining to transfer pricing and transparency obligations internationally and nationally.

This chapter examines the whole issue of transfer pricing on a global scale. It lays the foundation for the discussion on transparency obligations for investors in transfer pricing. It takes off by giving a clear picture of what transfer pricing is about and elaborates why it is an issue subject to major attention currently. The chapter establishes the theory as to why MNEs use transfer pricing in the first place and how such usage can lead to base erosion and profit shifting in states. A detailed description is given on the factors that affect transfer pricing and how these factors contribute to its current global situation. For a subject that is the concern of many today, it may be a shock to realise that there is no binding international legal framework on transfer pricing. However, there are guidelines and manuals provided for by the OECD and the UN that have acted as the basis for many domestic legal frameworks. The chapter elaborates on the methods available for determining transfer pricing most of which are based on the arm's length principle. A brief discussion is also provided of a method that does not depend on the arm's length principle and how it has been received by states. Finally, the chapter concludes with the developing trends in transfer pricing. This discusses the other ways developed by states and MNEs to create more certainty in transfer pricing matters.

2.2 The theory of law and development

More than 100 years ago, Max Weber argued that there is a relationship between “legal institutions and development”.⁴⁴ Classical theorists such as Mars and Weber showed early accession and production of theories supporting this notion.⁴⁵ Utilitarian theorists such as

⁴⁴ DM Trubek ‘The “rule of law” in development assistance: past, present, and future’ in DM Trubek & A Santos (eds) *The new law and economic development* (2006) 74 citing David M. Trubek, Max Weber on Law and the Rise of Capitalism, 1972 Wis. L. Rev. 720–753 (1972).

⁴⁵DM Trubek & A Santos ‘ Introduction: the third moment in law and development theory and the emergence of a new critical practice’ in DM Trubek & A Santos (eds) *The new law and economic development* (2006) 1

Bentham propounded that law had to go hand in hand with economic development⁴⁶ and that people had to actually see and enjoy such development. This eventually brought about a lot of policy making and even an up rise of projects in legal reform projects.⁴⁷ After the Second World War, the efforts grew and law made a gradual move from being considered as a means to development in the 1980s to being part and parcel of development from the 1990s. Today, when considering development in states, the legal system of the country is taken into account. A state with a legal system that caters for the needs of a state is considered to be more developed than one without proper laws. Apart from that, the development of global trade and investment has been greatly influenced by law.

A good example is the World Trade organisation (WTO). It was put in place for several reasons. The major reason was the liberalisation of trade activities yet every stage it went through was by using legal transformation. It originated from The General Agreement on Tariffs and Trade (GATT) 1947 was converted from the Havana Charter's international trade chapter⁴⁸. Then there were negotiation rounds such as the 1947 Geneva round to 1967 Kennedy round which focused on the reduction of tariffs. There were also the Tokyo (1973-1979) and the Uruguay rounds (1986-1994)⁴⁹ where the latter established the WTO as we know it today. This whole process shows that it was and still is through the creation of laws that the WTO developed to what it is today.

Using Bentham's Utilitarian theory, law is supposed to bring about economic development and happiness to the people. This can be linked with law as a basis for the provision, protection and administration of people's rights. It ties in with John Locke's social contract theory which provides that law is a social contract where many people select and give power to one person or a group of persons so that their rights can be provided for. Using the social contract theory and the utilitarian theory together, a conclusion can be drawn that the government has been selected with the primary duty to provide for the rights of the people and in doing so, should bring development and happiness to the people.

This primary duty of the state can only be fulfilled when there are sufficient funds. Rights such as social, cultural and economic rights are very essential but are provided for upon the

⁴⁶ DM Trubek & A Santos ' Introduction: the third moment in law and development theory and the emergence of a new critical practice' in DM Trubek & A Santos (n 45 above) 1

⁴⁷ DM Trubek 'The "rule of law" in development assistance: past, present, and future' in DM Trubek & A Santos (n 44 above) 74

⁴⁸ B L Das *World Trade Organisation a guide to the framework of international trade* (2000) 4

⁴⁹ Das (n 48 above) 5

availability of resources. Without the resources, there rights are not provided for. This brings us to the matter of transfer pricing and how it can be regulated to curb base erosion and profit shifting.

2.3 What is transfer pricing

These are prices used by associate or constituent parts of a company when transacting between themselves in matters of goods and services.⁵⁰ Transfer pricing though in itself not illegal, can be used to facilitate the illicit flow of finances. It can be used by MNEs to escape tax liabilities in the host state. Transfer pricing is said to be a problem when it becomes abusive transfer pricing.⁵¹ Abusive transfer pricing is when MNE deliberately use pricing as a way to escape tax liabilities. In this situation, goods or services from a country with a low tax rate are overpriced when sold to an affiliate company in a high tax rate. This facilitates an influx of funds in the state with low tax rates and increases the cost of doing business in the state with the high tax rate thus reducing the tax base. Just like that, a state loses its well deserved revenue.

The tampering of prices elaborated above is called trade misinvoicing. This is when prices of goods or services are deliberately jacked up or reduced in order to enable evading taxes. When trade misinvoicing is done between associate corporations, it is considered to be transfer pricing.⁵²

2.4 The theory of the firm and the challenge in regulating transfer pricing

There is an economic theory which provides that firms are at the centre in producing goods and providing services for maximising profits. These firms are organisations and the theory is called “The theory of the firm”.⁵³ The theory provides that the reason why transactions are done between associated enterprises is because of the ease of doing business. When transactions are between independent entities, there are a whole range of processes to follow. Independent entities will have to come up with contracts and in case these contracts have loopholes, there a risk of having to settle disputes later on. This all amounts to extra costs. On the other hand, transactions between associate enterprises or intra-firm transactions are considered to be smoother and relatively cheaper as administrative costs between associated

⁵⁰ GF Mathewson & GD Quirin *Fiscal transfer pricing in multinational corporations* (1979) 5

⁵¹ Illicit financial flow report (n 9 above) (2011) 11

⁵² Illicit financial flow report (n 9 above) (2011)

⁵³ United Nations *Practical manual on transfer pricing for developing countries* (2017) at www.un.org accessed on 8 August 2017 (UN Manual)

enterprises are less expensive.⁵⁴ There has been an expansion of internalised transactions even to the extent of corporations merging or acquiring other corporations. In situations like these, it is believed to be a plausible business move to acquire your largest provider than to trade with that provider as an independent entity. UNCTAD stated that the increase in internalised transactions “indicates that there are significant efficiency gains that may be achieved”⁵⁵

MNEs that cut across the globe put strategies in place which allow them to reduce their costs. If company X is a car assembling corporation with offices in Africa, Europe and Asia but receives its engines from independent corporations in North America and other parts from South America; one of the best strategies here would be to acquire the corporations in the Americas and use them as a hub for supplying parts and engines to all the car assembling factories in the other continents. This global integration is said to minimise costs and thus creating an advantage over domestic entities.⁵⁶ MNEs have centralised control of their global business in one location while integrating business conducted globally. This raises challenges for tax administrators and policy makers in trying to allocate the income of MNEs for tax purposes.⁵⁷

This is where regulating transfer pricing comes to join the party. Intra-firm transactions or associated transactions are conducted through transfer pricing. Transfer pricing as stated before, is not illegal unless it becomes abusive and contravenes the regulations in place to control it. Though states are not to begin with a premise that all MNEs abuse transfer pricing and evade tax,⁵⁸ it is wise for states to have proper regulations in place and a system of knowing whether such prices are being abused or not. While MNEs need to be mindful of the regulations used in respective states and this may be challenging to them,⁵⁹ there is also a challenge for the states to regulate MNE transfer pricing activities. As will be elaborated further when discussing factors that affect transfer pricing; for states to regulate transfer pricing MNEs need to be transparent about their affiliates and their businesses.

⁵⁴UN Manual (n 53 above)

⁵⁵ UN Manual (n 53 above) *citing* The United Nations Conference on Trade and Development (UNCTAD) *World investment report: transactional corporations and integrated production* (1993) 7, 153-154 Available at http://unctad.org/en/Docs/wir1993_en.pdf

⁵⁶ UN Manual (n 53 above)

⁵⁷ UN Manual (n 53 above)

⁵⁸ UN Manual (n 53 above) 19

⁵⁹ UN Manual (n 53 above) 14

2.5 Factors affecting transfer pricing

In his book, Tang⁶⁰ provides that there are environmental reasons that affect transfer pricing. These environmental reasons are: the global business environment, the tax and legal environment, corporate organisations and finally, communication and computer technologies.⁶¹ Therefore, after realising that it is easier to transact between associated entities, there are factors that determine the development of such transactions. These factors can affect the transfer prices of associate transactions and may even make it hard for such transfer prices to be determined. These factors are discussed below.

2.4.1 Changes in the global business environment

With the increase in international trade, investment and an outburst of MNEs international business has grown massively.⁶² Global exports have generally increased in the past 10 years. In the aspect of goods, with an exception of mining and fuel products which have decreased by 10% since 2006, exports of manufactured goods and agricultural products increased where agriculture increased by 70%.⁶³ By 2016, trade in services also increased by 65% since 2006.⁶⁴ Growth in the service sector was topped by trade in travel and other commercial activities which increased by 1.7 times since 2006.⁶⁵ Look for trends in investment and add them here. With this growth of international business comes the expansion of intercompany trading and regulation of transfer pricing. MNEs are evidently placed in a position of strength economically resulting in the trends of using transfer pricing to sidestep tax liabilities. This is better portrayed by a quote from the book of Tang⁶⁶ which says;

Global corporations will try to take advantage of their transnational status to operate beyond the control of national governments....And many use unrealistic transfer prices to shift income from high-tax jurisdictions to low-tax ones.⁶⁷

Therefore, the dynamic nature of the global environment affects both trade and investments. Transfer pricing has gained massive attention because of the vast number of MNEs and associate transactions. Growth of global business results in increased transfer pricing. Corporations are stretching their reach and settling into areas where they never existed

⁶⁰ RY Tang *Current trends and corporate cases in transfer pricing* (2002)

⁶¹ Tang (n 60 above) 5

⁶² Tang (n 60 above) 5

⁶³ World trade statistical review 2017 *World Trade Organisation* (2017) 10; available at https://www.wto.org/english/res_e/statis_e/wts2017_e/wts2017_e.pdf accessed on 8 August 2017

⁶⁴ World trade statistical review 2017 (n 63 above) 11

⁶⁵ World trade statistical review 2017 (n 63 above) 11

⁶⁶ Tang (n 60 above)

⁶⁷ Tang (n 60 above) 7 *citing* Business week (Coy 2000)

before. This creates a large network of associate corporations, making it difficult for host states to track down which corporation is actually associated to the one doing business in the state. As the saying goes, “information is key”, and without such information states cannot tell whether or not a transaction is a controlled one and subject to transfer pricing regulation. To be able to track abusive transfer pricing, states need to take initiative in understanding how the global environment affects business and to set up a system to obtain information on the growth of MNEs.

2.4.2 Changes in the tax and legal environment

Law is a very dynamic area. It evolves with time to cope with the relevant situation at hand. Regulation in relation to the tax aspect of transfer pricing has changed and evolved. More states are enacting laws that govern transfer pricing mechanisms. Taking East Africa as an example; Kenya, Uganda, Rwanda and Tanzania have transfer pricing legislation introduced.⁶⁸ While MNE transfer pricing activities increase, states increase the regulations on those activities which could eventually lead to “a global tax war”.⁶⁹ Practices that were previously permissible may be overturned by a state’s legislation. Corporations need to be constantly in check of their actions in order to make sure that they do not violate the relevant laws. Finally, the violation of the laws may lead to tremendous penalties or claims for back taxes issued by the states. For example:

The US Internal Revenue Service (IRS) once claimed that Nissan’s US subsidiary inflated the prices it paid to its parent for finished cars imported from Japan and demanded \$600 million for payment of back taxes.⁷⁰

An agreement was later reached for \$160 million.⁷¹

In 1992, the UK Inland Revenue issued a demand for £237 million in unpaid taxes against Nissan UK, the former distributor of Nissan Japan’s automobiles in the United Kingdom. The Inland Revenue claimed that “falsely inflated” shipping invoices were used to understate Nissan UK’s pretax profit from 1975 to 1992.⁷²

⁶⁸ *Global transfer pricing review* (n 20 above) 2 accessed on 8 August 2017

⁶⁹ Tang (n 60 above) 12

⁷⁰ Tang (n 60 above) 12

⁷¹ Tang (n 60 above) 12

⁷² Tang (n 60 above) 12

In a current situation, Tanzania has presented a claim of \$190 billion to Acacia Mining where \$40 billion is for unpaid taxes for 17 years and \$150 billion for interests and penalties.⁷³

When looking at legal systems, states are sovereign and have every right to regulate international investment and trade within their boundaries, subject to international obligations. Transfer pricing remains on the tip of the tongues of tax authorities and the challenge seems to be in the legal systems. It is high time that regulations governing transfer pricing put in place proper criteria to deal with transfer pricing. In a least developing country like Tanzania, one of the most needed things right after transfer pricing experts, is the information on controlled transactions. Laws should focus on curbing a problem. Having information as to what corporations are associated, what are the arm's length prices and what transfer pricing methods are best suited for the transaction is an affirmative step towards better regulation of transfer pricing. If corporations are not aware of what their transparency obligations are and the much needed information from corporations is not disclosed; states are at the losing end in this fight against transfer pricing.

2.4.3 Changes in corporate organisations

Corporations today are not what they used to be. With global business expanding, the same happens to corporations. Corporations cross borders and they merge for different reasons including creating business alliances.⁷⁴ Mergers and acquisitions are created when the corporate entities are trying to tap into a certain market⁷⁵ or even when corporate simply want to own another which happens to be their top supplier⁷⁶. Apart from mergers and acquisitions, corporations may simply set up subsidiaries in other countries to facilitate business.⁷⁷ These changes in corporate organisations bring about restructuring not only in the organisational structure but even in the transfer pricing methods.⁷⁸ This means that both corporations and regulatory bodies need to be on point on how transfer pricing trends take place and evolve.

⁷³ 'Tanzania slaps Acacia Mining with U.S. \$190 billion tax bill' *The East African* 25 July 2017 at <http://allafrica.com/stories/201707260518.html> accessed on 8 August 2017

⁷⁴ Tang (n 60 above) 12

⁷⁵ A good example is when Anheuser Busch InBev (AB InBev) acquired SABMiller. It was a merger of over \$100 billion and it gave AB InBev access to markets in the developing countries which SABMiller had. <https://www.forbes.com/sites/taranurin/2016/10/10/its-final-ab-inbev-closes-on-deal-to-buy-sabmiller/#4b2b6f95432c> accessed on 9 August 2017

⁷⁶ "For example in 1999 IBM and Dell Computer established a partnership agreement so that IBM will supply its disk-drive, chip, display and networking technologies to Dell" in Tang (n 35 above) 13

⁷⁷ For example; Acacia Mining is a UK based company but has subsidiaries all over the world such as Barrick Gold in Tanzania

⁷⁸ Tang (n 60 above) 19

2.4.4 Changes in communication and computer technologies

ICT is an area that evolves drastically and most times the regulations do not keep up with the changes. E-commerce has taken over and majority of trade takes place electronically. This expansion of an electronic way of doing business makes it simple to complete large transactions within minutes. For transfer pricing purposes, technological advancement may make it easier for regulatory authorities to monitor any irregularities⁷⁹ but it may also pose a problem for states that are underdeveloped technologically. For these states, abusive transfer pricing may be untraceable.

2.6 Laws governing transfer pricing internationally

To date, there is no universal multilateral legally binding document on transfer pricing. However, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration (OECD Guidelines) and the UN Transfer Pricing Manual for Developing Countries (UN Manual) have definitely made an impact on the global principles of transfer pricing as they are now.

2.5.1 The OECD Guidelines

The publication of the initial draft of the OECD guidelines was in 1995. Ever since, the guidelines have been updated and currently, there is a 2017 edition of the guidelines. This research focuses on the 2017 edition. Divided into nine chapters, the OECD guidelines take off by introducing the arm's length principle. This is pertinent as transfer prices today are determined by the arm's length principle. This principle is discussed in length in the next part on transfer pricing methods. However, there is an introduction of an approach that does not use the arm's length principle which may be of value especially in situations where there is no comparable data. This approach, known as the global formulary apportionment method is based on a consensus by the international community. This too is discussed at a later stage.

The OECD guidelines then provide for the methods used in transfer pricing dividing them into traditional transaction methods and transactional profit methods. It also elaborates on how to come up with an appropriate method depending on a case to case situation. Choice of method is to be determined depending on a number of factors including the availability of comparable data, ease of making adjustments and the reliability of available information.⁸⁰

The comparability analysis is also discussed in the guidelines where it is elaborated that it

⁷⁹ Tang (n 60 above) 19

⁸⁰ OECD *OECD transfer pricing guidelines for multinational enterprises and tax administrations* (OECD guidelines)(2017) 97 at <http://dx.doi.org/10.178/tpg-2017-en> accessed on 12 September 2017

takes more than just finding comparable data to make an appropriate comparability. The guidelines provide for the challenging issue of transfer pricing in matters of intangibles and ample information on other matters such as cost contribution arrangements and transfer pricing in relation to business restructuring.⁸¹

Although the OECD guidelines are not a treaty and are not binding upon states, they are one of the first things that pop up when the matter of transfer pricing is brought to the table. Needless to say, even the UN manual makes reference to the principles provided for in the OECD guidelines.⁸² When it comes to states, the OECD guidelines form the basis even if some alterations are made to suit the environment in question.

2.5.2 The UN Manual

The UN manual is a document that has broken down transfer pricing matters at length. It has been put in place to guide developing countries on matters of transfer pricing. The manual is divided into four parts.

Part A is on transfer pricing in a global environment. It begins by elaborating why enterprises prefer to trade with associates instead of independent entities. This is called the theory of the firm. This theory propounds that it is logical in terms of business to trade with associates as it gives MNEs an advantageous edge of avoiding extra costs.⁸³ This part then discusses legal structures and how transfer pricing functions can be managed in MNEs.⁸⁴

Part B delves into the whole transfer pricing matter. It gives a thorough introduction on transfer pricing discussing matters from what transfer pricing is, what transfer pricing methods can be used and transfer pricing considerations on intangible properties. It even considers contribution arrangements and transfer pricing in business restructuring.

Part C is the most pertinent in terms of this research. It discusses how to practically implement a workable transfer pricing regime. It will be discussed further in the next chapter on transparency in transfer pricing issues. However, it provides that there must first be a transfer pricing regime set up before anything else is considered. Documentation is next in line. For there to be any arm's length comparisons, states need to know the enterprises

⁸¹ OECD guidelines (n 80 above) 97 at <http://dx.doi.org/10.178/tpg-2017-en> accessed on 12 September 2017

⁸² UN manual (n 53 above) 395

⁸³ UN manual (n 53 above) 2

⁸⁴ UN manual (n 53 above) 14

making up the MNE, the prices used by the enterprises and other relevant information. All this together with auditing and dispute resolution are elaborated for in this part.⁸⁵

Part D dwells on case studies. It provides practices of five countries namely; Brazil, China, India, Mexico and South Africa.⁸⁶

2.7 What are the transfer pricing methods

Most of the transfer pricing methods are based on the arm's length principle and done through a comparability analysis. The arm's length principle is defined in 1963 OECD Model Tax Convention⁸⁷ where the prices between transactions conducted between associated corporations are compared to those conducted between corporations that are not associated. In using the arm's length principle, prices of controlled transactions are valued as if the transactions were conducted between non associated corporations.⁸⁸ So it all comes down to comparisons. Using the arm's length principle entails treating MNEs as separate entities and considering the transactions performed by MNEs as if they were performed by separate dissociated entities.⁸⁹ The transactions performed by the MNE would then be compared to transactions done by separate entities, and this is what is known as the comparability analysis.

A comparability analysis on the other hand does not simply entail the search for comparable data. It is a process that involves finding the potential comparable information. This search and identification of the potential comparable information can only be done by having access to the relevant information of the MNE in question.⁹⁰ The comparability analysis should be transparent and in doing so, proper documentation should be provided and obtained from the MNEs, tax administrators and should be supported by information from the foreign competent authorities.⁹¹

The arm's length principle and the comparability analysis are tied together and form the basis of most of the transfer pricing methods discussed below.

⁸⁵ UN manual (n 53 above)379 -522

⁸⁶ UN manual (n 53 above) 527-630

⁸⁷ Article 9

⁸⁸ UNCTAD Series on issues in international investment agreements *Transfer pricing* (UNCTAD transfer pricing report) (1999) 9

⁸⁹ OECD guidelines (n 80 above) 35 at <http://dx.doi.org/10.178/tpg-2017-en> accessed on 12 September 2017

⁹⁰ OECD guidelines (n 80 above) 150

⁹¹ OECD guidelines (n 80 above) 151

2.6.1 Traditional transactional methods

Comparable uncontrolled price method (CUP)

As its name provides, it deals with comparisons. In this method, prices used by one corporation in a controlled transaction are compared to the prices used by the same corporation in an uncontrolled transaction.⁹² This comparison can only be made when the corporations in comparison provide or sell the same services or goods.⁹³ It has a relatively strict adherence list depending on the jurisdiction. King notes in her book,⁹⁴ that in jurisdictions such as the US, consideration is placed on “product type similarity, functionality and quality, contractual terms, level of market, geographical market, timing, associated intangible property, foreign currency risks and alternatives realistically available to buyers and sellers”.⁹⁵ Simply put, the subject matter of comparison must be similar or comparable whether it is a tangible or intangible transaction.

Other factors such as circumstances and economic conditions are also to be considered when using the CUP method.⁹⁶ It is noted that using the CUP method is not entirely easy especially when the transaction in question does not fall in line with the jurisdiction’s adherence list. The other challenge faced by this method is actually finding an uncontrolled transaction that can be compared to the controlled one. Most times, issues such as non-similarity of products or quantity in transactions makes it challenging to compare the transactions but the OECD guidelines provide that those difficulties should not render the CUP method useless; rather, practical considerations may be used in applying the CUP method.⁹⁷

Cost plus method

This is when a mark-up is applied on the costs incurred by the supplier or producer so as to be able to attain a profit. This mark-up added in a controlled transaction is then compared to a mark-up added in a comparable uncontrolled transaction. The comparable uncontrolled transaction can be either by the same supplier or by an independent enterprise.⁹⁸

⁹² E King *Transfer pricing and corporate taxation: problems, practical implications and proposed solutions* (2009) 22; Abdallah (n 23 above) 166

⁹³ King (n 92 above) 22; Abdallah (n 23 above) 22

⁹⁴ King (n 92 above) 22; Abdallah (n 23 above)

⁹⁵ King (n 92 above) 22; Abdallah (n 23 above)

⁹⁶ King (n 92 above) 22; Abdallah (n 23 above) 23

⁹⁷ King (n 92 above) 22; Abdallah (n 23 above) 22 *citing* para 2.9, Chapter II, Transfer pricing guidelines for multinational enterprises and tax administrations, Organization for Economic Cooperation and Development, July 1995

⁹⁸ OECD transfer pricing methods *Centre for tax policy and administration* (2010) 5

Resale price method

This method focuses on the profit ratio of the reseller. Here, there are two transactions in play; the first one is between two associated corporations, the seller and the buyer who will be the distributor or reseller in the next transaction. In the first transaction, the price of the goods (inventory price) will be the transfer price. In the resale price method, the transfer price is measured by the resale price less the gross profit margin; where the resale price is the price that the customer pays in the second transaction and the gross profit margin is the percentage of the revenue derived from the sales in totality.⁹⁹

For example: an item is sold by the reseller at 200. The inventory price of the good was 120. The gross profit margin will then be $(200-120) = 80$; $80/200 * 100 = 40\%$.

With a resale price of 200 and a gross profit margin of 40%, the transfer price becomes 120.

The gross profit margin determines how much the distributor will need to add to the transfer price to be able to make a profit. After attaining the gross profit margins from the resale transaction, comparisons will be made between those gross profit margins obtained from controlled transactions and those obtained from comparable uncontrolled transactions.

The challenge arising in this method is the difference in costs and performances by the entities in the transaction. These normally differ between different enterprises for different reasons and it leads to the incorporation of adjustments to assist in making the comparisons.¹⁰⁰

2.6.2 Transactional profit methods

Profit split method

This is also known as the transactional profit split method. It determines the profit to be split by the associated corporations. This is the combined profit from the controlled transactions.¹⁰¹ This method is used when corporations contribute to a transaction and therefore expect a divided profit. The profit division is done on an economically valid basis

⁹⁹ R Feinschreiber (n 20 above) 70

¹⁰⁰ A Oguttu 'Resolving transfer-pricing disputes: are 'Advance Pricing Agreements' the way forward for South Africa?' (2006) SA Merc Law Journal 396

¹⁰¹ OECD transfer pricing methods *Centre for tax policy and administration* (2010) 8

which can be supported by market or internal data.¹⁰² The division of profits is then done in accordance with the contribution made by the corporation in realising the profit.

Transactional net margin method (TNMM)

The TNMM is a step further in relation to the resale price method or the cost plus method. In the TNMM, instead of using the gross profit margin or mark-up, the net profit or operating profit is what is used. It examines the net profit indicator realised from controlled transactions and compares it with the net profit indicator in comparable uncontrolled transactions.¹⁰³

2.6.3 Formulary apportionment methods

This method involves the creation of a formula to determine the transfer price. The formula has to be a global one thus giving the name “global formulary apportionment method”. The predetermined formula uses a consolidated basis to apportion profits to associated corporations globally.¹⁰⁴ It is the only method so far that is not based on the arm’s length principle. Although the method would entail comprehensive detail on the MNEs and the profit allocation together with “multiple tax authorities, guidelines, regulations, tax rates and tax bases in arriving at the tax revenues apportioned to each country”¹⁰⁵, it is said to be the method that reflects the true nature of international business.¹⁰⁶ However, looking it from a practical approach, it has been largely criticised especially by the OECD countries. The criticisms lay on the foundation of international taxation recognising MNEs as separate entities for the purpose of taxation, the method having a burdensome transparency obligation for the corporations and the practical difficulty on reaching a global consensus on the formula to be used.¹⁰⁷ The aspect of not being in conformity with the arm’s length principle is also a largely criticised point as there is developed expertise in the use of the arm’s length principle.¹⁰⁸

¹⁰² OECD transfer pricing methods (n 98 above) 8

¹⁰³ OECD transfer pricing methods (n 98 above) 6

¹⁰⁴ OECD transfer pricing methods (n 98 above) 12

¹⁰⁵ UNCTAD transfer pricing report (note 88 above) 12

¹⁰⁶ UNCTAD transfer pricing report (note 88 above) 12

¹⁰⁷ UNCTAD transfer pricing report (note 88 above); OECD ‘Review of comparability and of profit methods: revisions of chapters I-III of the transfer pricing guidelines’(2010) 8

¹⁰⁸ UNCTAD transfer pricing report (note 88 above) 12

2.8 What are the developing trends in transfer pricing

The United Nations in its practical manual on transfer pricing¹⁰⁹ directs that there should be a consistent global policy to govern transfer pricing. The manual discusses that the main aim is to have a global consensus on issues of transfer pricing instead of viewing transfer pricing policies as compliance issues facing MNEs alone. This view is not supported by many as states feel the need to be able to control taxes and other regulations of investments in their territories through exercising their sovereign rights. MNEs seek for stability when considering investing in a foreign state and a global policy pertaining to transfer pricing may offer such stability in that area. So is this the answer? To this moment, it seems not to be the case. There are several developments in matters of transfer pricing but a global framework is not one of them.

Transfer pricing has instead been dealt with using domestic regulations and other treaty arrangements as elaborated below.

2.7.1 Advanced price agreements (APAs)

An APA is a contract that settles the future method of transfer pricing to be used. It is concluded between the MNE and two or more tax authorities.¹¹⁰ APAs are created to avoid the unnecessary confusion and disputes when it comes down to selecting an appropriate method for transfer pricing. Though it may seem as a simple thing to attain, different states may decide to use different methods which may in turn affect the MNE. In matters of transfer pricing, tax authorities may use a different price than the one reported by the MNE when calculating the tax base. The increase in a tax base in one state ultimately reduces it in another state.¹¹¹ The use of different transfer pricing methods may lead to double taxation of the MNEs as tax authorities in both states may decide to set higher tax bases. Therefore, APAs come into play as a tool for all related states to accept the usage of one transfer pricing method in relation to a common MNE. APAs can also include “how to come up with an arm’s-length range of results, comparable and appropriate adjustments, and the proper application of the chosen arm’s-length method to the taxpayer’s particular facts and

¹⁰⁹ UN manual (n 53 above)16

¹¹⁰ J Becker et al *The economics of advance pricing agreements* WP 14/26 (2014) 2

¹¹¹ Becker et al (n 110 above) 2

circumstances”¹¹². When there is more than one tax authority as a party to the agreement, the APA becomes a bilateral one.¹¹³

Although they create a great degree of certainty, there are challenges with APAs. As APAs are put in place in the present to control future transfer prices, the assumptions made today may not necessarily be supported by future events. That, topped with the fact that APAs are for a fixed period of time may result into a ticking time bomb of disasters and dissatisfaction by either party to the agreement. It may result into rendering the tedious and sometimes very long negotiation processes fruitless.

There is also a question as to whether APAs are really needed to make a difference in transfer pricing matters. APAs determine the method to be used before hand but most of the methods used today are based on the arm’s length principle. This means that whatever comparable method is used, the transfer price will not be much different because the arm’s length price remains the same. So it begs the question as to why parties would tie themselves to a long term agreement that could eventually be overtaken by events, if the same outcome can still be obtained without the agreement. To top it all off, the APAs, especially non bilateral ones, could have domestic laws as governing laws which would bring everything back to square one.

2.7.2 Extractive industry transparency initiative (EITI)

The EITI is not specifically for transfer pricing but the principles enshrined in the initiative do play a role in regulating transfer pricing. The EITI standards¹¹⁴ are in place to provide greater transparency to the extractive industry including tax transparency. They address challenges pertaining to “...corruption, money laundering and tax evasion”¹¹⁵. The EITI has 12 principles which all focus on having the outcome of sustainable development from natural resources and the impact that revenues should have on development. To do this, the principles provide for a range of factors that the standard intends to address. The most relevant one to this research is the fifth principle which states; “We underline the importance of transparency by governments and companies in the extractive industries and the need to

¹¹² Oguttu (n 100 above) 400 *citing* Sven-Olof Lodin ‘Is the American Approach Fair? – Some Critical Views on the Transfer Pricing Issues’ May 1995 Intertax 243; Thomas C Pearson & Dennis R Schmidt ‘Transfer Pricing Tax Concerns for Global Financial Companies’ (1998) 76 Taxes at 25

¹¹³ Oguttu (n 100 above) 400

¹¹⁴ EITI international secretariat ‘The EITI standard’ (2016) at <https://eiti.org/document/standard> accessed on 11 September 2017

¹¹⁵ The EITI standard (n 114 above) 8

enhance public financial management and accountability”¹¹⁶. Transparency by governments and companies in extractive industries include transparency in matters of tax. Once that is achieved, it is a step in the right direction to cutting out abusive transfer pricing from its roots. Therefore, the EITI could be a pathway to major solutions in matters of transfer pricing.

2.7.3 International investment agreements (IIAs)

The role played by IIAs in shaping international law seems to be in a league of its own. These are investment agreements between states. They can be bilateral, multilateral or regional investment treaties. They show that states are ready to accept standards of investments.¹¹⁷ Although they are agreements between states, they aim at protecting the investor and the investment resulting in clauses such as minimum standards of treatment, national treatment, most favoured nation treatment and dispute settlement. There are different interests between the home state and the host state when considering investment. For the host state, the intention is to attract FDI, transfer knowledge and technology, create employment and promote economic growth.¹¹⁸ The home state on the other hand has the primary intention of creating an environment that will protect the investor so that there may be a realisation of profit.¹¹⁹

Traditionally, international law only governed the relationship between states. That position slowly evolved and today, the subjects of international law are states together with international organisations and individuals. International investment law has made major contributions to the development of individuals of subjects of international law. It is one of the areas that has put in place international dispute settlement mechanisms to solve disputes between individuals and states.

Once again, international investment law through IIAs seems to be taking the lead in placing obligations of investors in investment treaties. Originally, treaty law under the Vienna Convention on the Law of Treaties (VCLT)¹²⁰ provides that treaties are binding between parties to them and should be performed in good faith.¹²¹ The VCLT also provides that

¹¹⁶ The EITI standard (n 114 above) 10

¹¹⁷ Sornorajah (n 14 above) 172

¹¹⁸ Sornorajah (n 14 above) 172

¹¹⁹ Sornorajah (n 14 above) 172

¹²⁰ Vienna convention on the law of treaties 1969

¹²¹ Article 26 VCLT (n 120 above)

treaties are written agreements concluded between states¹²² and investors are not states. Foreign investors are MNEs. Yet, the SADC and India model BITs have openly imposed obligations, including those of transparency on the investors.¹²³

This seems to be the starting point of a new era of IIAs but there is scepticism as to the validity of incorporating investor obligations into treaties under international law.

2.9 Conclusion

For any state to develop, laws are needed. Laws are the basis for any development as they regulate what and how different matters should take place. Matters of transfer pricing are no exception. They also need to be regulated.

Transfer pricing is no small matter. It has been an issue of concern for many years and continues to be an issue of concern. However, there have been developments in the area as the methods of determining transfer pricing have increased and may continue to increase if the need persists. Access to information remains the one thing that carries the whole transfer pricing issue on its shoulders. For tax authorities to be able to monitor transfer pricing, information is needed and such information can only be obtained from the MNE. Similarly, for the MNE to be transparent and disclose the information, the relevant laws need to express exactly what is expected and needed from the MNE. The whole matter of transparency by MNEs and what they are to disclose is the subject of the next chapter.

¹²² Article 2 (a) VCLT (n 120 above)

¹²³ Article 18 SADC model bilateral investment treaty 2012;Chapter III India model bilateral investment treaty 2015

CHAPTER 3- FOREIGN INVESTOR’S TRANSPARENCY OBLIGATIONS IN TRANSFER PRICING

3.1 Introduction

Chapter 2 provided for the reason why there is a global direction towards creating more laws and policies. It provides for the different theories on law and development by different scholars and how each one linked law to development in one way or another. Law and development is then linked to regulating transfer pricing by establishing that such regulation will ultimately lead to the development of the state as a whole. Transfer pricing is then explored in detail.

Moving on from the previous chapter on transfer pricing, this chapter provides what is expected of foreign investors in terms of transparency. Basically, foreign investors are expected to disclose information relevant to their controlled transactions so that it can be established through audits that the transactions were conducted at arm’s length and there was no abusive transfer pricing that could lead to base erosion and profit shifting. So what exactly is transparency? How transparent is transparent? Is there a threshold to disclosures? Are there guidelines on what is to be disclosed? How does transparency affect investors? And what is the role of the state, particularly the host state in all this? This chapter provides the answers to the above questions and shows how investor disclosure responsibilities have evolved from having a general obligation to having a fully-fledged system in place.

3.2 Investment and transparency

An investment has been defined by the elements that it possesses. The Salini case¹²⁴ defines investment by providing four elements. There should be an element of duration, risk, economic contribution and significant development to the host state. The Joy Mining case¹²⁵ added that there should be a regularity of profit for something to be an investment and that it should not be looked at in isolation from the other elements. By looking at these elements, it is evident that a relationship is being created between the investor and the host state. This relationship is one where the investor creates profit despite the risks and in doing so, contributes to the economy and the development of the host state. For any relationship to work, transparency is needed.

¹²⁴ Salini Construttori SPA and Otastrade SPA v Kingdom of Morocco, ICSID Case No. ARB/00/4 (2001) para 43- 58

¹²⁵ Joy Mining Machinery Limited v The Arab Republic of Egypt, ICSID case No. ARB/03/11 (2004) para 53

Transparency or openness is defined by UNCTAD as a “social entity being prepared to subject itself to public scrutiny and consideration”.¹²⁶ Transparency is a necessity in investment as it creates an optimum environment for conducting such investment. Optimum transparency creates certainty for investors and a means to set policies against evasion of obligations.¹²⁷ An evaluation on how parties to IIAs are treated or protected cannot be done if there is no transparency by the parties.

Such transparency cuts across the home state, the host state and the investor.¹²⁸ This means that both states together with the investor have an obligation to be transparent. For the host state, this lies on the obligation to disclose the relevant regulations and policies that investors need to be acquainted with. This helps in determining what conditions an investor will be subject to in the host state.¹²⁹ Information from the home state is essential as it contributes to promote development for itself and the host state and lastly, transparency from the investor gives room for the host state to create policies and monitor their implementation. Lack of transparency by the investor may create an environment which renders the host state incapable of assessing the input that the investor is making to the economy.¹³⁰

Though this is the case, international investment agreements (IIAs) have a general tendency of focusing on the view of the foreign investor when it comes to matters of transparency. Seeing things through the lens of the foreign investor, this means that the transparency obligation is one that should be carried out by the host state, resulting in a fertile investment environment for the investor. The other side of the coin that is not usually captured in laws governing investments is that there is a need for transparency obligations to be placed on investors to assist the host state in policy making and regulatory aspects of the investment.¹³¹ This report further states that a transparency obligation on an investor is also beneficial for the home state in establishing the extent to which the investor is acting in accordance with the laws of the home state.¹³² The bottom line is that transparency is an essential aspect of international investment and should be properly articulated in the laws governing investments.

¹²⁶ UNCTAD Transparency report (note 38 above) 7

¹²⁷ UNCTAD Transparency report (note 38 above) 7

¹²⁸ UNCTAD Transparency report (note 38 above) 7

¹²⁹ UNCTAD Transparency report (note 38 above) 8

¹³⁰ UNCTAD Transparency report (note 38 above) 7

¹³¹ UNCTAD Transparency report (note 38 above) 7

¹³² UNCTAD Transparency report (note 38 above) 7

Transparency obligations placed on MNEs have gradually become more stringent and the perception that transparency is only an obligation of the host and home states is slowly fading.

3.3 Investor transparency in transfer pricing

Transparency obligations for investors simply mean the obligation of disclosing important information to the relevant authorities.

As stated in the previous chapter, though there is no multilateral instrument on transfer pricing, the UN manual and the OECD guidelines have made enormous steps in providing guidelines on matters of transfer pricing. In doing so, a series of disclosures to be done by MNEs have been developed.

3.3.1 OECD Guidelines

In 2017, new guidelines were issued by the OECD and incorporated the OECD/G20 disclosure guidelines from action 13 of the base erosion and profit shifting action plan as its chapter V.

The base erosion and profit shifting (BEPS) action plan came up with 15 actions to deal with BEPS. Action 13 provides for documentation to be provided by MNEs to assist tax authorities in evaluating compliance. This transparency measure obliges MNEs to provide information relevant to transfer pricing. The information to be disclosed is the allocation of income on a worldwide basis, the economic activities of the MNE and what taxes it has paid in different states.¹³³ The whole reason for establishing the disclosure mechanism is to create certainty in the business environment and not to make the situation more burdensome for the tax payer.¹³⁴ Rules are in place for the disclosure by host states in terms of regulations and there has been progress in matters of transparency by The Global forum on transparency and exchange on information for tax purposes.¹³⁵ This transparency system for MNEs is expected to eventually eliminate or reduce disputes arising from transfer pricing as all the relevant parties will have the requisite information to guide or regulate them.

¹³³ OECD *Action plan on base erosion and profit shifting* (2013) 23 at <http://dx.doi.org/10.1787/9789264202719-en> accessed on 20 September 2017

¹³⁴ OECD *Action plan on base erosion and profit shifting* (n 133 above) 21

¹³⁵ OECD *Action plan on base erosion and profit shifting* (n 133 above) 21

The initial report of 2013 was followed by work by the “OECD, G20 members, the European Commission, developing countries and other international stakeholders”.¹³⁶ This then led to the final report in 2015 addressing all 15 action points.¹³⁷ The chapter, “Transfer pricing documentation and country-by-country reporting, action 13-2015 final report”¹³⁸ specifically deals with transparency for MNEs (OECD/G20 disclosure guideline).

The OECD/G20 disclosure guideline gives tax authorities a path way on what to consider when setting rules for transfer pricing documentation. When making enquiries or conducting risk assessments, states need to know exactly what they are looking for and how to get to a correct conclusion.¹³⁹ This chapter replaces the whole of chapter V of the Transfer pricing guidelines on documentation.¹⁴⁰ Initially, the transfer pricing guidelines simply provided for reasonableness in terms of provision of documentation. With the little experience in matters of transfer pricing, this was considered enough. The main concern was cooperation. The guidelines insisted on cooperation between MNEs and the tax authorities but there was no clear depiction of what documentation should actually be given by the entities paying tax.¹⁴¹ Regardless of the lack of clear cut rules on documentation, many states enacted laws on the basis of the guidelines but most tax authorities have faced challenges as the documentation provided was not sufficient for the intended risk assessments.¹⁴²

Transfer pricing documentation does not only assist tax authorities with risk assessments, they also aim at making audits easier and creating good practise by the tax payers. This entails having consistency in considering appropriate prices and other matters in associated transaction. Having documentation creates a culture of compliance and removes the need for taxpayers to justify their actions after a dispute arises because all the important documentation has already been tendered.¹⁴³ Therefore, the 2015 final report increased the

¹³⁶ RW Tang & TD Schultz ‘Country-by-country reporting: the new OECD guidelines and IRS final regulations’ (2017) *The journal of Corporate Accounting & Finance* 38

¹³⁷ RW Tang & TD Schultz (n 136 above) 38

¹³⁸ *OECD/G20 base erosion and profit shifting project* (2015)

¹³⁹ *OECD Transfer pricing documentation and country-by-country reporting action 13-2015 final report OECD/G20 base erosion and profit shifting project* (2015) 11

¹⁴⁰ *OECD Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above) 11

¹⁴¹ *OECD Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above) 11

¹⁴² *OECD Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)

¹⁴³ *OECD Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above) 12

disclosure threshold for MNEs targeting consistency and compliance while giving tax authorities useful data for concise risk assessments.¹⁴⁴

One may question how transfer pricing documentation may actually assist in risk assessments and audits. After all, the assessments and audits have been happening even without the documents. Risk assessments come before audits.

Beginning with risk assessments, these deal with determining which transactions are to be audited. In order to do so, tax authorities need reliable information. That is the purpose of the documentation to be provided by MNEs. This documentation is considered to be reliable as it comes straight from the MNEs themselves. Once such information is obtained, the risk assessment is conducted and the tax authorities can limit their scarce resources to tackling the transactions that need an “in-depth review”.¹⁴⁵ This brings the process to auditing.

When moving on to auditing, the MNE transfer pricing documentation continues to be of great importance. Information is the key to successful audits. Audits are dependent on the availability of facts and the basis of conducting transfer pricing audits is to compare prices of different transactions. Such comparison would be hard if not impossible to achieve if the relevant information is unavailable. Information such as the prices used, the pricing method selected and the affiliates that the MNE traded with can only be attained through the documentation provided for by the MNE. Therefore it becomes essential for the MNE to provide concise information and in a timely manner.¹⁴⁶

The reasons why transfer pricing transparency by MNEs is needed are evident. The bigger question becomes what should these documents contain?

The OECD/G20 disclosure guideline provides for a three tiered approach.¹⁴⁷ It provides that documentation should be prepared and provided to the tax authorities in a master file, a local file and a country-by-country report.

a. The Master file

¹⁴⁴ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)

¹⁴⁵ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)13

¹⁴⁶ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)14

¹⁴⁷ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)14

The master file is all about the MNE. It discloses the business of the MNE and its affiliates around the globe. Everything from the MNEs economic activities to its global income is provided in the master file. The OECD/G20 disclosure guideline places the contents of the master file into five categories: the organisational structure, description of business(es), intangibles, intercompany financial activities and financial and tax positions¹⁴⁸.

A sample of the master file is provided for in the Appendix as *Annex I* incorporated from the OECD/G20 disclosure guideline providing the form and content of a master file.

b. The local file

The local file focuses on transactions relevant to a specific jurisdiction. Focus is placed on associate transactions between in the local jurisdiction and other states. Information in the local file bases on the transfer pricing method and comparability analysis in relation to those specific transactions. It supplements the master file. The information in the local file will be cross referenced over the information in the master file.¹⁴⁹

A sample of the local file is provided for in the Appendix as *Annex II* incorporated from the OECD/G20 disclosure guideline providing the form and content of a local file.

c. Country-by-country report

As the name goes, this report contains information on the MNEs global allocation of income and other pertinent information related to the MNEs global business. Information on all the entities of the MNE reflecting the methods selected and the main business the entity conducts should be in the report. This country-by-country report can be used to track other BEPS but should not be used as the only basis of altering prices for taxation purposes.¹⁵⁰

The OECD/G20 disclosure guideline provides templates for country-by-country reporting and guidelines. The templates are attached in the Appendix as *Annex III*

¹⁴⁸ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)15

¹⁴⁹ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)15

¹⁵⁰ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)16

3.3.2 UN MANUAL

The UN manual provides for documentation by MNEs. It covers three major areas; the international guidelines on transfer pricing documentation, experiences of multinational enterprises with existing international guidelines on documentation and the practical guidance on documentation rules and procedures.

International guidelines on transfer pricing documentation

The UN manual makes reference to the documentation standard of the OECD/G20 disclosure guideline. It provides a summarised framework of what has been discussed above.

The UN manual also provides insight on how developing countries are to implement the global documentation standards. Attention is initially drawn to the fact that the OECD/G20 disclosure guideline was a result of countries that had come up with disclosure mechanisms over time and eventually developed expertise in the area. These states had a major contribution in the OECD/G20 documentation guidelines.¹⁵¹ This ultimately means that developing states are not expected to automatically adopt these guidelines and even if they do, such adoption cannot be expected to happen overnight. The master files together with the country-by-country reports are documents that are exactly the same in any place that the MNE submits them. Therefore, this may not be a bone of contention for the developing states. The local file however, may pose a bit of a challenge and will need in depth consideration from developing states on whether or not any alterations will need to be made.¹⁵²

Once such a decision is made, the developing state will then have to put in place domestic laws and regulations to put the documentation standard into effect. The UN manual suggests that considering the differences in transactions, the local file should have a threshold of what is or is not material. Only the material information should appear in the local file and the threshold can be determined using factors such as “the size and the nature of the local economy, the importance of the MNE group in that economy, the size and nature of local operating entities, and the overall size and nature of the MNE group”.¹⁵³ The materiality standards are to be developed by the country.

¹⁵¹ UN manual (n 53 above) 403

¹⁵² UN manual (n 53 above) 404

¹⁵³ UN manual (n 53 above) 404

When considering the master file, it is the obligation of the taxpayer not to exclude information that would be considered important by the tax authorities. Whether or not information is important will depend on whether it was provided for in the regulations of the state in question and whether removing such information from the master file would make the file less reliable.¹⁵⁴

For the country-by-country reporting, developing states will need to put in place treaties for the exchange of information. This is relevant as the country-by-country report will be delivered to the country which holds the parent company of the MNE.¹⁵⁵

The UN manual also provides an option of using a disclosure form as a substitute of the local file. It states that if the form is supported by the master file and the country-by-country report, it may suffice. However, the UN manual does provide that consideration should be made and a balance should be struck between the compliance burden of the MNE and the information required by the tax authorities.¹⁵⁶

Therefore, though disclosure is the basis of investor transparency, the ultimate goal is to have a standard format of investor disclosure. This ensures global compliance by MNEs for different jurisdictions without having an over burdensome and costly responsibility.

Experiences of multinational enterprises with existing international guidelines on documentation

The UN manual gives insight on what MNEs have experienced with the documentation obligation and this experience may direct the way forward.

The number of states which have introduced documentation standards for MNEs has more than quadrupled since the beginning of this millennium.¹⁵⁷ This means that ultimately, the possibility of states having different conditions for MNEs is huge. Logically, MNEs would give a sigh of relief if there was a standard form of making disclosures. The UN manual provides that currently, there is an annual preparation of transfer pricing documentation by MNEs as compliance to local regulations.¹⁵⁸ It remains a fact that it is the host states' sovereign right to regulate investments and may set out rules and procedures to do so.

¹⁵⁴ UN manual (n 53 above) 405

¹⁵⁵ UN manual (n 53 above) 405

¹⁵⁶ UN manual (n 53 above) 405

¹⁵⁷ UN manual (n 53 above) 406

¹⁵⁸ UN manual (n 53 above) 406

Regardless, one global compliance format will serve as an advantage for the MNE. The bonus side of having a single global format is evident, yet it remains the option of a state whether to follow such a format or create its own.

Other compliance matters and Practical guidance on documentation rules and procedures provided by the OECD/G20 disclosure guideline and the UN manual respectively

The OECD/G20 disclosure guideline and the UN manual both provide for other compliance matters in relation to the documentation to be provided by MNEs. The compliance matters cover a wide range of areas including documentation, time limitations for providing such documentation, material information, storage of documents, how many times the documents should be updates, language of documentation, penalties and incentives and other issues.¹⁵⁹

All the aspects covered in this part may differ in different jurisdictions but some aspects are to be the basis for considerations. For example, on matters of documentation, MNEs are to first establish what transfer pricing method is to be used when determining the arm's length price before it provides this information in the documentation.

States are to provide for the time frame which MNEs are to comply with when submitting documentation and states should lay down rules for provision of information that will be material to risk assessments and audits. In this aspect, the OECD/G20 disclosure guideline urges states not to overburden MNEs with compliance measures of providing information that may not necessarily be material.¹⁶⁰ Questions may arise as to what is really immaterial and how states can rule it out as immaterial before even seeing the information. The UN manual provides that states should also consider what pricing approach was used between the arm's length price setting and the outcome-testing approach. The former is when an arm's length price is selected and the later is testing the outcome of the transaction with affiliates to determine whether the transactions were consistent with the arm's length principle.¹⁶¹ This consideration is essential because depending on the approach selected, more time may be needed by the MNE to prepare the documentation.

¹⁵⁹ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)16-20

¹⁶⁰ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)17

¹⁶¹ UN manual (n 53 above) 409

The state is once again responsible for providing rules on matters of how long the information should be kept handy by the MNE. This retention of information by the MNE is necessary for audit purposes, yet may once again be overly burdensome for MNEs to have to retain such information for a limited period of time especially when the tax authorities have received their own records of the same information. The contrary can also be argued and it can be put forward that keeping of information is necessary for any MNE. Whether this information is kept electronically or in physical form, the main objective is for it to be made available to the tax authorities once it is needed especially before the retention time is over.¹⁶² Updating the information is necessary particularly when there are major changes with the MNE.

The OECD/G20 disclosure guideline recommends that the master and local files should be updated annually. States can alter this to three years where there have been no changes.¹⁶³ The state therefore has the obligation of providing a viable time frame for such updates.

The language of the documentation is recommended to be a “commonly used language”¹⁶⁴ if at all a local translation is needed, then additional time should be given and specific requests should be made. The term “commonly used language” has not been defined but is to be determined through the regulations set out by domestic laws.

There is a matter of penalties. States have been prone to provide penalties when MNEs fail to fulfil the requisite obligations in time. The OECD/G20 disclosure guideline stresses that penalties should not be imposed on failure of an MNE to submit information that it did not have access to. Another suggestion raised by the OECD/G20 disclosure guideline is the issue of providing incentives. Instead of punishing MNEs for failure to provide the required documentation on time, states could try and incentivise MNEs that would provide the information on time.¹⁶⁵ It may not be a bad thing to do but the questions arises as to why states would provide incentives to an MNE for fulfilling its legal obligation.

¹⁶² OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above) 18

¹⁶³ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)18; UN manual (n 53 above)) 406

¹⁶⁴ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)18

¹⁶⁵ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)18; UN manual (n 53 above) 410

States are also to ensure that there is strict confidentiality in relation to a MNEs confidential information even in matters of dispute settlement such as public court proceeding. In these circumstances, disclosure of MNEs information should be on a needed basis.¹⁶⁶

The UN manual provides for special considerations for small and medium sized enterprises (SME). It provides instances by several countries that have relaxed or totally exempted SMEs from providing documentation as it poses a “significant burden”.¹⁶⁷ The OECD/G20 disclosure guideline also provides for exemptions for MNEs with global revenues of EUR 750 million from providing a country-by-country report.¹⁶⁸ The other disclosures are subject to the laws of the host state. The UN manual provides examples of France, Germany, Netherlands, Poland, Spain, China, Korea, India and Brazil which have specific regulations relating to SMEs.¹⁶⁹ These regulations range from total exemption, less documentation or equal standing with other MNEs.

3.4 How states can make MNE disclosure obligations legally binding

As mentioned in an earlier chapter, the OECD guidelines are not legally binding.¹⁷⁰ They act as a guiding framework for states to follow. They even provide model laws on transparency matters but such model laws are subject to alteration by states.

In order to make disclosure for MNEs a binding obligation, states have to take affirmative action and create legislation. The options that states have are provided for below.

3.4.1 Domestic legislation

This is the major way to regulate conducts of foreign investors. They stipulate the laws that are to govern the investment in a specific jurisdiction. MNEs have an obligation to comply with domestic laws of the host state. In their article, Tang and Schultz provide that countries such as Australia, Canada, China, France, Germany, Japan, Mexico and the United Kingdom had passed laws with regards to documentation as provided for in the OECD/G20 disclosure guideline.¹⁷¹ The United States of America (USA) have also provided for regulation on

¹⁶⁶ OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)19

¹⁶⁷ UN manual (n 53 above) 411

¹⁶⁸ UN manual (n 53 above); OECD *Transfer pricing documentation and country-by-country reporting action 13-2015 final report* (n 139 above)21

¹⁶⁹ UN manual (n 53 above) 412-414

¹⁷⁰ RW Tang & TD Schultz (n 136 above) 44

¹⁷¹ RW Tang & TD Schultz (n 136 above) 39

documentation and country-by-country reporting to be done by MNEs making necessary alterations as needed.¹⁷²

Therefore, states need to enact laws that govern the transparency process of foreign investors. This is regardless of whether the state uses the OECD/G20 disclosure guideline model or a model designed by the state. Domestic laws regulate investments in their jurisdiction and therefore they need to be enacted if MNEs are to implement them.

3.4.2 IIAs

As a rule of thumb, IIAs do not expressly provide for investor obligations. This is not the usual case of setting in place investor obligations. At the very least, they provide that investors shall be subject to the laws of the host state. It is through these laws that obligations are imposed on investors. This means that when there is a loop hole within the laws of the host state, there is no obligation on the investor. As elaborated in the previous chapter, IIAs are between states and are meant to bind states yet, there are IIAs which now impose investor obligations.

Chapter III of the model text for the Indian bilateral investment treaty is titled “Investor, Investment and Home state obligations”¹⁷³. Article 10 of the Indian Model BIT provides for disclosures to be done by investors and investments. Such disclosures are to be true and complete and must disclose relationships with affiliates, source and channel of funds. It even provides that the investment is to maintain true copies of the information. In a nut shell, the Indian model BIT provides at length for investor and investment obligations.

This is also the case in the SADC Model BIT.¹⁷⁴ Part 3 of the SADC model BIT provides for obligations of investors and state parties. Article 12 and Article 18 of the SADC model BIT provide for provision of information and transparency of contracts and payments respectively. These two articles dwell on the obligations of the investor to provide required information in a timely manner and to be able to disclose payments made in different transaction.

¹⁷² RW Tang & TD Schultz (n 136 above) 40

¹⁷³ Model text for the Indian bilateral investment treaty (2015) 11

¹⁷⁴ SADC model bilateral investment treaty template with commentary (2012)

Incorporating investor obligations into IIAs may be a positive thing to do as there may be times where there is no domestic law that governs a specific aspect. Therefore, the IIA provides a second layer of protection just in case the law is nonexistent or insufficient.

3.4.3 APAs

Are APAs the way to go? It is possible that APAs can incorporate investor obligations in them. After all, APAs are agreements. This may however pose to be a challenge especially when the APAs are bilateral ones. It means that both states would have to agree on the exact disclosure rules. What may not be an important point of disclosure in one state may be extremely important to another thus posing a challenge. As it is now, concluding APAs takes a very long time. If investor disclosure obligations are added to the mix, it may take an even longer time. Regardless, it may be an option to consider.

3.5 Conclusion

This chapter has provided that international business has come a long way and that experience leads to development in many areas. Investor transparency in matters of transfer pricing is one of them. It began in 1995 when the OECD first brought about guidelines for disclosures which had no specifics on the matters of content and resulted in states creating their own disclosure thresholds for MNEs leading up to the 2015 OECD/G20 disclosure guidelines. Though not binding, the guidelines have played their part in moulding transfer pricing disclosures into what they are today and it seems to be a step in the direction of forming a global consensus on what is to be disclosed by MNEs. It aims at providing a global standard acceptable by states and MNEs for its uniformity. At the end of the day, the major aim is to create consistency and a stable investment environment while allowing states to regulate revenues from such investments. From 2015 to date, a number of states have adopted the OECD/G20 guidelines into their domestic laws with relevant modifications. The next chapter focuses on investor transparency in matters of transfer pricing in the context of Tanzania.

CHAPTER 4- THE TANZANIAN PERSPECTIVE

4.1 Introduction

Chapter 3 expanded on the matter of investor transparency obligations. It provided for the global legal frameworks that form the basis for most transfer pricing regulations worldwide. It discovers that there exists a three tier system to disclosing information by an MNE. It includes a master file, a local file and a country by country report.

Continuing from the previous chapter which addressed the international framework on transfer pricing documentation, this chapter examines the legal framework of transfer pricing in Tanzania. After having no complaints on transfer pricing in Tanzania from time immemorial, this year, a presidential probe committee uprooted tax violations including transfer pricing. The concern is that, according to the committee, the violations that were declared had been happening for years and Tanzania has tax laws and transfer pricing regulations in place. This chapter examines, discusses and critiques the Tanzanian legal framework on transfer pricing in an attempt to establish whether it needs restructuring.

4.2 Tanzanian laws on transfer pricing

4.2.1 The Income Tax Act

The first law in the United Republic of Tanzania (Tanzania) to discuss transfer pricing in relation to tax was the Income Tax Act.¹⁷⁵ The section, titled “transfer pricing and other arrangements between associates” provides that

In any arrangement between persons who are associates, the persons shall quantify, apportion and allocate amounts to be included or deducted in calculating income between the persons as is necessary to reflect the total income or tax payable that would have arisen for them if the arrangement had been conducted at arm’s length.¹⁷⁶

The second part of the provision provides the mandate for the commissioner of income tax (The commissioner) to make adjustments. These adjustments could be made if in the opinion of the commissioner, the provisions of section 33(1) were not complied with. Such adjustment could be done by

¹⁷⁵ sec 33 Act 11 of 2004, RE 2008

¹⁷⁶ sec 33(1) Act 11 of 2004, RE 2008

- a. re-characterising the source and type of income, loss or payment¹⁷⁷
- b. Allocating and apportioning expenditure differently¹⁷⁸

4.2.2 Transfer pricing regulations

In 2014, Tanzania enacted the Income Tax (Transfer Pricing) Regulations (The regulations) as one of the first legal documents governing transfer pricing. The regulations apply to controlled transactions. One of the parties to the controlled transaction must be in Tanzania and subject to taxation in Tanzania. The other party must be outside of the Tanzanian jurisdiction.¹⁷⁹

The regulations are divided into six parts briefly provided for below.

Part I provides for the preliminaries which provide which situations are governed by the regulations and the interpretation of various terms.

Part II gets into the gist of transfer pricing. It provides for the arm's length methods. The methods are the CUP method, the resale price method, the cost plus method, the profit split method, the transactional net margin method and any other method that the commissioner may provide.¹⁸⁰ It also provides for the factors to be considered when determining comparable data which are the characteristics of the goods or services, functions undertaken by the person in the transaction, contractual terms of the transaction, economic circumstances and business strategies undertaken by the affiliate.¹⁸¹ The regulations provide for the use of controlled and uncontrolled transactions as comparables in transfer pricing matters.¹⁸² This part of the regulations sets out the documentation to be provided by parties to controlled transactions.¹⁸³ This area will be discussed in more detail in the next part of this chapter.

Part III brings the OECD guidelines and the UN manual into the picture. It provides that the regulations will be interpreted in accordance with the OECD guidelines and the UN manual. The regulations will prevail in a situation where there is a conflict between them and the OECD/UN manual¹⁸⁴

¹⁷⁷ sec 33(2) (a) Act 11 of 2004, RE 2008

¹⁷⁸ sec 33(2) (b) Act 11 of 2004, RE 2008

¹⁷⁹ Regulation 2, Tanzania Income Tax (Transfer Pricing) Regulations (2014) (The regulations)

¹⁸⁰ Regulation 5 of The regulations

¹⁸¹ Regulation 6(1) of The regulations

¹⁸² Regulation 6 of The regulations

¹⁸³ Regulation 7 of The regulations

¹⁸⁴ Regulation 9 of The regulations

Part IV governs intra group services, financing and intangible property. It provides that arm's length prices should be used for intangible property, services provided by associate to another and for interest rates charged by one associate for finances given to another.¹⁸⁵

Part V is on APAs. It provides that the taxpayer may request to enter into an APA which will put forward specific criteria on the determination of an arm's length transaction.¹⁸⁶ It also makes provision for the consideration of adjustments in situations that may lead to double taxation for the taxpayer.¹⁸⁷

Finally, Part VI provides for matters of general consideration. It provides the powers of the commissioner to make adjustments¹⁸⁸ and to make guidelines for "the better carrying into effect of the provisions of these regulations"¹⁸⁹.

This brings us to the guidelines.

4.2.3 The Tanzania Revenue Authority (TRA) transfer pricing guidelines (The guidelines)¹⁹⁰

These guidelines begin with a preface that state that they serve as a practical guide and are not necessarily "a prescriptive or exhaustive discussion"¹⁹¹ of all transfer pricing issues that may arise. The guidelines state that they are in place for providing taxpayers with a practical guide on the procedures to be followed in matters of transfer pricing. It is also in place to provide consistency in administering the transfer pricing laws.

The guidelines provide the position of the law to be the one provided for in the Income Tax Act and The regulations but are in more detail. The parts of the guidelines are arranged in a manner similar to the Regulations where they begin by describing the arm's length principle. The internationally recognised definition of the arm's length principle by the OECD is the one adopted by the TRA.

¹⁸⁵ Regulation 10 & 11 of The regulations

¹⁸⁶ Regulation 12 of The regulations

¹⁸⁷ Regulation 13 of The regulations

¹⁸⁸ Regulation 14 of The regulations

¹⁸⁹ Regulation 15 of The regulations

¹⁹⁰ Tanzania Revenue Authority *Transfer pricing guidelines* (2014) (The guidelines)

¹⁹¹ Preface of the guidelines 0

The scope of the guidelines provides that they will apply to controlled transactions where one party to the transaction is to be taxed in the United Republic of Tanzania. They also apply to domestic transactions. These transactions have to have a transactional price which does not adhere to the arms length standard. Parties to a transaction who are both under the tax jurisdiction of the United Republic of Tanzania are also subject to the guidelines. Finally, in transactions conducted between an entity that is permanently established in the United Republic of Tanzania and other branches or headquarters of the MNE, the guidelines will apply.¹⁹²

The guidelines provide for the position of the law. In this part, the guidelines refer to the Income Tax Act (The Act) and the Income Tax Regulations. It makes reference to the provision in the Act that provides the foundation for the legal framework on transfer pricing in Tanzania.¹⁹³ With respect to the regulations, it provides for the provisions that grant power to the commissioner to make guidelines. This resulted into these guidelines. The concerning part about these guidelines is that the provision providing for their enactment just simply states that the guidelines will be in place for the better carrying into effect of the provisions of the regulations.¹⁹⁴ It does not provide for the legal nature of the guidelines. It leaves questions as to the binding nature of these guidelines. As stated earlier, the guidelines are bulkier and have more detail than the regulations therefore, can a taxpayer be committing an offence by not fulfilling the guidelines? This is an area that needs to be clarified by the commissioner who created the guidelines or the minister who enacted the regulations.

The determination of the arm's length principle,¹⁹⁵ comparability analysis¹⁹⁶ and transfer pricing methods¹⁹⁷

Determining the arms length principle

The determination of the arm's length principle is provided for in detail in the guidelines. The determination is categorised into six steps.

First, the transactions and functions of the parties to a transaction must be analysed. A detailed elaboration is given of the procedure to do so.

¹⁹² Para 3 The guidelines 2

¹⁹³ sec 33 Act 11 of 2004, RE 2008 (n 10 above)

¹⁹⁴ Regulation 15 the regulations

¹⁹⁵ The guidelines (n 172 above) 5

¹⁹⁶ The guidelines (n 172 above) 9

¹⁹⁷ The guidelines (n 172 above) 12

- a. Considering the importance of a functional analysis in determining and identifying comparables, this is the heart of determining arm's length. The taxpayer will need to come up with the organisation and what the business operates.¹⁹⁸ The risks, functions and assets of parties to both controlled and uncontrolled transactions together with functions that contribute economically must be assessed.¹⁹⁹
- b. The functions performed can determine how much profit an entity makes. In general, a function that creates more profit than others is considered to be economically viable but this does not necessarily mean that the entity within your jurisdiction is going to make an enormous amount of profit. This sometimes depends on the amount of work that an entity places on the outcome of the transaction. Usually, the entity that contributes more to the development of the product ends up receiving the lion's share of the profit. This means that the taxpayer and taxing authority will have to use a transfer pricing method that is relevant to the transaction.²⁰⁰
- c. The assets used in controlled transactions can also be essential when trying to determine an arm's length price. Both tangible and intangible properties are expected to produce profit, the former through use of the assets and the latter through licensing of the asset. This may alter the scale as to who really gets the profit and determination of what exactly is the arm's length price.²⁰¹
- d. When an investor brings capital into a jurisdiction with a high level of risk, that investor is looking forward to a much higher profit than one that would have been obtained in a jurisdiction with low risk. The guidelines also provide for different types of risks such as occupational, market, product, business, financial, credit and debt collection, viability of the investment. This risk is to be borne by the parties to the transaction depending on the functions performed by that specific party.²⁰²

Second, the business needs to be characterised. And such characterisation is dependant on what the business does. A business that manufactures is different from one that distributes and from one that is a service provider.²⁰³

Third, comparable transactions need to be identified. The Tanzanian guidelines provide for the following categories when attempting to identify comparable transactions.

¹⁹⁸ The guidelines (n 172 above) 5

¹⁹⁹ The guidelines (n 172 above) 6

²⁰⁰ The guidelines (n 172 above) 6

²⁰¹ The guidelines (n 172 above) 6

²⁰² The guidelines (n 172 above) 7

²⁰³ The guidelines (n 172 above) 8

- (i) To compare a single transaction (e.g. the sale price and terms of sale of particular product);
- (ii) To compare a bundle of transactions;
- (iii) To compare results at gross margin level;
- (iv) To compare results at net margin level; or
- (v) To compare results by reference to some other measures, such as return on capital, ratio of costs to gross margin, etc.²⁰⁴

The fourth aspect is the determination of a tested party. A tested party is the most reliable party to assess a transfer pricing method against. In Tanzania the key criteria is information that is sufficient and capable of being verified. Foreign tested party information will not be acceptable if it cannot be verified. The challenge is that the guidelines do not provide exactly how such verification can be done and may therefore lead to a lot of back and forth between the taxpayer and the tax authority.²⁰⁵

Number five on the list is the transfer pricing method selection which will be dealt with under transfer pricing methods.

Sixth on the list is a profit level indicator. Simply put, this is a ratio on the profit that a transaction has obtained with an input of a certain amount of capital. The guidelines provide for commonly used profit level indicators to be:

- (i) Return on costs: cost plus margin and net cost plus margin.
- (ii) Return on sales: gross margin and operating margin.
- (iii) Return on capital employed: return on operating assets.²⁰⁶

Comparability analysis

The guidelines define the comparability analysis as the comparison of conditions in a controlled transaction to those in an independent transaction. The guidelines provide for five factors to be considered when making a comparability analysis. If the controlled and independent transactions have sufficient similarities in relation to these five factors, then the two transactions are comparable. The factors are: “characteristics of the property or service; functions performed, assets employed and risks assumed by the respective persons; contractual terms; economic circumstances; and business strategies”²⁰⁷ Apart from the factors, the guidelines also provide two conditions for comparability. Those conditions are that any difference found in the transactions should not have the capability of affecting the open market margin and that the material effects can be removed by reasonable adjusting.²⁰⁸

²⁰⁴ The guidelines (n 172 above) 8

²⁰⁵ The guidelines (n 172 above) 8

²⁰⁶ The guidelines (n 172 above) 9

²⁰⁷ The guidelines (n 172 above) 10

²⁰⁸ The guidelines (n 172 above) 10

Transfer pricing methods: the transfer pricing methods are similar to those provided for by the OECD guidelines and the UN manual. However, the Tanzanian guidelines lack the formulary apportionment methods. Therefore the regulations as they stand today show that Tanzania is not in support of this method.

After discussing the legal framework on transfer pricing in Tanzania, this research now moves on to the issue of whether Tanzania has provisions in place for investor transparency obligations.

4.3 Transfer pricing investor transparency obligations in Tanzania

4.3.1 Income Tax Act

The Tanzanian Income Tax Act is the starting point of this discussion. Sections 80, 139 and 140 of this Act provide for documentation.

Section 80 provides for maintenance of documentation where it states:

80.-(1) Unless otherwise authorised by the Commissioner by notice in writing, every person liable to tax under this Act shall maintain in the United Republic such documents -

(a) as are necessary to explain information to be provided in a return or in any other document to be filed with the Commissioner under this Act;

(b) as are necessary to enable an accurate determination of the tax payable by the person; and

(c) as may be prescribed by the Commissioner.

Though this provision does not specifically govern transfer pricing matters, it is the first provision that provides for documentation and is relevant even in transfer pricing matters. The documentation in this section is to be “maintained in Tanzania” by the taxpayer. This means that even after submission of these documents to the commissioner or the TRA, the taxpayer is to continue maintaining this documentation. The maintenance of documentation is not for an unlimited period of time. The same provision provides for a time limit of five years for maintaining the documentation.²⁰⁹ It also provides for the language of the documentation and in cases where documentation is not in the official language of the state, a translator approved by the commissioner may provide a translation.²¹⁰ Finally, the section provides for the power of the commissioner to require retention of documentation for any period of time.

²⁰⁹ sec 80 (2) Act 11 of 2004, RE 2008 (n 10 above)

²¹⁰ sec 80 (3) Act 11 of 2004, RE 2008 (n 10 above)

The commissioner may make such request by way of a written notice which will provide the period for retention of such documentation.²¹¹

Section 139 provides for the power of the commissioner to obtain information from a taxpayer. This information may be simple production of documentation provided for in the notice issued by the commissioner²¹² or through examination under oath.²¹³

Section 140 is on confidentiality. All documentation is to be treated with secrecy unless such disclosure is permitted under section 140 (2) of The Income Tax Act which provides:

- (2) An officer may disclose a document or information referred to in subsection (1) -
 - (a) to the extent required in order to perform the officer's duties under this Act;
 - (b) where required by a court or tribunal in relation to administrative review or proceedings with respect to a matter under this Act;
 - (c) to the Minister or the Chief Secretary of the President's Office;
 - (d) where the disclosure is necessary for the purposes of any law administered by the Tanzania Revenue Authority;
 - (e) to any person in the service of the Government of the United Republic or the Revolutionary Government of Zanzibar in a revenue or statistical department where such disclosure is necessary for the performance of the person's official duties;
 - (f) to the Auditor-General or any person authorised by the Auditor-General where such disclosure is necessary for the performance of official duties; or
 - (g) to the competent authority of the government of another country with which the United Republic has entered into an international agreement, to the extent permitted under that agreement.²¹⁴

This confidentiality obligation is extended to the courts, tribunal, authorities or other person receiving this information. Disclosures can only be made to the extent of achieving the purpose that permitted the disclosures in the first place.²¹⁵

The Income Tax Act provides for the basis of any tax matter in Tanzania and those three provisions are the ones that lay the foundation for tax documentation. Documentation specifically in the context of transfer pricing is provided for in the regulations.

4.3.2 Transfer pricing regulation

Part II of the regulations provides for documentation. Unlike the Income Tax Act, The regulations specifically provide for documentation in order to be able to determine whether controlled transactions were conducted at arm's length prices. It provides for the production of contemporaneous documentation and gives a specific list of what should be produced. It states that a party to a controlled transaction should prepare the following documentation:

²¹¹ sec 80 (4) Act 11 of 2004, RE 2008 (n 10 above)

²¹² sec 139 (1)(a) Act 11 of 2004, RE 2008 (n 10 above)

²¹³ sec 139 (1)(b) & (c) Act 11 of 2004, RE 2008 (n 10 above)

²¹⁴ sec 140 (2) Act 11 of 2004, RE 2008 (n 10 above)

²¹⁵ sec 140 (3) Act 11 of 2004, RE 2008 (n 10 above)

- a. Organisation structure, including an organisation chart covering persons involved in a controlled transaction
- b. Nature of the business or industry and market conditions
- c. The controlled transactions
- d. Strategies and assumptions regarding factors that influenced the setting of transfer pricing policies
- e. Comparability, functional and risk analysis
- f. Selection of transfer pricing method
- g. Documents that provide the foundation for or otherwise support or were referred to in developing the transfer pricing analysis
- h. Index to document and
- i. Any other information, data or document considered relevant by the commissioner²¹⁶

The regulation provides for timing. The documents are to be in place before the annual tax returns filing date is due²¹⁷ but may also be requested for by the commissioner and in such a situation, shall be filed within 30 days from the request.²¹⁸ Non compliance with the regulation on documentation constitutes an offence subject to imprisonment, a fine or both.²¹⁹

The regulations seem to provide essential requirements for the information needed to understand the operations an MNE or person conducting controlled transactions. They also give way to the creation of The Guidelines which provide more information on documentation.

4.3.3 The guidelines

The guidelines are more detailed than the regulations and they break down what is to exist in each category. A discussion is provided as follows.

- a. Organisational structure²²⁰: this is to include two aspects. The global organisation and ownership of the taxpayer's business is to be provided. Any changes must be expressed and a global organisational chart should be delivered to the tax authority. This organisational structure must disclose all associates but is limited to those with transactions that directly or indirectly affect the pricing of the documented transactions. Apart from the global organisation, the company organisational chart is also required. No elaboration is given on the aspect of the company organisational chart. Questions may arise as to whether it is the

²¹⁶ Regulation 7 (2) of The regulations

²¹⁷ Regulation 7 (3) of The regulations

²¹⁸ Regulation 7 (4) of The regulations

²¹⁹ Regulation 7 (5) of The regulations

²²⁰ The guidelines 26

company with all its branches or just the one in the Tanzanian jurisdiction. This is pertinent information to disclose as in matters of tax, holding and subsidiary companies are treated as separate entities. The guidelines should clearly provide what the company's organisational chart really entails, whether it refer to the whole holding and subsidiary trail or just the company within the Tanzanian jurisdiction.

b. Group financial report²²¹: this should be equivalent to an annual report covering controlled transactions in the most recent accounting period.

c. Nature of the business/industry and market conditions²²²: this includes three aspects. The first one is an outline of the business which should include relevant history, industries economic and legal factors and how they affect the business, business lines and the goods or services subjected to the controlled transaction. The relevant recent history has not been elaborated. Nothing provides what is to be considered relevant and nothing provides how recent is recent. This could pose a challenge as there are instances where trends and challenges occur over a long period of time and the relevancy of information in one jurisdiction may not be so relevant in another jurisdiction. This may lead to rejection of information or requests for more information by the tax authorities which may result in making it burdensome for taxpayer. Having a clear cut definition of exactly what is needed will also create an environment of certainty for both the taxpayer and the tax authority as one will know what to give and the other will know what to expect upon receiving the information.

The second aspect is that the MNE has to disclose the corporate business plans to provide taxpayers with an idea of the controlled transactions.

The third aspect is information on the competitive environment. The taxpayer is to provide the tax authorities with detailed information on how these environments are structured, how dynamic they are and what their intensity is.

d. Controlled transactions²²³: this is the heart of transfer pricing. Without controlled transactions, there can be no transfer pricing. Any MNE is aware when trading with an affiliate and therefore has to provide documentation to the tax authority. The documentation on controlled transactions is to incorporate the following six aspects.

²²¹ The guidelines (n 220 above) 26

²²² The guidelines (n 220 above) 26

²²³ The guidelines (n 220 above) 27

- (i) Description of details of the property or services to which the international/domestic transaction relates; any intangible rights or property attached thereto, the participants, the scope, timing, frequency, type and value of the controlled transactions (including all relevant related party dealings in relevant geographic markets);
 - (ii) Names and addresses of all associated persons, with details of the relationship with each such associated person;
 - (iii) The nature, terms (including prices) and conditions of international transactions (where applicable) entered into with each associated person and the quantum and value of each transaction;
 - (iv) An overview description of the business, as well as a functional analysis of all associated persons with whom the taxpayer has transacted;
 - (v) All commercial agreements setting forth the terms and conditions of transactions with associated persons as well as with third parties;
 - (vi) A record of any forecasts, budgets or any other financial estimates prepared by the person for the business as a whole and for each division or product separately.
- e. Pricing policies: there are no explanations on this aspect. Once again, it begs the question whether the pricing policies are those for the whole MNE or simply for the entity in the Tanzanian jurisdiction.
 - f. Assumption, strategies and information regarding factors that influenced the setting of pricing policies ²²⁴
 - g. Comparability, functional and risk analysis

Describing characterisation of the subject matter of the transaction, “the functions performed, assets employed, risks assumed, terms and conditions of the contract, business strategies pursued economic circumstances and any other special circumstances.”²²⁵

h. Selection of transfer pricing method

²²⁴ The guidelines (n 220 above); (i) Relevant information regarding business strategies and special circumstances at issue, for example, intentional set-off transactions, market share strategies, distribution channel selection and management strategies that influenced the determination of transfer prices;

(ii) Assumptions and information regarding factors that influenced the setting of prices or the establishment of any pricing policies for the taxpayer and the related party group as a whole;

(iii) Documentation to support material factors that could affect prices or profits in arm’s length dealings.

²²⁵ The guidelines (n 172 above) 27; they also include Information on functions performed (taking into account assets used and risks assumed) of the related party involved in the controlled transaction as well as a description of FAR of group of companies to the extent that they affect or are affected by the controlled transactions carried out by the taxpayer; Details of comparables, as mentioned in paragraph 9 including for tangible property: its physical features, quality and availability; for services: the nature and extent of the services; and for intangible property: the form of the transaction, the type of intangible, the rights to use the intangible that are assigned and the anticipated benefits from its use; The data collected and the analysis performed to evaluate comparability of uncontrolled transactions with the relevant controlled transactions.; Criteria used in the selection of comparables including database screens and economic considerations; Identification of any internal comparables; Adjustments (details and reasons for those adjustments) made to the comparables; Aggregation analysis (grouping of transactions for comparability)

How a transfer pricing method is selected is to be fully disclosed by the entity. The taxpayer should describe the data on the consideration of a transfer pricing method, what analysis was conducted in the determination and the reasons for selecting that specific method stating why that method would be more appropriate in that transaction.

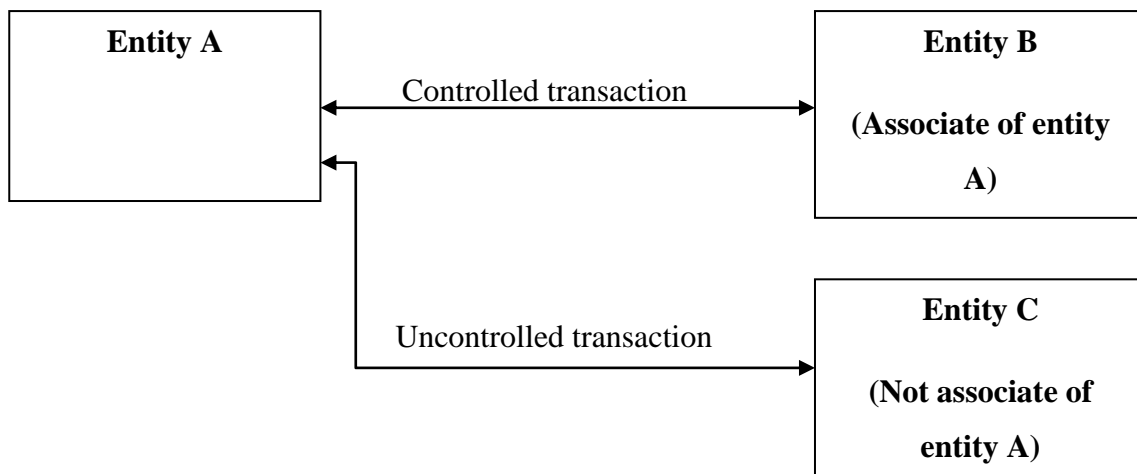
Documentation should also be provided on the procedure undertaken when selecting a transfer pricing method.

- i. Application of the transfer pricing method

4.4 Tanzania and the OECD guidelines and UN Manual

Tanzania is neither an OECD member nor a G20 member but Tanzania is UN member. However, when it comes to standards of documentation, The UN Manual makes a lot of reference to the OECD/G20 guidelines which provide for documentation in its Action 13 report. Never the less, being a member to any of these organisations does not make the OECD guidelines or the UN Manual automatically applicable in any state. There has to be a follow up action of creating laws to make the rules binding. The million dollar question then becomes whether the OECD guidelines or the UN Manual is what Tanzania needs.

Starting off with the reason why transfer pricing documentation is needed in the first place.



Considering the above illustration, the transfer price is the arrow labelled controlled transaction. This is because entity A and B affiliate entities. Entity C on the other hand is not associated to entity A and therefore there is no transfer price as the transaction is an uncontrolled one.

Documentation comes into play because it is difficult for an outsider to know which entities are associated. This is where the OECD master file comes into play. For the tax authority to know which transactions fall under transfer pricing, the first thing is to know which entities are associated. Transfer pricing is only between associate or controlled transactions.

The next thing is for the tax authority to be able to determine which transfer price transactions fall under its jurisdiction. In Tanzania, a controlled transaction where one entity is in Tanzania and subject to the laws of Tanzania and the other one is outside of the Tanzanian jurisdiction falls under transfer pricing regulation. The key words there are that there should be a transaction between more than one entity from more than one jurisdiction, one being the Tanzanian jurisdiction. This is where the OECD local file joins the picture. The local file provides for controlled transactions between the host state and other jurisdictions.

Finally, knowing the global structure of the entity and their global allocation of income and profit assists jurisdictions in understanding the operations on the entity which gives a clearer picture to the taxing jurisdictions and may assist in tracking other BEPS mechanisms. This is where the OECD country-by-country reporting comes in.

So, does Tanzania need documentation from MNEs? The answer is in the affirmative and it is the reason why there are regulations which provide for documentation. Tanzania's documentation regulations are based on the OECD guidelines and the UN Manual. However, the Tanzanian regulations and guidelines were enacted in 2014 but the final OECD/G20 report on Action 13 was in 2015, the OECD guidelines and the UN Manual have been updated as of 2017. This means that the Tanzanian guidelines lack the three tier approach established by the OECD.

4.5 Conclusion

This chapter has established that Tanzania is not entirely clueless in terms of regulating transfer pricing and transparency obligations of investors in matters of transfer pricing. The guidelines are very detailed and in some areas illustrated for purposes of clarity. The regulations on the other hand do not have as much information as the guidelines and it is the go to document in matters of transfer pricing. The regulations are brief and simple but without all the necessary information needed by a taxpayer. In addition to that, Tanzania has not adopted the three tier OECD approach. It is not compulsory for Tanzania to adopt the OECD regulations but so far they are the only international framework that has reached that level of development in matters of transfer pricing documentation, even the UN manual refers

to the OECD guidelines in matters of documentation. Tanzania could create its own legal framework on transfer pricing but there have not been enough interaction with the matter in the country to be able to establish a proper regulation top that off with the lacking expertise in the area and it creates a ticking time bomb for disaster. Furthermore, Tanzania's transfer pricing regulations and guidelines are all based on the OECD guidelines and the UN manual. The fact that it took a presidential probe committee to bring to light matters that have been occurring for 19 years means that Tanzania should step up and update its regulations, build expertise and be more aware of things happening in its own jurisdiction.

CHAPTER 5- CONCLUSION AND RECOMMENDATIONS

5.1 Recap

The whole research was based on the problem that tax authorities cannot track transfer pricing activities and therefore the investors are to have to be more transparent in their controlled transactions. Such transparency can only be put in force through proper regulation and this research focussed on coming up with a proper regulatory framework governing the transparency obligations of investors in transfer pricing matters.

5.2 Summary of findings

Transfer pricing is no small matter. It has been an issue of concern for many years and continues to be an issue of concern. However, there have been developments in the area as the methods of determining transfer pricing have increased and may continue to increase if the need persists. Access to information remains the one thing that carries the whole transfer pricing issue on its shoulders. For tax authorities to be able to monitor transfer pricing, information is needed and such information can only be obtained from the MNE. Similarly, for the MNE to be transparent and disclose the information, the relevant laws need to express exactly what is expected and needed from the MNE. The whole matter of transparency by MNEs and what they are to disclose was the subject of chapter 3.

Chapter 3 showed how international business has come a long way and that experience led to development in many areas. Investor transparency in matters of transfer pricing is one of them. It began in 1995 when the OECD first brought about guidelines for disclosures which had no specifics on the matters of content and resulted in states creating their own disclosure thresholds for MNEs leading up to the 2015 OECD/G20 disclosure guidelines. Though not binding, the guidelines have played their part in moulding transfer pricing disclosures into what they are today and it seems to be a step in the direction of forming a global consensus on what is to be disclosed by MNEs. It aims at providing a global standard acceptable by states and MNEs for its uniformity. At the end of the day, the major aim is to create consistency and a stable investment environment while allowing states to regulate revenues from such investments. From 2015 to date, a number of states have adopted the OECD/G20 guidelines into their domestic laws with relevant modifications. Chapter 3 concluded and guided the research into chapter 4 which focused on investor transparency in matters of transfer pricing in the context of Tanzania.

Chapter 4 established that Tanzania is not entirely clueless in terms of regulating transfer pricing and transparency obligations of investors in matters of transfer pricing. The guidelines are very detailed and in some areas illustrated for purposes of clarity. The regulations on the other hand do not have as much information as the guidelines and it is the go to document in matters of transfer pricing. The regulations are brief and simple but without all the necessary information needed by a taxpayer. In addition to that, Tanzania has not adopted the three tier OECD approach. It is not compulsory for Tanzania to adopt the OECD regulations but so far they are the only international framework that has reached that level of development in matters of transfer pricing documentation, even the UN manual refers to the OECD guidelines in matters of documentation. Tanzania could create its own legal framework on transfer pricing but there have not been enough interaction with the matter in the country to be able to establish a proper regulation. Top that off with the lacking expertise in the area and it creates a ticking time bomb for disaster. Furthermore, Tanzania's transfer pricing regulations and guidelines are all based on the OECD guidelines and the UN manual. The fact that it took a presidential probe committee to bring to light matters that have been occurring for 19 years means that Tanzania should step up and update its regulations, build expertise and be more aware of things happening in its own jurisdiction.

5.3 Conclusion

This research has concluded that although Tanzania has transfer pricing regulations on documentation, there is still a need for modification of the regulations. For the tax authorities to be able to track transfer pricing and other base erosion and profit shifting they need to have proper information that can only be obtained by proper regulation. This conclusion brings this research to the following recommendations.

5.4 Recommendations

This research recommends that first Tanzania creates new regulations on matters of transfer pricing documentation. Although there are transfer pricing regulations and guidelines which both provide for documentation, the regulations do not provide enough detail and the legal position of the guidelines is unclear. The preface to the guidelines states that the guidelines are for guiding purposes but do not state that the taxpayer is totally bound to provide this information.

In addition to that, the Tanzanian regulation and guidelines seem to be lacking some pertinent information which may lead to the creation of loopholes in the system or the dependency on

the power of the commissioner to request more information. This is not entirely a bad thing but may lead to an investment environment without certainty which is one of the things that transfer pricing documentation is trying to avoid. This lacking of information here may be in terms of presentation of information or setting out clear cut rules that give power only to transfer pricing experts to conduct risk assessments or audits.

Referring back to the dispute between Tanzania and Acacia were the parties are currently in negotiations on how to move forward, the second Presidential probe committee found over a period of 19 years, various offences were being committed by Acacia including transfer pricing manipulation.²²⁶ It begs the question as to why it took Tanzania 19 years to find out these offences. Tanzania has had laws governing transfer pricing since its Income Tax Act²²⁷ then in 2014, the transfer pricing regulations started operating yet it took a presidential probe committee to realise that something was going wrong. This only means that there is something wrong with the system, in terms of information receipt and its analysis. This is the reason why this research recommends a whole new regulation focussing just on transfer pricing documentation.

The African Tax Administration Forum (ATAF) has a publication on how to draft transfer pricing legislation.²²⁸ It provides for models on various types of transfer pricing legislation and Tanzania could benefit from adopting the model on transfer pricing documentation. It can be amended to suit the Tanzanian jurisdiction. The model is imported and attached in the Appendix after this chapter as *Annex IV*. This model is recommended by this research as it contains information that is not provided for in the Tanzanian legal framework on transfer pricing. For example, the corporate organisational structure is elaborated in this model while the Tanzanian guidelines simply state that the company organisation structure should be provided.

This research also recommends that the Tanzanian regulations provide for a three tier system. Although most of the documents provided for in the three tier system are also in the Tanzanian guidelines, there is no clear cut distinction or elaboration on what documents fall

²²⁶ Tanzania Daily News (Dar es Salaam) ‘Acacia has operated illegally for 19 years’ 13 June 2017 at allafrica.com/stories/201706130466.html accessed on 29 September 2017

²²⁷ Act 11 of 2004, RE 2008 (n 10 above)

²²⁸ The African Tax Administration Forum (ATAF) *Suggested approach to drafting transfer pricing legislation* at <https://www.ataftax.org/en/news-library/documents> accessed on 26 September 2017

under which category. As observed in Chapter 3 of this research the OECD guidelines provide for master files, local files and country-by-country reports. This categorisation provides ease of doing business and creates certainty in knowing what exactly is to be provided in each category. They can act as check list and will make it easier for the TRA to know what has been submitted and what is yet to be submitted.

Another recommendation by this research is that the transfer pricing documentation regulation should provide for templates or forms on matters of transfer pricing that give the tax payer a go to format when preparing documentation. This research recommends that as Tanzania has done in matters of companies, it should provide transfer pricing documentation prescribed forms. They should include master file, local file and country-by-country reporting forms. The ATAF suggested approach also provides for templates for annual return on transfer pricing reporting. The research recommends that Tanzania adopts this format with relevant modifications as it provides in depth information concerning transfer pricing matters. The Template is imported from the ATAF suggested approach and provided in the Appendix bellow as *Annex V*.

A further recommendation from this research is that Tanzania should create an electronic platform within the TRA system specifically for transfer pricing matters. This platform should not only be for allocation of and submitting information, it should be a platform where taxpayers can liaise with the tax authorities on matters pertaining to transfer pricing. It may even assist on reaching a mutual transfer pricing method before the submission of documentation and therefore reducing the risk of having a different method allocated by the TRA. It will also reduce unnecessary queuing at the TRA offices resulting into a speedy process.

This research recommends that Tanzania adopts regulating transfer pricing on an international level. As provided for in the previous chapters, IIAs are beginning to impose obligations on investors. This is a platform that Tanzania should explore when concluding any form of IIAs. Having transparency obligations for investors in IIAs could serve as a bonus when there are no explicit domestic laws governing the situation. The IIA will act as another layer of protection for the state. Another reason why IIAs are a good option is for dispute settlement purposes. This research will use the International Centre for Settlement of Investment Duties (ICSID) as an example. The subject matter in a dispute before ICSID

should be one arising directly out of an investment.²²⁹ According to Article 25 of the ICSID convention²³⁰ *locus standi* before the centre is only granted to a contracting state and a national of another contracting state or to parties that use the additional facilities. Basically, a case has to be one between a state and an investor. Nothing in the ICSID convention provides that such matters should be instituted by the investor, yet, almost all the cases heard before ICSID were instituted by the investor.

In his article, Laborde stated that only three cases in the history of ICSID had been instituted by the state. These cases are, *Gabon v Socié'te' Serete S.A.*;²³¹ *Tanzania Electric Supply Company Limited v Independent Power Tanzania Limited*;²³² and *Government of the Province of East Kalimantan v PT Kaltim Prima Coal and others*.²³³ This is not necessarily a bad thing as states tend to rely on their own domestic courts to solve matters with investors. However, arbitration does have its benefits, such as dealing with the case in a speedy manner and not having to undergo a whole domestic procedure and the investor still decides to take it to arbitration. Therefore, if states decide to opt for ICSID arbitration, the IIA is the first document that will be looked at as governing the relationship between the investor and the state. This means that having concise provisions in the IIA may serve as a bonus especially if the IIA does not provide for domestic law as law governing the investment, domestic regulations in that area are nonexistent or not properly developed.

However, the incorporation of investor obligations into IIAs is still a gray area in international law and it needs further research and probably even development of jurisprudence.

²²⁹ Article 25 Convention on the settlement of investment disputes between states and nationals of other states (ICSID convention)

²³⁰ Convention on the settlement of investment disputes between states and nationals of other states (ICSID convention)

²³¹ G Laborde 'The case for host state claims in investment arbitration' (2010) 1 *Journal of International Dispute Settlement* 100 *citing ICSID Case No ARB/76/1 Gabon v Socié'te' Serete S.A. In 1978, the case was settled, and the proceedings discontinued.*

²³² G Laborde (n 6 above) *citing ICSID Case No ARB/98/8 Tanzania Electric Supply Company Limited v Independent Power Tanzania Limited*

²³³ G Laborde (n 6 above) *citing ICSID Case No ARB/07/3 Government of the Province of East Kalimantan v PT Kaltim Prima Coal and others.*

APPENDIX

Annex I

Transfer pricing documentation – Master file

The following information should be included in the master file:

Organisational structure

- Chart illustrating the MNE's legal and ownership structure and geographical location of operating entities.

Description of MNE's business(es)

- General written description of the MNE's business including:
 - Important drivers of business profit;
 - A description of the supply chain for the group's five largest products and/ or service offerings by turnover plus any other products and/or services amounting to more than 5 percent of group turnover. The required description could take the form of a chart or a diagram;
 - A list and brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services, including a description of the capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;
 - A description of the main geographic markets for the group's products and services that are referred to in the second bullet point above;
 - A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used;
 - A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year.

MNE's intangibles (as defined in Chapter VI of these Guidelines)

- A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management.
- A list of intangibles or groups of intangibles of the MNE group that are important for transfer pricing purposes and which entities legally own them.
- A list of important agreements among identified associated enterprises related to intangibles, including cost contribution arrangements, principal research service agreements

and licence agreements.

- A general description of the group's transfer pricing policies related to R&D and intangibles.
- A general description of any important transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved.

MNE's intercompany financial activities

- A general description of how the group is financed, including important financing arrangements with unrelated lenders.
- The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organised and the place of effective management of such entities.
- A general description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises.

MNE's financial and tax positions

- The MNE's annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.
- A list and brief description of the MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.

Annex II

The following information should be included in the local file:

Local entity

- A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.
- A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.
- Key competitors.

Controlled transactions

For each material category of controlled transactions in which the entity is involved, provide the following information:

- A description of the material controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, financial and performance guarantees, licences of intangibles, etc.) and the context in which such transactions take place.
- The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity (i.e. payments and receipts for products, services, royalties, interest, etc.) broken down by tax jurisdiction of the foreign payor or recipient.
- An identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them.
- Copies of all material intercompany agreements concluded by the local entity.
- A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years.(To the extent this functional analysis duplicates information in the master file, a cross reference to the master file is sufficient.)
- An indication of the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method.

An indication of which associated enterprise is selected as the tested party, if applicable, and an explanation of the reasons for this selection.

- A summary of the important assumptions made in applying the transfer pricing methodology.
- If relevant, an explanation of the reasons for performing a multi-year analysis.
- A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information.
- A description of any comparability adjustments performed, and an indication of whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both.
- A description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer pricing method.
- A summary of financial information used in applying the transfer pricing methodology.
- A copy of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above.

Financial information

- Annual local entity financial accounts for the fiscal year concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied.
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements.
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

ANNEX III

Annex III to Chapter V

Transfer pricing documentation – Country-by-Country Report

A. Model template for the Country-by-Country Report

Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) before Income Tax	Income Tax Paid (on Cash Basis)	Income Tax Accrued Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other than cash and cash
	Unrelated party	Related party	Total							

Table 2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Main Business Activity(ies)	Other1						
	Dormant						
	Holding Shares or Other Equity instruments						
	Insurance						
	Regulated Financial Services						
	Internal Group Finance						
	Provision of Services to Unrelated Parties						
	Administrative, Management or Support Services						
	Sales, Marketing or Distribution						
	Manufacturing or Production						
	Purchasing or Procurement						
	Holding or Managing Intellectual Property						
	Research and Development						
Tax Jurisdiction of Organisation or Incorporation if Different from Tax Jurisdiction of Residence							
Constituent Entities Resident in the Tax Jurisdiction							
Tax Jurisdiction							

Please specify the nature of the activity of the Constituent Entity in the “Additional Information” section.

Table 3. Additional Information

Name of the MNE group: Fiscal year concerned:
Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the Country-by-Country Report

ANNEX IV

*imported from the ATAF suggested model²³⁴

IN EXERCISE of the powers conferred on the [Commissioner-General/Commissioner] by section XXXX of the Income Tax Act, the following Regulations are hereby made-	
<i>Citation</i>	1. These Regulations may be cited as the Income Tax (Transfer Pricing Documentation) Regulations, [20XX].
<i>Required documents</i>	2. (1) A taxpayer must have in place contemporaneous documentation that verifies that the conditions in its controlled transactions for the relevant tax year are consistent with the arm's length principle.
	2. (2) Documentation shall include: <ul style="list-style-type: none"> a. an overview of the taxpayer's business operations (history, recent evolution and general overview of the relevant markets of reference) and organizational chart (details of business units/departments and organizational structure); b. a description of the corporate organizational structure of the group that the taxpayer is a member (including details of all group members, their legal form, and their shareholding percentages) and the group's operational structure (including a general description of the role that each of the group members carries out with respect to the group's activities, as relevant to the controlled transaction(s)); c. General written description of the MNE's business including: <ul style="list-style-type: none"> Important drivers of business profit; A description of the supply chain for the group's five largest products and/or service offerings by turnover plus any other products and/or services amounting to more than 5 percent of group turnover. The required description could take the form of a chart or a diagram; A list and brief description of important service arrangements between members of the group, other than research and development (R&D) services, including a description of the

²³⁴ ATAF Suggested approach to drafting transfer pricing legislation (n 210 above)

	<p>capabilities of the principal locations providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;</p> <p>A description of the main geographic markets for the group’s products and services that are referred to in the second bullet point above;</p> <p>A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used;</p> <p>A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year.</p> <p>d. a detailed description of the business and business strategy pursued by the taxpayer including an indication whether the taxpayer has been involved in or affected by business restructurings or intangible transfers in the present or immediately preceding year and an explanation of those aspects of such transactions affecting the taxpayer</p> <p>e. a list of the taxpayer’s key competitors in [Country]</p>
	<p>For each material category of controlled transactions in which the taxpayer is involved;</p> <p>f. description of the controlled transaction(s), and the context in which such transactions took place including an analysis of the comparability factors specified in Paragraph 4 of the Income Tax Transfer Pricing Regulations, 20XX;</p> <p>g. the amount of intra-group payments and receipts for each category of controlled transactions involving the taxpayer broken down by tax jurisdiction of the foreign payer or recipient</p> <p>h. identification of the connected persons involved in each category of controlled transactions, and the relationship amongst them.</p> <p>i. copies of all material intercompany agreements concluded by the taxpayer</p> <p>j. detailed comparability and functional analysis of the connected</p>

	<p>parties in relation to the controlled transaction. This should include details of assets in relation to the controlled transaction as well as risk assumed by each party.</p> <p>k. explanation of the selection of most appropriate transfer pricing method(s), and, where relevant, the selection of the tested party and the financial indicator;</p> <p>l. financial statements for the parties to the controlled transaction including where the tested party has been selected as a party outside the country.</p> <p>m. a summary of the important assumptions made in applying the transfer pricing methodology</p> <p>n. If relevant an explanation of the reasons for performing a multi-year analysis</p> <p>o. comparability analysis, including; description of the process undertaken to identify comparable uncontrolled transactions; explanation of the basis for the rejection of any potential internal comparable uncontrolled transactions (where applicable); description of the comparable uncontrolled transactions; analysis of comparability of the controlled transaction(s) and the comparable uncontrolled transactions (taking into account Paragraph ... of the Income Tax Transfer Pricing Regulations, 20XX); and, details and explanation of any comparability adjustments made;</p> <p>p. a summary of financial information used in applying the transfer pricing methodology</p> <p>q. detail of any industry analysis, economic analysis, budgets or projections relied on;</p> <p>r. details of any advance pricing agreements or similar arrangements in other countries that are applicable to the controlled transactions;</p> <p>s. a conclusion as to consistency of the conditions of the controlled transactions with the arm's length principle, including details of any adjustment made to ensure compliance; and</p> <p>t. summary of the taxpayer's financial accounts for the fiscal year</p>
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	<p>concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied</p> <p>u. information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements</p> <p>v. summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained</p> <p>w. any other documentation or information that is necessary for determination of the taxpayer's compliance with the arm's length principle with respect to the controlled transactions.</p>
<i>Language of documentation</i>	3. Documentation may be submitted in XXXXX or English language.
<i>Contemporaneous documentation</i>	4. Documentation for a relevant tax year is considered to be contemporaneous where it is in place at the statutory tax return's filing date
<i>Time limit for submission of documentation</i>	5. Documentation shall be provided to the [Commissioner-General/Commissioner] within 45 days of the written request being duly issued by the [Commissioner-General/Commissioner].
<i>Power to request additional information</i>	6. The obligation of the taxpayer to provide this documentation is established without prejudice to the power of the [Commissioner General/Commissioner] to request additional information that in the course of audit procedures it deems necessary to carry out its functions.

ANNEX V

- Imported from the ATAF suggested guidelines²³⁵

Annual return on transfer pricing draft

[Country tax administration]

Annual return on transfer pricing

This return forms part of Form XXX and must be completed by those taxpayers with aggregate **transactions within [Section XX]** exceeding USDXXXXXX during the relevant fiscal period. In determining the aggregate value of **transactions within [Section XX]** for the relevant fiscal period, loan balances and capital transactions should be included and income and expenses may not be offset.

1. Name of taxpayer:

.....
.....

2. TIN Number:

.....
.....

3. Contact person:

.....
.....

4. Describe the taxpayer's principal business activities.

.....
.....

5. Describe the principal business activities of the ultimate parent company and its consolidated group.

.....
.....

6. Particulars of connected persons with which the taxpayer had transactions with

Name of the connected person	Nature of the relationship	Country of tax residence	Country of incorporation (where	Description of transactions	Aggregate value of transactions**
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²³⁵ ATAF Suggested approach to drafting transfer pricing legislation 23-26

			applicable)*		

* *In the case of a legal person, the country under which laws the legal person was formed*

** *Income and expenses should not be offset*

7. Details of the performance of the [Country] taxpayer and the consolidated group of the ultimate parent company (where applicable)

	[Country] Taxpayer	Holding Company (Consolidated)
Total assets		
Operating Assets		
Current Liabilities		
Turnover		
Gross profit		
Total expenses		
Operating expenses		
Operating profit		

8. Details of controlled transactions that give rise to taxable income or tax deductible expenses

Category/ Item	Purchases/ Expenditure (ETB)	Sales/ Revenue (ETB)	Transfer pricing adjustments (if any)	Percentage (%) which transfer pricing documentation has been prepared	Transfer pricing method
Tangible property					
Finished goods					
Raw materials					
Other					
Rents,					

royalties and intangible property					
Rent					
Royalties					
License or franchise fees					
Other					
Services					
Management					
Administrative					
Marketing					
Engineering, technical, construction, etc					
Research and development					
Training					
Commissions					
Other					
Financial					
Interest					
Guarantee fees					
Lease payments					
Insurance					
Other					
Reimbursement of expenses					
Employment cost for expatriate					

employees					
Other (not included elsewhere)					
Total					

** Please select from the following:*

CUP – comparable uncontrolled price method

RPM – resale price method

CPLM – cost plus method

TNMM – transactional net margin method

PSM – profit split method

OTH – other method

Note - Where more than one method is applicable for a category of transaction, please specify the transfer pricing method applicable to the largest portion

9. Details of loans to and from connected persons

(a) Loans to connected persons

Name of connected person	Opening balance	Closing balance	Interest bearing (yes/no)

(b) Loans from connected persons

Name of connected person	Opening balance	Closing balance	Interest bearing (yes/no)

10. Details of transactions with connected persons of a capital nature:

(a) Did you have any transactions with connected persons of capital nature in which you acquired interest in asset(s)? Yes [] No []

If yes, state the subject of the transaction (i.e. machinery, shares, intangible asset etc.) and the method(s) used to determine the purchase price.

.....

(b) Did you have any transactions with connected persons of capital nature in which you disposed of asset(s)? Yes [] No []

If yes, state the subject of the transaction (i.e. machinery, shares, intangible asset etc.) and the method(s) used to determine the disposal proceeds.

.....

11. Dealings with connected persons involving non-monetary or nil consideration:

(a) Have you received from or provided to a connected person any non-monetary consideration for the performance of services, transfer of property (tangible or intangible), processes, rights or obligations?

Yes [] No []

(b) Have you provided to a connected person any services, transfer of property (tangible or intangible), processes, rights or obligations for which the consideration was nil? Yes [] No []

12. Has there been any change in the business structure during the year (changes to ownership structure or other business restructuring)? Yes [] No []

If yes, please provide details.

.....

Name of authorized official.....
Designation:
Signature:
Date:

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