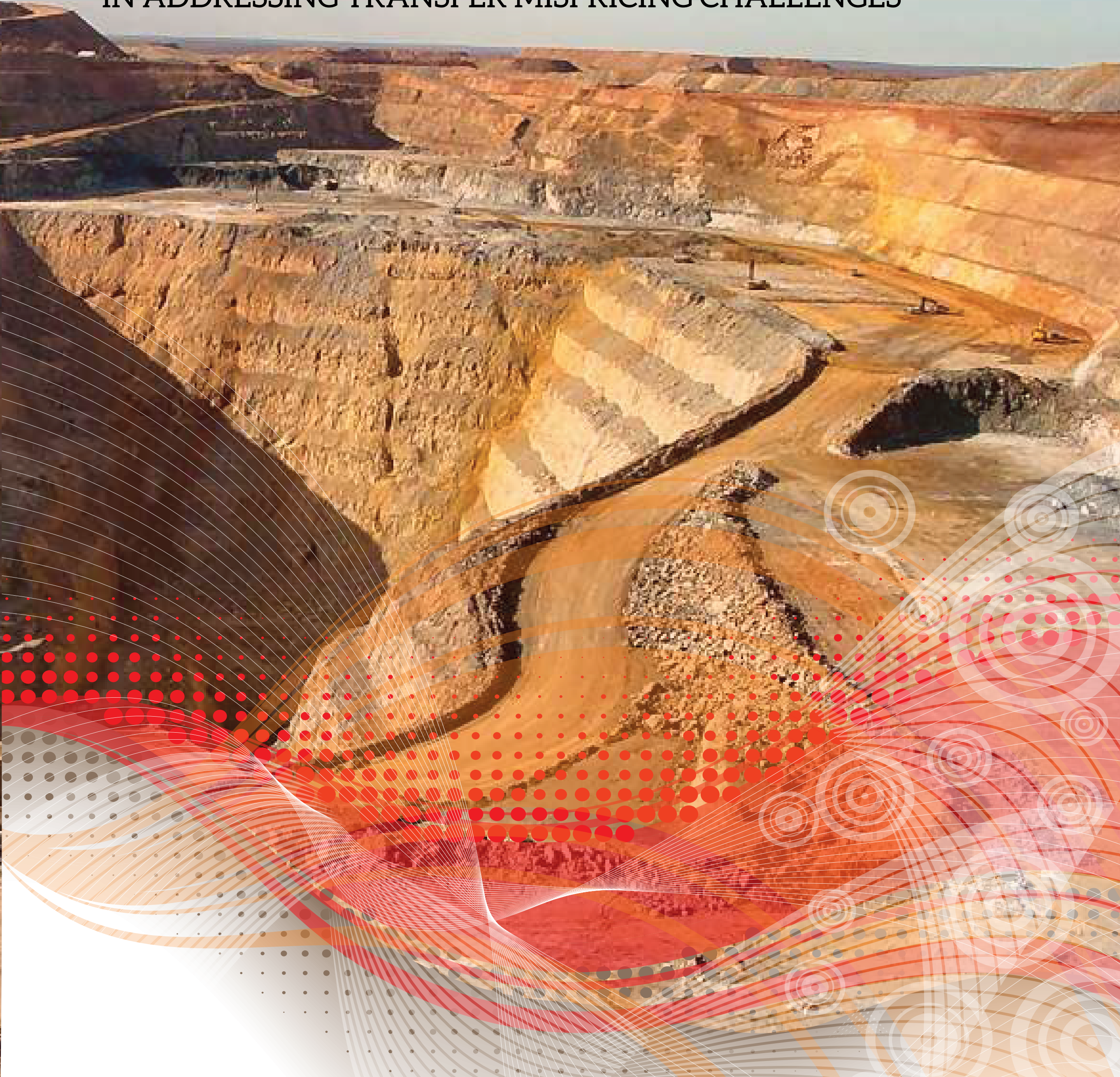
A POLICY BRIEFING PAPER

TOWARDS REAL OWNERSHIP & COOPERATION: INCREASING AFRICA'S VOICE AND INFLUENCE IN ADDRESSING TRANSFER MISPRICING CHALLENGES



tax justice network - Africa

Tax Justice Network-Africa (TJN-A) is a Pan-African initiative and a member of the Global Alliance for Tax Justice. TJN-A seeks to promote socially just and progressive taxation systems in Africa, advocating for pro-poor tax regimes and the strengthening of tax regimes to enhance domestic resource mobilisation.

Our vision is a new Africa in which tax justice prevails and ensures an equitable, inclusive and sustainable development which enables all its citizens to lead a dignified and fulfilled life.

TJN-A's mission is to spearhead tax justice in Africa's development by enabling citizens and institutions to promote equitable tax systems. We do this through applied research, capacity building and policy influencing.

We work with members in Africa and partners in other parts of the world.

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Executive Summary

Transfer pricing (TP) is and remains a complex problem and the uptake by Africa in addressing this challenge has remained low. This is despite the fact that Africa has occasioned the most losses from transfer pricing.

This paper will examine existing institutions and arrangements at the regional and national level that are or can be deployed to address TP challenges. It will show the increase in understanding and empirical evidence indicating the increased policy responses to the problems that TP has brought about.

It will examine the potential of three regional responses namely the African Tax Administration Forum (ATAF), the African Union and United Nations High Level Panel on Illicit Financial Flows from Africa (HLP), the African Union Advisory Board on Corruption (AU-ABC) and individual national responses of Tanzania and South Africa in dealing with transfer pricing.

It recommends the full utilization of these institutions and approaches to influence policy debate and formulation on TP so that African countries take ownership of and play an active role in addressing TP issues at a regional and potentially international level. However, for these African responses to be effective they will also need to engage and influence policy discourse at the international level. The varying interests of African countries and the perceived lack of political will and support to these institutions may hinder their full potential and effectiveness.

Introduction

The exhaustible nature of mineral resources in Africa means that transfer pricing abuse is a problem that needs to be addressed with great urgency. International Tax Compact estimates that developing countries only collect about 40% of their tax potential and with 28 of the 36 Least Developed Countries coming from Africa, this constitutes a major challenge. [1]Whilst some may argue that this is not entirely due to TP, aggressive tax planning methods and the abuse of transfer price have been identified as significant contributors.

Transfer pricing of inputs and equipment constitutes a complex problem for governments and one harder for them to handle than TP of outputs. [2]Prices are often less transparent and tax evasion may take place through the use of suppliers or subsidiaries with the same parent company based in tax havens.

Research shows that in addition to legitimate capital flows, Africa has experienced large illicit financial flows, estimated at over US$850 billion in the period between 1970 and 2008.[3] Illicit financial flows have increased steadily over time averaging US$50 billion annuallybetween 1998 and 2008. [4]The continued illicit flow of capital and funds out of poor African countries over the long term and at the current rapid pace, means efforts to reduce poverty and boost economic development will fail, leading to sustained economic and political instability. Commentators are of the view that the immensity of the problem will require intervention and cooperation between African governments and development partners.

A major factor that has delayed the response of African governments in dealing with transfer pricing is its complexity. This is illustrated in the intricate nature of transfer pricing transactions as well as the difficulties involved in obtaining reliable data on thesetransactions. It was not until 2001 that the first empirical study focused on Africa addressed the challenge of transfer pricing. [5]More recently, an increasing number of reports have documented illicit financial flows of which transfer pricing forms one part. However, a vast number of government officials in Africa do not appear to understand the mechanics of these illicit financial flows.

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[1] *Report by EuropeAid Implementing the Tax and Development Policy Agenda "Transfer Pricing and Developing " Countries" Final Report pg. 5*

[2] *Southern Times "The Paradox of Africa's Wealth" http://www.southerntimesafrica.com/news_article.php?id=6454&title=The%20paradox%20of%20%20%20Africa%E2%80%99s%20wealth&type=83#.UzKnZvmSxGI accessed 25 March 2014.*

[3] *DevKar and Devon Cartwright-Smith Illicit Financial Flows from Africa: Hidden Resource for Development Global Financial Integrity 2010.*

[4] *Joint Report by Economic Commission for Africa and the Organisation for Economic Development and Co-operation "The Mutual Review of Development Effectiveness in Africa: Promise and Performance" 2011 pg. 39.*

[5] *James Boyce and LeonceNdikumanaIs Africa a Net Creditor? New Estimates of Capital Flight from Severely Indebted Sub-Saharan African Countries, 1970-96*

This policy paper aims to contribute to the ongoing discourse on tackling transfer pricing in Africa by examining available mechanisms that can be deployed by policymakers and citizens alike to increase Africa's voice in dealing with transfer pricing challenges. It will highlight select continental and national mechanisms within existing institutional infrastructures and propose recommendations for their use in curbing transfer pricing.

Regional Mechanisms

The African Tax Administration Forum

The African Tax Administration Forum (ATAF) was set up in 2009 by 34 African Tax Commissioners to provide an African voice on tax issues and promote learning and skills development in African tax administrations. ATAF is based in Pretoria, South Africa and is an international organisation offering a platform for African administrators to address Africa's unique tax priorities, instil good practices and build capacity in African tax policy and administration through peer learning and knowledge development. ATAF also promotes dialogue among African tax administrations and between businesses and investors. The organization seeks to achieve the following main objectives, namely eestablishing of a well-functioning international organisation; building capable African tax administrations that develop, share and implement best practices; becoming the African voice on tax issues to inform and influence the global dialogue; fostering sustainable partnerships with stakeholders; and improving good governance and accountability between state and citizens.

ATAF recognizes the lack of capacity and capability as a critical issue for developing countries. But there are examples of transfer pricing teams with the right mix of skills and tax administrations that have structured themselves to maximize the effectiveness of their transfer pricing resources. ATAF's members aspire to draw on the extensive and varied experience of developing and developed countries alike in building TP teams and how to position those teams within the tax administration. Another priority of ATAF is to assist in establishing a coordinated approach towards transfer pricing. Through creating information exchange networks, revenue authorities can ensure that they are collecting the correct taxes, in a timely manner and within the correct jurisdictions.

ATAF also recognizes that there is a lack of TP skills and experience in many of their member countries and sees a critical need to build those skills as quickly as possible. They envisage this being done through on the ground technical assistance. ATAF capacity building programmes in the area of transfer pricing include facilitation of technical specialists through secondments on a short term or mid-term basis and by the twinning of tax commissioners from the Organisation for Economic Co-operation and Development

Forum of Tax Administration (OECD - FTA) to provide strategic oversight.This technical assistance capacity is linked to the broader ATAF capacity development programme comprising different modules, such as face-to-face training as well as e-learning courses on specific tax issues. In 2011 ATAF trained more than 400 tax officials in various aspects of tax and also hosted nine technical training programmes ranging from tax treaties to the organisation and management of tax administrations. These capacity building initiatives have contributed to the development of a highly skilled pool of African tax administrators who can engage with their western counterparts on complex issues of cross-border taxation and transfer pricing.

ATAF however notes that such capacity development approaches must be responsive to the needs of the countries themselves and providers of assistance have a responsibility to co-ordinate this form of assistance to ensure that it is demand led, and delivered at the right time in the right way.

One noteworthy project addresses the challenges experienced in the areas of good financial governance and Africa's dependence on development aid. ATAF not only aims to increase revenues needed for national development programmes, but it also seeks to use taxation as an instrument through which citizen and state relations can be improved. To this end, the German Federal Ministry of Economic Cooperation and Development (BMZ), the GIZ Programme "Good Financial Governance in Africa" which aims to contribute to good financial governance by strengthening pan-African public finance forums such as the African Organizationof Supreme Audit Institutions (AFROSAI), the African Tax Administration Forum (ATAF) and the Collaborative Africa Budget Reform Initiative (CABRI). Within the work area of 'Tax Administration', which supports the objectives of ATAF, GIZ will assist ATAF to establish its own research and capacity development projects.

ATAF have also signaled theirintention to develop a register of needs and resources on transfer pricing and requested the assistance of the OECD-FTA to establish and maintain a register of countries prepared to provide assistance to tax administrations in developing countries that are looking to build up their transfer pricing skills. The register would identify the particular areas of expertise in which a country can provide assistance. This would involve individual countries with expertise in a particular aspect of transfer pricing offering in depth support to a partner country in the developing world.

ATAF has also hosted conferences geared at addressing advanced transfer pricing issues. The purpose of these high level training events is to discuss the objectives of implementing transfer pricing legislation to protect tax bases against the transfer of profits abroad, while avoiding double taxation that would be detrimental to foreign investment. ATAF seeks to provide a balanced view on regulating transfer pricing within the unique African context.

African Union - United Nations Economic Commission for Africa High Level Panel on Illicit Financial Flows from Africa

The High Level Panel on Illicit Financial Flows from Africa was established by the African Union (AU) and United Nations Economic Commission for Africa (UNECA) and was inaugurated on 18 February 2012. The Panel was established following a resolution of the 4th Joint Annual Meetings of the Economic Commission of African and (ECA) and AU Conference of Ministers of Finance, Planning and Economic Development in Africa in March 2011, which decided to address the debilitating problem of illicit financial outflows from Africa.

The Panel chaired by H.E Thabo Mbeki, former President of South Africa brings together eminent personalities from within and outside Africa who share a common concern and expertise in the financial aspects of Africa's development. The focus of the Panel is to carry out advocacy and sensitization work to a broad coalition of support on the issue of illicit financial flows; identify strategies for addressing different aspects of illicit flows in the different sectors and encourage national and sub-regional knowledge production and policy discourse on the problem.

The Panel has identified TP as one of the key drivers of illicit flows and has proposed several recommendations to mitigate transfer pricing including strong regulatory oversight, capacity building for national institutions and stronger enforcement measures. With specific respect to transfer pricing in the extractive industries, the Panel recommends that African policy makers should encourage Extractive Industries Transparency Initiative (EITI) membership and the appropriate implementation of the AU Mining Vision.

The panel has carried out regional advocacy and sensitization missions to further bring TP and its relationship to illicit financial flows to the fore. The fact that the Panel is composed of eminent persons has also significantly contributed to increased dialogue on TP and its impact on Africa's development path.

The Panel's report is expected to provide a basis for further policy debate around issues of transfer pricing. It has for example identified that within the context of Africa, natural resource extraction is one of the key drivers of capital flight. The attention this has raised has caused many African countries to begin to review and take precautionary measures byrestructuring agreements for the exploitation of natural resources.

The Panel is set to wind down its work in 2014 when it will issue its final report to the African Union and the United Nations. The recommendations of the Panel are likely to be adopted by the African Union and this will translate into the obligation to implement the decision by AU member states. The level of implementation will depend on the decision taken by the AU Assembly but may include formulation of sector specific laws to deal with Illicit Financial Flows and mainstreaming of recommendations in national financial policies. While it is still unclear how the Panel's recommendations will feed into the larger UN system, it presents the first time that a global approach has been taken to address issues of capital flight from Africa. This presents an opportunity for actors working on the issue of transfer pricing to identify entry points for the Panel's recommendation into other processes such as the debate on the Post 2015 agenda and Africa's Vision 2063.

African Union Advisory Board on Corruption

The African Union Advisory Board on Corruption is a continental treaty-based mechanism established under the African Union Convention on Preventing and Combating Corruption. The Convention currently has 48 signatories with 35 countries having ratified the Convention.[6]

The Convention establishes several offences including money laundering and requires States Parties to domesticate these within their jurisdictions. The Convention also establishes jurisdiction over other "corrupt practises." Where transfer pricing is explicitly prohibited in certain jurisdictions, it can be a predicate offence for the crime of money laundering and therefore fall within the jurisdiction of the convention.

The Advisory Board is established under Article 22 of the Convention as a "follow up mechanism" to monitor enforcement and compliance of the Convention.[7] Its functions include; to promote and encourage adoption and application of anticorruption measures on the continent, to collect and document information on the nature and scope of corruption and related offences in Africa; to develop methodologies for analyzing the nature and extent of corruption in Africa, and disseminate information and sensitize the public on the negative effects of corruption and related offences as well as advise governments on how to deal with the scourge of corruption and related offences in their domestic jurisdictions.

The Board is composed of 11 members of high integrity and knowledge on corruption issues drawn from the current 45 signatories to the Convention. The functions of the Board are facilitated by aSecretariat in Arusha, Tanzania.

In relation to transfer pricing, Article 22(5)(e) of the Convention mandates the Board to collect information and analyze the conduct and behavior of multi-national corporations operating in Africa and disseminate such information to national authorities.Such investigative powers, coupled with the Board's continental reach and international character, can prove a valuable tool in investigating money laundering and transfer pricing activities carried out by multi-national corporations. These powers are even more critical

[6] *See link for status list http://www.au.int/en/sites/default/files/Corruption_0.pdf*

[7] *Article 22 of the African Union Convention on Preventing and Combating Corruption*

in facilitating mutual legal assistance the recovery of transferred assets. Due to the relative nascence of the Board, these powers have not been put to use to date but could be useful in facilitating international cooperation between different tax jurisdictions.

More importantly, the Advisory Board is empowered and required to annually report to the AU Executive Council, which iscomposed of ministers of foreign affairs, on the status of implementation of the Convention by States Parties. States Parties, through their national Anti-Corruption Commissions (ACCs), are further required to report to the Advisory Board on the progress of implementation of the Convention once a year. This reporting is carried by the administration of an annual questionnaire that includes various aspects related to transfer pricing such as the tracking and documentation of transfer pricing incidents, the investigation and prosecution of money laundering offences where transfer pricing is prohibited by national laws and compliance with domestication of the convention on issues such as financial information disclosure and banking secrecy.

Through this process of annual reporting the Board can highlight problem areas and track and monitor implementation measures taken by States Parties to curb transfer pricing. This can include the adoption and review of sector specific laws and policy reform, progress in the capacitation of national institutions, and prosecution and conviction rates of transfer pricing where restricted under national laws.

Since decisions of the Executive Council of the African Union are documented and openly discussed among all AU Member States and not just those States Parties to the Convention, this creates an additional layer of political peer pressure to ensure states are not identified as non-compliant and therefore liable to sanctions. The discussions and debate on the national reports also create a further regional platform for policy development and coherence on issues of transfer pricing as well as the space for experience sharing between states.

Access to the Board is open to a broad range of actors as it is required to engage with civil society, the media and other non-state actors in carrying out its mandate. This also means that the private sector and civil society can engage and partner with the Board to discuss various aspects of transfer pricing. While the recommendations of the Board have no binding effect on Member States, they through mutual evaluation and peer pressure create a culture of compliance where no state will want to be viewed as dragging its feet on implementation.

National Mechanisms and Experiences in Preventing Transfer Pricing

Tanzania

The Tanzanian Revenue Authority (TRA) is investing time and resources whilst working closely with numerous stakeholdersto research, define, manage and evaluate the extent of transfer pricing in the country. It has established an International Tax Unit (ITU), which has facilitated transfer pricing audits and the drafting of initial transfer pricing rules and guidelines. TRA is also working toward implementing a more robust legal framework and has indicated its willingness to consult policy makers, legislators, state departments and the public. It is also working toward the acquisition of information databases that will assist with identifying transfer mispricing.

The Tanzanian government and TRA are also looking to partner with advanced tax authorities such as the US Treasury, Norwegian Tax Administration (NTA), the UK Government's Her Majesty's Revenue and Customs (HMRC) and various other authorities in order to build capacity and skills through trainings and skills development for its staff. Currently, with the support of the Government of Norway, the Ministry of Finance and the Bank of Tanzania are carrying out an in-depth country report as well as developing a database and policy and administrative recommendations on illicit financial flows.

TRA has also adopted an inter-agency approach in dealing with transfer pricing issues. A Coordination Committee has been established between the Ministry of Finance, the Financial Intelligence Unit of the Bank of Tanzania(the Central Bank) and the Prevention and Combating of Corruption Bureau to foster cooperation and inter-agency coordination in dealing with economic crimes and transfer pricing. Each organization represented at the Coordination Committee plays a unique role. The Central Bank of Tanzania provides the Committee with data and statistics that is then analysed and investigated by the Financial Intelligence with the Prevention and Combating of Corruption Bureau subsequently tasked with carrying out prosecutions. This inter-agency approach played a critical role in the unearthing of the External Payments Arrear (EPA) scam that involved the fraudulent payment of about TSh133 billion (US$116 million) by the Bank of Tanzania to 22 companies in 2005/06 involving the repayment of the country's external debt.Other African countries may choose to adopt this approach in leveraging on the unique skills of each of their public bodies.

South Africa

South Africa is a relatively mature jurisdiction when it comes to TP regulation. However, despite a number of years' experience in TP regulation, international taxation remains one of the most challenging aspects of the tax regime. The regulatory framework for transfer pricing in South Africa includes legislation and Practice Notes. The South African Revenue Service (SARS) is responsible for spearheading activities on transfer pricing. It has adopted and modeled OECD Guidelines that it found relevant to the country's needs.

SARS has a specialized Transfer Pricing Unit constituting some 40 individuals. This model allows significant expertise to be built up and maintained but it does not grow across the tax administration a broad base of knowledge and skills in relation to TP risk.

The major success of this Unit has been its ability to flexibly apply OECD principles in TP investigations. For example, SARS employs a variety of methods to determine an arm's length price. Each of these methods is drawn and fashioned on the OECD guidelines and depends on the circumstances of that case and the availability of reliable data.For example, the OECD Transfer Pricing Guidelines discourage the use of more than one TP method, mainly for the reason that it placesan undue burden on the taxpayer. This is because South Africa is of the view that for TP methods to be successful, they must be supported by the further analysis of one or more secondary methods for determining the transfer price.

South Africa has also leveraged on comparative skills from foreign jurisdictions for instance,the United Kingdom provided technical assistance by posting a senior TP specialist from the HMRC to SARS for a five-year period. The specialist was able to develop a cutting edge Transfer Pricing Unit made up of tax specialists and economists.

SARS also appreciates the need to broaden skills and knowledge on transfer pricing and it is seeking to establish a Business, Tax Adviser and Tax Administration Forum to discuss transfer pricing issues.

Despite these developments, SARS faces several shortcomings. Taxpayers perceive transfer pricing Regulations and Practice Notes to be difficult to interpret and apply as they are an additional requirement on the already voluminous tax code. The transfer pricing regulatory regime also requires voluminous documentation and taxpayers consider this burdensome.

Although South Africa is considered to have a progressive transfer pricing regime, uncertainty exists around the fact that there is no Advance Pricing Agreement (APA) process. An APA is an Agreement between one or more domestic tax authorities and a multinational corporation involved in international transactions. An APA comes about as a result of full disclosures of the commercial and sectoral interests being made to the relevant tax authorities. It is more like a binding ruling than an agreement. An APA is more desirable as it avoids prolonged audits, queries and disputes. The unavailability of the APA procedure is mainly thought to be due to a lack of administrative capacity within SARS.[8]

[8] *See generally Lynette Olivier and Michael HoniballInternational Tax: A South African Perspective (2005) Chapter 21.*

Recommendations

International and Regional Level

African countries need to intensify cooperation on TP and require greater transparency in key sectors such as the extractive industry. Regional Economic Communities with their predominant focus on stimulating intra-regional trade are encouraged to develop and implement Mutual Tax Agreements (MTAs) among their members. Mutual Tax Agreements will facilitate the sharing of information, particularly where information is required from foreign jurisdictions. However, regional cooperation will only be successful if there is strong political will from African leaders to prioritize the loss of revenue through transfer mispricing, recognizing that it is a major challenge to development.

Supporting the African Tax Administration Forum

The African Tax Administration Forum has only 34 members out of 54 African States. African tax authorities that havenot are urged to join the body in order to increase their voice and share their concerns, successes and challenges on an international forum. For those authorities that are members of the Forum, they could play a role in ensuring that the register of needs and resources on transfer pricing is established and that it adequately addresses the specific needs of African tax administrations.However, support for the Forum is largely dependent on the political will of states.

Demand more from Development Partners

African States should demand that development partners and their western counterparts support Africa's efforts to improve its capacity, skills and public resources. African leaders need to seek strong political will from Western countries. They must support Africa's bid for policy reform in this area by putting pressure on their own multinational enterprises to be more transparent and conclude equitable contracts with African nations. Other areas for reform include eliminating tax havens and jurisdictions with high banking secrecy as well as facilitating the recovery of stolen assets. To this end, increased African participation, as Observers, at the OECD will prove crucial in ensuring these issues remain high on the agenda. While this has proved challenging, some successes have included the admission of South Africa as an observer at the OECD with suggestions that Nigeria would soon follow suit. Also in 2012 the candidature of Nigerian Finance Minister NgoziOkonjo-Iweala for the position of World Bank President sparked robust discussions about the perceived exclusion of Africa in the management of the global economy. Such discussions are likely to continue and may lead to more inclusion of African states in global financial policy development.

Domestic Level

Tax Administration is Tax Policy

African countries must realize that combining improvements in revenue administration with supportive efficient, fair, effective tax policies is essential. Tax policies set out the framework within which the revenue administration must operate in practice. It is, therefore, very difficult to make a distinction between the tax policies and the administrative authority, particularly in developing countries. If the tax administration fails, the policies also fail. Within the African context however, corruption, underpaid officials, widespread non-compliance and non-uniformity, political interference and lack of independence are the main barriers to effective tax regimes. Countries should implement transfer pricing-specific legislation and ensure that the implementing authorities are sufficiently capacitated.

Deepening the Tax Base

Developing countries need to improve the implementation of transfer pricing legislation, through deepening their tax base. Many African jurisdictions fail to meet their objectives, and implement their transfer pricing legislation, due to a shortage of financial resources. The transfer pricing function of any tax system is highly labourand resource intensive.

In order to improve the situation in the short term, policy makers should formulate ways to deepen the tax base in the most efficient and fairest way by removing tax preferences, renegotiating and where necessary increasing tax rates in the extractive industries, levying royalties at a rate that is fair to the country and citizens and ensuring that the country is compensated fairly for the loss of its natural resources, dealing with transfer pricing abuses by multinational enterprises and tax reforms in the critical industries.

In order to achieve this, African states will need to overcome the challenge of investing in improved macroeconomic planning as well as moving their countries into the formal financial system.

Robust Legislative Frameworks

Policy makers are encouraged to introduce stricter measures for Multinational Enterprises to put at the forefront of their agenda, improved tax transparency and compliance in developing countries and place good tax compliance at the centre of their corporate governance strategies and risk assessment systems. These include legislative frameworks around country-by-country reporting, contract and payment disclosures, transparency around beneficial ownership of companies and the removal of unnecessary tax breaks and incentives.This however should be coupled with similarly full-bodied monitoring and enforcement frameworks.

Skills Development and Training

African States should leverage on opportunities to improve the skills of tax officials, through various training opportunities. These include those from OECD jurisdictions, International Monetary Fund (IMF) and other developed revenue authorities as an initial step that most African countries can take towards skills development in this highly technical field.

Conclusion

With the formation of various African regional and international bodies, Africans have at their disposal numerous opportunities and forums to address transfer pricing. Furthermore, they are not restricted to addressing transfer mispricing as a subject under international tax, but larger economic governance challenges. This will prove useful in developing a holistic approach to tackling transfer pricing.

In order to successfully combat transfer-mispricing within their jurisdictions, African states not only need to make a firm commitment towards legal reform, allocating the necessary budgets and training their staff, they also require the assistance of numerous participants. International organizations, regional organizations, civil society, multi-national enterprises, foreign and neighboring tax authorities all have a role in ensuring that more is done to curb the revenue losses suffered by developing countries. The African voice and ownership can be further enhanced through the strategic use of the avenues available. African policy-makers can also emulate the more successful tax authorities on the continent and also learn from those nations that are unaccustomed to this problem but have taken decisive steps to address it adequately.

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