COMPREHENSIVE TRANSFER PRICING RULES AS A MEANS OF REGULATING FOREIGN DIRECT INVESTMENT IN ZIMBABWE

By

LARRY NEGONDE - 12242439

Under the supervision of Dr Femi Oluyeju

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Declaration

I declare this Mini-Dissertation which is hereby submitted for the award for the Legum Magister (LLM) in International Trade and Investment Law in Africa at the International Development Unit, Centre for Human Rights, Faculty of Law, University of Pretoria, is my original work and has not been previously submitted for the award of a degree at this or any other tertiary institution.
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(b) My mother for her continuous love and support which kept me going and motivated.

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(d) Dr Femi Oluyeju, my supervisor for his guidance.
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<tr>
<td>AFRODAD</td>
<td>African forum and network on debt and development</td>
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<td>BIT</td>
<td>Bilateral Investment Treaty</td>
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<td>CP</td>
<td>Cost Plus</td>
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<td>CUP</td>
<td>Comparable uncontrolled price</td>
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<td>FDI</td>
<td>Foreign direct investment</td>
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<td>MNE</td>
<td>Multinational Enterprise</td>
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<td>OECD</td>
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<td>PWC</td>
<td>Price Waterhouse Coopers</td>
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<td>United States of America</td>
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<td>UNCTAD</td>
<td>United Nations Conference on trade and Development</td>
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Abstract

Transfer pricing refers is a practice that is mainly conducted by Multinational Enterprises to evade their tax obligations. This is done by the transfer of profits from a country where the payable tax is higher and declaring them in a country where the payable tax will be less. This practice affects the host state as the tax base of that state is reduced. In some countries, this practice has resulted in annual losses that amount to billions.

Developed countries have successfully tackled the challenge of Transfer Pricing. The United States of America and the United Kingdom were the first countries to introduce transfer pricing legislation. Other developed countries followed the trend and now have comprehensive regimes that do not promote illicit financial flows. With these developments in the developed countries came the Organisation for Economic Cooperation and Development which assisted countries in further developing their governing laws. The main contribution that was introduced by the organisation were reports that interpreted complex terms and provided guidelines that can be used in the adoption of new laws. Africa has always lagged behind in the regulation of Transfer Pricing. Most States that have governing legislation adopted the laws in the last 10 years and some countries are still in the process of adopting new regulating laws. The OECD guidelines have been instrumental in the developments taken by the African countries. Zimbabwe recently amended its Income Tax Act to provide for the regulation of illicit financial flows. However, as with most African countries, the laws are not comprehensive enough to ensure that Multinational Enterprises desist from evading their tax obligations. Therefore, there is need for further development of the governing laws.

The Arm’s length principle has become the accepted standard to be used in the assessment of Transfer Pricing issues. The principle entails that related companies should transact as if they are not related. This mainly deals with the manner in which they charge each other for services rendered or for the sale of goods. Price fixation is a practice that is common with such companies which is targeted at manipulation of profits in a targeted country. Therefore, with the introduction of the arm’s length principle, such practices are effectively addressed. In this study, the issues surrounding illicit financial flows and the legislation governing Transfer Pricing in Zimbabwe will be discussed. A comparative study with the United Kingdom will also be undertaken to assess how the existing laws can be improved to become more comprehensive.
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CHAPTER 1: INTRODUCTION

1.1 Background to the study
Zimbabwe is a sovereign landlocked state located in the Southern part of Africa. It has a total landmass of 390 757 square kilometres and a population of 14.2 million people.\(^1\) Zimbabwe's system of governance is a full presidential republic, the president holds the office of head of government and chief of state. South Africa, Mozambique, Botswana and Zambia are neighbouring states which qualify as some of the large trading partners.

Economically, the country is regaining its strength after a drastic financial crisis that struck in 2008.\(^2\) This resulted in devaluation of the national currency, which was eventually replaced by the South African rand and the United States of America dollar. Most of the investors that operated in the country left due to the political and economic climate.\(^3\) Thus, the growth rate is notably low and the country’s share in regional trade is equally poor.

To improve the current economic situation, Zimbabwe will require investors to return and revive the industries. To enjoy the benefits of foreign investment, structures that attract large companies must be implemented.\(^4\) Ideal investors include multinational corporations such as AB Inbev and Anglo-gold Ashanti. The aforementioned corporations tend to improve the economic situations of their host states. In addition, the government will acquire revenue through corporate taxes and income taxes, which will be substantial considering the number of people they employ.\(^5\) As much as the government has been striving to improve the ease of doing business, foreign investors continue to be elusive and wary. According to the United Nations Conference on Trade and Development’s (UNCTAD) 2016 World Investment Report, Zimbabwe' FDI flows were pegged at USD 421 million. When comparing with countries such as Angola, it is evident that the country is in dire need for legislative and policy reform to boost investment.

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2. AFRODAD Illicit financial flows: towards a more integrated approach for curbing illicit flows from Zimbabwe 4.
4. Dube (n3 above) 12.
However, as much as the country needs investors to invest and inject life into the dying economy, it has to be noted that comprehensive rules need to be in place to ensure that the country does not become victim to fraudulent investors.

1.2 Research problem
Despite the recent amendments to the Income Tax Act, transfer pricing is still topical and problematic in Zimbabwe. The Zimbabwe revenue authority (ZIMRA) continuously faces challenges in regulating transactions involving multinational corporations. Recent studies found that the country lost US$2.83 billion between 2009 and 2013. It is estimated that 98% of the losses were from the mining sector. Furthermore, as of last year the country was still a victim of illicit transactions which led to losses in revenue of up to US$500 million. Therefore, the amendments done to curb this problem are not sufficient and comprehensive enough for the fight against transfer pricing.

It is against this backdrop that this study will seek to make a case for the adoption of comprehensive transfer pricing rules.

1.3 Research question(s)
The broad question which this study for an answer is: Can the adoption of comprehensive regulations governing transfer pricing ensure that multinational corporations comply with their tax obligations in Zimbabwe?

In answering the broad research question, the following sub questions will be answered:

i. What is transfer pricing?
ii. What is the relationship between transfer pricing and foreign direct investment?
iii. How is transfer pricing regulated in Zimbabwe?
iv. Should there be an amendment of the existing provisions or an implementation of a new regime?

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6 T Mandizha Zimra loses sleep over transfer pricing March 31 2017
7 AFRODAD (n2 above) 2.
8 AFRODAD (n2 above) 2.
9 Mandizha (n6 above) 2.
1.4. **Thesis statement**
Zimbabwe is a country full of potential and provides the adequate resources for businesses to thrive. The mining sector has benefited from injection of capital by foreign owned companies. However, this has led to the evasion of tax by such investors. Transfer pricing has become prominent and caused a serious deficit in the tax base of the government. To combat this problem, ZIMRA has introduced provisions that regulate transactions between related persons. The main challenge addressed by this paper relates to the efficacy of the provisions introduced. The provisions are not robust enough to ensure that MNEs comply with their tax obligations.

1.5 **Aims and objectives of the study**
The main objective of the study is to analyse the efficacy of the current transfer-pricing regime and propose the adoption of comprehensive rules. The focus being on the obligations of investors in their disclosure obligations. The result of the research is the formulation of a regime that is motivated by the current laws but able to counter the loopholes in the current structure.

1.6. **Literature review**
Transfer pricing has been a topical issue for the past decade. It is a practice that drastically affects the economics of a country as it affects the tax base of a government. However, the effects that the practice has on an economy depends on the development of the country. In general, developing and least developed countries tend to suffer the most when MNEs engage in such practices. Their dependence on foreign investors have made them more susceptible to such practices.

Regulation of transfer pricing has been a common practice in the developed countries but has come to the attention of most developing countries recently. Therefore, the literature addressing the issue on the continent is scarce. This is mainly attributable to the fact that most countries were not even aware of the practice hence they did not consider introducing regulating legislation. For purposes of this paper, literature relied on was mainly introduced by the developed countries.

The OECD has been the major drive in the regulation of transfer pricing. They have been providing assistance and publications on the field for decades. Their main form of assistance comes in the form of guidelines in the investigation and regulation of transfer pricing matters. The guidelines address the considerations that must be taken into account before the adoption laws governing transfer pricing and they also provide the framework that can be followed. It has to be noted that it is not mandatory for countries to adopt the guidelines, they merely assist
the legislature. Notably, most countries have adopted the guidelines into domestic legislation. Such a practice has proven to be beneficial as it resulted in uniformity of laws with other countries which makes the regulations easier to implement. Zimbabwe recently adopted the guidelines and attempted to resolve the issue of transfer pricing by amending the Income Tax Act to include the guidelines. However, it has been argued that the guidelines do not necessarily solve the challenges that are faced by some African countries. Such an argument is supported by the report that was published by ZIMRA in 2016. The report stated that the country was continuously losing millions despite the attempts to regulate transfer pricing.

According to Price Waterhouse Coopers (PWC), Africa has taken too long in the development of adequate legislation in the adoption of comprehensive legislation. They contend that MNEs continuously deprive the continent of billions annually by shifting their profits. Despite other factors contributing to the sluggish growth in most African economies, tax evasion has contributed significantly. Their assertion concurs with the arguments presented in this paper. However, my arguments will be restricted to the Zimbabwean context.

Most developing countries find foreign direct investment as a major drive for the economy. “Foreign investment entails the transfer of tangible or intangible assets from one country into another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets”. In most developing countries, tangible assets are preferred because there is an assumption that they entail the wealth of the investor. There are two contrasting theories that underpin foreign investment. On one hand there is the classical theory which suggests that investments will ultimately benefit or assist the host state in its development. Scholars that follow the theory argue that for a developing country to improve its economic standing, there must be foreign investment. Whereas the dependency theory suggests that dependency on foreign investment has weakened developing countries and that they will not develop until they depart from such dependency. A middle path has been suggested as a means of reconciling the classical and the dependency theory. According to this theory adequate and effective regulation can result in economic benefits for the host state.

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11 Sornarajah (n10 above) 50.
12 Sornarajah (n10 above) 50.
13 Sornarajah (n10 above) 51.
14 Sornarajah (n 10 above) 54.
Therefore, for countries like Zimbabwe to enjoy the fruits of FDIs, the legislature must adopt robust and comprehensive rules that restrict illegal activities by MNEs.

Zimbabwe is part of the countries that believe in the classical theory. However, such desire for investments has made the country vulnerable to tax evasion. Most of the evasion takes place in the mining sector and is mainly done through transfer pricing. The conclusion of a transfer pricing act is characterised by the establishment of a price for the transaction. To combat the problem, the legislature introduced section 98B in the Income Tax Act to govern transactions involving connected persons. Application of the section was influenced by the Organisation for Economic Co-operation and Development (OECD) transfer pricing guidelines.

According to Dalu, an economics analyst in Zimbabwe, the main challenge in the regulation of multination transaction fell within the disclosure requirements of foreign investors. Currently, they are obliged to give a detailed account of their transactions through audits. However, such corporations, the usually record their transactions in 2 sets of books. Such acts tend to lead to a lack of information by the tax authorities which will ultimately lead to a loss of revenue. Unfortunately, such matters were not covered by the legislature when they adopted the transfer pricing provisions. Thus, it can be stated that the current regulation is too malleable to be relied on.

The most notable addition to the Income Tax Act dealing with transfer pricing was the arm’s length principle. The principle entails that transactions conducted between related persons should have similar terms and conditions as though it was undertaken by parties who are not known to each other. In theory, the principle is solid and provides the solution for most of the challenges faced by tax collectors with regard to transfer pricing. However, the principle can easily be manipulated thus leaving room for tax avoidance and evasion. The following as some of the shortcomings of the arm’s length principle:

Auditing of transfer pricing cases is one of the challenges that ZIMRA continually faces. The root of the problems stems from the fact that regulators constantly seek guidance from the

15 AFRODAD (n2 above) 12.
17 W Cheng and D Zhang "The arm’s length principle, transfer pricing and foreclosure under imperfect conditions 6.
18 M Ngorima ICAZ transfer pricing, thin capitalisation, international tax planning 16.
19 M Ngorima ICAZ transfer pricing, thin capitalisation, international tax planning 14.
OECD guidelines where the methods are considered appropriate.\textsuperscript{21} However, some of the solutions are not applicable to Zimbabwean problems. Thus, the one size fits all approach cannot be applied in resolving transfer pricing issues.

In addition, there are no specific penalties that apply when dealing with transfer pricing, instead general penalty rules apply.\textsuperscript{22} The laws can be regarded as vague and misleading which leads to manipulation by corporations. Lack of penalties also promote attempts of transfer pricing by larger companies as they will eventually make more profits after the general penalties are applied. Therefore, the failure of the legislature in this regard will eventually promote transfer pricing transactions.

Furthermore, ZIMRA and other tax authorities have been on guard and have been striving to maximise the use of their limited resources in handling tax challenges. In addition, there is also dire need for the management of their relationships with businesses or taxpayers more effectively.\textsuperscript{23} Improving the management of tax risk and developing relationships between ZIMRA and multinational corporations have been two of the primary focuses the organisation has embarked on.\textsuperscript{24} Thus, re-evaluation of ZIMRA’s relations with the taxpayers might result in positive change.

Therefore, from the research conducted, it is evident that the current regime is not robust enough to tackle transfer pricing. Introduction of new rules will result in the eradication of loopholes and assist in the generation of revenue through tax collection.

1.7 Research methodology

This is a desktop and library research. The study will involve descriptive and analytical exploration of primary and secondary sources. In the assessment of a more comprehensive regime, the United Kingdom transfer pricing laws will be used for comparative purposes. Primary sources that will be used include Zimbabwe’s income tax Act, the Finance bill of 2016 and the OECD guiding principles on transfer pricing. Secondary sources to will include academic books, journals and articles.\textsuperscript{25}

\textsuperscript{21} T Dalu (note 20 above) 23.
\textsuperscript{22} T Dalu (note 20 above) 23.
\textsuperscript{23} T Dalu (note 20 above) 24.
\textsuperscript{24} N Ngorima (note 22 above) 31.
\textsuperscript{25} \url{www.deloitte.co.zw Transfer pricing in Zimbabwe (accessed} on Monday 3 April 2017).
1.8 Limitation to the study
The research covers the transfer-pricing regime introduced in 2016. To provide comprehensive results, an assessment on the provisions governing anti-avoidance in particular the General Anti Avoidance rules. Finally, an analysis will be made on how a comprehensive transfer-pricing regime can be introduced.

1.9 Structure of chapters
The study will be divided into the following chapters;

Chapter 1 - Introduction
Under this chapter, the background to the study will be addressed. There will be an assessment of the research problem, the research question, justification, literature review and the research methodology. The chapter will be presented in a descriptive manner.

Chapter 2 - Concept of transfer pricing
The focus of this chapter will be on the definition and types of transfer pricing. The chapter will also discuss the common ways in which transfer pricing transactions are structured. Lastly, there will be an analysis of the theories proposed dealing with tax evasion and economic development.

Chapter 3 - Transfer pricing regime in Zimbabwe
The existing developments in the field of transfer pricing will be discussed under this chapter. Emphasis will be placed on the introduction of section 98B into the Income Tax Act governing transaction concluded by related parties. In addition, there will be an evaluation of the shortfalls in the current regime.

Chapter 4 - Comparative study
To adopt a comprehensive system, inspiration will be drawn from a developed country’s system. The United Kingdom transfer pricing regime will be discussed in this chapter and consideration will be made on how Zimbabwe can adopt a similar model.

Chapter 5 - Recommendations and conclusion
This is chapter will provide recommendations on how to change the transfer pricing regime in Zimbabwe. In addition, the appropriate method of implementation will also be analysed in this chapter. Finally, there will be a conclusion to the study summarising the outcomes of the research.
CHAPTER 2-CONCEPT OF TRANSFER PRICING

2.1 Introduction
Evasion of tax obligations by multinational corporations has been a challenge for many countries. For decades, revenue authorities have attempted to tackle the issue but in some cases they were not successful. The effects of such a practice vary from country to country. However, African countries seem to suffer the most when multinational corporations evade their obligations. This is mainly attributable to the fact that their economies mainly depend on the collection of taxes. In this chapter, an analysis of the concept of transfer pricing will be made, how it occurs and how it has developed. In addition, the relationship between transfer pricing and foreign direct investment will also be addressed.

2.2 What is Transfer Pricing?
Transfer pricing refers to “the amount charged by one segment of an organisation for a product or service that it supplies to another segment of the same organisation”.26 This is done by the fixing of prices for a given transaction which deals with cross-border trade.27 Multinational entities MNEs are notorious for such practices. MNEs are global entities that may share common resources and usually have the same people or corporations managing their affairs. “Controlled transactions” is the term that is usually used in such matters.28 These parties will transact in goods or services which may be tangible or intangible.29 Such transactions usually involve two countries that have different tax regimes. Therefore, the corporation will declare low profits and increased costs in a jurisdiction that has higher tax rates and declare more profits in a jurisdiction where the tax rates are lower. In most cases, there will be a holding and a wholly owned subsidiary company. It has to be noted that such transactions are extremely complicated and are usually structured in a manner that they are undetectable or noticeable when it is too late.

The main effect of such transactions is that there will be mispricing or unjustified pricing that will result in lower revenues for the host state.30 Below is an example of a controlled transaction:

27 T Dalu (note 20 above) 12.
30 M Ngorima (n22 above) 18.
A profitable cell phone group in country X purchases its batteries from its own subsidiary in country Y. The parent company determines the price of the batteries and the method of payment for the transaction. Therefore, the price will determine how much profit the subsidiary will make and ultimately the corporate tax payable in country Y. This means that if the parent company pays a substantially low amount for the batteries which is below the market value, the subsidiary will appear to be in financial distress. Thus, low or no profits will be recorded in country Y on the transaction. The completed cell phone can later be sold by another wholly owned subsidiary operating in country Z where the tax rates are lower. Thus, the amount that will be payable in corporate tax will be substantially reduced.

The example above clearly illustrates how a MNE can manipulate recorded profits in a country with a high corporate tax rate. The fixing of prices can be used as a means of assessing the performance of an individual company that is part of a group.\textsuperscript{31} To ensure that such transactions are not carried out, an assessment of the market value of the goods has to be made. Therefore, the entities must transact as if they are not related. This will entail the application of the arm’s length price. This means that the parent company must pay a similar amount to the one they would have paid had they dealt with an unrelated company or entity.

An in depth explanation of terms such as arm’s length and how it is determined will be provided in paragraph 2.5.

2.3 Relevance of transfer pricing
Transfer pricing is currently one most important international tax issue around the globe. In Africa most countries have made strong attempts to provide adequate regulation to combat the practice. As mentioned above, transfer pricing can be used as a mechanism for relocating profits to a more favourable tax jurisdiction for the purposes of obtaining a tax benefit. Thus, the practice is increasingly being seen as a risk and regulators are being tasked with providing lasting solutions to discourage MNEs from depriving governments of the tax collectable. Agencies such as the OECD and United Nations UN, have immensely contributed in the development of transfer pricing material and measures that can be taken by governments in the fight against the practice. This has mainly been done through the compilation of guidelines that can be used in the development of local legislation. Dispute prevention procedures, such as Advanced Pricing Agreements (APAs), may become more prevalent as MNEs and tax authorities are required to reach efficient, cost effective solutions to transfer pricing issues. Despite the improvements in the regulation of transfer pricing, MNEs will continuously attempt to conclude more complex transactions to ensure that the practice continues.

\textsuperscript{31} www.UN.org ‘An introduction to transfer pricing’ 5 (accessed on 11 August 2017).
2.4 Evolution of MNEs and introduction of Transfer Pricing regulations
The fifteenth and sixteenth centuries are regarded as the roots of MNEs. Most companies that were registered in Europe and the United States of America (USA) were considering other markets. The introduction of colonisation made the expansion of companies a lot easier. Towards the twentieth century most companies had developed to such an extent that their manufacturing activities were no longer done in their home territories. The colonies that were acquired by the developed countries were mainly used as a source for raw materials. These countries were not to be considered as markets as they lagged behind in terms of development.

When the Second World War (WWII) erupted, most MNEs that were based in Europe were affected. Their markets were affected by the war which resulted in the forced closure of some companies. However, when the war ended, production levels significantly increased as developed countries began to invest heavily in the reconstruction of their economies. MNEs managed to establish themselves as the main drivers of global production and trade during this period. Most of the companies began taking advantage of the availability of cheap labour, and the growing demand of products in the developing countries. Therefore, with such expansions, there was a dire need to ensure that the MNEs were effectively regulated.

The United Kingdom and the USA were the first countries to enact transfer pricing legislation. The provisions were introduced to deter companies from shifting profits to overseas partners through price distortions of cross-border transactions. However, the provisions were not effective because the increasing size of the corporation and advanced price manipulations. As the manipulation of prices escalated, countries began concluding treaties as a means of regulating the activities of MNEs. A notable development during this period was the adoption of Article 9(1) of the OECD draft. The Article allowed the tax administrations to adjust profits and institute mechanisms that restrict profit shifting and ensure that MNEs comply with their appropriate tax obligations.

In 1979, the OECD engaged in an in depth analysis of the regulation of transfer pricing and published a report on “Transfer pricing and Multinational Enterprises”. The report reaffirmed...
the arm’s length principle and also provided the methods to be used in the computation of the Arm’s length price. In subsequent years the OECD continuously published reports that discussed the development of transfer pricing and how governments could develop their laws to combat profit shifting.

In 1984 the UK introduced further anti-avoidance regulations were referred to as “The Controlled Foreign Corporation (CFC) rules."\(^{39}\) The purpose of the legislation was to regulate the excessive use of tax heavens by domestic corporations. The provisions had the effect that profits that were acquired by offshore subsidiaries had to be attributed back to the parent company.\(^{40}\) Therefore, with such legislation, assessment of the profits made by MNEs would be assessed in a much efficient manner.

In 1987, 1988 and 1994 the OECD engaged with the problems relating to thin capitalization, the tax consequences of foreign exchange gains and losses, and the attribution of income to permanent establishments.\(^{41}\) During this period the USA introduced new provisions that supplemented the OECD guidelines. The regulations dealt with the compliance requirements, penalties and interest deductions. Such advancements improved the position of developed countries in the fight against transfer pricing. By the year 1999, companies had expanded to most parts of the world which facilitated the introduction of more stringent rules for the regulation of their cross-border transactions. The OECD then introduced guidelines for conducting advanced-pricing arrangements.\(^{42}\) These guidelines were adopted by most countries that had a fair share in world trade. Notable, countries such as Canada, France, West Germany, Australia, South Korea and China began paying more attention to the problems posed by transfer pricing which led to the enactment of comprehensive legislation in the field of transfer pricing.\(^{43}\)

Regrettably, African countries did not participate in the development of the laws governing transfer pricing. It can be argued that some countries were still healing from the wounds the liberation wars they were involved in to eradicate colonial rule. To some extent, a lack of expertise also contributed to the sluggish development in the laws dealing with taxation.


\(^{41}\) OECD Report on transfer pricing 1979.

\(^{42}\) VS Wahi (n42 above) 322.

\(^{43}\) VS Wahi (n42 above) 322.
Whatever the reason, Africa became the victim of MNEs and continuously loses billions due to price manipulations and profit shifting by MNEs.

2.5 The arm’s length principle
This principle applies in the assessment of transactions concluded by MNEs. It has been widely accepted and adopted by most countries into domestic legislation. The arm’s length principle requires that compensation for any intercompany transaction shall conform to the level that would have applied had the transaction taken place between unrelated parties, all other factors remaining the same. The principle strives to ensure that prices are adjusted to reflect an arm’s length price which would have applied had the transaction been concluded on normal commercial grounds between unrelated parties.

Therefore, the principle ensures that connected persons do not transact on terms that will result in a tax benefit that would not have been acquired had they transacted at arm’s length. However, it has to be noted that the arm’s length principle has several shortfalls and can be an unreliable tool for the identification of transfer pricing transactions.

2.5.1 Introduction of the arm’s length principle in domestic legislation
Theoretically, the challenges that are faced by developing countries in the adoption and development of transfer pricing legislation is in essence the same as for OECD countries. The main concern of the legislature evolves around the protection of a country’s tax base while avoiding the creation of double taxation or uncertainties that could interfere with the prospects of foreign direct investment and cross-border trade. The adoption of transfer pricing legislation embodying the arm’s length principle can be instrumental in achieving this dual objective. Most countries have introduced domestic legislations that govern transfer pricing. The arm’s length has been a principle that is common is all the laws that have been passed governing the matter. According to Paragraph 3 of the Commentary on Article 9 of the United Nations Model Convention it is stated that “With regard to transfer pricing of goods, technology, trademarks and services between associated enterprises and the methodologies which may be applied for determining correct prices where transfers have been on other than arm’s length terms, the Contracting States will follow the OECD principles which are set out in the OECD Transfer Pricing Guidelines”. Therefore, it is evident that the principles provided

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44 M Ngorima ICAZ transfer pricing, thin capitalisation, international tax planning 16.
45 W Cheng ‘the arm’s length principle, transfer pricing and foreclosure under imperfect condition.
are to be recognised as internationally accepted and it is recommended that the Guidelines should be followed for the application of the arm’s length principle which underlies the article. In addition, ensuring that domestic legislation is consistent with the internationally accepted principles provided in the OECD Transfer Pricing Guidelines can:

• Equip countries with the skills and knowhow they need to provide regulation for the artificial shifting of profits out of their countries by MNEs

• Provide MNEs with some certainty and knowledge of treatment practices followed in the country concerned;

• Reduce the risk and possibility of double taxation for MNEs;

• Provide uniformity between countries, which is less likely to distort the pattern of international trade and investment; and

• Provide a level playing field which ensures equal treatment between MNEs and independent enterprises doing business within a country.

Whenever two countries have concluded a treaty that contains provisions dealing with associated enterprises, that are similar to Article 9 of the OECD and UN Models, such an article shall be interpreted in accordance with the transfer pricing principles that are internationally accepted. Article 9 reads as follows:

Article 9

“Where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or the same persons participate directly or indirectly in the management, control or capital of an enterprise of Contracting State and an enterprise of the other Contracting State; and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprise, but, by reason of those conditions, have not accrued, may be included in the profits of that enterprise and taxed accordingly.”

Furthermore, even where no treaty is in place, domestic courts may fall back on internationally accepted principles to interpret domestic legislation, especially where countries do not provide detailed guidance on the application and interpretation of their domestic legislation. For all the reasons listed above, it is desirable to avoid any significant discrepancy between domestic

47 W Cheng (n 48 above) 12.
48 W Cheng (n48 above0 12.
transfer pricing legislation and internationally agreed principles. However, where a country wish to incorporate in its domestic legislation a significant departure from internationally agreed principles, it is advisable for it to do so in an informed and transparent manner.\textsuperscript{50}

2.5.2 Shortfalls of the arm’s length principle

(i) \textit{Lack of agreement as to what constitutes an arm’s length agreement}\textsuperscript{51}

Transactions that fall under the ambit of the principle are not defined by the legislature. Therefore, it is difficult to regulate transactions where the regulator has little to no knowledge of what would constitute an arm’s length agreement. Thus, as long as there is no agreement on the composition and structure of an arm’s length agreement, transfer pricing regulation will be problematic.

(ii) \textit{Lack of comparable transaction}.\textsuperscript{52}

Transactions that can be used for comparative purposes are extremely limited. Lack of conditions used in prior agreements make it difficult to ensure that a given transaction complied with the arm’s length principle. Therefore, such a deficit affects the efficiency of the legislation governing transfer pricing.

(iii) \textit{Information difficult to obtain for confidentiality reasons}.

Most large companies sign confidentiality clauses when entering into commercial transactions. Issues such as share prices are considered volatile thus most of the information is kept private. Thus when regulating such a transaction, most of the vital information will be unknown to the regulator. In some cases, some information will be made accessible but it may be incomplete or difficult to interpret. Such problems affect the functionality of the arm’s length principle thus making the regulation of transfer pricing problematic.

Therefore, the aforementioned problems clearly illustrate the challenges that are posed by reliance on the arm’s length principle in the regulation of transfer pricing.

2.6 Transfer pricing methods

According to the OECD Guidelines, transfer pricing methods can be classified as traditional transaction methods and transactional profit methods.
Traditional transaction methods rely on information that relates to the pricing which would be applicable where there are uncontrolled comparable transactions between unrelated parties. These methods include the comparable uncontrolled price method (CUP), the resale price method (RP) and the cost plus (CP) method.

Transactional profit methods rely on information that relates to either the division of the total profits brought in by both parties to a given transaction or the total amount of profit that was generated by one party in comparison to an uncontrolled transaction. The methods used for this category include the transactional net margin method and the profit split method.  

2.6.1 Traditional transaction methods

Comparable Uncontrolled Price method (CUP)
The CUP is applicable when making a comparison between the prices charged for goods or services in a transaction. Such transaction must be controlled and the prices charged should relate to comparable goods or services in a transaction that is uncontrolled, where the circumstances are also comparable. However, in practice, the comparability of goods or services is made difficult due to small changes in trading circumstances that can significantly impact the price.  

Where there are differences between the two transactions, adjustments may be made to enable comparisons to be made. Examples of adjustments that are often allowed include differences in the terms of a transaction (for example, credit terms, sell FOB to a connected person and at CIF to an independent party), differences in the volumes transferred and differences in the timing of the transaction. However, where there are differences in the quality of the products,

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53 OECD Transfer Pricing Guidelines op cit note 20 II-2.

54 SARS Practice Note No 7 op cit note 16 para 9.4.1.


56 SARS Practice Note No 7 op cit note 16 para 9.4.2.

57 PricewaterhouseCoopers cited in Richardson op cit note 5; SARS Practice Note No 7 op cit note 16 para 9.4.2.
differences in the geographic markets, differences in the market levels and differences in the amount and type of intangible property involved such adjustments may not be done.  

The external comparables and the internal comparables are the two categories applied with the CUP method. An external comparable transaction deals with the transference of similar goods or services under similar circumstances between two unrelated enterprises. On the other hand, an internal comparable transaction deals with the transference of similar goods and services under similar circumstances with one of the parties involved being the taxpayer and the other an unrelated enterprise. According to the SARS interpretation notes, the CUP method should be used over other methods if information on comparable uncontrolled transactions can be obtained.

*The Resale Price method*

The RP method involves working backwards with supply chain transactions. The price charged for goods or services sold to an unrelated third party, that were originally bought a connected enterprise, is reduced by an appropriate gross margin plus any adjustments for other related purchase costs. This can be in the form of customs duties adjusted to arrive at the arm’s length price. The gross margin covers the reseller’s general, selling and administrative expenses and provides for a profit after taking into account functions performed, assets used and risks assumed by the reseller.

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58 SARS’ Practice Note No 7 op cit note 16 para 9.4.2.
59 Ibid; Wikipedia op cit note 36.
60 SARS’ Practice Note No 7 op cit note 16 para 9.4.2.
61 Wikipedia op cit note 38.
62 SARS’ Practice Note No 7 op cit note 16 para 9.5.1.
The diagram below illustrates how the RP method applies in practice:

**Resale Price Method**

In the determination of the resale price margin in a controlled transaction, the resale price margin that was earned by the same reseller earns on goods or services purchased and sold in a comparable uncontrolled transaction may be referred to.

With this method, the comparability of the functions performed by the connected and the independent entities plays a more important role than that of the product comparability. This is based on the fact that differences in products are more likely to have an effect on prices than on profit margins. Therefore this method enjoys more preference over the CUP method in

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63 Taxation Ruling 97/20 *Income tax: arm’s length transfer pricing methodologies for international dealings* (1997) para 3.2.2.

64 Ibid. 50

OECD *Transfer Pricing Guidelines* II-6 cited in Richardson op cit note 5 at 33.
situations where controlled and uncontrolled transactions are comparable in all aspects other
than the product itself".50

The Cost Plus method
The CP method is mainly used for the trade of finished goods. In its application, there is the
addition of an appropriate ‘cost plus mark-up’ to the costs that were incurred by the supplier in
manufacturing/purchasing the goods or services.65 The transaction involved will relate to sales
between associated enterprises. The mark up includes an appropriate profit, taking into account
the functions performed, assets used and risks assumed.66

The diagram below serves as an illustration on how the CP method can be applied:

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65 SARS' Practice Note No 7 op cit note 16 para 9.6.1; Wikipedia op cit note 38.

66 SARS' Practice Note No 7 op cit note 16 para 9.6.1.
In the assessment of the mark-up, reference should be made to the mark up earned by the same enterprise in a comparable uncontrolled transaction. If such a mark-up cannot be ascertained, the mark-up earned by an independent enterprise in a comparable uncontrolled transaction may be used. With this method, the functional comparability is also more important than product comparability.68

However, this method can lead to some complications in its application. Firstly, the determination of the costs to use can be problematic as the effectiveness of companies varies, resulting in some incurring lower costs than others. Secondly, to stay in accordance with accounting policies the same type of costs need to be compared which will ultimately require making appropriate adjustments. Thirdly, this method usually requires segregated product data which is often not easily attainable in respect of the uncontrolled enterprises that are being used as comparisons.69 Finally, in some cases a link between the cost and the sale price cannot be established. Application of this method is complex and will be determined by the facts of each case.70

2.6.2 Transactional Profit Methods

Transactional Net Margin method

The TNMM method is used in the evaluation of the taxpayer to establish the net profit margin realised from a controlled transaction, relative to an appropriate base, such as cost, sales or assets.71 This ratio is compared to profit level indicators of the taxpayer’s comparable uncontrolled dealings or an independent enterprise’s uncontrolled dealings.72

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67 Taxation Ruling 97/20 op cit note 47 para 3.32.

68 SARS’ Practice Note No 7 op cit note 16 para 9.6.2.

69 SARS’ Practice Note No 7 op cit note 16 para 9.6.3.

70 OECD Transfer Pricing Guidelines II-12 cited in Richardson op cit note 5 at 35.

71 SARS’ Practice Note No 7 op cit note 16 para 9.7.1.

The diagram below illustrates the application of the TNMM on the ‘net resale price’ basis:

![Diagram](image)

Figure 3- Application of the TNMM on a ‘net resale price’ basis

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73 Taxation Ruling 97/20 op cit note 47 para 3.75.
Similarly, the method can be applied on a ‘net cost plus’ basis, which is illustrated by the diagram below:

![Diagram of Transactional net margin method applied on a net cost plus basis](image)

Figure 4 - Illustration of the TNMM applied on a ‘net cost plus’ basis

TNMM is seen as a “unified version” of the RP and CP methods because it also makes use of comparable companies to determine an appropriate margin to apply. As with the RP and CUP methods, this method also focuses on the functions and activities of the enterprises, but it then compares net profit as opposed to gross profit.

Traditional transaction methods are seen as more reliable than the TNMM due to the fact that the TNMM is sensitive to the differences in cost structures of comparable enterprises because of the inclusion of operating expenses, and the TNMM also requires structural similarity

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74 Ibid.

75 SARS’ Practice Note No 7 op cit note 16 para 9.7.2.
between the associated enterprise and the independent enterprise being compared, when in fact firms are structurally unique in practice.76

Practical problems surrounding the TNMM include the fact that net margins can be affected by certain factors that may not have an effect on price or gross margins, resulting in the possibility of an unreliable and inaccurate arm’s length net margin.77 Application of the TNMM may not be possible due to unavailability of information about the taxpayer when the arm’s length price is required to be determined, as well as due to unavailability of information on the controlled transaction.78 However, reliable information on gross margins may be impossible to get hold of and therefore in certain cases the TNMM may be the only practical method to apply.79

The Profit Split method
This method involves taking the combined profit of the related enterprises in a controlled transaction and allocating the profit amongst the enterprises on a basis that is economically valid and that would have been used in an arm’s length agreement.80 The profit split method is mostly applicable to transactions that are so unified that it would be impossible to examine them independently.81

There are two approaches to determining an arm’s length transfer price under this method and they are as follows:

a). Residual Profit Split Analysis
This approach involves two stages. Firstly, each enterprise is allocated a basic return that is determined with reference to comparable transactions, in terms of functions and risks, of independent enterprises. The second stage involves the allocation of the remaining residual profit amongst the enterprises in a manner that would have been adopted by independent enterprises. Contributions by the enterprises to the residual profit are often subjectively measured due to the lack of an external benchmark when the transactions entered into between

76 Ibid.

77 SARS’ Practice Note No 7 op cit note 16 para 9.7.3; Richardson op cit note 5 at 42.

78 SARS’ Practice Note No 7 op cit note 16 para 9.7.3.

79 SARS’ Practice Note No 7 op cit note 16 para 9.7.2.

80 SARS’ Practice Note No 7 op cit note 16 para 9.8.1.

81 SARS’ Practice Note No 7 op cit note 16 para 9.8.2.
the enterprises are unique. This may cause the reliability of this method to determine an arm’s length price to be questioned.

b). Contribution Analysis
This approach is useful when the transaction is between large integrated multinationals that operate under economies of scale. The reason being is that independent enterprises are not always able to save costs the way large integrated multinationals can and therefore it may be difficult for such multinationals to find an uncontrolled comparable transaction in order to determine a reliable arm’s length transfer price. The combined operating profit of the two enterprises is divided amongst the enterprises with reference to the value of the functions each one has performed, taking into account assets used and risks assumed.

The calculation of an appropriate arm’s length price is complex and requires skilled personnel to analyse a given transaction. Transfer pricing methods are used to calculate the reasonable profits that could be made after a transaction has been concluded. Several methods can be used to calculate the arm’s length price. However, not all methods are effective and the appropriate methods will depend on the nature and circumstances of the transaction.

Regardless of which method is to be used, the starting point in the selection process is to undertake a functional analysis of the controlled transaction. Such an analysis will help in the following ways:

(1) Identification and understanding of transactions undertaken by associated parties;
(2) Identification of the characteristics that would make a given transaction appropriate for comparative purposes;
(3) Assessment of the relative reliability of the method selected; and
(4) Determine if there will be need for modification of the method over time, if there has been alterations to the transaction or relevant components of the transaction.

82 (n 70 above).
83 SARS’ Practice Note No 7 op cit note 16 para 9.8.2.
84 OECD Transfer Pricing Guidelines op cit note 20 III-6.
85 KPMG transfer pricing methods 2.
86 KPMG transfer pricing methods 2.
87 KPMG transfer pricing methods 4.
Thus, with the functional analysis, there will be an assessment of the functions, assets and risks. Such an analysis is recommended because it will lead to the selection of the appropriate method. Time and resources are saved by taking such precautions and this will also result in the effective implementation of the governing legislation.

2.5 Relationship between transfer pricing and FDI
The influx of MNEs in a country can have positive results on the country’s economy. However, if not monitored or properly regulated, it can result in serious economic and social loses. FDIs are mainly favoured by the developing countries as most of the developed countries are capital exporters. Larger corporations that were established in the developed countries are continuously expanding and looking for better and more profitable markets and manufacturing hubs. The African continent is a lucrative option for these corporations due to the availability of natural resources and considerably cheap labour. In this subsection, there will be a discussion on the concept of FDI and how it may lead to practices such as transfer pricing.

2.5.1 What is FDI?
This entails the establishment of an interest with a long term vision by a resident enterprise of another country (home state) into an economy of another country (host state). The moving of resources in this manner is referred to as a direct investment. Such investments create long term relationships between the home state, the host state and the investor. Some authors argue that if there is ownership of 10% or more of the voting power in the host state by the investor then the relationship will be triggered. The ownership can be direct or indirect.

The investment can be done in the form of an equity investment or result from reinvested earnings and inter-company debt. These investments are mainly governed by Bilateral Investment Treaties (BITs). These treaties were proposed by the developed countries when they started to expand their establishments. Currently there are 2361 BITs in force. These treaties provide the roadmap that has to be followed by the relevant players in an investment. They provide the definitions, obligations of the investor and of the host state. In addition, they provide security to the investor from the host state in matters such as expropriation. Most modern BITs such as the ones signed by the USA, India and China provide for the

89 OECD (n52 above) 48
dispute resolution mechanism if there is a misunderstanding. Such treaties have the effect of promoting investor confidence and will result in the attraction of larger and better corporations.

2.5.2 FDI in Zimbabwe

The policy environment in Zimbabwe between 1980 and 1990 was considered to be unstable which resulted in very low FDI inflows.\(^{91}\) These policies included the excessively long process required to approve foreign investors’ proposals. There were also ownership restrictions that were introduced which required at least 30% local participation in some sectors, and the restrictive repatriation of profits policy.\(^{92}\) The government decided to revise the policies towards foreign investors in the late 1980s, as it realised the continuous decline in the levels of FDI. A new investment code was adopted in 1989 in an attempt to improve the investment climate. The code resulted in an increase of the proportion of after-tax profits that MNEs could repatriate: from 50% to 100%.\(^{93}\) In 1990, the government of Zimbabwe adopted the International Monetary Fund (IMF)-funded economic structural adjustment programme (ESAP) which encompassed measures that promoted FDI.\(^{94}\)

In 1992, the Zimbabwe Investment Centre (ZIC) was established as a one-stop shop for the approval of FDI proposals. Positive results were noticeable and investor confidence was improved. This resulted in a surge of FDI inflows averaging above US$ 10 million per year between 1992 and 1997, reaching a record high level of US$ 444 million in 1998.\(^{95}\) An analysis of the sectoral distribution of inward FDI from 1993 to 1997 showed that the mining sector has been the major beneficiary of FDI, followed by the manufacturing, and then the financial sector respectively.\(^{96}\) For instance, in 1993, mining and the manufacturing sectors together received about 90% of the FDI inflows into Zimbabwe, whilst agriculture and commerce only received about 9.6% and 4.6%, respectively.\(^{97}\) Growth in other sectors such as forestry and tourism was marginal. The sectors were generating considerable revenue as most of the investors were scrambling for their fair share in the mines.

\(^{91}\) K Tsaurai, N Odhiambo ‘Foreign direct investment and economic growth in Zimbabwe: A dynamic causality test 244.
\(^{92}\) K Tsaurai (n 62 above) 244.
\(^{94}\) K Tsaurai (n62 above) 260.
\(^{95}\) www.indexmundi.com Zimbabwe-foreign direct investment’ 3 (accessed 18 August 2017).
\(^{97}\) M Sikwila (n 67 above) 14.
In the year 2000, the government engaged in a fast track land reform program which was supported by the Land Acquisition Act as amended in 1999. Most farmers were forced to leave the farms. The main drive of the redistribution was to address the injustices faced by the previously disadvantaged citizens. However, this resulted in farmers failing to honour loans that were acquired from commercial banks which later resulted in the liquidation of the banks. In addition, fertilizer and tractor manufacturing companies that were dependant on agricultural value chain went out of business and had to close down. Furthermore, engineering and processing companies that were based in Bulawayo and Gweru were negatively affected by the uncertainties in the political climate which led to the closure.

However, with the introduction of the US dollar, there has been improvements in the inflows of investors. Regrettably, there seems to be some political barriers that continuously make investors wary of returning or introducing their businesses to Zimbabwe.

2.5.2 Conflicting economic theories on foreign investment
These theories attempt to establish the goals and effects of investments. The classical theory and the dependency theory are the main theories that are recognised. In an attempt to harmonize the two theories, there was the addition of the middle path. In general both theories focus on the development and benefits attained by the host state. In this subsection there will be a discussion on the theories and emphasis will be placed on the theory relied on by most developing countries such as Zimbabwe.

The classical theory
According to the classical theory, the investment will be extremely beneficial to the host state. It is argued that the capital that is brought into the host state will be used in that state for public benefit. In addition, the investor will bring advanced technology to the home state thus, assisting with the development of the state. Other benefits that the investor will introduce include infrastructure development, improvement of the quality of life for the people and also there will be better employment prospects and opportunities for the development of professional skills for the labour force in the home state.

Most African countries subscribe to the classical theory. Attempts have continuously been made to attract more FDIs. For some countries, FDIs have assisted in their economic growth and development. However, for others, their problems and challenges were heightened. The

98 C Munangagwa (n above)4.
99 Sornarajah (n8 above) 48.
main issue that arises with reliance on such an approach towards investment is that governments will end up giving up fundamental rights of the people to attract investors. For instance, a government can compromise on the powers of labour unions to ensure that they attract investor. It is generally accepted that investors tend to prefer working in a country were the labour laws are weak because they can employ and dismiss employees as they please. Thus, the people of the host state will in turn be affected.

In addition, most African countries have become dependent on FDIs to such a point that they are no longer investing in their local companies. This is a major problem in the mining sector. It is believed that MNEs will introduce advanced machinery that will be used in the extraction of minerals and further processing. However, the smaller local companies are not given the opportunity to access loans and major projects. This will eventually result in a country with a strong employment base which is reliant of foreign employers. Recently, the government of Zimbabwe awarded a $1 billion dollar tender to an Austrian company for the construction of a 500km highway.\footnote{The herald ‘Beitbridge-Harare road dualisation begins’ 6 June 2017.} It was stated that the company won the tender due the expertise they had that could not be provided by local companies. Therefore, with continuous dependence on such companies, the continent will not develop and grow and reach its full potential.

The other issue that comes with the belief that FDIs will result in the development of the host state is that even investors that come in bad faith are also welcomed. Unfortunately, governments get desperate in their attempts to attract FDIs to such a point that the due diligence involved in the investment process is relaxed. Some investors will take advantage of this and engage in unlawful activities. Notorious activities that can be done by investors include trading of illegal drugs, promotion of prostitution and in extreme cases, they may be involved in poaching. However, some investors may establish a business for the sole purpose of shifting profits. This is mainly done by engagement in transfer pricing activities. Therefore, with the need to attract as much foreign direct investment as possible, countries have made themselves vulnerable to unscrupulous investors that engage in unlawful activities.
**The dependency theory**

This theory is in direct conflict with the classical theory. The theory provides that an investment will not bring about meaningful economic development for the host state.\(^{101}\) The theory is based on the fact that most of the investors that invest in developed countries are MNEs with their headquarters in developed countries and they only operate through subsidiaries in developing countries. Thus, the subsidiaries will always act in a way that benefits the parent company. This in turn will result in the developing states serving the needs of developed countries.

It is argued that such dependency will hinder the development of peripheral economies.\(^{102}\) According to the scholars that support this theory, the resources that are brought into the host state benefit the elite classes in the developing state due to their alliances with the foreign capital.\(^{103}\) In addition, the investors will have the powers to manipulate local legislation because they will have the support of the elite and powerful class. Therefore, instead of providing better services, opportunity and development prospects for a developing host state, such a country can be left in a much more devastated position.

Some African countries have been fortunate enough to discover oil in their territories. Such a resource has the potential to generate wealth that can be used for the development of a country. The United Arab Emirates (UAE) serves as a good example for a country that managed to develop its economy using its oil reserves. A place that used to be a desert with no sign of life has turned to be one of the most glamorous places on the globe.\(^{104}\) However, on the African continent the story is different. Nigeria discovered their oil reserves decades ago and sought foreign investors to extract the oil.\(^{105}\) It is sad to note that the country did not improve its economic position but rather suffered serious deterioration in their economic growth. Foreign investors continuously make millions whilst the local citizens live in poverty. Therefore, it is evident that reliance on the prospects of foreign investments have crippled developing countries and as long as countries maintain such an approach Africa will never be independent.

Personally I agree with this approach. The approach clearly demonstrates the belief that African countries have towards foreign investors. Thus, this dependency has led to the

\(^{101}\) M Somarajah (n8 above) 53.
\(^{102}\) M Somarajah (n8 above) 53.
\(^{103}\) M Somarajah (n8 above) 53.
\(^{104}\) M Somarajah (n8 above) 53.
\(^{105}\) M Somarajah (n8 above) 53.
impoverishment of the continent regardless of the fact that Africa is one of the richest continents. I strongly believe that with the resources available on the continent, countries can develop their economies and eradicate issues such as poverty if they do away with the dependency on foreign investors.

The middle path
This theory attempts to reconcile the classical and dependency theories. The theory proposes that an investment can be beneficial to the host state if there is adequate regulation.\textsuperscript{106} It is argued that the benefits attainable from an investment solely depends on how a government regulates the entry, conduct and expectations of an investor in their territory. For instance a government can place an obligation on the foreign investor to assist in the development of the community he conducts his business. Such expectations are mainly common in the mining sector where the investor has a set target for the contribution towards community development. The Indian BIT model also places obligations on an investor. For an investor to conduct his business in India, he has to agree with the obligations imposed on the investment by the government.

In cases of issues such as transfer pricing, comprehensive rules can be introduced to regulate FDI. Investors that intend on shifting profits and evading their tax obligations will be discouraged by such regulations. Therefore, for countries such as Zimbabwe that seek FDIs to assist and drive economic growth, they should enforce effective regulation of investors.

2.6 Effects of transfer pricing on a host state
For most African countries, transfer pricing mainly affected their revenues from a tax perspective. However, such a practice can have devastating consequences on a country such as threatening a country’s labour empowerment welfare.\textsuperscript{107} In this paragraph, a discussion of how countries are affected by transfer pricing are discussed. Emphasis will be placed on the non-fiscal challenges posed by transfer pricing.

The most notable challenge a country faces when companies engage in transfer pricing activities is a dwindled revenue collection base. In most cases, a corporation will record losses in the host state due to the under-pricing involved in the sale of their products. The prices are fixed in such a manner that the government will collect a considerably low amount

\textsuperscript{106} M Sornarajah (n above) 55.
\textsuperscript{107} E Budu Addo ' Effects of transfer pricing beyond tax revenue loss: A threat to economic development' 1.
in corporate tax. Therefore, the revenue that could be used to develop a nation is shifted to another country.

The deprivation of revenue by corporations affects the effective redistribution policy. Revenue collection can be used as a means of redistribution of resources. Sectors that are less developed or less productive can benefit from the funds collected from more profitable sectors. For instance, in most African countries, the mining sector produces the largest revenue. Such revenues can be used to assist sectors such as health and the education sector which need additional government assistance. Therefore, in such situations the government may be forced to acquire the required funds by increasing the income tax payable. Evidently, the failure of MNEs to pay their taxes will affect the government and the citizens as well.

In addition, transfer pricing has the effect of threatening labour empowerment and welfare. Tension, threats of restructuring, and poorly organised labour is rife in organisations where transfer mispricing thrives. These create fear and job insecurity in the labour force, making it difficult for workers to enjoy their basics rights. Therefore, employees cannot make long term plans and their families are constantly at risk due to the practices of such corporations. Furthermore, the value addition by employees is affected by transfer pricing activities. The value addition is the difference between the value of outputs and inputs. Therefore, the contribution of the employees is highly undermined by the fixation of prices by the companies. Thus in turn will affect the remuneration of the employees.

Transfer pricing can also affect entrepreneurial development and investment as this affects the access of credible information. Companies will send false or manipulated information about their business which will ultimately affect the perceived potential of the country’s economic potential. Therefore, investors considering establishing their businesses such a country will be wary and establish the businesses in countries where the business climate is more conducive. Such a problem will ultimately result in the loss of employment and financial opportunities for the country.

Lastly, such practices can lead to the threatening of resource optimisation. When companies can easily acquire their desired profits they tend to waste resource and pay less attention to

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108 E Budu Addo (n63 above) 2.
109 E Budu Addo (n63 above) 2.
110 E Budu Addo (n63 above) 3.
customer service.\textsuperscript{111} In addition, such companies will invest in skilled personnel that will propose strategies of shifting their profits. Accountants and lawyers are usually involved in such transactions. The money invested in such skilled personnel could be used for employee assistance schemes or could be used for honouring their tax obligations. Therefore, with such practices, only the corporation benefits at the expense of the host state and the employees.

\textbf{2.7 Conclusion}

Transfer pricing involves the shifting of profits by an international company with the sole purpose of evading their tax obligations. This is mainly done by the fixing of prices by related companies operating in different countries. African countries have been victims of such practices due to their desire to attract FDI and improve their economic positions. Hence, without adequate regulations, MNEs will continue to invest in African countries and shift their profits to tax havens. The manner in which transfer pricing is regulated will be discussed in the following chapter. There will be an in-depth analysis of the provisions introduced in the Income Tax Act and how effective they are in the regulation of transfer pricing.
CHAPTER 3-TRANSFER PRICING REGIME IN ZIMBABWE

3.1 Introduction
In the previous chapter, the concept of transfer pricing was introduced. A comprehensive definition was provided which dealt with the components and establishment of a transaction simulated transaction. It was established that such transactions are targeted at the evasion of tax obligations by MNEs. The chapter also addressed the history of MNEs and the evolution of transfer pricing regulations. An introduction of the arm’s length principle was also done and the methods that are used in the determination of an arm’s length price. Lastly, the relationship between transfer pricing and FDI was also analysed. The main focus was on how FDIs can result in transfer pricing and how transfer pricing can ultimately affect the host state.

In this chapter there will be a discussion on the manner in which transfer pricing is regulated in Zimbabwe. An in depth assessment of the legislation and governing provisions will be made. The relevance of regulating MNEs in Zimbabwe will also be addressed and particular attention will be given to the mining and agricultural as they are the strongest in the economy. In addition, the chapter will also investigate into the challenges faced by ZIMRA in the regulation of MNE activities and also in ensuring adequate compliance with the laws.

3.2 Tax evasion and the need for comprehensive legislation in Zimbabwe
Zimbabwe’s economy is mainly based on agricultural and mining activities. Most of the revenue generated by the government stems from the taxes paid by investors in the two fields. However, due to the economic challenges that affected the country in 2008, informal businesses have since been on the rise. Accounting for the revenues and transactions entered into by such businesses is still a challenge. This issue has affected most countries in the region. South Africa is the only country in the region that introduced a macro-business tax in 2009.\(^\text{112}\) However, the law has not been receiving favourable acceptance.

According to a survey conducted by chartered accountants and tax consultants in the country, it was discovered that approximately 60% of the business carried out was done in the informal sector.\(^\text{113}\) Therefore, with such a large proportion of businesses paying taxes, the country’s economic performance is continuously deteriorating. In some sectors, these informal businesses are no longer small and owned by poor people. In the furniture business, some

\(^{112}\) AFRODAD ‘What has tax got to do with development: A critical look at Zimbabwe’s tax system’ 24.

\(^{113}\) AFRODAD (n69 above) 24.
manufacturers have turnovers which exceed $50 000 annually. However, such businesses do not pay taxes as they continually regard themselves as small and vulnerable.

In the case of MNEs, the problem of tax collection is notable and poses serious challenges to the economy. Tax evasion by one company can result in loses in the excess on $1 million dollars that could have been used by the government for the public benefit or economic growth. The main driver of such practices is the aged laws that are relied on in the revenue collection process. For instance, such laws do not provide a comprehensive definition of transfer pricing and the tax system does not keep up with the changes in accounting rules. Therefore, with such weak regulation MNEs maximise on their profits by evading their tax obligations.

Not only foreign investors are troubling the revenue authorities in the country, but also large local companies such as Econet wireless. The company is the largest mobile operator and has extended its business to other countries on the continent such as Nigeria. It is alleged that the company has deprived the country of up to $300 million due to transfer pricing activities. ZIMRA claims that this was achieved through the importation of goods by Econet and the company did not declare the tax payable. Furthermore the company engaged in a transfer pricing scheme that involved the overstatement of prices on equipment bought from Econet Capital – its sister company based in Mauritius. Therefore, it is evident that the revenue authority is losing a lot of revenue from small, medium and large businesses.

In addition, the mining companies are also contributing immensely in the evasion of tax in Zimbabwe. Companies engaging in platinum mining took advantage of the loopholes in the regulation and engaged in transfer pricing activities. Currently, Zimbabwe uses ad valorem based tax system, which is not optimal since it is based on export values. The values represented are not only lower than production values, but also subject to transfer pricing by the mining companies and their sister companies in South Africa. Beneficiation in Zimbabwe was mainly being pushed through the mining sector policies rather than through the industrial

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114 G Chigumira ZEPARU interview, October 2010.
115 G Chigumira (n71 above) 25.
116 ZIMTRADE, S Muchineuta interview, Nov 2010.
117 techZim ‘Econet responds to tax evasion & transfer pricing scandal- dismisses allegations, says case is already before the courts’ 6 Feb 2017.
118 TechZim (n74 above) 2.
119 Afrodad ‘The impact of fluctuating commodity prices on government revenue in the SADC region-The case of platinum in Zimbabwe’ 4.
120 Afrodad (n 76 above) 5.
policy.\textsuperscript{121} Such an approach is not efficient and effective, as the firms have mining expertise, but do not have the requisite technical capacity to beneficiate minerals. Urgent reform in the taxation policy is required because the government is continually granting tenders. Recently, a $200 million deal was signed with Australia’s Kelltech Ltd for the construction of a platinum refinery. In addition, platinum mining companies have adjusted their procurement policies to effectively exploit VAT refunds on local procurement, thus, effectively reducing tax revenue due to the government. In an attempt to assist the revenue collectors in the country, AFRODAD urged the country to develop systems to evaluate components of tax regimes for leakages, losses and tax avoidance and evasion through practices such as transfer pricing. In addition, they proposed the reviewing of double taxation agreements and BITs that involved investments done by mining companies.

The government of Zimbabwe has continuously made strides to attract new investors in the country. If the aggressive approach is to be a success, adequate and effective regulation of such investors must be in place. By the end of 2016, Zimbabwe had reintroduced its special economic zones. Three locations were targeted for trial purposes.\textsuperscript{122} Tax laws and the indigenisation policies were relaxed to attract foreign investors. The main drive for the establishment of the zones was the need to revive the industries and tackle a high unemployment rate of up to 90\%.\textsuperscript{123} In May 2016, president Robert Mugabe visited Japan and managed to convince the authorities in Japan to sign an agreement for the promotion of Japanese investments in the country.\textsuperscript{124} Therefore, due to the potential influx of investors in the country, laws regulating transfer pricing must be elevated to ensure that the country can develop from the revenue generated.

3.3 Measures to improve tax collection

The Minister of Finance proposed a review of ZIMRA in the 2010 mid-term statement. “The review process involves implementation of reforms such as taxpayers’ segmentation, setting up comprehensive valuation, origin and harmonised system tariff management, establishment of a risk based post clearance audit, streamlining cargo clearance procedures, upgrading information technology systems and enforcement of the management function through

\textsuperscript{121} NewsDay ‘Government loses out on mining tax’ May 30 2017.
\textsuperscript{122} The insider in stories ‘Zimbabwe selects 3 locations for special economic zones trials’ 19 May 2016 2.
\textsuperscript{123} www.forbes.com ‘with 95% unemployment rate Mugabe insists Zimbabwe is not fragile.
\textsuperscript{124} The insider in stories (n79 above) 3.
development of a national anti-smuggling strategy, among others,” the Minister said. He also acknowledged the need for specialised skills in ZIMRA.

Already, several measures have been proposed to reduce tax evasion. These include the following:

- The use of fiscalised electronic devices for VAT collection, which is expected to address the loss of revenue as these devices cannot be tampered with. The compulsory use has been deferred from 1 October 2010 to 1 January 2011 and again to June 2011,
- The adoption of Generally Accepted Accounting Practice (GAP) in accounting in the new Income Tax Act, if adopted by the small and medium businesses, could reduce the incidences of cheating on transactions,
- ZIMRA has reported success with its road patrols on its website. The success of other measures in place such as whistle blowing has however not been disclosed,
- ZIMRA has dismissed employees for corruption over the years.

Some incentives have been used successfully in other countries to bring in defaulting medium scale businesses and the informal sector into the tax system. These include the granting of amnesty to companies not paying tax so that penalties are not charged and questions are not asked. South Africa granted amnesty to tax defaulters to bring them into the tax net. The amnesty was however successful with larger tax payers but not with the small businesses.

A one stop border post for trade could reduce loss on the collection of duty and also reduce the time spent at the border following the example of Zambia which set up the one stop shop on the border between Zambia and Zimbabwe. A one stop shop between South Africa and Zimbabwe should be considered.

3.4 Introduction of transfer pricing regulations in Zimbabwe

Zimbabwe enacted new legislation on transfer pricing with effect from January 1, 2017 to eradicate issues of tax evasion and avoidance. The transfer pricing framework introduced broadly follows the Organisation for Economic Co-operation and Development (OECD) transfer pricing guidelines. The main features of the rules are as follows:

1. Where a person in a controlled transaction for example, a transaction with a related party, the amount of taxable income derived must be consistent with the arm’s length
principle. The conditions that apply to the transaction must be similar to the conditions that would apply between independent parties under comparable situations.\textsuperscript{125}

2. Comparability will be determined by taking into account the characteristics of property/service, functions performed, assets owned and risks borne, contractual terms, economic circumstances and the business strategies of each of the associated parties.\textsuperscript{126}

3. Documents supporting the arm’s length nature of intercompany transactions must be prepared and maintained, to enable the Zimbabwe tax authorities to ascertain whether a transaction was conducted in accordance with the arm’s length principles.\textsuperscript{127}

4. In accordance with OECD principles, the supporting documentation must contain a detailed ‘functional analysis’ and an economic analysis including information on how the most appropriate transfer pricing method was selected and the application of the method to demonstrate the arm’s length nature of the transaction and price.\textsuperscript{128}

5. Traditional transaction methods (comparable uncontrolled price, resale price and cost plus methods) and profit-based methods (transactional net margin method and profit split method) may be used.\textsuperscript{129}

6. Although the transfer pricing rules typically apply only with respect to foreign related parties, the legislation indicates that, in line with Zimbabwe’s anti-avoidance legislation, domestic transactions also may be subject to the rules.\textsuperscript{130}

7. The transfer pricing principles also apply where a Zimbabwe-resident person engages in a transaction with a person (whether or not related) resident outside Zimbabwe in a jurisdiction considered by the Commissioner General to provide a tax benefit in relation to the transaction. It appears that the aim of this section is to point out cross-border transactions between Zimbabwe and a low-tax jurisdiction (tax haven), particularly if the overseas entity lacks substance and significant people functions.\textsuperscript{131}

\textsuperscript{125} www.deloitte.co.zw (accessed on 20 August 2017).
\textsuperscript{126} www.deloitte.co.zw (accessed on 20 August 2017).
\textsuperscript{127} www.deloitte.co.zw (accessed on 20 August 2017).
\textsuperscript{128} www.deloitte.co.zw (accessed on 20 August 2017).
\textsuperscript{129} www.deloitte.co.zw (accessed on 20 August 2017).
\textsuperscript{130} www.deloitte.co.zw (accessed on 20 August 2017).
\textsuperscript{131} www.deloitte.co.zw (accessed on Monday 3 April 2017).
Therefore, the principles provided a solid base upon which the transfer pricing laws were formulated. With proper implementation, revenue collected through corporate tax should increase.

3.5 Applicable law.
Transfer pricing in Zimbabwe is regulated by the Income Tax Act 11 of 2014 (ITA). It has to be noted that there are no specific provisions that govern transfer pricing, anti-avoidance provisions serve to ensure tax compliance. The Act endorses the arm’s length principle and imposes documentary obligations on taxpayers. Section 98 of the Act outline the governance of transactions between connected persons. The section reads as follows:

3.5.1 Section 98B

(1) “For the purposes of this section, where a person engages directly or indirectly in any transaction, operation or scheme (hereinafter referred to as a controlled transaction), with an associated person, the amount of taxable income derived by a person that engages in that transaction shall be consistent with the arm’s length principle, where the conditions of the controlled transaction do not differ from an uncontrolled transaction, that is to say, from the conditions that would have applied between independent persons, in comparable transactions carried out under comparable circumstances.

(2) Any amount of income that would have accrued to either of the associated persons in a controlled transaction and been taxable in Zimbabwe, shall, in the absence of the arm’s length principle in that transaction which resolved in the avoidance, reduction or postponement of the liability to tax of either or both of them for any year of assessment, be included in the taxable income of either or both of them and be liable to be taxed accordingly.

(3) The determination of whether the conditions of a controlled transaction between associated persons are consistent with the arm’s length principle, and of the quantum of any tax payable under subsection (2), are prescribed in the Thirty-Fifth Schedule.

(4) Subsection (1) also applies where a person (whether or not an associated person) who is resident in Zimbabwe engages in any transaction with a person resident outside Zimbabwe in a jurisdiction considered by the Commissioner-General to provide a taxable benefit in relation to that transaction,

(5) Every person who engages in a transaction to which subsection (1) or (4) applies shall keep the documentation prescribed in the Thirty-Fifth Schedule to enable the Commissioner-General to ascertain whether a transaction was conducted in accordance with the arm’s length principle.

(6) The Minister, after consultation with the Commissioner-General, may by notice in a statutory instrument amend or replace the Thirty-Fifth Schedule.
(4) When the Minister wishes to amend or substitute the Thirty-Fifth Schedule the Minister shall lay the draft statutory instrument amending or substituting the Thirty-Fifth Schedule before the House of Assembly, and if the House makes no resolution against the publication of the statutory instrument within the next seven sitting days after it is so laid before the House, the Minister shall cause it to be published in the Gazette.”.

3.5.2 Application of section 98B in a transaction.

The section attempts to ensure that there are no hidden transactions that will result in tax evasion or avoidance. Subsection 1 imposes similar conditions to apply in transactions between connected persons as if they were not connected. Thus, related companies must structure their transactions in a way that does not result in a substantial financial benefit due their relations or connection.

In addition, where companies enter into a transaction that is inconsistent with the arm’s length principle there will be financial consequences. Subsection 2 is worded in a way that shows that the tax benefit that the companies acquired will be included in their taxable incomes. Therefore, such a provision will discourage sham transactions that are aimed at reducing the tax burden of a company.

Furthermore, transactions involving International Corporations that have multiple offices in different jurisdictions are covered in subsection 4. Such companies usually have a holding company and several subsidiaries in different countries. The subsection applies when one of the subsidiaries or the holding company is incorporated in Zimbabwe. Thus, it becomes difficult for companies to enter into transfer pricing transactions where one of the companies is located in Zimbabwe.

Implications

Taxpayers currently transacting with associates, trading with foreign entities, or planning on entering into contracts with any of the aforementioned categories of entities must do so after considering their position in relation to this new legislation. Affected taxpayers should:

• Apply the arm’s length principle on all transactions with associated parties.

• Develop a transfer pricing policy that conforms to the new legislative requirements.

• Review and align any existing policies to the new legislation.

• Review affected contracts and evaluate the impact of the new legislation, and ensure all intercompany transfer prices are within the arm’s length range.
• Develop and maintain relevant transfer pricing

3.6. Additional regulating provisions.
There are other provisions that indirectly regulate transfer pricing in the ITA. The sections read as follows-

Section 19 of the Income Tax Act: Special provisions relating to persons carrying on business which extends beyond Zimbabwe

‘Where the trade of any person extends across borders and the Commissioner is satisfied that it is impossible or impracticable to determine the taxable income derived by such person from sources in Zimbabwe in the manner otherwise provided the Act, such person shall submit proposals for the determination of his taxable income to the Commissioner in a prescribed format. The Commissioner can accept such proposal and the taxable income determined for any year of assessment shall be deemed to be the taxable income of the respective taxpayer for that year. Hence we note that in cases, were no such proposals have been submitted, or if the Commissioner is not satisfied with the proposals submitted, the Commissioner may determine the taxable income in a manner that appears to him as the most appropriate, taking into account the circumstances of the case’.

Section 23 of the Income Tax Act: Special provisions relating to determination of taxable income of persons buying and selling any property at a price in excess of or less than the fair market price and of non-resident persons exporting products of Zimbabwe without prior sale

The Commissioner may regulate the fair market price of either movable or immovable in deference of persons carrying on trade in Zimbabwe where:

(a) Property is sold at less than the fair market price or

(b) Property is purchased at a price in excess of the fair market price.

Section 24 of the Income Tax Act [Chapter 23:06]: Special provisions relating to determination of taxable income in accordance with double taxation agreements.

The section states that the Commissioner may:

(a) If any person

i. carrying on business across the borders of Zimbabwe and participates openly or circuitously in the management, control or capitalisation of a business carried on by some other person in Zimbabwe, or

ii. carrying on business in Zimbabwe and participates openly or circuitously in the management, control or capitalisation of a business carried on by other person outside Zimbabwe, or

iii. participates openly or circuitously in the management, control or capitalisation both of a business carried on in Zimbabwe by some other person and of a business carried on outside Zimbabwe by some other person; and

(c) If circumstances are made or imposed between any of the persons stated in paragraph (a) in their business or financial relations which, in the view of the Commissioner, differ from those which would be made amongst two persons trading with each other at arm’s length, the Commissioner may decide the taxable income of the person trading in Zimbabwe as if such circumstances or conditions had
not been made or imposed but in agreement with the conditions which, in his opinion, might be likely to have been made or enforced amongst two persons dealing at arm’s length.

Section 77 of the Value Added Tax Act: Schemes for obtaining undue tax benefits
Whenever the Commissioner is satisfied that, any scheme has been entered into or carried out that has the effect of granting a tax benefit to any person and having regard to the substance of the scheme:

(a) Was arrived at or carried out by means or in a way which would not normally be engaged for bona fide business purposes, and has the influence of granting a tax benefit,

(b) Has produced rights or obligations which would not usually be formed between persons trading at arm’s length,

(c) Was entered into or voted for solely or mainly for the resolution of obtaining a tax benefit,

(d) Does not matter whether the scheme was entered into or carried before or after the fixed date.

The Commissioner shall determine the tax liability imposed by the Act, and the decision is subject to objection and appeal but however until proven to the contrary, it shall be presumed that the transaction was done mainly for the purpose of obtaining an undue tax benefit.

3.7 Methods used
In Zimbabwe, the Commissioner General of ZIMRA prefers the cost-plus method and the comparable uncontrolled price method.\(^{132}\)

3.7.1 Cost-Plus Method
This method is mainly used when we are dealing with semi-finished goods transferred between foreign associates or where a company acts as a subcontractor for another.\(^{133}\) With this method, a mark-up is added to tie the conveying subsidiaries’ cost mainly were the other methods are not applicable.\(^{134}\)

3.7.2 Comparable uncontrolled price method
With this approach transfer prices are set by references to prices used in comparable transactions, between independent companies or between, the corporation and an unrelated third party.\(^{135}\) It has to be noted that this method is easy and appears to be the most acceptable method in virtually all OECD member countries.\(^{136}\)

3.8 Weaknesses in the regulation of transfer pricing in Zimbabwe
The current legal regime does not place an obligation on taxpayers to prepare transfer pricing documents. A taxpayer must only demonstrate that the transaction was at an arm’s length price.

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\(^{132}\) T Dalu Transfer Pricing: A Zimbabwean brief 19.

\(^{133}\) T Dalu (note 20 above) 20.

\(^{134}\) T Dalu (note 20 above) 20.

\(^{135}\) T Dalu (note 20 above) 20.

\(^{136}\) N Ngorima (note 22 above) 22.
Thus, there are no specific disclosure requirements on the nature or details of transactions concluded with related parties. In such cases, MNEs are given the power to manipulate the information they wish to disclose. With no specific requirements on the disclosure of documents, it becomes extremely difficult for the revenue collectors to ensure that the MNEs are paying the correct taxes they are required to pay by law. In addition, ensuring that the transaction was concluded at an arm’s length price will also be problematic. Thus, the purpose of the regulation becomes flawed due to the omissions they made regarding the obligations of MNEs.

Clarity of the law is also a major problem in the regulation of transfer pricing in Zimbabwe. There are no definitions that deal with relevant matters. For instance, the term transfer pricing is not defined. Other terms that are not defined include connected persons or what an arm’s length price is. Implementation of such legislation is usually problematic. In cases of disputes or misunderstanding, the cases will take longer than required because the judges will have to get an understanding of the provisions before they engage with the dispute at hand. Thus, such a problem results in the wastage of time and added costs for the litigating parties. To address this issue, the legislature should consider adopting a comprehensive Act or guidelines that can be used by the courts in defining terms.

Furthermore, auditing of transfer pricing cases is one of the challenges that ZIMRA continually faces. The root of the problems stems from the fact that regulators constantly seek guidance from the OECD guidelines where the methods are considered appropriate. However, some of the solutions are not applicable to Zimbabwean problems. Thus, the one size fits all approach cannot be applied in resolving transfer pricing issues.

The responsible authorities in the regulation process suffer from a lack of funding to ensure compliance. With the economic meltdown that affected the country, ZIMRA cannot afford to train their employees to ensure that MNEs comply with the tax laws. The shortage of funding also results in their failure to employ skilled accountants who can effectively audit the complex transactions of MNEs. Thus, such problems continuously make the regulation of transfer pricing ineffective.

A lack of strong taxation courts and judges also hinder the progress of ZIMRA in the regulation of transfer pricing. The country does not have a tax court that has judges that specialise in tax disputes. Any issues that result in a tax dispute are handled in the courts as a commercial
dispute. Considering the complexities involved in transfer pricing matters, it is prudent that a highly knowledgeable judge should preside in such disputes. Such a deficit makes it impossible for the system to develop as there are no cases to learn from. With good judgments, laws can develop and the legislators can easily notice the areas that need attention and resolve them by updating the legislation. However, this is not the case in Zimbabwe and upgrading the courts and introducing skilled judicial officers is a necessity. Therefore, the courts do not provide decisions that can deter MNEs from engaging in transfer pricing or evasion practices.

In addition, there are no specific penalties that apply when dealing with transfer pricing, instead general penalty rules apply. The system heavily rely on the anti-avoidance rules. The rules provide fines and penalties that can be paid by defaulters. However, those rules mainly target individuals and smaller businesses dealing with smaller amounts. With transfer pricing, the amounts that are involved a much more significant. Thus, most MNEs will opt for the fine because they will eventually make their profits. In addition, without strict penalties, companies will never run the risk of losing their operating licences when then commit offences. Such a failure by the legislature needs to be addressed urgently for the governing rules to be effective. Therefore, the failure of the legislature in this regard will eventually promote transfer pricing transactions.

Furthermore, ZIMRA and other tax authorities are increasingly aware of the need to make best use of their limited resources and of the need to manage their relationship with business or taxpayers more effectively. Improving the management of tax risk and developing relationships between ZIMRA and multinational corporations have been two of the primary focuses the organisation has embarked on. Thus, re-evaluation of ZIMRA’s relations with the taxpayers might result in positive change.

3.9 Conclusion
Zimbabwe is a country that losses a lot of revenue due to illicit transactions carried out by MNEs. According to studies by the revenue authority, the country was losing millions of dollars annually. In an attempt to combat issues such as transfer pricing, an amendment was made to the Income Tax Act. Section 98B was introduced to regulate transactions between related persons and the regulation is to be guided by the arm’s length principle. However, the research conducted clearly indicates that the provisions are not comprehensive enough to

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138 T Dalu (note 20 above) 23.
139 T Dalu (note 20 above) 24.
140 N Ngorima (note 22 above) 31.
ensure compliance by MNEs. Hence, additional measures need to be taken. The following chapter will address the transfer pricing regime used in the United Kingdom. The system has developed over the years and will be used for comparative purposes. Emphasis will be on the strengths of the system and how Zimbabwe can draw inspiration in the adoption of more comprehensive rules.
CHAPTER 4 - ANALYSIS OF THE UNITED KINGDOM TRANSFER PRICING REGIME

4.1 Introduction
The previous chapter investigated into the manner in which transfer pricing is regulated in Zimbabwe. The chapter began by providing a brief introduction into the problem of tax evasion in Zimbabwe. Issues such as non-compliance with the payment of tax by the platinum mining companies was discussed. Incidents of tax evasion were also established and examples were also provided to shed more light on the matter. In addition, there was a discussion on the relevance of the regulation of transfer pricing in Zimbabwe and the efforts that the government has made to address the matter. The methods used in the calculation of an arm’s length price were also introduced and an assessment on how efficient the methods are. In the last section of the chapter, there was a discussion on the general problems encountered by ZIMRA in working with transfer pricing issues and ensuring compliance.

The UK has one of the most comprehensive transfer pricing regimes in the world, the laws have evolved over the years and have become robust and effective in combating transfer pricing. They adopted their first transfer pricing legislation in 1915. This makes the UK’s system advanced as they had the opportunity to amend and modify their laws over time. In this chapter, there will be a discussion on how the UK transfer pricing system developed over the years and how they regulate transactions between related persons. The motive for this chapter is to analyse how the UK system became comprehensive and elaborate to ensure that MNEs comply with their tax obligations. The lessons drawn are to be taken into consideration and used in advising the legislature in Zimbabwe to follow a similar approach and handle transfer pricing issues in a more effective manner.

4.2 Transfer pricing legislation used in the UK
In the UK, transfer pricing rules apply to almost all forms of related party transactions, including sales or purchases of goods and services, exploitation of intellectual property, debt or other transactions not reflected in any accounts. The interaction with other areas of tax law can be complex with several special sets of transfer pricing rules for specific issues in different parts of the Taxes Acts.

Since 1915, the UK has had a comprehensive regime based on the arm's length principle for applying transfer pricing methodologies to transactions between enterprises under common control.\textsuperscript{141} These rules are applicable in the assessment corporate and individual tax matters.

\textsuperscript{141} R Feinsschreiber 'Transfer pricing: A country by country guide' 2000.
Enterprises and individuals are both required to calculate their taxable profits using transfer pricing adjustments. It is also advisable for taxpayers to maintain sufficient records and documentation recording the methodology adopted.\textsuperscript{142}

UK law explicitly makes reference to the 2010 version of the OECD transfer pricing guidelines. Section 164 of the Taxation (International and Other Provisions) Act 2010 provides that the legislation applied should be consistent with the guidelines. Therefore, domestic legislation essentially incorporates the guidelines and when necessary updates are introduced through secondary legislation.\textsuperscript{143}

### 4.2.1 Primary legislation

The UK's applicable laws on transfer pricing are contained in Part 4 of Taxation (International and Other Provisions) Act 2010 (TIOPA). The transfer pricing provisions broadly apply where (\textit{section 147(1), TIOPA}):

- Any two entities have entered into a provision by means of a single transaction or multiple follow-up transactions.\textsuperscript{144}

- Those two entities satisfy a connection test (referred to as the "participation condition").\textsuperscript{145}

- The actual provision differs from the provision which would have been made as between persons acting at arm's length.\textsuperscript{146}

Where the abovementioned conditions have been satisfies, the provision has the effect of reducing the UK tax liability borne by one of the entities. Thus, the person's tax liability can be calculated on the basis of an arm's length provision.

The condition relating to participation will vary depending on whether or not the relevant provision relates to a financing arrangement which can be an arrangement relating to any debt, capital or any other form of financing.\textsuperscript{147} The participation condition is satisfied if at

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\textsuperscript{142} F Feinschreiber (n160 above).
\textsuperscript{143} F Feinschreiber (n160 above).
\textsuperscript{144} G Cottani 'Transfer pricing IBDF' 84.
\textsuperscript{145} G Cottani (n 163 above) 84.
\textsuperscript{146} G Cottani (n 163 above) 85.
\textsuperscript{147} F Feinschreiber (n160 above).
the time of the relevant transaction (or within six months following that date in the case of financing arrangements) either:

- One of the parties is involved in the management, control or capital of the other.\(^{148}\) Such involvement can be direct or indirect.
- The same person (or persons) directly or indirectly participates in the management, control or capital of both parties.\(^{149}\)

Where there has been a financing arrangement, the participation condition will be satisfied where one person is a company and the other persons act together in the financing arrangements.\(^{150}\) However, the other persons must establish control over the company involved. In that case, each of these persons is treated as satisfying this participation condition.\(^{151}\)

### 4.2.2 Exemptions

The transfer pricing rules do not always apply to companies that are small or medium-sized enterprises in the relevant accounting period. However, where a company elects or, in certain circumstances, HM Revenue & Customs (HMRC) serves a notice, the transfer pricing provisions become applicable to those entities.\(^{152}\)

### 4.3 Secondary legislation

The rules governing base erosion or profit came into force from 18 March 2016.\(^{153}\) The explanatory notes state that they put into effect the UK's undertaking to introduce country-by-country reporting for MNEs. According to the regulations, certain MNEs are obliged to report annually to HMRC details of revenue, profit, taxes and other measures of economic activity for each tax jurisdiction in which they do business.\(^{154}\)

Parent or holding companies of MNEs with consolidated group revenue of EUR750million or more in an accounting period that starts before, and ends on or after, 31 December 2015,

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\(^{149}\) [www.pwc.com/assets/united](http://www.pwc.com/assets/united) kingdom UK transfer pricing (accessed 12 September 2012).

\(^{150}\) H Bertam 'The development of fiscal controls over international transfer pricing, University of Birmingham.

\(^{151}\) [https://uk.practicallaw.thomsonreuters.com](https://uk.practicallaw.thomsonreuters.com) Transfer pricing in UK 8.

\(^{152}\) T Sacha Lord 'Transfer pricing in South African Income Tax Law UCT 2010

\(^{153}\) [https://uk.practicallaw.thomsonreuters.com](https://uk.practicallaw.thomsonreuters.com) Transfer pricing in UK 8.

\(^{154}\) [www.pwc.com/assets/united](http://www.pwc.com/assets/united) kingdom UK transfer pricing (accessed 12 September 2012).
or which starts on or after 1 January 2016, will be required to file country-by-country reports for the immediately following accounting period.\textsuperscript{155}

The Regulations also introduce a filing requirement for entities of a foreign-headed multinational resident in the UK for tax purposes or with a permanent establishment in the UK to file a version of the country-by-country report in the UK, if the information would not otherwise be reported or received by HMRC.\textsuperscript{156} This is done to ensure that all their transactions are effectively assessed.

\textit{Definition of a related party}

The related party requirement is applied by reference to body corporates or partnerships which are controlled by a person. The term “Person” can cover individuals as well as corporates or other legal entities. “Control”, in relation to a body corporate, means the power of a person to secure –

\begin{itemize}
  \item by means of the holding of shares or the possession of voting power in or in relation to that or any other body corporate; or
  \item by virtue of any powers conferred by the articles of association or other document regulating that or any other body corporate, that the affairs of the first-mentioned body corporate are conducted in accordance with the wishes of that person and, in relation to a partnership, means the right to a share of more than one-half of the assets, or of more than one-half of the income, of the partnership. There are two important additions to the control definition:
    \begin{itemize}
      \item the 40\% test (section 160(3) TIOPA) that applies to joint venture companies where each party has an interest of at least 40 per cent; and
      \item attribution rules (section 160(5) TIOPA) that trace control relationships through a number of levels in determining whether parties are controlled.
    \end{itemize}
\end{itemize}

\textbf{4.4 Methods applied}

The HMRC accepts all OECD transfer pricing methods that are provided in the guidelines. It has to be noted that there is no absolute hierarchy in the methods used. However, the CUP method is most preferred by experts due its efficient application in comparable uncontrolled

\begin{itemize}
\end{itemize}

\textsuperscript{155} https://uk.practicallaw.thomsonreuters.com Transfer pricing in UK 8.
\textsuperscript{156} www.pwc.com/assets/united kingdom UK transfer pricing (accessed 12 September 2012).
transactions. In transactions where both traditional transaction methods and transactional profit methods are applicable, the guidelines provide that it will be advisable to rely on the traditional transaction methods as these are more direct and produce more accurate results. Where a reliable CUP cannot be established, the HMRC places emphasis on choosing the most appropriate method for the particular type of transaction, rather than attempting to categorise the methods in a hierarchical order. In transactions involving tangible property transactions, such as processing and retail, the resale minus method is considered by the OECD to be the most appropriate method. In cases of semi-finished goods such as, the transfer of goods from a supplier to related party and for transactions involving services, the cost plus method is most useful. The profit split and transaction net margin methods are considered to be useful for complex trading relationships involving highly integrated operations where it would otherwise be difficult to split the relationship into separate transactions to which the analysis can be applied.

4.5 UK policy, documentation and penalties
According to the UK system, a taxpayer is obliged to have his transfer pricing documentation ready before the filing of an annual tax return. However, the documentation need not be submitted as attachments to the tax return.157

The following guidelines have been provided by the Inland Revenue regarding the availability of transfer pricing records:

- All transactions should be recorded and accounted for when they are entered into;
- “Records of tax adjustments and transactions with connected parties need only be performed on filing of the tax return”;158 and
- There is no need to provide proof that a transaction has been concluded at an arm’s length price unless requested by the revenue authorities.159

4.6 Penalties
“In cases of non-compliance in delivering the documentation when requested by the Tax Authorities, paragraph 23 of schedule 18 of the Finance Act 1998 imposes a fixed penalty

157 G Mathewson Fiscal transfer pricing in multinational corporations 1979 23.
158 G Mathewson (n178 above) 24.
not exceeding £3000.\textsuperscript{160} Where there is need for adjustment of transfer pricing, resulting from a fraudulent or negligent tax return being submitted, additional penalties of up to 100% of the tax lost will also be imposed on the taxpayer.\textsuperscript{161} Interest will also be levied on the additional tax payable by the taxpayer due to the transfer pricing adjustment”.\textsuperscript{162}

Documenting transfer pricing policies may protect taxpayers from neglect penalties, as the documentation will serve as proof of the application of the ALP. Any reduction in penalties will be made after taking into account size, gravity, disclosure and co-operation.\textsuperscript{163}

\subsection*{4.7 Advanced pricing agreements (APAs)}

Legislation on APAs was introduced in the UK in 1999 in section 85-87 of the Finance Act. Guidelines applicable in the application of these sections are contained in a Statement of Practice released in September 1999.\textsuperscript{164} For an APA application order to be granted, it needs to be established that the transfer pricing issues to be dealt with in the APA are so complex that it will impact compliance with the ALP.\textsuperscript{165}

“Both unilateral and bilateral APAs applications are considered. However, bilateral APAs tend to be favoured over unilateral APAs.\textsuperscript{166} The rationale stems from the fact that bilateral APAs result in tax administrations of both countries agreeing to the method selected for dealing with the transfer pricing issues covered in the APA.\textsuperscript{167} On average an APA will last a minimum period of three years and a maximum period of five years. There are also provisions in place for an APA to be renewed, unless the issues remain unchanged stay the same the APA can just be amended and extended”.\textsuperscript{168} A disincentive to the APA process is the time factor, with the UK taking 18 – 21 months from the receipt of an application. In cases where the taxpayer is guilty of misrepresentation or omission of facts resulting in the APA reflecting non-arm’s length conditions, the tax authorities may revoke the APA.\textsuperscript{169}

\begin{thebibliography}{99}
\bibitem{160} S Foley (n180 above).
\bibitem{161} S Foley (n180 above).
\bibitem{162} M Mathewson (n 178 above) 33.
\bibitem{163} www.ey.uk/transfer pricing (accessed 13 September 2017).
\bibitem{164} F Feinschreiber (n160 above).
\bibitem{165} www.ey.uk/transfer pricing (accessed 13 September 2017).
\bibitem{166} F Feinschreiber (n160 above).
\bibitem{168} www.ey.uk/transfer pricing (accessed 13 September 2017).
\end{thebibliography}
Furthermore, a taxpayer cannot appeal against a revocation. The only form of redress is done by lodging an appeal against the assessments issued subsequent to the revocation. APAs do not provide protection against transfer pricing penalties for tax evasion in a tax return as a result of fraudulence, misrepresentation or non-disclosure of material facts. False or misleading information in an APA application will also attract penalties.

4.8 Dispute resolution mechanisms
The regulations do not provide a specific process that is followed in transfer pricing matters. Generally, the process starts with a HMRC enquiry into the business’ tax return, the outcome of which may be subject to appeal to the First Tier Tax Tribunal. One of the most effective ways to avoid disputes is to pre-agree on transfer pricing methodology. The most popular form of agreement is an advanced thin capitalisation agreement (ATCA). An ATCA is an advanced pricing agreement (APA) which deals with the deductibility of interest expense in relation to intra-group or shareholder financing. On average, an ATCA takes approximately 12 months to agree with HMRC.

APAs are less popular when compared with ATCAs because, unlike an ATCA, HMRC will only consider an APA where the issues involved are complex. The absolute size of the transaction is not considered a relevant factor for the acceptance of an APA request, nor is there any expedited regime for small businesses.

HMRC encourages the use of bilateral or multilateral APAs, but the taxpayer has the option of requesting a unilateral agreement where it is deemed relevant. While a unilateral agreement may have less value because it does not eliminate the risk of double taxation, it may be useful where a bilateral APA would result in long time consuming processes.

4.9 Case law
Ametalco UK v IR Commrs (1996)
“The facts of Ametalco concerned the nature of the transactions to which the transfer pricing legislation could be applied. The UK Company had, at the request of its parent, advanced an interest-free loan to a related company. Under the provisions of ICTA 1988, Sections 770 to 773, the tax authority claimed the right to impute notional interest on the loan and tax the consequent notional income in the hands of the UK lending company. The Revenue
authority maintained that the legislation applied to all types of transaction, including loans or advances of money, and, in its view, this type of transaction was covered by ICTA 1988, Section 773 as a business facility of whatever kind. Various arguments to refute this position were advanced by the taxpayer, but these were rejected by the Special Commissioners who decided in favour of the Revenue. This case was important in relation to the old legislation, since it clarified the position with regard to the applicability of the legislation to loans and interest in general, and interest-free loans in particular.”

*Glaxo Group Ltd v IR Commrs (1995)*

“In Glaxo Group Ltd, several companies in the Glaxo group had many years of open (unagreed) assessments as a result of unresolved appeals. The Revenue authority suspected that the companies had been engaged in transactions with related parties on a non-arm’s-length basis and sought to increase the open assessments to reflect transfer pricing adjustments. Glaxo contended that transfer pricing adjustments had to be effected by raising new assessments and not by amending existing open assessments. There was then a six year time limit on new assessments (except in cases involving fraud or negligence) and this would have limited the adjustments the Revenue could make. It was held by the Special Commissioners that transfer pricing adjustments could be made to the open assessments.”

*Special Commissioners decision – Waterloo plc and other v IR Commrs (2001)*

“In this case, the Special Commissioners considered the transfer pricing rules in connection with the costs associated with the operation of international share plans by Waterloo plc (the name of the company was made anonymous in the published judgment). The Special Commissioners held that Waterloo plc should be taxed as if it had charged a fee to its overseas subsidiaries for providing share benefits to their employees, and that an upward adjustment to Waterloo’s taxable profits should be made under the transfer pricing rules. The Special Commissioners decided that providing the ability for the employees of the subsidiaries to participate in the option arrangements was a ‘business facility’. The Special Commissioners accepted that the options were remuneration for the employees. The parent company therefore provided some of the remuneration of employees of the subsidiaries, by


means of the totality of the arrangements. Provision of remuneration to the subsidiaries was
the valuable business facility in question. The business facility was made directly to the
subsidiaries employing the individuals who participated in the option arrangements. ICTA
1988, Section 770 as amended by Section 773(4) required a ‘giving’ of facilities to a
recipient – not a clear transaction 798 International Transfer Pricing 2013/14 United
Kingdom with a sale and a purchaser – therefore, there was no need to identify a transaction
directly between the parent and the subsidiary. The Special Commissioners decided that
there was a clear, valuable benefit from the share scheme to the subsidiary employing the
relevant employees, and the value of that benefit was capable of being calculated. On a
wider level, the case provides a presumption that ICTA 1988, Section 773(4) allowed the
Revenue to tax the total facility provided intra-group and did not require a transaction-by-
transaction analysis: “the phrase ‘business facility’ is a commercial not a legal term, and
… that where a commercial term is used in legislation, the test of ordinary business might
require an aggregation of transactions which transcended their juristic individuality
(paragraph 57 of the published decision). Following this reasoning, Waterloo plc failed in
its argument that ICTA 1988, Section 770 did not apply because the transactions took place
between persons not under common control (i.e. the share scheme trustee and Waterloo
plc). The Revenue issued guidance on its view of this case and, subsequently on the
application of the arm’s-length principle to share plans in light of the accounting rules for
share-based payments under IFRS, which apply to accounting periods beginning on or after
1 January 2005. In addition to these court cases, appeals on transfer pricing – which are
now heard in the first instance by the tax tribunals rather than the Special Commissioners
– create a rebuttable presumption on the interpretation of the legislation and can establish
the facts of a case and the transfer pricing methodologies that should be applied”.175

DSG Retail Ltd and others v Revenue and Customs Commissioners [2009] 11 ITLR 869
The abovementioned case dealt with a group of companies including DSG Retail Ltd (the
Dixons Group) whose businesses comprised of retailing electrical goods. The Dixons Group
also offered its customers extended warranties relating to goods sold. Until 1996, the Dixons
Group entered into contracts with Cornhill Insurance under which Cornhill Insurance was
the insurer of the extended warranties sold to customers. It reinsured 95% of that risk to

25 September 2017).
Dixons Insurance Services Limited (DISC), another member of the Dixons Group, resident in the Isle of Man.

Following an increase in insurance premium tax in April 1997, Appliance Service plan Limited (ASL), a non-group company, issued service contracts rather than warranties. ASL's liabilities were wholly insured by DISC.

The relevant issues considered in this case were:

1. **Whether the transactions resulted in a provision being made or imposed between DISC and other members of the Dixons Group.**
   
   The court held that it is necessary to identify a provision between two persons and that there is no scope for reading "two" as "two or more". The term "provision" is not defined but was held not to be limited to formal or enforceable arrangements, and could include informal arrangements and understandings.

   On the face of it, the reinsurance contract was between Cornhill and DISC who were unconnected. As such it might be thought that transfer pricing principles could not apply. However, in 1993, members of the Dixons group renegotiated a commercial reduction to the amounts paid to Cornhill for the insurance contract which had the effect of reducing Cornhill's profits from the contract. Cornhill made no attempt to renegotiate the terms of its own contract with DISC. If Cornhill had been considering its own interests it would have applied a similar commercial squeeze on DISC. The decision not to renegotiate led to an inference that it had agreed with members of the Dixons Group not to do so when its own contract was renegotiated. The court concluded that there was a provision between the relevant members of the Dixons Group and DISC for DISC to enter into the reinsurance contract on the unchanged terms.

   Similarly, in relation to the service contract arrangements with ASL, there was a provision between the parties imposed by a series of contracts. The documentary evidence recorded that they wished to replace the existing structure with a similar structure involving the same parties on the same terms (that is, an arrangement which involved DISC). There was always an expectation of the income accruing to DISC; particularly to retain the tax benefits of DISC (which was exempt from tax in the Isle of Man).

2. **Whether that provision would have been made if the parties had been independent.**
In considering this question, the court relied heavily on Organisation for Economic Co-operation and Development guidelines noting the importance of looking for truly comparable transactions, the need to strive to make adjustments to create comparability if at all possible and that more than one method may be considered.

The Special Commissioners considered a number of potential comparables, but were not satisfied that any were truly comparable or that they would be adjusted satisfactorily. The particular issues they encountered were the:

- Bargaining powers of the parties.
- Substantial variance of information available about the insured risks over time.
- Fact that one of the potential comparables related only to satellite equipment and not electrical goods generally.
- Absence of available data to adjust commission rates for more risky businesses to ones with less risk.

A large independent insurer, Domestic & General, might have been comparable as they provided similar services to independent retailers, but they had much stronger bargaining power with independent retailers than DISC had with the Dixons Group.

The Special Commissioners held that a profit split methodology should be adopted based on the capital asset pricing model. As DISC had no debt funding, the appropriate measure was the opportunity cost of equity, which is the rate of return an investor would require to invest in share capital of a comparable business. In view of the relative bargaining power, all the residual profit was held to be allocated to the Dixons Group. The hearing was then adjourned to allow the parties to agree the exact methodology.

The case is helpful in demonstrating the court's approach to transfer pricing issues and the priority given to seeking comparable transactions as a transfer pricing method. It also highlights the difficulties encountered in identifying true comparables, so that ultimately, profit split methodologies may have to be used instead.

Thus, the cases indicate the manner in which the tax authorities amicably handle transfer pricing disputes. The development of the legal regime is also illustrated and it has advance in such a manner that most of the technical principles are now clearly defined.
4.10 Conclusion
The UK transfer pricing regime is one of the oldest and most advanced system in the world. They effectively adopted the OECD guidelines and continuously modified the rules to keep up with the changes. Cases that have arisen involving MNEs have been dealt with in a manner that shows the maturity of the regime. Furthermore, the disclosure of documents is an integral part of the system that ensures compliance by MNEs, hence non-compliance will result in harsh penalties.
CHAPTER 5- SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction.
The research evolved around the transfer pricing regime in Zimbabwe. The main focus was on the amendments that were introduced in the Income Tax Act, which embodies the arm’s length principle and regulates transactions between connected persons. However, the laws applicable are not comprehensive enough to ensure that MNEs comply with their tax obligations. ZIMRA continuously loses millions of dollars due to illicit transactions concluded by MNEs. The most prominent practice that calls for urgent attention is transfer pricing. Therefore, in this mini-dissertation, the adoption of a comprehensive legal regime was proposed for the regulation of FDI in Zimbabwe.

5.2 Summary of findings
The main purpose of the study was to evaluate the efficacy of the transfer pricing regime in Zimbabwe. An investigation into the governing laws and how they govern transactions concluded by MNEs. To acquire comprehensive results, a desktop and library research was conducted. Such research was supplemented by a comparative study which analysed the UK transfer pricing regime. The results clearly indicated that the laws adopted in Zimbabwe lag behind when compared with advanced legal systems such the regime in the UK.

The main challenges that are faced by the revenue authorities in Zimbabwe include the lack of sufficient definitions in the legislation. For instance, the term transfer pricing is not defined thus, making it difficult to apply the law. A lack of penalties directed at transfer pricing issues was another challenge that was established in the research. MNEs continuously engage in transfer pricing activities as the will not be severely punished. The lack of strict document disclosure requirements also hinder the regulation process. Such loopholes in the law clearly defeat the purpose of the recent amendments. In addition, there is no effective dispute resolution mechanism in place to handle such matters. There is not court that specialises in such complex matters and the judges are also not well versed with transfer pricing challenges. Thus, the structures provide the adequate platform for MNEs to engage in transfer pricing activities.

In analysing the UK regime, it was evident that the system has developed over the years and is now effective in the regulation of transfer pricing. The courts effectively analyse disputes and the cases discuss indicate the developments in the system and clearly discourage tax evasion by MNEs. Therefore, the system can be used as a benchmark by Zimbabwe in the introduction of laws that are comprehensive in the regulation of FDI.
In Chapter 2, the concept of transfer pricing was introduced and how it relates to FDI. It was established that it involves the shifting of profits by an international company with the sole purpose of evading their tax obligations. This is mainly done by the fixing of prices by related companies operating in different countries. African countries have been victims of such practices due to their desire to attract FDI and improve their economic positions. Hence, without adequate regulations, MNEs will continue to invest in African countries and shift their profits to tax havens.

Chapter 3 then addressed the manner in which transfer pricing is regulated in Zimbabwe. An assessment of the legal regime was made, the main focus being on the efficacy of the amendments to the Income Tax Act. Section 98B was evaluated which embodies that arm’s length principle and provides regulation for transactions concluded by related persons. The research indicated that the laws are not effective in the regulation and to ensure that MNEs desist from transfer pricing activities, a comprehensive regime must be adopted.

Lastly, a comparative study was undertaken in chapter 4. The chapter dealt with the UK transfer pricing regime and how it has evolved. It is evident that the laws have matured and are continuously being developed. They effectively adopted the OECD guidelines and continuously modified the rules to keep up with the changes. Cases that have arisen involving MNEs have been dealt with in a manner that shows the maturity of the regime. Furthermore, the disclosure of documents is an integral part of the system that ensures compliance by MNEs, hence non-compliance will result in harsh penalties. Therefore, for Zimbabwe to ensure that they collect the appropriate taxes, they must adopt a similar approach.

5.3 Conclusion
In conducting research for this paper, a desktop and computer based research was undertaken. The concept of transfer pricing was critically analysed and the challenges that follow. Zimbabwe was the main focus of the research. It was established that the country subscribes to the classical school of thought in issues dealing with foreign direct investment. As was discussed in chapter 2, the theory entails that a foreign investment will greatly benefit the host state and assist in its economic development. However, such an approach has made the country susceptible to practices such as transfer pricing. ZIMRA has attempted to regulate the transactions concluded by MNEs by introducing new governing provisions in the Income Tax Act. It was evident in the research that the provisions are too basic for the regulation of such a
practice. Thus, a comparative study was undertaken to assist in the adoption of a comprehensive regime. The study analysed the advancement of the UK regime and how they handle transfer pricing disputes. Hence, for Zimbabwe to effectively ensure that MNEs comply with their tax obligations, there is dire need for the adoption of comprehensive rules.

5.4 Recommendations
Continuous evolution of the laws is a necessity in the country as they are not up to date with the changes in the economic world. The legislature must embark on the introduction of comprehensive laws that are dedicated towards the demise of Transfer Pricing. This could be done by means of the introduction of an Act. Issues such as interpretation or gaps in the law will be resolved by such legislation. Therefore, regulation of illicit financial flows will be regulated in a much efficient manner. In addition, there is also need for the adoption of subordinate legislation that will complement the main piece of legislation governing Transfer Pricing. Such legislation will provide more clarity and make the system comprehensive. Thus, manipulation of the laws will become a daunting task.

Furthermore, ZIMRA should improve on the auditing and monitoring of transactions concluded by MNEs. With regular audits, financial transactions will be easier to control and regulate. Therefore, there is need for increased monitoring of MNEs to ensure that they honour their obligations and assess their compliance with the law.

Moreover, a lack of skilled personnel has affected the revenue authority in the handling of transfer pricing matters. ZIMRA should strive to employ specialised staff that will aggressively pursue transfer pricing audits. The staff will ensure that there is compliance with the tax laws thus reducing the possibility and opportunities for MNE transactions that are aimed at obtaining tax benefits. The skilled staff will also assist in the cases that have to be taken to court due to their advanced knowledge and skills. Thus, the main challenges regarding illicit financial flows will be handled in a much more professional manner.

The government should also engage in assisting ZIMRA in the training of employees. This can be done by providing financial assistance targeted at advanced training and introduction of specialists. Training workshops with advanced countries such as South Africa can be introduced to promote skills transfer. This will ensure that the employees are exposed to leading experts in the field and also the regulation process followed by advanced regimes. Therefore, the challenge of having employees that do not understand relevant issues or regulation of illicit financial flows will be eradicated effectively.
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