

The suitability and practicality of the OECD Transfer Pricing Methods to Zimbabwe

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DECLARATION

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Abstract

The provisions of Section 98B of the Zimbabwe Income Tax Act as read with the 35th schedule governing all related party transactions both domestic and cross border between companies forms the foundation of the transfer pricing legislative regulatory framework in Zimbabwe. The arm's length principle (ALP) is the source of applying the provisions in the regulations. Reference to the Organisation of Economic Cooperation and Development (OECD) comprehensive transfer pricing guidelines is given for interpretation purposes. Although Zimbabwe is not a member of the OECD it adopted the transfer pricing guidelines. This study examines the Zimbabwe Transfer Pricing Legislation with the aim of establishing the suitability and practicality of the transfer pricing methods for Zimbabwe. The unique Zimbabwean economic situation is considered.

As a taxation tool, the guidelines' suggested methods have been applied with a lot of challenges, sometimes resulting to unwarranted loss of revenue with comparability being the major source of difficulties. It is against this backdrop that it was found necessary to examine the level in which OECD methods are relevant and applicable in the Zimbabwe's tax regime. To achieve this, this study identifies the 5 OECD transfer pricing methods and the comparability challenges that are faced when applying them to establish the arm's length prices. Comparability is an intrinsic part of the application of the Arm's Length Principle, which requires comparison of conditions under which related enterprises transact compared to those entered by unrelated enterprises (McNair, 2012). "The issue of comparability remains the cornerstone of transfer pricing" (Sikka, P. and Willmott, H., 2010). The comparability analysis should result in a range of prices, set for uncontrolled transactions with conditions like those of the controlled transactions (McNair, 2012).

The five existing comparability factors are (i) the characteristics of the property or services transferred, (ii) the functions performed considering the assets used and risks assumed, (iii) the contractual terms, (iv) the economic circumstances of the parties and (v) the business strategies pursued by the parties (OECD, 2017).

Overall the ALP, applied through specific pricing methodologies evaluated in this dissertation, is considered to provide a reasonable arm's length price. The applicability the methods is however, specific to each transaction and the accessibility of comparable information. Inadequate information on comparable uncontrolled transactions in Zimbabwe makes the application of the arm's length principle cumbersome.

Moreover, other general problems include the size of the market being considered which limits the nature and extent of information available; the time and expense involved in undertaking comparability analyses; and underestimation of the impact of the differences between the tested party and the comparables (Ado, E. 2015). These problems can be a hindrance in achieving the desired level of comparability and, therefore, can affect the accurate application of the arm's length principle. Hence it is necessary to consider other options to ensure certainty and to avoid the adverse effects of double taxation and double non-taxation that may otherwise arise.

Further, the research showed that Zimbabwe is lagging as there is no compliance threshold for documentation, no practice notes for guidance, and does not subscribe to the BEPS Action plan. The three main risks that were identified included the following the following:

- Unavailability of a database that will assist the revenue authorities in determining an appropriate arm's length price.
- The inadequacy of skills, know-how and experience in evaluating arm's length prices.
- The challenges of having access to relevant, appropriate, and apt information to precisely determine arm's length price for different classes of transactions.

In Zimbabwe, both the economic and political climate has been volatile over years, as result comparable transactions are less existent. For example, the period 1998-2007 was the Zimbabwe Dollar era, 2008 was hyper-inflationary period, 2009-2013 the economy and trade improved, and the period 2014-2018 has been a fall in economy activities and changes to the political landscape. All these trends affect the availability of comparable transactions. For this reason, it is very important for the taxpayer to critically assess the acceptability of the comparable data chosen, consider and document any adjustments and ensure that an adequate comparability analysis, including the review of more than one transfer pricing methodology, has been performed and recorded in full (Miller, K. and Joubert, B., 2016). Lastly, appropriate recommendations are then made to the relevant authorities for a possible modification and or provide guidance with regards to the Transfer Pricing legislation.

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CHAPTER 1

INTRODUCTION AND BACKGROUND TO THE STUDY

Multi-divisional business setups have been benefiting during the development of global trade. Several entities have set their sights to their outside territorial limits by way of expanding and venturing into other jurisdictions through mergers, acquisitions, restructurings and diversification in turn creating Multinational Corporations (MNCs) (Shapiro, 2013). *“The international reach of some MNCs can be likened to an organism which has a network of tentacles traversing the globe connecting the headquarters of the MNC to the subsidiaries and connecting the subsidiaries to each other”* (Picciotto, S., 2018). This network is used to move resources in various segments of the MNC all over the world.

Research in transfer pricing has grown in the past decade (Ratombo and Blumenthal, 2007). Tremendous developments have occurred in both developing and developed countries hence this has been prompted by an increase in volumes of trade, both domestic and international (Fukui & Lakatos, (2012). Assuming rational economic agents, it can be argued that the increase in trade between associates seeks to maximize profits. It is the view of this study that the increased level of interest in auditing and properly taxing related parties that has followed the increase in trade may have been motivated by the desire to increase tax income on the part of revenue authorities. Moreover, risks and penalties on transactions involving large tax implications have contributed to the need for research (Cools et al, 2008). Olivier, L., and Honiball, M. (2008), defined a transfer price as the settled price for property or services between connected persons, persons including entities. This definition also includes domestic and cross border transactions. In contrast, the United Nations Practical Manual on Transfer Pricing defines transfer pricing as the deliberate coming up with prices for cross-border transactions between connected persons (United Nations, 2013). Whilst the UN definition puts its focus on cross-border transactions; Olivier and Honiball’s definition incorporates even domestic transactions. Both definitions look at related party transactions which have grown interest in recent times. For the purposes of this study, a transfer price will follow the definition of Olivier and Honiball above as it incorporates both aspects i.e. domestic and cross border transactions.

LO, W.Y., 2004, found that transfer pricing tops as one most crucial topic in international tax. In addition, a survey carried out by Ernst & Young (2012) found that transfer pricing is ranked by MNCs as the most crucial international tax subject. Modern day business processes have drastically changed in recent years, more-so for cross-border transaction with multinational

corporations (MNCs) having notably changed their way of conducting business (Gonnet, Fris, Starkov, Coriano. 2011). According to Blumenthal, R., (2008) a significant portion of world trade is conducted between connected parties, with Ornelas, E. and Turner, J. L., (2008) asserting that it is more than 60%. This unprecedented trade has made MNCs the force that drives globalization forward, (Oguttu, 2006). Consequently, related party trades are growing both in volume and scope.

Most transfer pricing regimes focus largely on international transactions and yet transfer mispricing also occurs in the domestic environment. Typical examples include excessive commercial free-interest loans; excessive payment for services and goods with specific tax benefit/incentives; re-invoicing with excessive charges for management and administration services; and asset disposals at unrealistic prices (Sikka, P. and Willmott, H., 2010). Therefore, overlooking the domestic market ultimately undermines the effectiveness of a taxation framework and system. The OECD, (2012) established that domestic transfer pricing regulations (arm's length principle) were fully operating in only 26 of the 41-member countries studied. The study also established all 41-member states have fully rolled out the arm's length principle for international transactions. This shows the weaknesses of the prevailing domestic tax and transfer pricing regimes.

Effective transfer pricing regimes have tax revenue benefits. In countries where tax authorities have paid little attention to the possibility of manipulation of transactions, considerable revenue has been lost. This is largely because transfer mispricing is aimed at reducing the overall tax paid (Beer and Loepnick, 2013). This amounts to loss in revenue which is irrecoverable. Therefore, transfer pricing regulations secure the tax base and builds capacity to recover tax revenue that was originally forgone. There is an avenue to enforce compliance and mitigate profit shifting. Examples of significant revenue impacts from transfer pricing legislation enactment include China that collected an additional \$1.5 billion (Avi-Yonah, R., Xu, H. China, and BEPS. Laws 2018, 7, 4. <https://doi.org/10.3390/laws7010004>) ; India \$15.82 Billion (Kapur, 2012); Hungary \$670 million; and UK \$1.5 billion (HMRC, 2011).

For developing countries, whose income is highly dependent on tax revenue, there is an enormous dilemma to balance revenue needs of the government with the needs of taxpayer with Zimbabwe not being an exception (Vito Tanzi and Howell H. Zee; 2000). Consequently, taxpayers are always on the lookout for new and innovative ways to structure prices in such a way that reduces the overall tax burden imposed on them, and on the other hand the government

tries to keep legislation up to date to curtail these new and innovative ways of tax planning (Hans Gribnau, 2017).

The former anti-avoidance provisions contained in Section 98 of the Zimbabwe Income Tax Act (Chapter 23:06) “ITA” were found to not be effective in so far as transfer pricing in domestic and international trade was concerned. Consequently, Zimbabwe introduced new legislation (Section 98B) on transfer pricing to reinforce the old provisions effective 1 January 2016 (Leon Gona, 2019). The enacted provisions target both transactions between related domestic entities and transactions with foreign entities.

Considering these developments, and the arm’s length principle in Zimbabwe, this paper analyses the provisions of Section 98B of the ITA as read with the 35th schedule. Zimbabwe has transfer pricing regulations that fully endorse the arm’s length principle and, in most instances impose documentary obligations on taxpayers (Tapera, 2017). However, it still has some developments to undertake if there is to be success in the application of transfer pricing methodologies. The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations are considered an authoritative source on transfer pricing by both member and non-member countries alike (Tapera, 2017).

In 1979, the OECD published general guidelines, “the OECD Report Transfer Pricing and Multinational Enterprises”. In 1995, the guidelines were changed to “”. The organisation has continued to update the guidelines ever since to ensure they continue to have economic relevance. The latest update was done in 2017 and they are referred to hereinafter as the “OECD Guidelines”, or simply as “the Guidelines”. The Guidelines are meant to assist countries in the implementation and application of transfer pricing policies. They provide a comprehensive framework for both member and non-member countries interacting in the transfer pricing arena. The aim of the OECD Guidelines is to simplify the application of transfer pricing principles and to ensure uniform implementation of transfer pricing rules (OECD, 2010; Baxter, 2015).

Zimbabwe, a non-OECD member country, has incorporated the arm’s length principle into the tax laws through Section 98B and the Thirty-Fifth Schedule of the ITA.

Below is an extract from Section 98B:

98B Transactions between associates.

“(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 resulted 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.”

The OECD and United Nations (UN) have undertaken to develop transfer pricing material, both of which have Guidelines to assist tax authorities and MNCs in the regulation of this area of international tax. The OECD Guidelines have naturally been inclined to address the needs and circumstances of the developed countries who form the membership of the organisation. The UN, on the other hand, has been more accommodative of the needs and circumstances of the developing countries. Overwhelmingly, tax audits conducted on large MNCs are concerned with the transfer price and whether it reflects market conditions (BDO, 2017). Transfer pricing in recent decades has become a more and more important consideration for both tax administrations and MNCs and will continue to be of consequence for the foreseeable future.

The ITA Section 98B and Thirty-fifth Schedule changes in Zimbabwean tax law appear to be inspired, at least in part, by Article 9 of the OECD Model Convention. Emphasis is on the need to scrutinize related or connected persons transacting. The Article comprises guidelines on the taxation of related enterprises, as well as the acceptance of the arm's length principle as the instrument for determining the appropriateness of the price of the transaction. Although much focus is on cross border transactions, domestic transactions between connected parties or

associates have grown in the past decades (Tapera, 2017) and the ITA has been amended to cover both international and domestic transactions.

Transfer pricing represents the mechanism by which tax authorities levy adjustments to reflect income attributable to related transacting parties and to try curb the avoidance of taxes on the transactions. (Ruslan Melnychenko et al, 2017). Cross border transfer pricing has given rise to transfer pricing manipulation globally, where multinational entities arrange their transactions in a way to minimize overall tax liability burden (Hines Jr, J.R., 1990).

This study appreciates that as organisations grow or expand to other countries, they do so by establishing, or acquiring in whole or in part, a local branch or a subsidiary (Ehlers, T., 2014). This culminates in an MNC with common ownership, management, and or control (Eiteman, Stonehill, & Moffett, (2016). The subsidiaries are capable of trading as associates and the holding firm is also capable of trading with its subsidiaries. Because of these relationships, transactions between them are rarely independent. Even though it may not be so in practice, such corporations should be subject to market forces. Tax legislation across the globe has therefore undergone review to ensure that transfer prices are not subject to manipulation. Each transaction has to occur in such a way that the result is similar to those of trade between entirely independent parties under similar or comparable conditions.

Several case studies for example the SABMiller case show that Base Erosion and Profit Shifting (BEPS) adversely affects developing countries higher than developed countries (Hearse, 2014). The negative economic impact of BEPS is evident in the form of dilapidated infrastructure, weak educational systems, and below standard health care hence leading to high mortality rate. This is because of inadequate funds which are supposed to be collected by governments through taxes. (Picciotto, S., 2018).

The ineffectiveness of the old provisions of the ITA necessitated the alignment of the Zimbabwe Tax Laws with the transfer pricing principles developed by the OECD. Although the Guidelines are not directly mentioned in the new amendments, the ITA changes move much closer to the guidelines than they were previously. Section 98B read as in conjunction with the 35th schedule accepts the five OECD-recognized methods as the basis of determining the arm's length price for a transaction. These methods are the comparable uncontrolled price method, resale price method, cost plus method, transactional net margin method and the transactional profit split method (35th schedule to the Zimbabwe Income Tax Act).

Below is an extract from the 35th Schedule to the Income Tax Act) which guides the amended Section 98B:

“(5) The following shall be the approved transfer pricing methods for purposes of subparagraph (2)—

*(a) the **Comparable Uncontrolled Price Method**, which is the comparable uncontrolled price method consisting of comparing the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction; and”*

*“(b) the **Resale Price Method**, which is the resale price method consisting of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions; and”*

*“(c) the **Cost-Plus Method**, which is the cost-plus method consisting of comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction: and”*

*“(d) the **Transactional Net Margin Method**, which is the transactional net margin method consisting of comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions; and”*

*“(e) the **Transactional Profit Split Method**, which is the transactional profit split method consisting of allocating to each associated person participating in a controlled transaction the portion of common profit (or loss) derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction. When it is possible to determine an arm's length remuneration for some of the functions performed by the associated persons in connection with the transaction using one of the approved methods described in subparagraphs (a) to (d) above, the transactional profit split method shall be applied based on the common residual profit that results once such functions are so remunerated.”*

However, the application of the ALP in Zimbabwe is yet to be assessed in the wake of changes in legislation. Following the enactment of Section 98B, this study focusses on the approach Zimbabwe has taken to address transfer pricing considering the international principles contained in the OECD. It seeks to examine the suitability of the transfer pricing methods to Zimbabwe and their practical application both on domestic and international trade. Also, this

study also seeks to reveal those challenges facing a developing country that impede the effectiveness of the ALP.

1.2. Purpose of the Study

Some literature argues that the arm's length principle is not suitable for developing countries (David Spencer, David McNair; 2012). In such literature it is asserted that, "*developing economies are at a disadvantage in relation to developed countries because of the difficulties they face in implementing the principle*" (Ado, E. (2015).

The application of the ALP by using the chosen method depends on heavily on (comparable) information, which may not exist or be readily available thereby making its application difficult (Tapera & Majachani, A. F; 2017). Furthermore, it needs the discretion of the revenue authorities. There is need for controlling this as it may open a gateway for corruption or burden taxpayers with compliance costs that are not necessary.

1.2.1. Research Objectives

In studying the transfer pricing methods and their suitability to Zimbabwe objectives are needed to serve as a direction to fulfil the task of the whole work. In any kind of endeavour, objectives should be clear in order to establish a flowing research discussion. This paper has the following objectives necessary for the fulfilment of the task:

1. To investigate the suitability and practicality of the OECD transfer pricing methods to Zimbabwe.
2. To outline the challenges that developing countries face in the application of the OECD transfer pricing methods.
3. To recommend strategies that can be used for possible modification and or provide guidance with regards to the Transfer Pricing legislation.

1.3. Research Design

Researchers are faced with a variety of research designs. These include exploratory, descriptive, explanatory, case study, comparative and hypothesis-testing. This research explores a field based on research, theories, and regulations hence, the most appropriate approach for this research is the interpretative focus (Hanlon, M., 2018.). Criticality forms part of the study, hence, the study will not be purely interpretative.

Furthermore, this research is founded on documented information. The sources of the information include but not limited to, abstracts of legislation, extracts from documents such as articles as well as reports and research papers on transfer pricing. The research is classified as a qualitative research.

1.4 Research Approach and Methods

Desk research will be done to gather information on transfer pricing in Zimbabwe. Textual review of findings in Zimbabwe and other developing countries shall augment the readily available desk research. As a consequence, the materials utilized are both primary and secondary sources. The conventions and guidelines published by the OECD, the various manuals issued by the OECD and UN, as well as Zimbabwean legislation will form the backbone upon which this research paper is based. The study considers journals on the ALP in Africa and related publications to assess the practicality and suitability of the methods in Zimbabwe.

1.5 Outline of the Chapters

1.5.1 Chapter One – Introduction and Background to the Study

The foundation of this research has been constructed in this chapter. It gives the introduction and background of study. The contents of this chapter are: background to the study, research design and the outline of the study.

1.5.2 Chapter Two – Theoretical developments on transfer pricing and the Arm's Length Principle

The transfer pricing regulations not only affect MNCs. They also cover trade between companies with common substantial shareholders whose relationship dilutes independence in trade. Transfer pricing itself is not illegal (Tapera, 2017) but remains a red-zone due to a rise in trade volumes and anti-avoidance provisions. The intended objective of Transfer Pricing Regulations is to address instances where there is price manipulation or transfer mispricing. Literature on the development and application of transfer pricing globally is considered in Chapter 2. Most studies and much development in transfer pricing has been undertaken in developed and developing countries are yet to catch up in this respect. The arm's length principle is the cornerstone of taxation in modern day transaction (Tapera, 2017). When ignored it has implications on the duty collection, income tax and VAT depending on context.

Therefore, this chapter reviews both theoretical and empirical literature on Transfer Pricing and the Arm's length principle; and investigates challenges on application of the TP methods and the ALP. Chapter 2 shall explore the arm's length principle (ALP) and how it underpins transfer pricing.

1.5.3 Chapter Three – Transfer Pricing provisions and the requirements in Zimbabwe

The focus of this chapter is to interpret Section 98B and the 35th Schedule, benchmarking it against the OECD Transfer Pricing guidelines. The chapter also analyses the requirements and or conditions prompting the ALP and general overview of comparability.

1.5.4 Chapter Four- The application of transfer pricing methodologies and comparability challenges in Zimbabwe

This chapter examines the suitability of the five adopted methods (as highlighted in Chapter Four) to determine a transfer price in Zimbabwe. The chapter will assess the practicality of these principles in the Zimbabwe context as guided by Section 98B of the ITA and explore comparability challenges. Comparability factors such as product characteristics, functional profile, business strategy, contractual requirements and economic circumstances are reviewed in the context of Zimbabwe their practicality assessed against the prevailing conditions in the tax's environment.

1.5.5 Chapter Five – Conclusions and Recommendations

The final chapter is the researcher's conclusions and recommendations drawn from the research findings.

CHAPTER 2

THEORETICAL DEVELOPMENTS ON TRANSFER PRICING AND THE ARM'S LENGTH PRINCIPLE

2.0 Introduction

This chapter reviews related literature by various scholars on the practicality of the Arm's Length Principle (ALP) and its relevance in various tax jurisdictions. The chapter builds on both hypothetical and observed literature already existing on transfer pricing and the ALP. It is expected that the review of the existing body of literature paves way for interpretation and application of Section 98B of the ITA.

2.1 Overview of concepts

This section provides definitional analysis of the underlying concepts in this study.

2.1.1 Transfer Pricing

According to the UNCTAD report of 2013 (UNCTAD/PRESS/PR/2013/001), about 60% of trade takes place in 'value chains' linked to transnational corporations, inside MNC groups. Less than a decade later, at least 70% of world trade was reportedly being conducted between connected entities (World Investment Report, 2020). These statistics suggest that trade within MNCs are growing drastically. Related party transactions tend to shift profits from one economy to another, unfairly depriving an economy of benefits that would be otherwise due to it. This has increased over the years and relations between entities now influence terms of the contracts and other aspects of trade hence the introduction of transfer pricing regulations.

The OECD guidelines recommended the arm's length principle to be the key standard for transfer pricing. These guidelines clearly describe transfer pricing methods and recommend multi-methods considered fair in pricing transactions between related companies. The principle has been construed and accepted as an international standard for transfer pricing adjustments. The application of the principle as the most appropriate approach for transfer pricing is applied through the OECD guidelines, adopted by the OECD signatories into their domestic tax legislations (OECD, 2015). The arm's length principle stipulates that prices between related parties should be set as if they are unrelated companies that operate independently. ATAF (2014) established that this was one of the ways to eliminate affiliate influence on transactions and promote arm's length transactions. Even though the arm's length principle has been

accepted as the most appropriate standard for testing related party transactions, the intensity, and the approach by which the principle has been applied differs with jurisdictions (Perčević, H. and Hladika, M., 2017). The reason why such differences exist appear not to have been previously fully studied. It is assumed, in the absence of any evidence to the contrary, that the differences in approach and intensity of implementation may be due to the different macro and micro economic circumstances that are existent between different countries. Nonetheless, while outside the scope of this dissertation, it may be interesting to conduct studies to determine if it is indeed

According to Lin X (2016), “a transfer price is the internal price set by multinational enterprises basing on financial strategies”. In general, economic theory predicts that when third parties transact, the market forces are expected to shape the pricing of property and or services transacted (Schwarzer, J. A 2016). The assumption is that there are sufficient competitive forces both on the demand and supply side. However, in transactions involving related parties, it is conceivable to assume that the unavailability of independence in their relations may lead to the coming up with prices that may be deviating from independent prices. This would still be true even if competitive forces do exist in that industry in which the related parties exist (U. Schreiber et al., 2020). Thus, this results in the misrepresentation of revenues and expenses and ultimately in the taxable income of the related parties.

According to Perčević & Hladika (2017) transfer pricing has been a matter of interest for both MNCs’ management as well as tax authorities. Transfer Pricing’s significance has been reiterated at international level when related entities transact in a manner which will enable them to meet predefined goals. Transfer pricing methods sometimes affect the profit attributable to an MNC consequently affecting the tax revenues reported in that jurisdiction. (Riedel, N, et al; 2015). National tax authorities now endeavour to control transfer pricing to reduce or eliminate tax avoidance, double taxation and double non-taxation. Keeping transfer pricing in check is a rather onerous job for tax authorities, because often they have inadequate or wrong information about the group and its related entities and the transactions between them. Occasionally, when the information is available, there is difficulty in judging the objectivity of the prices charged between related parties Considering all the developments that have been taking place, tax authorities seem to have increased transfer pricing audits, and taxpayers also concerned about how they transact with their related parties to ensure that they do not breach the arm’s length principle (Schneemelcher, P., 2020).

2.1.2 The Arm's length doctrine

The arm's length principle (ALP) is a standard globally accepted for testing related party transactions. The prices reflect what would have been charged between unrelated parties under similar circumstances and conditions. In other words, the ALP is a remedy to various transfer pricing issues (Schreiber, U. et al; 2020).

The objective of the ALP is to make sure that related party transactions are in parity with unrelated party transactions (Yao, J.T., 2013.). The ALP is brought to light in paragraph 1 of Article 9 (Associated Enterprises) of the OECD Model Tax Convention on Income and on Capital as follows:

“Where...conditions are made or imposed between...two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.” (OECD Model Tax Convention on Income and Capital)

Another perspective by Schneemelcher, P. (2020), was that the conditions imposed in a related party transaction should be reflective of what would happen in the market with the forces of demand and supply at play where both parties want to benefit the most from the transaction

The legitimacy of transactions is tested using the ALP, which should be adhered to by referring to the market price. *“This requirement is often flouted, however, with transactions mispriced to enable the parent company to move money around to minimise tax”* (Jian, M. and Wong, T.J., 2010). Revenue authorities adopt the principle to make any adjustments on transactions concluded on a non- arm's length basis and ultimately to the taxable profits to reflect the true value that would be at arm's length (Lin X, et al; 2016).

2.2 Theoretical developments on transfer pricing

Transfer pricing was initially dominated by modelling approaches in its primitive years with the seminal modelling frameworks being rooted on Hirschlefer and Gould in 1956 and 1964 respectively. The recommendation was that there was need to follow intermediate prices from the market since they represented the market forces of demand and supply. The marginal cost was to be used where market prices are not available (Cottani, G., 2015)

According to Horst, et al (2010), MNCs aim is to maximise after tax profits by making sure that they earn the most revenue on low tax jurisdictions and the most deductions in a high tax jurisdiction. This can only be done by way of manipulating prices between the related parties. Often transfer pricing is used as response to tax rate differences in different countries (Cottani, G; 2015).

Table 1 summarizes major developments on theories underpinning transfer pricing

Table 1. Development of transfer pricing models

Period	1950–1970	1970–1990	1990–2010
Major developments and peculiarities of transfer pricing models	Transfer pricing was analysed mainly for corporate management purposes	Analysis of manipulations of transfer prices' impact on income shifting and transfer pricing responses to income tax differentials	Transfer pricing setting in monopolistic and oligopolistic markets; analysis and comparison of the arm's length and formula apportionment approaches; impact of transfer pricing on the calculation of the international price indexes
Authors	Hirshleife, 1956; Argyris, 1957; Heflebower, 1960; Gould, 1964	Horst, 1971; Musgrave, 1972; Halperin and Srinidhi, 1987; Capithorne 1971; Samuelson, 1982	Nielsen, Raimondos-Møller and Schjelderup, 2001; Wellisch, 2004; Shackelford and Slemrod, 1998; Devereux, 2004; Sirensen, 2004; Mintz and Weiner, 2003; Goolsbee and Maydew, 2000

Source: Novikovas (2011)

2.3 Transfer Pricing Methodologies

The OECD Guidelines are arguably influential enough, to the extent that even non-member countries, like Zimbabwe and other African countries have been inclined to borrow from them,

albeit in part. The Guidelines classify the methods into two broad groupings – the traditional transaction methods, and the transaction profit methods. The two categories are expanded on in Figure 1.

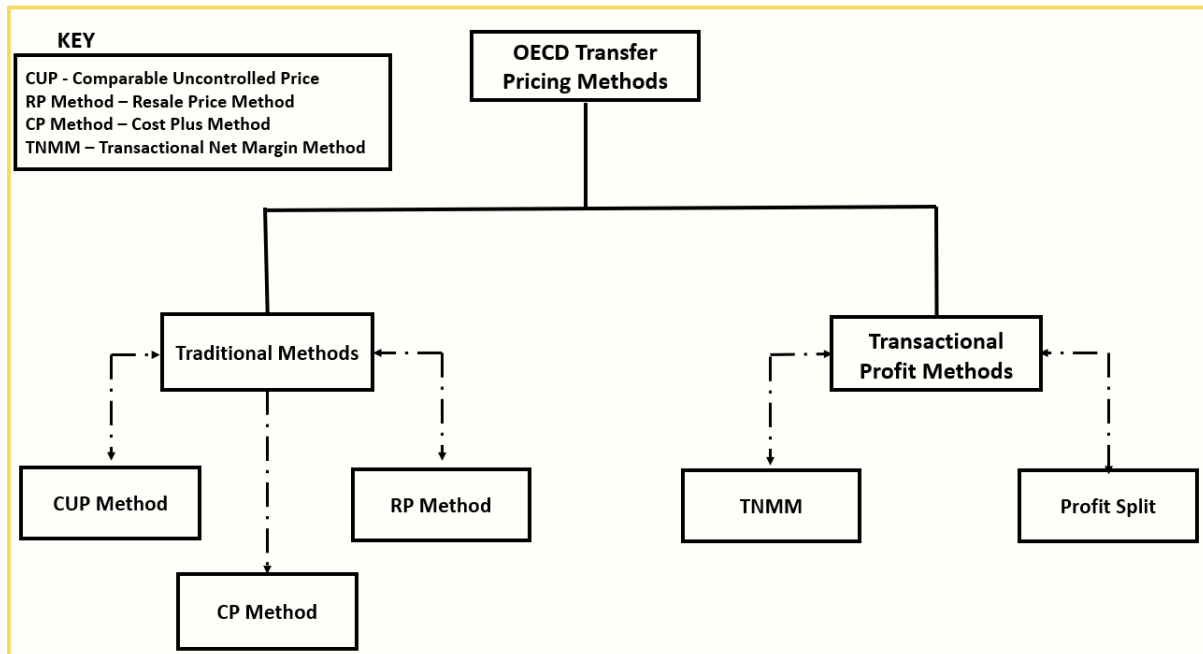


Figure 1: Transfer Pricing Methods: (Source: Author)

According to OECD (2017), the ALP does not need the use of more than one method for a transaction. This calls for selection of one most appropriate methodology on a transaction (Novikovas; 2011). The taxpayer and the authority have two broad pools to select from:

2.3.1 Preferred Methods

It is believed that the traditional transaction methods (CUP, the Resale Price Method (RPM) and Cost-Plus Method (CPM)) are more direct in establishing whether the conditions in prevailing in the transactions between the related companies meet the arm's length criteria (OECD, 2017). The difference in the prices between the controlled transaction and comparable uncontrolled transaction can be easily attributed to the commercial and financial relations made or imposed between transacting entities. In this regard, establishing the arm's length conditions by price substitutions is possible.

CUP

The CUP method is preferable where a third-party trade in the same or similar product as is sold between two related entities. It can be reliable in situations where the material characteristics of the controlled transaction and the uncontrolled transactions are comparable.

If no adjustment cannot be done, the accuracy and reliability of the CUP method would be brought into question hence the need to select another method (<http://tpadvice.com/wp-content/uploads/2016/09/Customs-Valuation-Transfer-Pricing.pdf> ; OECD Guidelines, 2017)

RPM

According (OECD, 2017) the determination of resale price margin for a related party transaction can be assessed by evaluating the resale price margin that a similar reseller makes on his products in a comparable uncontrolled transaction. The RPM is arguably the best approach to recover cost. This method is most applicable where there is little or no value addition by the reseller and there are no unique intangibles to be considered (WCO guide to customs valuation and transfer pricing, OECD Guidelines, 2017).

CPM

The cost-plus method requires one to apply a comparable mark-up to a comparable cost base. This retains the ALP. The starting point is the evaluation of the associated costs that are borne in a controlled transaction i.e. the supplier's costs. Considering the functions, assets, and risks analysis an appropriate mark-up is levied onto the cost (OECD Guidelines; 2017). Market conditions are also considered as they play a pivotal role in the price charged. Determining costs is not an easy exercise making CPM difficult in practice (OECD Guidelines, 2017). Additionally, the method relies heavily on comparing the mark up levied between the controlled and uncontrolled transaction with a comparable cost base.

2.3.2 Last Resort Methods

These include the Transactional Net Margin Method (TNMM), Profit Split Method (PSM) and Comparable Profit Method (CPM). Not to disqualify the techniques due to tax authorities' preference of the traditional techniques, transactional profit methods are equally reliable. However, they are less preferred to the traditional techniques. It goes without saying that there are instances where the transactional profit methods are more suitable. Suppose a transacting party contributes uniquely in a transaction or the operations of the parties are integrated, then Profit split would apply as it is a two-sided approach (Transfer Pricing manual for developing nations, 2017; OECD 2017).

As in most developing nations, there is limited publicly available information to use to apply the traditional methods, the transactional profit methods would mostly apply (OECD, 2017)

2.4 The Development of Transfer pricing and the Arm's Length Principle in Zimbabwe

In 1979, the OECD published general guidelines, “The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” (the “OECD Guidelines”) to help countries with the implementation of transfer pricing regulations as well as their application. The OECD Guidelines, which the OECD has undertaken to regularly update to ensure the continued economic relevance thereof, provide a comprehensive framework for member and non-member countries alike interacting within the transfer pricing arena. These OECD Guidelines offer guidance to encourage uniformity in the application of transfer pricing rules, but they do not they simplify, or prescribe, the application of the principles.

The Transfer Pricing Guidelines are an authoritative source on transfer pricing issues, even in Zimbabwe, a non-member country. The Zimbabwe Income Tax Act as read with the 35th schedule is focussed on transactions between related or connected parties. The new provisions require transaction between related or connected persons to be scrutinised. While the traditional focus is on cross border transactions, domestic transactions are equally governed by these provisions.

Ratombo (2007), et al assert that over the last decade, copious arguments relating to the most suitable transfer pricing regime intended for emerging countries has opened. In addition, many countries in the sub-Saharan Africa and beyond consider implementation of the ALP as a standard and central feature of the transfer pricing regimes. This is primarily so, due to massive developments by nations in executing the OECD Transfer Pricing Guidelines (Tapera M, 2017). This may, however, be arguably resource-intensive, to the extent of being prohibitive in terms of costs, for developing countries. Costs remain one of the greatest challenges to TP in developing countries (Ratombo, 2007). Consequently, alternative approaches have been put forward (PwC, 2015). These alternative techniques include formulary apportionment of profits or fixed margins of returns for intercompany transactions (PwC, 2015). While these alternatives seem less complicated to apply, they do not have international consensus and still require concurrence on the formular.

It is important for developing countries to come up with stable transfer pricing regimes. Stability is a quality that tends, in general, to resonate favourably with investors, therefore potentially attracting FDI (Eiteman, D.K; et al, 2016). In addition, if the wealth that was being exported through transfer pricing can be retained, both economic growth and increase in tax revenue collections are likely to result (Eiteman, D.K et al; 2016). In Africa, notably South

Africa, Morocco, Kenya and Egypt have stable and broad transfer pricing regimes. Uganda recently passed tax legislation based on the ALP. Zimbabwe only enacted the Transfer Pricing legislation in 2016 through insertion of Section 98B to be part of the Act. According to Fukui, T et al (2012), an efficient tax policy should provide the hosting nation with a protection of their tax base making sure there is no impediment of global trade and investment. Fukui T (2012) further postulates that although studies indicate that a protective transfer pricing regime can hinder FDI and trade; investors prefer certainty, and broad transfer pricing regimes which are legitimate and consistent.

2.5 Practical challenges of the OECD Transfer Pricing Model in Zimbabwe

The notion of comparability is key to the application of the ALP. Comparability is the nexus between the ALP and the application of transfer pricing methods (Beer and Loeprick, 2013). One of the requirements of the ALP is assessing the related party transactions by the tax authorities as well as the taxpayers (PwC, 2011). Unrelated party transactions should be compared with those of connected enterprises. This would imply the need to have access to a substantial amount of data for comparison. Consequently, at the time of the transaction information availability is a potential challenge for the tax payer. Transfer pricing is subjective, it is a task that arguably requires notable experienced verdict from the perspective of both revenue authorities and tax payer.

In further support Sikka (2009), states that the guidelines on transfer pricing heavily depend on the assumption that costs are malleable. Further, it was highlighted that several markets are largely dominated by the same MNCs.

Todtenhaupt, M., Voget et al (2020), stipulated that there is a difficulty for countries to get hold of information on comparables particularly for developing countries because of the following:

- Databases that exist have a bias towards the developed nations hence the difficulty in performing benchmarking studies as there won't be any comparables.
- Since the economies of developing countries tend to put more focus on other sectors of the economy hence the unexploited sectors tend to lack comparables, further the level of growth and development in data collation is still at its infancy ultimately affecting the information available.
- The limited number of companies in different sectors against which to compare (Cutis et al, 2012);

- The is lack of technical know-how and resources to sufficiently assess and evaluate transactions appropriately (OECD 2014);

Identification of appropriate comparables is challenging (OECD, 2017). Zimbabwe is one of many countries encountering challenges in as far as publicly available information is concerned. Except for recent times, there were no requirements for entities to submit documents with organizational or professional bodies (Robinson, 2015). In Zimbabwe, there are no mandatory requirements for companies to submit their financial statements to the revenue authority, hence the submitted information in the form of annual returns is inadequate to make comparisons (Tapera, 2017). The availability and adequacy of information is one of the problems that arise in trying to come up with the arm's length price (SARS, 2000),

The is mounting pressure on developing countries from developed countries where there are related party transactions that are affecting both countries (i.e. developed and developing). As per Europe Aid (2016), there is an expectation that developing countries are going to improve their transfer pricing enforcement efforts regarding these transactions. In such instances where a transaction involves both nations there is need for transparency and timely exchange of information (Davies, RB, et al; 2014). Unfortunately, developing countries have often neglected the need to have an on exchange of information in their DTAs which is a new way of improving cooperation between nations on transfer pricing issues. Without any indicator to the contrary, this might still be the case (Dean, K.N. (2014).

Another challenge regarding the comparability analysis is the fact that some transactions are complex and unique to the MNC hence it becomes difficult find similar transactions for example the value of an intangible (Davies, RB, et al; 2014). Comparisons within a market tend to be difficult as the ALP is not so apparent. Chances are high for the manipulation of prices often regarding intellectual property and other proprietary information. Sikka, P. and Willmott, H., 2010, agree that globalization has motivated consensus regarding the ALP, although international trade global seems to be more focused on a few MNCs, consequently independent comparables are hard to come by. With these situations, it is difficult to get perfect comparables as a result determination of the arm's length prices is hindered.

The application of the ALP if often technical know-how and resource intensive, this is a challenge particularly for developing economies who have limited resources (OECD, 2017; Becker 2014). Developing countries do not face this challenge as they have already implemented the necessary legislations and they are still working to improve them. With

regards to Zimbabwe, in recent years ZIMRA has recruited more qualified and knowledgeable workforce to fill in the skills gap although it may take a while to get to the required resources and levels of expertise (Mawere & Sibanda, 2017). It is evident that most African countries have an inadequate skills challenge and the mere fact that transfer pricing regulations are not easy to apply practically. Evidence to support the arm's length nature of a transaction is key in the assessment, this often hard to get hold of (E&Y, 2016).

Sikka P; (2009) also contended that inadequate resources for revenue authorities to deal with transfer pricing and tax avoidance case is a major challenge. In as much as the transfer pricing disputes or issues are more in developing countries, it is also apparent that even revenue authorities of developed countries are still to match the resources required in the different sectors of their economy (Sikka, P. 2009.).

Silberstein C (2010), brings into the picture the harm arm's length approach has created, he argues that substantial amounts have been spent around the world all in the name of enforcement and meeting pricey compliance requirements. This further confirms the notion that the application of the ALP is a burden and is costly particularly for developing and transitioning countries (Sikka P; (2009). The OECD (2010), admits that some view the ALP as fundamentally imperfect since the separate legal entity approach does not often take into consideration economies of scale earned by entities and the unique activities undertaken by integrated business models. The OECD (2010) further acknowledges that there are no universally accepted sound criteria for apportioning economies of scale and or advantages of integration amongst related parties.

2.6 Costs and benefits of regulating transfer pricing

There are instances where countries have paid no attention to transfer pricing issues, cases of transfer mispricing have led to loss of tax revenue which would most likely be irrecoverable. (Becker, C. (2014). On the other hand, introducing effective transfer pricing controls can help in re-establishing and protecting the tax base (Cazacu, AL. 2017). Countries with already existing transfer pricing regimes but have not introduced effective controls and guidelines, an upscale of capacity may help in trying to recover revenues previously not collected (Cristea, Anca & Nguyen, Daniel; 2014).

Effective transfer pricing regimes have tax revenue benefits. In jurisdictions where there is little attention, if any, paid to transfer pricing; there is high risk of transfer mispricing to reduce

tax liabilities (Beer and Loeprick, 2013). This amounts to loss in revenue which is irrecoverable. Therefore, when effectively administered, transfer pricing regulations secure the tax base and build capacity to recover tax revenue originally forgone. There is an avenue to enforce compliance and mitigate, examples of significant revenue impact from transfer pricing legislation enactment include China that collected an additional \$1.5 billion (PwC, 2011); India \$15.82 Billion (Kapur, 2012); Hungary \$670 million; and UK \$1.5 billion (HMRC, 2011).

The amount of investment in transfer pricing resources and programs to effectively administer transfer pricing may be substantial and the direct impact regarding additional taxes collected may be cumbersome to quantify, it is believed the benefits outweigh the costs. (Deloitte, 2013).

Furthermore, on top of coming up and implementing essential transfer pricing regulations, there will be a need to substantially capacitate the revenue authorities and all the relevant stakeholders to effectively deal with transfer pricing issues (Visser A; 2015). Upgrades to IT systems, renewal of database subscriptions and introducing electronic filing are other steps required to ensure that revenue authorities are ready and able to handle transfer pricing issues. In this regard, there is need for the government to be in the lead to ensure that all essential resources are made available timeously. The planning and implementation of any transfer pricing reforms requires a holistic approach and due diligence.

2.7 The Suitability of the Arm's Length Principle (ALP) in Developing Economies

The objective of a transfer pricing regime being premised on the ALP to make sure that the conditions imposed in a covered transaction or related party transaction are not influenced by the relationship of the parties to negatively affect the calculation of the applicable taxable income (Ernst & Young, 2011). In such scenarios, the ALP is an impartial concept which does not, theoretically, favour the developing or developed countries (KPMG, 2012). However, in practice, often, it is contended that developing countries are disadvantaged in comparison to developed economies because of the challenges that are faced in implementing the ALP (Cooper, J; et al, 2017).

Shapiro, A (2013). points out that Tax Authorities in developed economies are likely to encounter similar hiccups of partial information, however these countries are better off as they have effective policies and tools to try and alleviate these challenges. To support the administration of transfer pricing regulatory authorities, need to be clear on reporting and filing obligations among others (Deloitte. (2013). According to Dean, K.N. (2014), basing a

country's transfer pricing regulations on the ALP may have benefits and disadvantages but for most of the countries (i.e. both developing and developed) the benefits of adopting the ALP will generally outweigh the costs and difficulties associated with its implementation keeping in mind that the regulations are specifically suited for the country itself, resource constraints are addressed, capacity building of tax authorities is done and enforcement efforts are risk based.

By mid-2017, ZIMRA had not been at ease with losses emanating from transfer pricing. The tax authority was worried about transfer pricing and illegal financial outflows; however, the loss could not be quantified (ZIMRA 2017 Annual Report). There are indications to the fact that Zimbabwe, and arguably the rest of the African continent, have lost significant revenue because of transfer pricing and other illegal financial happenings (Tapera, 2017). This is despite the presence of enacted transfer pricing legislation effective the 1st of January 2016. The regulations recognise the ALP and impose documentation requirements on taxpayers. The scope of the regulations encompasses all transactions between related parties be it cross border or domestic. The 35th Schedule to the Income Tax Act covers how TP guidelines are to be applied. Without direct acknowledgement, the 35th Schedule arguably borrows ideas from the OECD Transfer Pricing Guidelines as a key source of interpreting the regulations (KPMG, 2016). Subject to the approval by the revenue authority, other sources may be allowed to compliment the OECD models.

According to Ratombo and Blumenthal (2017), the OECD and the UN stress how crucial it is for a country's legislation to be in tandem with international principles by applying the ALP and warranting the transfer pricing legislation addresses the country's unique needs. Therefore, transfer pricing, no matter how complex, is key to addressing BEPS globally. The absence of transfer pricing legislation may enable entities to shift profits or funds to other jurisdictions to get a tax benefit. (Batxer, 2015).

According to the doctrine of economic substance, tax is paid where the business activity that generated those profits occurred (BDO, 2016). One could argue regarding the practicality of some transfer pricing methodologies in Zimbabwe, as a developing country, based on the explored challenges, but the relevance to regulating transfer pricing is commended by various authors and revenue authorities. Therefore, of the available methodologies, countries should strive to identify the most efficient and effective technique, to regulate transfer pricing.

2.8 Chapter summary

The chapter reviewed some relevant literature on the growth of transfer pricing worldwide to contextualise the position in Zimbabwe. It can be deduced from the literature reviewed that the ALP foundation is challenged by limited information and resources making it rather complicated to implement for the countries that lack resources especially developing countries. Despite recommendations to tailor make legislation by each jurisdiction, prioritizing transfer pricing implementation in tandem with the requirements of each economy, a challenge remains to get hold information that can be used for comparability purposes in assessing the ALP to be applied. Introducing an effective transfer pricing regime, though costly and time consuming, may help in re-establishing and protecting the tax base. (EY,2017).

CHAPTER 3

TRANSFER PRICING PROVISIONS AND REQUIREMENTS IN ZIMBABWE

3.1 Introduction

The focus of this chapter is to delve into the requirements of Section 98B as read with the 35th Schedule to the Zimbabwean Income Tax Act, benchmarking it against the OECD Transfer Pricing guidelines. The chapter also analyses the requirements and or conditions prompting the ALP.

3.1.1 Overview

Transfer pricing regulations have been expanded in Africa, while countries like Zimbabwe, Ghana and Mozambique are lagging, larger economies such as South Africa, Nigeria and Kenya already possess comprehensive transfer pricing regulations in place (EY,2017). This has been achieved through the internationally recommended ALP, that is, the conditions imposed in a related party transaction should be the same or similar to that of an unrelated party transaction where both parties seek to maximise on the benefits.

There has been a growing need to strengthen the tax systems of developing countries, to supplement tax base to increase revenue collections if the MDGs are to be met as well as to support the distribution of the benefits from globalization (UN, 2013). Presently, there are numerous stages where the development of transfer pricing basis in Africa rests, i.e. ranging from a non-existent transfer pricing regime to a fully developed and functional regime in other countries (Tax Justice Network-Africa, 2012).

The Zimbabwe TP legislation does not provide precision on measuring the ALP or any possible quantitative measure (ZIMRA, 2019). Although the local legislation lacks the information as to how the ALP ought to be applied, the 35th Schedule gives guidance on the appropriate application of the arm's length principle from the OECD guidelines. Thus, currently companies in Zimbabwe make use of the OECD recommendations.

3.2. Transfer pricing provisions in Zimbabwe

Before TP legislation was introduced, Zimbabwe was dependent on Section 98A of the Act [Chapter 23:06] to expose any tax avoidance schemes by MNCs. The revenue authority had the onus to prove that a taxpayer entered transactions that were not at arm's length. Further, the regulations were general and did not contain any specified methodologies to support comparability. Considering the, ZIMRA implemented the OECD transfer pricing guidelines believing that they would assist making sure that base erosion and profit shifting was addressed (Tapera, M and Majachani, A. F; 2017).

Transfer pricing in Zimbabwe, is regulated by sections 98B as read with the 35th schedule to the Zimbabwe Income Tax Act, Chapter 23:06, with supporting guidance the OECD Guidelines.

The scope of the transfer pricing legislation also encompasses transactions between domestic connected persons as well-defined in Section 2 of the Income Tax Act, as well as transactions with unrelated parties which are incorporated in jurisdictions that provide tax benefits as determined by the revenue authority (Section 98B subsection 4). The legislation gives the revenue authority powers to adjust transactions that do not meet the ALP. The adjustments may create additional tax liabilities for the parties concerned. The foundation of the compliance requirement entails that all taxpayers should satisfy the arm's length principle on all related party transactions and the preparation of a transfer pricing report annually. The report must be submitted upon request within 7days of the written request.

Less economically developed countries (LEDC) with Zimbabwe being included have been faced with the loss of potential tax revenue through transfer pricing, capital flight because of ineffective policies as well as the illicit financial flows (Masango, D.T., 2019). LEDCs face resource challenges when it comes to transfer pricing audits hence their ability to carry out their mandate is grossly hindered (OECD, 2014). ZIMRA is not fully capacitated in terms of having a fully-fledged functional TP division and with no access to benchmarking tools. The OECD classifies the afore mentioned as part of the challenges that exist when conducting TP audits (OECD, 2017).

The Zimbabwean TP legislation recommends five possible methods (discussed in Chapter 2.3) to test whether the transactions concluded were arm's length (35th schedule to the ITA). In addition, the legislation is in tandem with the OECD guidelines, also referring to the guidelines as a source of interpretation. The UN Manual is also expressly referred to as a relevant source. explicitly mentioned as relevant sources.

3.2.1 The ALP in the Zimbabwe TP legislation

The ALP was originally brought to light by sections 23, 24 and 98 of the Income Tax Act and have been in existence for several years. The anti-avoidance provisions [Sections 98, 16q, 19 & 23 of the ITA gave the Commissioner power to disregard any transaction which was deemed to be outside arm's length provisions and had been solely for avoiding tax. Section 16q deals with thin capitalization issues, 19 and 23 deal with business beyond Zimbabwean borders. In January 2014, section 98 was split into section 98A (income splitting) and section 98B (anti-avoidance). Effective 1 January 2016, Section 98B of the ITA was repealed and amended by the insertion of the 35th schedule (Mashiri, E; 2018)

From the extracts of legislation, it can be established that the ALP is the cornerstone of these legislations. Before the detailed transfer pricing legislation in Zimbabwe, GAAR (Section 98) ensured that transacting parties are independent of any influence (Mashiri, E; 2018). The general anti-avoidance rules had limitations and the basis for disregarding a taxpayer's transfer prices was not clear and explicit (Section 98 of the ITA).

Section 98B targets transactions which are concluded on a non-arm's length basis. Upward or downward review of the actual price. It is expected that transacting parties do so on an arm's length basis, that is, their relationship does not affect the prices that will be charged, hence the principle of substance over is applied on the transactions. Unlike Section 98, which placed the burden of proof on the Commissioner to prove that a transaction by a taxpayer has been done solely for purposes of postponement, avoidance, or reduction of the liability to tax, the new rules have brought in a new dispensation. The implications are that taxpayers currently transacting with associates, trading with foreign enterprises, or planning on entering into contracts with such, must comply with the requirements of the new legislation. This also means the affected taxpayers should:

- i. Apply the arm's length principle on all transactions with associated enterprises.
- ii. Develop a transfer pricing policy that conforms to the new legislative requirements.
- iii. Review and align any existing policies to the new legislation.

- iv. Review affected contracts and evaluate the impact of the new legislation and ensure all intercompany transfer prices are within the arm's length range.
- v. Develop and maintain relevant transfer pricing documentation (35th schedule to the ITA).

The principle focuses more on the substance of the transaction even if the form stipulates otherwise. In this regard when the court notes the variations present between the substance of the transaction and the form, the substance of the transaction is to be considered. The efficiency of courts in dealing with such matters has largely assisted developed countries and it is an area from which developing countries could learn. In Zimbabwe there is a backlog at the Fiscal Court of Appeal, of more two years (Tapera, 2017) and legal avenues have become costly.

In addition, the ALP is triggered by the relationship that exists between the transacting entities. The OECD guidelines require a taxpayer to consider, whether the price charged in a related party transaction was arrived at as if the other transacting party was not a connected person. These are the same foundational principles embedded in the Zimbabwe transfer pricing legislation. The 35th Schedule closely resembles the OECD TP guidelines. They both address associates or connected persons, cross-border trade, and the ALP.

The notion that the Commissioner can adjust transactions conducted on a non-arm's length basis is in tandem with the OECD guidelines (paragraph 4.29 of the 2017 OECD Guidelines) which give guidance on primary and secondary adjustments, to correct the direct effect of a non-arm's length price on the taxable income of a related parties. These transfer pricing methodologies try to solve the likelihood of disparity between the allocation of profit for tax purposes as well as the dispersion of the functions performed, assets employed, and the risks assumed between related entities.

Appendix D cites the Zimbabwe transfer pricing legislation. It provides substance to interpretation and application of Section 98B on transfer pricing matters. The 35th Schedule introduces the ALP, which ZIMRA implements on both domestic and cross border transactions. Specifically, paragraph 11 of the 35th schedule refers to possible transfer pricing adjustments for domestic transactions by the Commissioner which applies to the income of both parties involved in the transaction. According to ZELA (2016), the scope of the new transfer pricing laws extends to both domestic and cross-border transactions. This implies that all the enterprises (domestic/foreign) should comply with all the requirements for transfer pricing purposes. ZELA (2016) acknowledges that the new provisions adopt the OECD transfer

pricing principles and recognise the OECD and UN transfer pricing guidelines for developing countries as relevant sources for transfer pricing issues

It is comprehensive but difficult to implement due to the technical demands, documentary requirements and lack of comparables. Appendix D also contains both the Traditional transaction methods (comparable uncontrolled price, resale price and the cost plus) and the profit-based techniques (Transaction Net Margin method and the profit split method). This piece of legislation is comprehensive in that, though the transfer pricing rules were crafted with respect to foreign related trading, there has been an inclusion where the provisions empower the implementation of these transfer pricing provisions on domestic transactions where the ALP has been breached. Therefore, transactions between domestic local companies and transactions between foreign and domestic companies are treated alike when applying the ALP. Section 98B also covers transactions with low tax jurisdictions whereas the OECD guidelines' main emphasis is on cross border transactions. This is one significant difference between the two approaches.

3.7. Chapter summary

The transfer pricing regulations appears comprehensive in all matters, relevant to both domestic and international transactions. The 35th schedule recommends both traditional and modern techniques to determining the arm's length price and the onus of proof is with the taxpayer. Moreover, it can be noted that the Schedule is not rigid, it is not absolute as it makes room for outsourcing interpretation from OECD. However, the absence of transfer pricing guidelines in Zimbabwe and silence by the legislation on the transfer pricing method preferred makes the determination of arm's length prices complex. Instead the legislation specified that each transaction is scrutinised on its own merits and the Commissioner has discretion regarding the applied method. When applying the ALP there is need to address the comparability issue is proving to be a major challenge for developing nations. The next chapter looks at the comparability issues and relevance of the ALP in Zimbabwean context.

CHAPTER 4

THE APPLICATION OF TRANSFER PRICING METHODOLOGIES AND COMPARABILITY CHALLENGES IN ZIMBABWE

4.1 Introduction

This chapter examines the suitability of the five adopted methods with comparability being the focal point of their application (as highlighted in Chapter 3) to determine a transfer price in Zimbabwe. This chapter further examines the challenges of comparability and how it impacts Zimbabwe.

The ALP has largely been recommended for adjustments to controlled transactions (Tapera M, 2017). The ALP has made immense contribution to OECD members and most developed countries (Tax Justice Network, 2012). However, the practicality of the ALP in Zimbabwe has been a contentious subject and the relevance of the provisions of Section 98B of the Act in the wake of current economic conditions and position (Tapera, M; 2017).

4.2 The transfer pricing methodologies in Zimbabwe

In developing countries, there is inadequate capacity, technical know-how and negotiating capability in terms of monitoring transfer pricing issues effectively. The complex nature of transfer pricing and transactions within MNCs poses an obstacle to the developing countries' revenue authorities. Developing countries lack the capacity to effectively monitor transactions entered by these MNCs presenting an opportunity for the shifting of profits to other low tax jurisdictions. (McNair et al, 2010). Consensually, the main impediment facing developing countries in applying the ALP is resource scarcity. (Cazacu, AL. 2017).

In a survey conducted by ZIMRA (2016) it was established that significant research on transfer pricing has been conducted across the globe, mostly in developed countries. However not much research has been done to evaluate the completeness and the practical application of the ALP in Zimbabwe. Both the taxpayers (domestic or cross border) and the tax authority seem to shy away from applying the transfer pricing methodologies outlined within the 35th Schedule to the Act.

Research in South Africa found that documentary compliance costs were high and that the period of retention of documents was unknown (Ernst and Young, 2012). This lack of documentary proof and failure by taxpayers to file transfer pricing reports has been construed as being non-compliance by the revenue authority.

South Africa has come up with robust regulations addressing profit shifting and base erosion as well as abuse of tax laws. South Africa also has a limitation of resources which will greatly affect the efficiency of the regulations (Hattingh 2017). Zimbabwe is a relatively smaller economy when compared to South Africa. South Africa is well advanced and yet lacks adequate resources to maintain the ALP intact. Zimbabwe has no APAs in place and lacks transfer pricing guidelines equivalent to SA's PN7.

In Zimbabwe, just like in many other developing countries, there is no threshold for submitting or non-submission of documentations. This is burdensome to the small to medium taxpayers considering their scale of operations. In Spain, for example, only in transfer of shares securities and or real estate is documentation required and in Australia there are income thresholds (Glaize, 2012), notably differing from the Zimbabwe documentation requirements which do not have any thresholds. Such an approach levies a heavy compliance cost in developing countries and consequently corruption levels have risen (Tax Justice Network, 2012). In South Africa inability to submit the transfer pricing report disadvantages the one who has the obligation to support the accuracy of the price (Deloitte, 2015; SARS, 2013). Recommendations from PATA (Pacific Association of Tax Administrators) are on record keeping for future purposes. ZIMRA requires, in accordance with legislation, the filing and retention of relevant documentation for at least 7 years.

4.3. Comparability and the transfer pricing strategies

Generally, Zimbabwe as a developing country faces challenges relating to the search for comparables against which to benchmark the controlled transactions (Dean, 2014). Comparability or lack thereof carries substantial influence regarding the use of the approved OECD TP methodologies (Tapera, 2017). According to Owens (2005), the OECD, recognizes some difficulties in the application of the ALP, mainly in the non-existence of similar transactions that are comparable. When there is difficulty in finding relevant comparable data or when a transaction is unique to the MNE group, challenges may arise. Many MNEs deal with goods and services that are exclusive to their group as a result comparative information may not readily available. The objective of the 35th Schedule and Section 98B as well as with other TP regulations around the globe is to seek the highest practicable degree of comparability. The main challenge concerning the practicality of the ALP is that the principle relies heavily assumptions. The related challenges and assumptions are as follows:

1. Article 9 of the OECD Model Treaty, incorporated in the United Nations Model Tax Treaty, profits may be reallocated if the terms and conditions between connected entities vary compared to the ones for independent enterprises. The assumption underpinning the above is that unrelated parties are engaged in a mutually beneficial transaction with each party seeking to get the highest possible profits and, through this, to achieve an equitable and proportionate benefit in terms of the functional analysis performed by each entity in the transaction. In that regard, the ALP establishes that the distribution of revenue between companies within the same group should be assumed as being the way the income would have been distributed between unrelated parties acting on an arm's length basis.
2. The OECD maintains that the ALP is the most favoured standard in the pricing of transactions between related parties, since it allows for the same treatment of related party transactions as well as independent transactions. Avoidance of tax benefits that may arise in turn affecting the competitive advantage regarding each form of organization. This however is dependent on the notion of substance over form.
3. In addition to the need for resourcing, transfer pricing needs industrial expertise and know-how, and both require extensive training. Implementation is a process that will take years to complete. ZIMRA have yet to train the officers. Apart from making it difficult to find the suitable comparable, "*the nature of the intellectual property often makes it cumbersome in determining the price of the property at the point of the transacting*" (Neighbour, J. and Owens, J., 2002).
4. Lastly, another problem affecting the practicality of the ALP is the discord as to what makes up an arm's length transaction. Timing, terms and economic factors may dictate the price. In fact, when evaluating the "open market valuation" relating to either properties or services, the value of the property must be negotiated through a prospective purchaser and seller working through an agreement that believed to be arm's length, otherwise the agreed selling price will likely vary from the "*fair market price*" of the property or service. (Neighbour, J. and Owens, J., 2002)

Wilkie, S; et al, (2006) asserted that the comparability analysis is an all-encompassing process requiring specialized information. This includes providing information on specific variables for an entity, as well as understanding of other variables, such as the market in which an enterprise operates; factors that affect its activities in that market; and how it compares with similar enterprises in the same environment. Nevertheless, with globalization and increased vertical integration, organizations are increasingly being structured in highly complex ways.

(McNair, Dotley and Cobham, 2010). Thus, finding comparables, is an uphill task. In addition, information on these comparables may not be accessible, and may be available with inadequate detail or may be available in a format that is not adequate for an accurate study of comparability. The lack of information may be a result of the following:

- The difference in the accounting and reporting requirements found in different jurisdictions limits the publicly available information;
- time and expense that is linked to getting the information, especially where the use of commercial databases becomes inevitable; or
- the impossibility of finding comparables that operate in the same manner as the associated enterprises. (McNair, et al 2010)

Theoretically, it is simple to apply the ALP but in practice this requires the identifying the appropriate comparable (the comparable uncontrolled price or CUP). This is often difficult because for most transactions no appropriate CUPs exist. In the 1979 OECD report, it was stated that while recognizing the desirability of using CUPs, it was concluded that using CUPs could often a challenge to put in practice.

According to the OECD (2010), it acknowledges that transfer pricing is a subjective issue. Determining as well as establishing consensus with the ALP requires practising judgment. Therefore, OECD advises that tax payers make use of the realistic method in determining the arm's length price for transactions between related parties. Hence, tax payers may not be required to follow strictly to the laid-out rules to come up with the price that is arm's length. Rather, it is meant to give valuable direction that will help in the establishment of an arm's length price.

Furthermore, the OECD (2010), supports the notion that the ALP should be used when evaluating related party transactions. The principle is used across numerous jurisdictions by OECD member countries as well as non-OECD countries. Some developing countries extract data from the European and the US databases for comparable data on some transactions. Thus, such may be problematic because of the differences such geography as well the operating market (McNaire et al, 2010).

The identification of comparable transactions is often time consuming and cumbersome. Difficulties in obtaining comparable information (developing countries) may be caused by the following:

- There are a few entities the sectors that exist (Cazacu, AL. 2017).

- There is inadequate comparable information because of the unavailability of resources (OECD, 2015).
- It is difficult to undertake benchmarking studies because the information the databases relates to develops nations (Cazacu, AL. 2017)
- Developing countries' have recently begun to expand economically hence there are limited comparable transactions and information. (McNaire, et al; 2010).

According to OECD (2010), the notion relating to determining comparability is key to applying the ALP. In Zimbabwe, ALP is the founded-on Section 98B. Comparability connects the ALP with the implementation of the transfer pricing methods outlined in the 35th Schedule to the Act.

According to the OECD Guidelines (2017), comparability factors comprise the following:

Characteristics of property or services – this seeks to identify the crucial aspect of getting the characteristics of property or service right when conducting the comparability analysis. The tax authority should consider the features of each service or good involved in both related and unrelated transactions to satisfy the ALP. It is of great concern where products are peculiar and MNE has monopoly in the supply of goods or services (Transfer Pricing Handbook, 2015)

Contractual terms- these, are the key determinants of risk allocation, benefit and the parts being played and shared between the transacting parties. Therefore, they play a key role in comparability analysis. Material differences are hidden in contractual terms and comparable transactions should require minimum adjustments, if any. Therefore, both the taxpayer and the authority review contractual terms for the purposes of distinguishing conditions in both the related and unrelated party transaction (OECD Guidelines, 2017).

Economic circumstances- different economic circumstances may explain prices deemed to be arm's length being different even for similar transactions. Thus, comparable transactions require the consideration of economic circumstances where the transacting parties as well as comparables operate in. Hence, economic circumstances need to be considered when conducting a comparability analysis (OECD Guidelines,2017).

Business strategies - Business strategies affect comparability for transfer pricing purposes. Aspects like modernisation, diversification as well as new product development, the risk appetite, among others affecting the day to day manner of business. Differences in strategies also affect the ALP. (OECD, Guidelines,2017)

As identified above, comparability remains the greatest obstacle in applying transfer pricing methods contained in the 35th Schedule. Rarely, if ever, does a comparable transaction have identical characteristic and timing. In Zimbabwe, both the economic and political climate have been volatile over years, as result comparable transactions are less existent. For example, from the years 1998-2006 was the Zimbabwe Dollar era, 2007-2008 was the hyper-inflationary period, 2009-2013 the economy and trade improved having dollarized, and the period 2014-2019 downward movement in economic activities and changes to the political landscape. All these trends greatly affect the availability of comparable transactions.

The Tax Justice Network (2012) elaborated that in Practice Note 7 issued by the South African tax authority there is acceptance of the use of international databases, however there may be need for adjustments for use in the domestically. Previously, SARS was dependant on European companies for comparability, they have since widened their scope to include other geographic areas, hinging on the circumstances of the transaction and the industry in which the tested party operates. This is something ZIMRA is yet to develop and subscribe to (Tapers M, 2017).

4.4. Chapter Summary

With imperfections present in almost all tax instruments, there is no wisdom in a nation seeking to come up with a theoretically perfect tax system (Tapera, M; 2017). Thus, ZIMRA should strike a balance with other tax heads such as VAT which contributes 34% to the fiscus. Having explored the practicality of the ALP in Zimbabwe, it goes without mention that the continued economic pressures to collect more tax revenue at the same time bearing in mind the essential structure susceptibility of income tax may have a negative impact on developing countries in terms of meeting their developmental needs. More so, the enactment TP regulation should be supported by relevant changes in approach to try and resolve problems which may be associated with unavailability of comparables in the domestic. Further, the instability on the Zimbabwean economy also hinders consistent planning and implementation of a TP policy (Davies, et al; 2014). The next chapter summarises the study findings and makes recommendations.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 Research Conclusion

The research sought to examine the applicability and practicality of transfer pricing methods to Zimbabwe with comparability being the focal point in the application of these methods. The OECD guidelines form the basis of Zimbabwean legislation on this subject. Critical to this analysis was the extent to which such methods are relevant and credible in the Zimbabwean context. The adopted OECD guidelines have inherent weaknesses such as:

- (i) the ALP rarely if at all reflects the economic reality of the MNCs
- (ii) not all circumstances allow for the use of the ALP e.g. where MNCs are involved in unique transactions that unrelated parties in the market wouldn't ordinarily partake in.

In adopting the guidelines, adjustments need to be made to alleviate or minimize the impact of the weaknesses inherent in the OECD guidelines, in Zimbabwe's transfer pricing regime. The same reason given by the OECD that there is no justifiable substitute applies in a Zimbabwean context. The study findings are discussed below.

The OECD Guidelines are detailed and therefore designed to assist in the protecting the tax base in each jurisdiction in a way avoiding double taxation and double non-taxation (Tapera, 2017). This is achieved through the applying the ALP in the methodologies used to calculate a transfer price. These methods preferred are:

- Traditional transactional methods such as; Comparable Uncontrolled Price Method (CUP), Resale Price method (RP) and the Cost-Plus Method (CP)
- Transactions profit methods, including Profit Split Method and Transaction Net Margin Method (TNMM)

Applicability of these methods depends on circumstances of each case and the documentation of the evaluating and determining a transfer price is crucial.

Furthermore, the ALP advocates for a separate entity approach which puts it focus on substance of the dealings in the group. The principle also grants revenue authorities the power to adjust the profits relating to associated entities to reflect profit that is arm's length. The arm's length principle is therefore accepted to create and ensure the most convenient and stable economic environment for enterprises to operate within.

The UN Manual (2017) in paragraph 1.10.6-7, highlights and acknowledges the challenges faced by developing countries in practice regarding obtaining information to apply the ALP. This is may be because of the following:

- i. Developing countries usually do not have fully functional sectors as compared to the developed world hence find appropriate comparables in such a sector with very few organized entities may prove difficult;
- ii. The challenge mentioned above may result in getting information (if any) that is not complete and cannot be analysed in a proper manner owing to the unavailability of resources and processes.

To further buttress the assertions of the UN Manual, the study also revealed that, the unavailability of local comparables with Zimbabwe specific information also influences the establishment of an appropriate price meeting the ALP. Given this set back, the secondary approach would be the use of the European databases although there will be need for adjustments to enhance comparability. After adjusting, however, there is a likelihood that the data may not be useful since adjustments are sometimes subjective hence making it inappropriate. Reliability as well as finding the appropriate comparables will be one of the major challenges for Zimbabwe and many developing nations (UN, 2017)

It has been a couple of years since the promulgation of Section 98B and the country still has a lot to be done regarding the implementation of the regulations, training of staff and amass resources to be able to support the strategy for revenue optimisation. Despite efforts by UN and the OECD to come up with guidelines to implement the arm's length efficiently and effectively, Zimbabwe's needs and circumstances are peculiar and should be addressed as such. The country's economic conditions are deplorable and corruption levels are significantly high as such it would be unfair to compare the progress and standards with global powerhouses yet. The country through ZIMRA's new administration has taken into consideration the OECD's echo of the significance of the ALP regulations and implementation to ensure global competitiveness. It should be emphasised that no universal template of transfer pricing exists that applies to all situations and circumstances. Even United Nations (2013) acknowledged that TP regulations should be in sync with the needs and wants of a specific country. The ALP is not easy to implement, it will take time to achieve acceptable standard and yet it is an indispensable tool in the short-run (UN,2013).

5.3 Recommendations

The challenges associated with the absence of comparables will be resolved when a local data base is developed. Appropriate law may be put in place to compel all companies to file annual audited accounts with the registrar of companies. Although it may take a while because of unavailability of resources, a data base may be developed from such documents and made available to taxpayers. The database may include the following information on companies:

- Industry classification
- Trade description of companies
- Complete financial statements on an unconsolidated and consolidated basis
- If listed, sector on the securities exchange, share price information, primary and secondary listing particulars

Further, there is need for Zimbabwe and other emerging economies alike to come up with action points to enable information sharing with revenue authorities in other developed countries. The information may assist in aiding developing countries like Zimbabwe to better deal with TP issues. The exchange of information may go a long way in assisting developing countries to come up with their own databases.

There is also need for constant skills upgrade or training on transfer pricing in the ever changing and dynamic world. The trainings would assist in staying up to date with the evolving challenges and approaches that may exist when dealing with Transfer Pricing. Also, the training may focus on the use of new technology in documentation, databases among other important aspects of transfer pricing.

The Zimbabwe regulations must also be consistent in their application to try and close any leakages arising from TP by companies. This can be in the form of re-examination of documentation requirements by way of putting in place thresh-hold for documentation preparation.

5.4. Chapter Conclusion

The TP phenomenon is not only complex for developing nations, it is also a challenge for the developed world. There is need to make sure that developing nations effectively regulate transfer pricing to protect their tax base also keeping in mind that they must stimulate FDI for the much needed for growth. In as much as there is a need to regulate transfer pricing for developing countries, as already shown in this research it is rather a cumbersome task to do so

given the numerous challenges faced by developing countries. Countries need to find an equilibrium between stimulating economic growth and protecting the country's tax base. An important role has been played by the UN and the OECD in trying to deal with the challenges encountered by developing nations. The OECD and the UN stress the fact that there is need for a country's TP legislation to be in consensus with global standards and to make sure the needs of the country are met by the regulations. Of significance to note, no model or template exists for TP legislation and is applicable in every situation. (United Nations 2013)

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APPENDICES**Appendix A: Extract of Section 98A of the Zimbabwean Income Tax Act (Chapter 23:06)****98A Income splitting**

“(1) Where an individual attempt to split income with an associate, the Commissioner may adjust the taxable income of the taxpayer and the associate to prevent any reduction in tax payable as a result of the splitting.

(2) A taxpayer shall be treated as having attempted to split income where—

(a) the taxpayer transfers income, directly or indirectly, to an associate; or

(b) the taxpayer transfers property, directly or indirectly, to an associate with the result that the associate receives or enjoys the income from that property; and the sole or main reason for the transfer is to lower the tax payable upon the incomes of the taxpayer and the associate.

(3) In determining whether a taxpayer is seeking to split income, the Commissioner shall consider the value, if any, given by the associate for the transfer of the income or property concerned.

Appendix B: Extract of Section 98B of the Zimbabwean Income Tax Act (Chapter 23:06)

98B Transactions between associates.

*(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 resulted 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.

(7) 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 7 sitting days after it is so laid before the House, the Minister shall cause it to be published in the Gazette.

Appendix C: Section 80A of the South African Income Tax Act

80A Impermissible tax avoidance arrangements

An avoidance arrangement is an impermissible tax avoidance arrangement if its sole or main purpose was to obtain a tax benefit and

a) in the context of business-

(i) it was entered into or carried out by means or in a manner which would not normally be employed for bona fide business purposes, other than obtaining a tax benefit; or

(ii) it lacks commercial substance, in whole or in part, taking into account the provisions of section 80C;

(b) in a context other than business, it was entered into or carried out by means or in a manner which would not normally be employed for a bona fide purpose, other than obtaining a tax benefit; or

(c) in any context-

(i) it has created rights or obligations that would not normally be created between persons dealing at arm's length; or

(ii) it would result directly or indirectly in the misuse or abuse of the provisions of this Act (including the provisions of this Part).

**Appendix D: Thirty-Fifth Schedule to the Zimbabwean Income Tax Act (Chapter
23:06)**

THIRTY-FIFTH SCHEDULE (Section 98B)

Inserted by Sect 6 of the Finance (No.2) Act 9 of 2015 with effect from the year of assessment beginning 1st January 2016.

TRANSFER PRICING

Interpretation

1. (1) *In this Schedule—*

"comparable transaction" means a transaction that is comparable by reference to paragraph 3;

"uncontrolled transaction" means any transaction between independent persons;

Arm's length principle

2. *The determination of whether the conditions of a controlled transaction are consistent with the arm's length principle for the purposes of section ninety-eight shall be made by the Commissioner-General in accordance with this Schedule.*

Comparability

3. (1) *An uncontrolled transaction is comparable to a controlled transaction within the meaning of section ninety-eight (1) —*

*(a) when there are **no differences** between them that could materially affect the financial indicator being examined under the appropriate transfer pricing method; or*

*(b) when such **differences exist**, if a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison.*

(2) *To determine whether 2 or more transactions are comparable, the following factors shall be considered to the extent that they are economically relevant to the facts and circumstances of the transactions —*

(a) the characteristics of the property or services transferred; and

- (b) *the functions undertaken by each person with respect to the transactions, taking into account assets used and risks assumed; and*
- (c) *the contractual terms of the transactions; and*
- (d) *the economic circumstances in which the transactions take place: and*
- (e) *the business strategies pursued by each of the associated persons in relation to the transactions.*

Transfer pricing

4. (1) *The arm's length remuneration of a controlled transaction shall be determined by applying the most appropriate transfer pricing method to the circumstances of the case.*

(2) *The most appropriate transfer pricing method shall be selected from among the approved transfer pricing methods set out in paragraph 5(5), taking into consideration the following criteria—*

- (a) *the respective strengths and weaknesses of the approved methods: and*
- (b) *the appropriateness of an approved method in view of the nature of the controlled transaction, determined through an analysis of the functions undertaken by each person in the controlled transaction, taking into account assets used and risks assumed; and*
- (c) *the availability of reliable information needed to apply the selected transfer pricing method or other methods; and*
- (d) *the degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.*

(3) *It shall not be necessary to apply more than one method to determine whether the conditions of a given controlled transaction are consistent with the arm's length principle.*

(4) *Where a taxpayer has used an approved transfer pricing method and the selection of that method is consistent with this regulation, the examination by the Commissioner of whether the conditions of the taxpayer's controlled transactions are consistent with the arm's length principle shall be based on that transfer pricing method applied by the taxpayer.*

(5) *The following shall be the approved transfer pricing methods for purposes of subparagraph (2)—*

(a) *the **Comparable Uncontrolled Price Method**, which is the comparable uncontrolled price method consisting of comparing the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction; and*

(b) *the **Resale Price Method**, which is the resale price method consisting of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions; and*

(c) *the **Cost Plus Method**, which is the cost plus method consisting of comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction: and*

(d) *the **Transactional Net Margin Method**, which is the transactional net margin method consisting of comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions; and*

(e) *the **Transactional Net Margin Method**, which is the transactional net margin method consisting of comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions; and*

(f) *the **Transactional Profit Split Method**, which is the transactional profit split method consisting of allocating to each associated person participating in a controlled transaction the portion of common profit (or loss) derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction. When it is possible to determine an arm's length remuneration for some of the functions performed by the associated persons in connection with the transaction using one of the approved methods described in subparagraphs (a) to (d) above, the transactional profit split method shall be applied based on the common residual profit that results once such functions are so remunerated.*

(6) Where, taking account of the criteria described in subparagraph (3), a comparable uncontrolled price method described in subparagraph (5)(a) and an approved method described in subparagraph (5)(b) to (e) can be applied with equal reliability, the determination of arm's length conditions shall be made using **the comparable uncontrolled price method**.

(7) Where, taking account of the criteria described in subparagraph (2), an approved method described in paragraph 5(5)(a) to (c) and an approved method described in subparagraph (5)(a) to (c) can be applied with equal reliability, the determination of arm's length conditions shall be made using the method described in subparagraph (5)(a) to (c).

(8) It shall not be necessary to apply more than one method to determine the arm's length remuneration for a given controlled transaction.

(9) A transfer pricing method other than the approved methods contained in subparagraph (5) may be applied where the Commissioner is satisfied that —

(a) none of the approved methods can be reasonably applied to determine arm's length conditions for the controlled transaction; and

(b) such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

(10) When a method other than the approved methods contained in subparagraph (5) is used it shall establish that the requirements of subparagraph (9) have been satisfied.

(11) When applying a **cost plus, resale price or transactional net margin method**, provided under subparagraph (5), it shall be necessary to select the party(hereinafter referred to as the "**tested party**") to the transaction for which a financial indicator, mark-up on costs, gross margin, or net profit indicator, is tested under the applicable transfer pricing method.

(12) The selection of the tested party should be consistent with the functional analysis of the transaction.

(13) Where a taxpayer has used a transfer pricing method to establish the remuneration of its controlled transactions and that transfer pricing method is consistent with the provisions of this paragraph, then the Commissioner's examination of whether the conditions of the taxpayer's controlled transactions are consistent with the arm's length principle shall be based on the transfer pricing method applied by the taxpayer.

Evaluation of taxpayer's combined controlled transactions

5. If a taxpayer carries out, under the same or similar circumstances, 2 or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analysed separately, those transactions may be combined to

(i) perform the comparability analysis set out in paragraph 3 and

(ii) apply the transfer pricing methods set out in paragraph 5.

Arm's length range

6. (1) An arm's length range is a range of relevant financial indicator figures (e.g. prices, margins or profit shares) produced by the application of the most appropriate transfer pricing method as set out in paragraph 4 to a number of uncontrolled transactions, each of which is relatively equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with paragraph 3.

(2) A controlled transaction, or a set of transactions that are combined according to paragraph 5 shall not be subject to an adjustment under section ninety-eight B where the relevant financial indicator derived from the controlled transaction or set of transactions and being tested under the appropriate transfer pricing method is within the arm's length range.

(3) Where the relevant financial indicator derived from a controlled transaction, or from a set of transactions that are combined according to paragraph 5, falls outside the arm's length range, the Commissioner may adjust it pursuant to section ninety-eight B (1), and any such adjustment shall be to the median in the arm's length range.

(4) For the purposes of subparagraph (3), the median of the arm's length range shall be the **50th percentile** of the financial indicator figures derived from the comparable uncontrolled transactions forming the arm's length range. For this purpose, **the 50th percentile** is the lowest financial indicator figure such that **at least 50 %** of the financial indicator figure are at or below the value of that figure. However, if exactly 50 % of the results are at or below a financial indicator figure, then the 50th percentile is equal to the arithmetic mean of that figure and the next highest figure.

Sources of information on comparable uncontrolled transactions

7. (1) Possible sources of information on comparable uncontrolled transactions that may include —

(a) **internal** uncontrolled transactions, which are uncontrolled transactions where one of the parties to the controlled transaction is also a party to the uncontrolled transaction; and

(b) **external** uncontrolled transactions, which are uncontrolled transactions to which **neither** of the parties to the controlled transaction is a party

(2) Information concerning a comparable external uncontrolled transaction may not be relied upon by the Commissioner for the purposes of making an adjustment under section ninety-eight B if the information concerning the transaction is not available to the taxpayer.

(3) Information concerning a comparable uncontrolled transaction may not be relied upon by the taxpayer for the purposes of demonstrating the consistency (*of) a transaction with section ninety-eight B if the information on the transaction is not available to the Commissioner.

**inserted by the Editor*

(4) In the absence of information on uncontrolled transactions from the same geographic market as the controlled transaction, comparable uncontrolled transactions from other geographic markets may be accepted by the Commissioner.

(5) A determination of whether comparables from other geographic markets are reliable has to be made on a case-by-case basis, and by reference to the extent to which they satisfy paragraph 3 of this Schedule.

(6) Taxpayers using such comparables would be expected to assess the expected impact of geographic differences and other factors on the price and profitability.

Services between associated enterprises

8. (1) A service charge between a taxpayer and an associated person shall be considered consistent with the arm's length principle where—

(a) it is charged for a service that is actually rendered; and

(b) the service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position; and

(c) it is charged for a service that an independent enterprise in comparable circumstances would have been willing to pay for if performed for it by an independent enterprise, or would have performed in-house for itself; and

(d) its amount corresponds to that which would have been agreed between independent enterprises for comparable services in comparable circumstances.

(2) A service charge made to a person shall not be consistent with the arm's length principle where it is made by an associated person solely because of the shareholder's ownership interest in 1 or more other group members, including for any of the following- costs incurred or activities undertaken by such associated person —

(a) costs or activities relating to the juridical structure of the parent company of the first-mentioned person, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the parent company's supervisory board; and

(b) costs or activities relating to reporting requirements of the parent company of the first-mentioned person, including the consolidation of reports; and

(c) costs or activities related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by the first-mentioned person and the acquisition benefits or is expected to benefit that first-mentioned person.

(3) Where it is possible to identify specific services provided by a taxpayer to an associated person, the determination whether the service charge is consistent with the arm's length principle shall be made for each specific service, subject to the provisions of subparagraph (4).

(4) Where services are rendered by a taxpayer jointly to various associated persons and it is not possible to identify specific services provided to each of them, the total service charge shall be allocated among the associated persons that benefit or expect to benefit from the services according to reasonable allocation criteria.

(5) For the purpose of this paragraph, allocation criteria shall be viewed as reasonable where they are based on a variable or variables that —

(a) consider the nature of the services, the circumstances under which they are provided, and the benefits obtained or that were expected to be obtained by the persons for which the services are intended; and

(b) relate exclusively to uncontrolled, rather than controlled transactions; and

(c) are capable of being measured in a reasonably reliable manner.

Transactions involving intangible property

9. (1) *The determination of arm's length conditions for **controlled transactions** involving licenses, sales or other transfers of intangible property between associated persons shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including in particular the pricing at which a comparable independent enterprise would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.*

(2) *In applying the provisions of paragraph 3 to a transaction involving the license, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including —*

(a) *the expected benefits from the intangible property; and*

(b) *any geographic limitations on the exercise of rights to the intangible property; and*

(c) *the exclusive or non-exclusive character of the rights transferred; and*

(d) *whether the transferee has the right to participate in further developments of the intangible property by the transferor.*

Corresponding adjustments for domestic transactions

10. (1) *The determination of arm's length conditions for **controlled transactions** involving licenses, sales or other transfers of intangible property between associated persons shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including in particular the pricing at which a comparable independent enterprise would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.*

(2) *In applying the provisions of paragraph 3 to a transaction involving the license, sale or other transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including —*

(a) *the expected benefits from the intangible property; and*

(b) *any geographic limitations on the exercise of rights to the intangible property; and*

(c) *the exclusive or non-exclusive character of the rights transferred; and*

(d) *whether the transferee has the right to participate in further developments of the intangible property by the transferor.*

Corresponding adjustments for domestic transactions

(11) Where an adjustment is made by the Commissioner under section ninety-eight B to the taxable income of a taxpayer in relation to domestic transaction, then, the Commissioner shall make an appropriate adjustment to the taxable income of the other party to the transaction.

Corresponding adjustments for international transactions

12.(1) A service charge between a taxpayer and an associated person shall be considered consistent with the arm's length principle where—

(a) an adjustment to the conditions of transactions between a person resident in Zimbabwe and an associated person is made or proposed by a tax administration in a country other than Zimbabwe; and

(b) this adjustment results in the taxation in that other country of an amount of income on which the person resident in Zimbabwe has already been charged to tax in Zimbabwe; and

(c) the country making or proposing the adjustment has a treaty with Zimbabwe that reflects an intention to provide for the relief of economic double taxation.

(3) The Commissioner, shall after a request is made by the person resident in Zimbabwe, examine the consistency of that adjustment with the arm's length principle provided for under section ninety-eight B, consulting as necessary with the competent authority of the other country.

(4) If the adjustment proposed or made by the other country is consistent with the arm's length principle both in principle and as regards the amount, the Commissioner shall make a corresponding adjustment to the amount of the tax charged in Zimbabwe to that person on those profits, in order to eliminate the economic double taxation that would result from the inclusion of the same profits in the taxable income of both that person and the associated person.

(5) A request under paragraph (2) must include the information necessary for the Commissioner to examine the consistency of the adjustment made by the tax administration of the other country with the arm's length principle, including—

(a) the name, registered address and, where applicable, trading name(s) of the related person; and

(b) evidence of the tax residence of the related person;

- (c) the year(s) in which the adjusted controlled transaction(s) took place;*
 - (d) the amount of the requested corresponding adjustment and the amounts of the adjustment made by the tax administration of the other country;*
 - (e) evidence of the adjustment made by the tax administration of the other country and the basis for the adjustment, including details of comparability analysis relied upon and the transfer pricing method applied;*
 - (f) confirmation that the related person party will not, or is unable to, pursue any further recourse under the domestic law of the other country that may result in the adjustment made by the tax administration of the other country being reduced or reversed;*
 - (g) any other information that may be relevant for examining the consistency of the adjustment with the arm's length principle.*
- (5) The request must be made within the applicable time period for making a request for the case to be resolved by way of mutual agreement procedure under the applicable tax treaty.*

Relevance of OECD Transfer Pricing Guidelines

13. The Organization for Economic Cooperation and Development (OECD) "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" and the UN Manual on the interpretation of transfer pricing are relevant sources of interpretation for this Schedule. There may also be other relevant sources such as the 'United Nations Practical Manual on Transfer Pricing for developing countries.