



## Manipulation of Transfer Pricing Rules by Multinational Enterprises in Developing Countries: The Challenges and Solutions

Wealth Eukeria<sup>1,2</sup>  , Favouate Yelesedzani Mpfu<sup>3</sup> 

<sup>1</sup> University of Namibia, Windhoek, Namibia

<sup>2</sup> University of South Africa, Pretoria, South Africa

<sup>3</sup> National University of Science and Technology, Bulawayo, Zimbabwe

 ewealth@unam.na

### ABSTRACT

Domestic revenue mobilisation has become a topical issue in developing countries, and their capacity to regulate multinational enterprises (MNE) transactions to minimise Base Erosion and Profit Shifting (BEPS) remains a formidable task. Faced with legislative deficiencies, implementation incapacities, and being at the nascent stages of adopting transfer pricing (TP) regulation, developing countries have remained at the mercy of MNEs' BEPS practices. The complexity and intricacies of intragroup transactions have an impact on profit allocation, thus affecting the distribution of taxing rights across countries where these MNEs operate. This study explores the regulatory policies toward international transfer pricing in the context of developing nations and the associated challenges. The paper proffers possible solutions to improve TP regulation and implementation. Specifically, the paper centres its attention on Zimbabwe, one of the developing nations that have implemented transfer pricing legislation in recent years. Mitigating the impact of BEPS through efforts, such as regulating and managing TP would avail potential substantial finance to shift developing countries from aid dependence to self-sustenance, yet these efforts face a lot of hurdles. Research that contributes to knowledge development in the area, evaluates the hurdles faced and contributes to policy and implementation improvements becomes vital. This study found that Zimbabwe is faced with challenges such as lack of legislative clarity, lack of comparability data, shortage of resources, lack of capacity and dysfunctional double taxation agreements in dealing with transfer pricing. The study recommends Zimbabwe should improve legislation, create TP databases, improve revenue authorities' capacity, and increase stakeholder awareness of TP.

### KEYWORDS

transfer pricing, multinational enterprises, base erosion, profit shifting, Zimbabwe Revenue Authority (ZIMRA)

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## Манипулирование правилами трансфертного ценообразования транснациональными корпорациями в развивающихся странах: проблемы и решения

Веалтх Еукериа<sup>1,2</sup>  , Фавоурате Йелеседзани Мпфу<sup>3</sup> 

<sup>1</sup> Университет Намибии, г. Виндхук, Намибия

<sup>2</sup> Университет Южной Африки, г. Претория, Южная Африка

<sup>3</sup> Национальный университет науки и технологий, г. Булавайо, Зимбабве

 ewealth@unam.na

### АННОТАЦИЯ

Мобилизация внутренних налоговых доходов стала актуальной проблемой в развивающихся странах, а их способность регулировать операции транснациональных корпораций с целью минимизации размывания налогооблагаемой базы

и вывода прибыли из-под налогообложения (BEPS) остается сложной задачей. Столкнувшись с недостатками законодательства, находящегося на начальном этапе принятия регулирования трансфертного ценообразования, развивающиеся страны полностью остаются в рамках применения практики BEPS. Сложность и запутанность внутригрупповых сделок сказывается на распределении прибыли, тем самым влияя на распределение налоговых прав между странами, где работают эти транснациональные корпорации. В статье исследуется регуляторная политика в отношении международного трансфертного ценообразования в контексте развивающихся стран и связанных с этим проблем. В статье предложены возможные решения по совершенствованию регулирования и реализации трансфертного ценообразования. Основное внимание уделяется Зимбабве. Это одна из развивающихся стран, которые в последние годы внедрили законодательство о трансфертном ценообразовании. Смягчение воздействия BEPS с помощью таких мер, как регулирование и управление трансфертным ценообразованием, позволило бы использовать потенциал существенного финансирования развивающихся стран для перехода от помощи к самообеспечению. Однако эти усилия сталкиваются со многими препятствиями. Жизненно важными становятся исследования, способствующие развитию знаний в этой области, оценке стоящих перед ними препятствий и способствующих совершенствованию политики и ее реализации. Наше исследование показало, что Зимбабве сталкивается с такими проблемами, как отсутствие законодательной ясности, отсутствие сопоставимых данных, нехватка ресурсов и сохранение дисфункциональных соглашений об избежании двойного налогообложения в области трансфертного ценообразования. В исследовании обосновываются рекомендации Зимбабве усовершенствовать законодательство, создать базы данных по трансфертному ценообразованию, расширить возможности налоговых органов и повысить осведомленность заинтересованных сторон о трансфертном ценообразовании.

#### КЛЮЧЕВЫЕ СЛОВА

трансфертное ценообразование, транснациональные корпорации, размывание налогооблагаемой базы, вывод прибыли из-под налогообложения, налоговое управление Зимбабве (ZIMRA)

### 1. Introduction

Domestic revenue mobilisation has become a topical issue in developing countries [1], with one of the focal and fundamental issues under discussion being tax revenues generated from the taxation of activities by multinational enterprises (MNEs). Core to this debate are the challenges emerging due to transfer pricing (TP) [2–4].

TP is generally defined as the pricing and transfer of goods and services that are sold between autonomous divisions of a company or group of companies. Notwithstanding this definition, contemporary literature in economics, accounting, taxation, and law has paid renewed focus on transfer pricing as a tool employed by MNEs to reduce their global tax obligations by shifting profits from high tax jurisdictions to low tax jurisdictions (tax havens) [3].

TP has been described as an avenue used for the purpose of tax planning, tax avoidance and tax evasion (abusing taxing rights), with the main objectives being minimisation of tax obligations or outright escape from tax. MNEs often manipulate TP to their benefit, but at the same time depriving and siphoning countries of millions and at times billions.

TP is described as the greatest profit-shifting problem in international taxation in developing countries [5; 6]. As posited by Sebele-Mpofu et al. [3], the United Nations Conference on Trade and Development (UNCTAD) Report in 2020 explains that Africa is losing approximately \$89 billion (estimated to equal the aggregate total annual receipts of development aid and foreign direct investment inflows) through illicit financial flows (IFFs) because of illegal activities, abusive transfer pricing, corruption, trade mispricing and mis-in-

voicing, tax avoidance and evasion among other ways. Sebele-Mpofu et al. [3] further emphasise the need to address the different dimensions in which the TP scourge presents itself as it arguably contributes to IFFs that deprive African nations and their people of their significant domestic revenue, weaken transparency and accountability and reducing trust in African institutions.

TP is not illicit but the deliberate mispricing of transactions (over or under-pricing) and manipulation to shift profits or minimise tax obligations is abusive and unethical tax avoidance [7–9]. Abusive TP remains one of the pressing issues facing revenue authorities, policymakers, and tax practitioners worldwide. Of the estimated US\$89 billion in annual IFFs, transfer pricing is argued to account for around US\$55 billion [3].

Tax-driven transfer pricing moves taxing rights from countries in which tax rates are perceived to be high to those countries with lower tax rates, yet in most developing countries retaining of taxation rights of MNEs' incomes are essential for revenue generation as more than 60% of the national revenues are generated from taxation in most of these developing countries [10].

Tax revenue mobilisation in developing countries is important for economic development, poverty alleviation, infrastructural development, social security, and fulfilment of citizens' expectations with regard to improving health, education, and the general standards of living [11].

MNEs positively contribute to developing economies through foreign direct investment (FDI), infrastructural investment and development, employment creation, innovation and novel technologies (which are essential in the dynamic and ever-changing globalised business world) and contribute to the welfare of citizens through their various corporate social responsibility efforts.

However, their negative impact on revenue mobilisation through tax avoidance and evasion, abuse of tax treaties and abusive TP arrangements have generated a lot of scrutiny and outcry [7; 9].

Highlighting the costly nature of tax revenue losses due to TP in Africa, Sebele-Mpofu et al. [3] approximates the losses to tax havens at \$9.6 billion (roughly 2.5% of total tax revenues) in 2014. It is also problematic for revenue authorities to maintain a balance between their revenue generation objectives and enforce their legitimate taxing rights with the need to still provide a considerably fair, stable, predictable, and conducive investment environment [7].

With too much aggressiveness in tax policy, the same strategy at reducing Base Erosion and Profit Shifting (BEPS) and improving domestic revenue mobilisation, can result in exposing MNEs to double taxation and overly burdensome tax obligations.

De Mooij & Liu [12] acknowledge these mixed ramifications and unresolved puzzles that exist within the current tax avoidance literature and hence called for further research in this area.

Rathke et al. [13] also found differences in the strength levels of some transfer pricing rules compared to others. Therefore, this study contributes to the theoretical debate on how transfer pricing regulation affects taxation and BEPS in developing countries. The study also develops a conceptual framework to unpack the challenges and possible solutions to TP manipulation in developing countries.

It is against this background that this paper focuses on exploring the legislative regime associated with international TP in developing countries as well as the challenges faced in implementation, particularly anchoring on Zimbabwe, one of the African nations that adopted the OECD TP guidelines and enacted TP regulation in 2016.

The paper has three main objectives, the first being, to investigate the challenges of transfer pricing in a developing context by focusing on Zimbabwe. Secondly, the paper endeavours to explore the suggested solutions and efforts made by developing countries from both literature and empirical research towards mitigating these challenges. Thirdly, the paper aims to make possible suggestions on how to improve TP regulation, implementation

and manage these challenges to make TP regulations more effective.

Since the adoption of TP regulation is still in its early development stages in developing countries, with some having adopted the regulation (Zimbabwe, South Africa, Kenya, Tanzania among others) and some yet to, research that contributes to knowledge development in the area, evaluates the hurdles faced and contributes to policy and implementation improvements is vital.

*Research hypotheses:* MNEs are more likely to engage in TP manipulation in developing countries due to challenges associated with weak tax administration issues in these countries.

*Article structure:* This article is made up of six sections. The first section gave an introduction to the paper while the second section of the paper reviews related literature to put into perspective the problem of TP manipulation in developing countries. The third section of the paper describes the research methodology adopted for collecting and analysing data for the paper. The fourth section presents the findings of the paper while the fifth section provides a brief discussion of the findings. The sixth section concludes the paper and makes recommendations on how to mitigate TP manipulation by MNEs in developing countries.

## 2. Literature Review

Tax-motivated TP has been a topical discussion in both developed and developing countries, due to the increase in MNEs activities and the existence of tax havens. Developing countries especially in the African continent suffer the most from TP abuse [14; 15].

Approximately 60% of trade transactions flowing in and out of Africa are mispriced by more than 11% on average, amounting to an estimated capital flight portion of around 7% of African trade [16].

Developing countries have sought to deal with TP to reduce income shifting and capital flight [9].

The application of the arm's length principle in pricing has been advocated for as an important measure to tackle

the challenge. The OECD, UN and other various country-by-country guidelines have been crafted suggesting several TP methods that can be used to determine the arm's length principle [8; 17].

Zimbabwe adopted TP legislation in 2016. Zimbabwe has been working on legislative reforms for transfer pricing purposes in a bid to protect its tax base. For many years, the country has had the arm's length principle (ALP), but in the form of general anti-avoidance measures. In 2012 it started being actively involved in transfer pricing training of the revenue agents, and in 2014 the anti-avoidance measures were revised but lacked clarity on the application of the ALP. The year 2016 came with specific transfer pricing rules (section 98B as read with the 35<sup>th</sup> schedule of the Income Tax Act 1996 (Chapter 23:06) which adopted the ALP as prescribed by the Organisation for Economic Co-operation and Development (OECD) and placed a demand on taxpayers to prepare contemporaneous documentation.

Nonetheless, the rules still lacked sufficient guidance leading to additional amendments to the Income Tax Act (Statutory Instrument 109) in 2019 [7]. The recent amendments are an attempt to address the weaknesses of the specific transfer pricing rules and provide guidance on the documentation requirements, preparation, and submission deadlines as well as penalties for non-compliance. Zimbabwe also introduced a TP return specifically dedicated to TP transactions.

### 2.1. Challenges of Transfer pricing regulation and management in developing countries

Mitigating the impact of illicit financial flows through efforts, such as regulating and managing TP would avail potential substantial finance to fund education, health, productivity, and infrastructural needs of developing countries, yet these efforts face a lot of hurdles [4; 7].

McNair et al. [18], while studying developing countries that included Mozambique and Sierra Leone summarise these constraints as the skills and informational gaps, the absence of effective transfer pri-

cing legislation, weak capacities to implement, evaluate, monitor TP legislations, or even take appropriate legal action where legislation abuse has been noted.

Indeed, most developing countries have no adequate TP regulations or where it exists, it is inadequate and weakly developed or there is no expertise to clearly articulate it and MNEs often exploit these capacity weaknesses and underdeveloped to their advantage, robbing developing countries of taxing rights and the much-needed tax revenues. Sebele-Mpofu et al. [7] reiterate these challenges in Zimbabwe.

Beer & Loerprick [19] group them into lack of watertight TP regulation (policy, documentation, and legislative clarity), inadequate knowledge of TP regulation amongst different stakeholders (such as taxpayers, tax administrators, tax court officials and tax consultants), absence of comprehensive databases and weak implementation capacities (experience and expertise, financial resources, unsound staffing policy, and the absence of specific TP implementation, administration and monitoring team).

Wealth et al. [20] affirms the lack of sufficient and appropriate regulation and administrative TP guidelines, scarcity of information and poor capacity as major obstacles to effective regulation of TP and productively taxing MNEs, exposing developing countries to more aggressive and exploitative TP arrangements.

Mpofu & Wealth [21] allude to the challenges of applying the arm's length principle as one of the major obstacles to enforcing TP rules in developing countries and thus enabling profit shifting by MNEs [22].

Acknowledging the need to pay close attention to the obstacles to effective regulation of MNE transfer pricing activities in Tanzania, Luhende [23], tables the various issues as likely problems. The issues include lack of awareness of TP regulations by taxpayers, absence of comparable data, companies and transactions, uncertainty around the TP documentation to be filed with the Tanzanian Revenue Authority (TRA), difficulties in carrying out TP au-

ditions and inadequate capacity at TRA to effectively administer TP policy and regulation.

Barrogard et al. [24] through desktop research and a survey of seven developing countries that are German Development partners (Cameroon, Gambia, Burkina Faso, Democratic Republic of Congo, Uganda, Honduras, and Liberia) allude to the lack of comparable information to use for TP, lack of prioritisation of BEPS mitigation measures, lack of awareness, expertise, and capacity inadequacies.

It is evident from the discussion that despite the urgent need to regulate TP arrangements in developing countries due to the globalised nature of transactions as well as the importance of minimising revenue leakages and illicit flows, it remains a formidable task. It is also clear that these developing countries share similarities in these challenges to a greater extent, but there are also challenges that are unique to each national context [7; 21], hence the need to contextualise the investigation of the complexities as well as to tailor make possible solutions to developing countries and to country-by-country settings. The different challenges are categorised in terms of similarities and discussed comprehensively below.

### **2.1.1. Challenges and Subjectivity of the arm's length principle**

The arm's length principle advocated for in the TP regulations is somewhat subjective. Several challenges and disadvantages of the arm's length principle make it difficult for TP regulations to be effective. These have been tabled by various researchers such as Oguttu [6], Luhende [23], Cooper et al. [25], Wier [26] and Silberztein [27]. Key among the hurdles is the heavy dependence on the availability of comparable data, which may be unavailable or not readily accessible [6; 7].

Oguttu [6] also stresses how it is more vexing for African states to apply the comparability analysis which is the basis for the arm's length principle that is believed to curb TP manipulations. The principle also puts immense documentation provision responsibilities on the revenue

authorities and taxpayer, heightening administrative and compliance burdens imposed on these respectively.

It can also create confusion and uncertainty on how certain transactions are treated for both taxpayers and administrators where comparability data is not there or readily available [23; 25].

Where data on comparable information is not in existence and an uncontrolled price exists that must be adjusted to make it more comparable, the process may be subjective and complex if not arbitrary. In some instances, the arm's length price does not cater for limited packaging costs, reduced marketing and distribution costs, economies of scale and networks profits and other advantages enjoyed by member companies within a group [23; 28].

Most developing countries have no minimum conditions in place such as tax treaties and double taxation agreements to curb and minimise the likely double taxation implications that might emanate from the enforcement of the arm's length principle [21].

In addition to the above challenge, the application of the principle has significant implications for capacity building in the form of skills, technical expertise and technological needs for governments and their tax administrators.

### **2.1.2. Tax Administration Capacity**

Inadequate and weak capacity, together with lack of expertise have been alluded to as the constraints to effective tax administration in developing countries [29] as well as to effecting implementation of the national TP rules [30] or OECD and UN TP guidelines in developing countries and African countries [9]. The application of the OECD and UN transfer guidelines is still in its infancy in most developing implying that there is limited experience and very few specialists, who are generally not yet fully equipped.

In some developing countries such as Tanzania [23] and Zimbabwe [3; 7], even though revenue authorities (such as TRA and ZIMRA respectively), tax consultants, accounting and taxpayers have embarked on various activities towards capacitation,

these are not enough. It continues to be challenging for TP laws to be administered competently and professionally.

The gravity of this challenge is expressed by Cooper et al. [25], stating that "a lack of administrative capacity can lead to a disregard for the legislation, or alternatively may result in "innovative" and poorly targeted enforcement. The former may result in further erosion of the tax base, because of opportunistic investor behaviour or simply tax avoidance or a bias towards risk aversion in countries with stronger administrative capacity." Contrary to the situation in developing country revenue authorities, MNEs and their tax advisory departments hire professional, highly qualified, and experienced individuals who are conversant with TP issues. With financial resources at their disposal, they give them opportunities for continuous professional development (CPD), thus putting them in a more privileged position to arrange the TP activities of MNEs in a complex manner and even in defending their TP and tax decisions in a court of law.

These professionals are no match for revenue officers, who are sometimes inexperienced and not well trained [23]. Even where capacity building is progressively on the right track and revenue authorities having trained specialists, it is hampered by high staff turnover. It is often difficult to retain them due to poor remuneration and they leave for more lucrative and higher-paying jobs in accounting firms, the private sector and ironically these MNEs [7].

Beebejan [31] points to a general concurrence that the shortage of resources exacerbates the capacity constraints to effective TP regulation.

Mashiri et al. [8] splits these capacity constraints into financial constraints, lack of experience and expertise, lack of sound staffing policy and lack of specific transfer pricing teams. Despite the separation of these constraints, they are interrelated in the way they impact TP regulation, implementation, and taxation of the activities. For example, financial resources shortages and lack of expertise as discussed above.

Lack of sound staffing policy and lack of specific TP administration teams impacts negatively on the development of appropriate experience and expertise.

### 2.1.3. Inadequate, absent, or weakly developed TP Regulations

Barrogard et al. [24] adduce that BEPS is not prioritised in most developing countries where there are knowledge gaps, administration gaps and at times commitment of the nation at the policy design level, implementation of the tax policy and its communication to revenue administrators is disconnected and disorganised.

Most developing nations have inadequate, or no TP regulations and enforcements as acknowledged by Blumenthal & Ratombo [32].

With respect to African countries, Shongwe [28], states that “African countries have traditionally either not updated their laws or have narrow definitions in their laws that allow MNEs to structure transactions either with aggressive transfer pricing mechanisms or through excessive debt structuring to shift profits to low tax jurisdictions”.

Affirming this challenge, the UNCTAD Secretary-General asseverates that nearly half of Sub-Saharan African nations lack

adequately crafted TP policies, rules, regulations as well as administrative capacity in their jurisprudence. Sebele-Mpofu et al. [7] adduces that there is a scarcity of TP guidelines tailored to the contexts and needs of developing countries. These shortcomings leave these developing countries exposed and with little capacity to stand up against MNEs even in these countries’ own courts, let alone international courts.

Wealth et al. [33] observes that even where TP regulations are in place, the complexity of the tax systems opens many arbitrage opportunities that lead to profit shifting between different tax jurisdictions, with varying tax laws. Contrary to availing a level playing, this ends up disadvantaging developing countries, while favouring developed ones.

Reiterating this concern, Shongwe [28] posits that “In African countries, primary rules on TP lack clarity and risk being ineffective in addressing complex transfer pricing arrangements”, thus opening room for abusive tax planning and making the investment climate less favourable.

A snapshot of the level of development of TP legislation in a few selected African countries is shown in Table 1 as adapted from Shongwe [28] and buttressed with information from Mashiri et al. [8].

**Table 1. Level of Development of TP legislation in selected African countries**

Country	TP implementation Regulations or guidelines	Comprehensive documentation requirements and penalties	Yearly disclosure of related party transaction requirements
Botswana	TP rules currently being developed	No	No
Cameroon	2012 Finance Law	Yes	Yes, upon request
Malawi	Section 41 of the Income Tax Act (ITA)	Yes, No clear-cut penalties for TP	No, upon request
Zambia	Section 97A if the ITA	Yes, no TP-specific penalties	No, Upon request
South Africa	Well-developed TP laws	Yes	Yes
Tanzania	Anti-avoidance Section 33 of the ITA	No, Penalty powers discretionary	Yes
Kenya	Section 470 of the ITA	Yes	Yes, but not widespread
Lesotho	No specific TP rules, Arms’ Length prices referred to in ITA	No	No
Zimbabwe	TP introduced in 2016 in the ITA	Yes	Yes
Uganda	ITA	Yes	No, on request

Source: [28]

#### **2.1.4. Complexity of MNEs transactions and lack of cooperation by MNEs**

Various researchers [3; 9] highlight that developing and emerging economies are faced with challenges such as lack of capacity and expertise, weak negotiating power and corruption in effectively monitoring and regulating TP arrangements and even in administering taxes on MNEs income generating activities, the complexity of the MNEs transaction compounds these constraints.

The complexity of these transactions that are intra-group or between subsidiaries of a group or subsidiaries and parent company have an impact on the profit allocation, thus affecting the distribution of taxing rights across countries where these MNEs operate. TP transactions have increasingly become very complex due to the growth in globalisation, the rise in the sophisticated financial sector and cross-border mergers [16].

The intricacy of transactions has led to intractable battles over the taxing rights and ease of profit shifting from developing countries that have weak or no capacity to either keep an eye on the TP activities or challenge such activities. MNEs have abundant financial and technical resources to engage in complex global transactions and procedures or to hire highly qualified experts to conceal such transactions through creative accounting and special purpose vehicles [7].

Due to a lack of adequate expertise, developing countries may find it challenging if not impossible to trace, track and tap these into the tax base. The lack of expertise and transaction intricacy are also a stumbling block to effective auditing of these transactions or even raising a strong case that can be successfully argued in a court of law [21].

As outlined by the Sebele-Mpofu et al. [3], MNEs are often not willing or “economical” when it comes to information sharing when asked by tax administrators and auditors. At times they provide voluminous information to confuse tax administrators and auditors. This makes dispute resolution and liability assessment a formidable task. The ineffectiveness

of DTAs in ensuring access to information and sharing compounds the lack of cooperation challenges. Information might take long to be provided or it might be incomplete when provided.

#### **2.1.5. Information Asymmetry**

The information asymmetry privileges developed countries at the expense of developing countries, as the developed countries often infringe on the rights of developing countries with less information. The availability of resources, both financial and technical (tax experts, knowledgeable revenue officers and legal experts on TP) in developed countries give the already politically domineering developed countries an upper hand in getting TP information from MNEs [18].

On the other hand, the lack of resources and weak political standing of developing countries stifles their negotiation and enforcement capabilities and capacities, leading to failure to get relevant information [16].

Taxation and TP regulation depend on information. This information power imbalance gives more power and leverage to both taxpayers, revenue officers and legal and tax experts in developed countries, allowing them to be more aggressive in their tax planning and TP decisions to the detriment of the less powerful developing countries’ taxpayers, revenue administrators and the courts [15; 18].

Cooper et al. [25] acknowledge the difficulties in adopting the arm’s length principle for both developed and developing countries. They face similar challenges of informational constraints; the differences lie in the capacity to handle them. The researchers state that “administrators in more developed economies may face the same challenges of incomplete or asymmetric information, but often have a more refined set of policy and administrative tools to address these challenges”.

There is also a general lack of knowledge or awareness on TP issues in many developing countries [23]. The tax knowledge gap is one challenge that makes tax administration a difficult task and tax compliance problematic in developing countries.

Citizens are either unaware of certain tax policy issues or in case where they are, they don't have adequate knowledge on how to compute the taxes, or procedures to follow to submit returns and settle the tax liability [34].

This lack of awareness is even greater for TP, which is in the early adoption stages or inception in most developing countries [28]. For example, in some developing countries like Zimbabwe, Kenya and Tanzania, notwithstanding the development and dissemination of information on the application of the TP guidelines and the required documentation, most taxpayers are still unaware of these or do not fully comprehend the regulations and documentation requirements. This compromises compliance [7; 8].

The lack of sufficient knowledge is not only affecting taxpayers but tax officers as well as tax consultants [16]. In addition to the lack of databases, even where they are available, tax officers have no adequate knowledge to conduct the relevant economic analysis based on these databases and even customise the information to national context becomes a complex exercise.

This compromises TP implementation, audits, monitoring, and dispute resolution [3]. Generally, all stakeholders are trying to grasp the regulations, considering the concept is still in its early stages. Tax authorities are trying to provide adequate documentation, consultation, and fall-back in case of disagreements.

#### **2.1.6. Political obstacles and power imbalances between developed and developing economies**

The unfair distribution of power between developed and developing countries is substantial, especially in relation to information [16; 18]. Tax administration in developed countries is more sophisticated, developed and equipped with financial resources, technical skills, and expertise, coupled with a political muscle to deal with TP issues as compared to those in developing countries. These evident disparities in the ability to handle TP aspects have seen developing and emerging economies on the receiving end of unfair,

aggressive, and exploitative TP activities and decisions. This results in a greater share of profits being allocated to the more assertive, capacitated and politically forceful developed economies, hence resulting in BEPS. This is often done for fear of antagonising and stirring tax disputes with these aggressive nations.

Kabala & Ndulo [16] point to the lack of political will to deal with TP issues and the absence of a unified and consistent regional focus on tax avoidance and evasion curbing as other problems that hinder the effective application of TP.

There is no political will to address the issues of TP and BEPS in most developing countries, perhaps due to a lack of understanding of the issues and their impact [1; 24].

There is also no uniform and consistent approach to curbing tax evasion and avoidance even through regional organisations such as the Economic Community of West African States (ECOWAS), Southern African Development Community and African Tax Administration Forum (ATAF), among many such bodies [16].

Sebele-Mpofu et al. [7] acknowledges the need for a combined effort considering the globalised nature of the business world and the tremendous growth in international trade and cross-border transactions.

Kabala & Ndulo [16] portend out that ATAF is making commendable efforts to empower member states on different aspects on taxation including TP and providing a platform for expertise and knowledge sharing, discussions on challenges of tax administration and BEPS and mapping of solutions.

Kabalo & Ndulo [16] further explain the argument by discussing how HMRC assisted South Africa by seconding a specialist to South Africa Revenue Services SARS, who in turn after being capacitated made available their experts to ATAF to assist member countries in crafting their TP legislation, build capacity and capability in these African countries too.

There is indeed a great need to do more in TP regulation development, provide experts to assist member countries with

advice on dispute resolutions, knowledge sharing on TP and databases, direction on risk analysis as well as general tax administration.

#### **2.1.7. Ineffective TP dispute resolution mechanisms**

Kabala & Ndulo [16] advance that most developing countries in general and African nations, in particular, have no appropriate legislation and regulation on TP matters and most have adopted the OECD transfer pricing guidelines, without building legal capacities and institutions for their effective implementation. The judicial systems and tax courts are ill-equipped to constructively handle the cases and revenue authorities are technical weak to defend their cases.

This leads to some promising cases being dismissed on grounds of merit [7; 20]. This is affirmed by Sebele-Mpofu et al. [30] who submit that many developing countries lack strong and robust legal systems as well as dispute resolution frameworks. These ineffective judicial systems and fragile legislative structures lead to protracted TP cases or revenue authorities losing most cases and loss of taxpayer confidence if disputes take forever to resolve.

#### **2.1.8. Lack of comparable companies, databases, and transactions**

The lack of identifiable comparable prices is a fundamental hurdle confronting developing countries [16; 32].

It is often problematic for developing countries' revenue officers, taxpayers, and TP auditors to find comparable data, items, and transactions to allow for comparability assessment and determination of costs and prices of goods based on the arm's length principle [21; 32].

It could be due to the fact there are relatively few companies operating in some sectors. Even more challenging is establishing an internal comparable uncontrolled price (CUP) because, in some instances, intra-group transactions are unique to the parent and its subsidiaries. Compounding the comparability analysis pitfall is the lack of national databases that can be used for comparability purposes in

most developing countries, Tanzania included [23] and Zimbabwe [8].

In short, where the internal CUP is non-existent, there are no comparable transactions and prices in the open market and there is no comparable national database, the taxpayer is left with no option but to adopt a margin and justify it. This already brings an element of subjectivity and leaves room for abuse as transfers can still be made to related enterprises in low-tax jurisdictions. These enterprises can act as merely re-invoicing entities, thus enabling BEPS. Due to information asymmetry and confidentiality issues, it is difficult for tax authorities to check whether the transferred items are sold at arms' length in the tax haven. The lack of comparability databases impacts negatively also on the successful conduct of TP audits [28; 32].

Revenue authorities in developing countries find it difficult to audit effectively without adequate comparative information or benchmarks. Comparability data is normally from European and Asian markets and these markets' fundamentals differ from those of African markets [16].

The other formidable aspect of lack of comparability data has to do with intangibles, the difficulties in their measurement and valuation leave room for abuse and exploitation, as it is practically hard to trace pricing issues [16; 28; 32]. Efforts are being made in some developing countries such as Tanzania, Kenya, and Zimbabwe among others (refer to Table 1) to create an enabling environment by availing appropriate policy documentation, working facilities and making TP databases accessible (at times even through subscribing to some of the established databases) in order to fully operationalise TP guidelines in line with international ones such as the OECD and UN transfer pricing guidelines.

The other problem emanating from the lack of databases in developing countries is that in most cases databases on TP assessments have information relating to developed countries making comparability challenging or even customisation [32; 33].

There have been worthwhile attempts to address the challenge, but these have been slow and gradual, as these efforts are

also hampered by financial constraints. The cost constraints and challenges of accessing comparability data impede both successful regulation of TP and compliance to these regulations by revenue authorities and taxpayers respectively.

## 2.2. Suggested solutions and efforts made so far towards mitigating the challenges of TP

It is indisputable that MNEs are a vital fountain of economic growth, investment, global innovation, and government revenue, but on the other hand, they undesirably employ avenues to exploit variations in national tax laws and systems across countries of operation through strategies such as mis-invoicing, mispricing, and TP. The aggressive tax planning decisions often applied by these MNEs weaken tax bases and the fairness of tax systems, especially for developing nations [25].

TP is considered a “financing for development issue” because failure to collect adequate revenues hampers the country’s ability to gather enough financial resources

to finance public expenditure [34]. Having discussed that regulating MNEs activities through TP is a formidable task with various challenges it is imperative to find solutions to mitigate these challenges and protect tax bases from transfer mispricing.

Sebele Mpofo et al. [30] make three vital suggestions to policymakers in order to alleviate the challenges of TP. These are: (a) the need to target taxpayers and transactions that are likely to pose the greatest risk to TP and revenue mobilisation; (b) transfer pricing documentation and disclosure requirements to be commensurate with the needs and capacity of revenue administration and should not be so significantly different from the needs of trading partners in order not to cause undue compliance and administrative burdens; (c) capacitation and equipping of tax administration to efficiently, effectively, uniformly and productively address TP aspects.

Table 2 presents a summary of a few selected previous studies on the challenges and possible solutions to TP in developing countries.

**Table 2.** Summary of selected studies on the challenges and possible solutions to TP

Researcher(s)	Countries of focus	Methodology	Challenges	Suggested solutions
Mashiri et al. [8]	General perspective	Theoretical review (deductive theorising)	Information asymmetry and frail TP audits	Capacitate tax authorities and regulate tax practitioners
Shongwe [28]	African countries	Review of literature (policy brief)	Weak legislation, poor administration capacity and lack of access to information	Improve and modernise TP regulations and Regulation through customisation of ATAF arm’s length guidelines, TP guidance and Audit process suggestions
Barrogard et al. [24]	Cameroon, Burkina Faso, DRC, Gambia, Honduras, Liberia and Uganda	Desk study and Survey study	Lack of BEPS prioritisation or strategic link in policy crafting, communication, and administrative implementation. Lack of data for comparability, awareness, capacity, and resources	Build capacity in terms of legislation, expertise, technical resources, information technology and creating databases
Blumenthal & Ratombo [32]	South Africa	Qualitative, interpretive literature review	Resources and capacity constraints, limited access to and availability of comparable data. Strong reliance on use of alternative dispute resolution, no Advanced Pricing Agreement to encourage compliance, limited guidance on the handling of double tax agreements	South Africa’s TP regulation is ahead of other developing countries but there is a need to continuously improve the dispute resolution mechanism, develop TP skills and expertise and investigate TP mispricing

**2.3. Conceptual framework**

From the literature reviewed it was evident that the challenges of TP impacted the effectiveness of the TP as well as how revenue authorities used TP to regulate the activities of MNEs to reduce BEPS and tax revenue leakages. It became evident that the suggested solutions could be the moderating variables to help mitigate the impact of these challenges on the effectiveness of TP (Dependent variable).

This relationship is schematically displayed in Figure 1. The presentation is such that the first point on the challenges corresponds with the possible solution under the suggested solutions.

**3. Research Methodology**

In addition to using the conceptual framework displayed in Figure 1 above, the methodology was guided by Creswell & Clark [35].

This study adopted an interpretivism research paradigm as it is suitable for research that seeks to have in-depth knowledge of a phenomenon. Epistemologically, the study sought to understand and give meanings through interpretations attached to the views and actions of study participants. The fundamental principle is contextualisation, interpretation, and derived meanings within the study context (in this case TP within developing while specifically focusing on Zimbabwe).

This study employed an exploratory design as this design is ideal for researching or investigating under-researched areas or subjects that are in their nascent stages of development and implementa-

tion. Employing interviews with various informants allowed the researchers to get rich and insightful information on the TP regulatory regime in Zimbabwe, while the review of literature gave detailed insights into the situation in other developing countries.

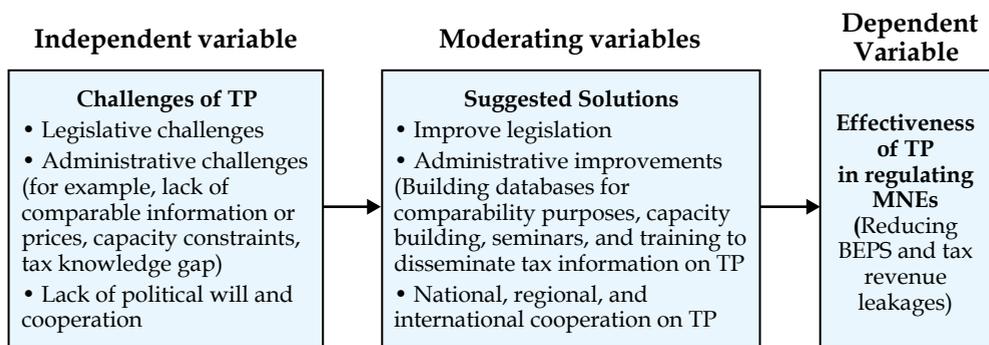
This study adopted a qualitative research approach. The approach takes into consideration a variety of approaches and multiple truths within what is termed the interpretive, naturalistic or constructivist world view [36].

The research approach has to do with discovery (exploring) and giving a descriptive analysis, hence interviews were employed for data gathering to allow for in-depth data gathering.

The study targeted MNEs’ tax consultants, Ministry of Finance Officials and Zimbabwe Revenue Authority (ZIMRA) officers. Qualitative studies are known for small samples [37] and these can be identified through purposive sampling and snowballing [35; 38] as was the case in this study.

Samples of between 3 and 10 were used and these stakeholders were sampled because of their intense knowledge of TP. In some cases, these experts referred the researchers to those they considered the best in the area, thus snowballing, this was most common with MNEs’ Tax consultants, ZIMRA officers and Ministry of Finance Officials.

Wealth et al. [33] argues that the outcomes of TP are a result of rational decisions taken by the various economic actors influenced by different understanding and



**Figure 1. Conceptual framework**

interpretations of the legislation. These different interpretations could possibly reflect the roles played by these stakeholders, policymakers, regulators, taxpayers, and tax administrators (implementers of policy).

This research combined document examination and analysis (court cases, TP guidelines including OECD guidelines and UN standards on TP, TP legislation in Zimbabwe, budget statements, media briefs and previous studies on TP in developing countries) and in-depth interviews.

In-depth interviews were conducted with the different stakeholders (10 ZIMRA officers, 10 MNEs' Tax Consultants and 3 Ministry of Finance Officials). In-depth interviews were chosen because they are more suitable for exploratory research as they enable one to dig more for and seek clarification and at the same time tap on non-verbal cues [35].

Considering that TP was an under-researched area it was important to gain a deeper understanding of the TP legislation and its constraints to effective enforcement from the various stakeholders that have experience on the subject matter. Interviews were initially conducted with two respondents one tax officer and one MNEs tax consultant to test for clarity and appropriateness of questions in addressing the research objectives and eliciting adequate information. Revision and elimination of questions were done accordingly, where necessary.

The qualitative research permitted multiple crystallisations of the TP phenomenon which was essential for its exploration and investigation into the challenges and suggested solutions. For example, ZIMRA officers as the enforcers of TP legislation shared their knowledge on TP and the challenges that they faced in administering them as well as what they thought could be ideal solutions or ways to improve the status quo. The department consisted of 22 team members at the time of research. For both domestic and International TP, the focus was on those dealing with international issues. Ministry of Finance officials were pivotal as the policymakers who craft the TP policy. Lastly, the MNEs' tax consultants were key to

the study as the pivotal participants as the taxpayers or the ones to be regulated.

The documents reviewed included the Zimbabwe Income Tax Act and TP legislation, International TP Guidelines (OECD and UN) as well as the National Budgets statements as well as cases. This was because tax law in Zimbabwe is drawn from legislation, Acts of Parliament, pronouncements in the budgets and legal precedence or decided court cases.

Further to addressing the credibility and trustworthiness of the results through pre-testing of interview guides, the researchers took notes during interviews and tape-recorded them where informed consent was granted. Participant feedback was also employed. Data was analysed employing both deductive and inductive approaches in content analysis for both the interview scripts and examined documents.

The researchers used a Computer Aided Qualitative Data Analysis Software known as ATLAS.ti. Data presentation and analysis followed the guidance of Braun & Clarke [39], who advocated for matching themes derived from the data with study objectives. Data presentation was largely narrative in nature with a few numerical expressions. Data presentation was also aided by using quotations for elaborative, clarification and evidence purposes.

The interviewed stakeholders were given identification codes and individual numbers for analysis purposes and from here onwards they were described using the code names, MOF (Ministry of Finance Officials), ZIMRA (Zimbabwe Revenue Authority Officers) and TC (MNEs Tax Consultants). An example of the coding is TC1, for tax consultant 1.

#### **4. Results**

As highlighted earlier, the study results were presented in a thematic manner as guided by the themes that emerged from data analysis and the research objectives. Before delving into the challenges of TP in Zimbabwe, it was important to have an appreciation of the TP legislation in Zimbabwe and how it relates to international best practices such as the OECD and UN transfer pricing guidelines.

The analysis presents itself under three themes. Theme 1 focuses on the applicability of the international guidelines on TP to the Zimbabwean context (4.1), Theme 2 centres on the challenges of TP in Zimbabwe (4.2) and theme 3 was built on the suggested solutions to TP in developing countries and Zimbabwe in particular (4.3).

**4.1. Application of International TP guidelines (OECD and UN guidelines) to the Zimbabwe setting**

It was evident from document analysis that Zimbabwe sought to follow the OECD and UN guidelines as a basis for their TP legislation and it became necessary to evaluate their applicability and appropriateness to Zimbabwe. This was because also from literature review it was evident that researchers found these guidelines lacking in some important dimensions as they relate to developing countries [6; 30] and African countries [28; 33].

During the interviews, it was evident that ATAF was considered an important player in providing guidelines on TP in Africa, especially to member countries such as Zimbabwe. This was consistent with literature from Shongwe [28] that ATAF provides guidance to African member states on TP in order to help them fully comprehend international guidelines.

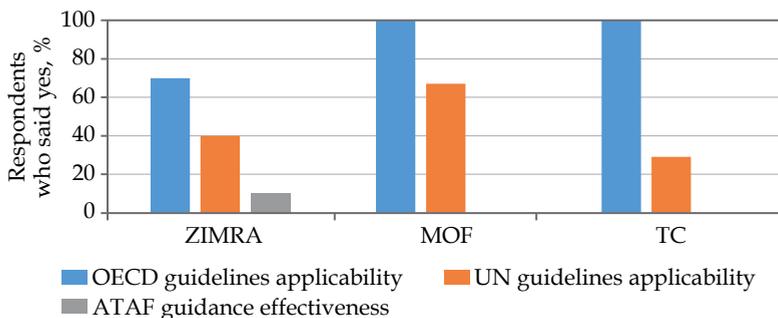
The interview results were grouped in terms of those that found either the OECD, UN or ATAF guidelines applicable to Zimbabwe from their understanding and assessment. This was done using yes and no as representing what was deduced from the discussion. The results are presented graphically as shown in Figure 2.

From Figure 2, it was evident that there was a consensus among stakeholders that the OECD guidelines were the commonly applied guidelines with all the MOF officials and TCs concurring. The majority of ZIMRA officers (70%) also shared similar sentiments. The UN guidelines were found to be less applied as compared to the OECD, with 67% of the MOF officials acknowledging their application and only 40% and 29% of the ZIMRA officers and TCs agreeing to them being applicable. ATAF guidance was found to be ineffective and only 10% of ZIMRA pointed to the contrary.

It is not surprising because the bulk of the studies referred to the OECD guidelines as the widely adopted guidelines by both developed and developing countries.

The interviewees indicated that even mandatory to adopt the OECD guidelines, they felt persuaded to adopt these as they are frequently updated to respond to the changing risk environment and tax evasion and avoidance strategies. This was highlighted by ZIMRA6 who made it clear that even though the authority was not tied to any specific body they preferred the OECD.

The ZIMRA officers and TCs pointed out that Zimbabwe’s TP legislation differed from the OECD in that the country applied TP legislation also to domestic transactions in local companies (this was not explored further because the focus of the study was on MNEs and international transactions). This was found to be burdensome especially to small and medium enterprises in the country [20].



**Figure 2. Adoption of International guidelines in Zimbabwe**

Even though interviewees concurred to a greater extent on the adoption of the OECD guidelines, they were quick to point out that these are not without problems. They were described as voluminous, confusing, and difficult to comprehend, with TCs calling on ZIMRA to simplify them. ZIMRA officials on the other hand acknowledged that these were not wholly suitable for Zimbabwe as they are more applicable to developed countries (OECD countries and European countries).

ZIMRA4 affirmed the concern as follows: “As a country, we adopted the OECD regulations without any amendments. We have the advantage of applying guidelines that are acceptable internationally, but administering them in our environment is very challenging, especially applying the recommended transfer pricing methods for testing for adherence to the arm’s length principle. The shortage of comparable information and the prevailing economic conditions in the country making it difficult to apply transfer pricing rules and even to audit productively”.

Barrogard et al. [24] when studying TP in developing, including African countries like Cameroon, Tanzania and Burkina Faso arrived at an alike conclusion arguing that contextualising was key. The researchers emphasised the need to select those minimum standards and actions that addressed the TP challenges in each country as the economic environment settings differ. The other issue making the use of the OECD guidelines problematic was identified as the lack of comparable databases for transactions. This led to the use of foreign databases which were often difficult to use or not entirely comparable, hence bringing in subjectivity and inaccuracies. This was also shared by Mpfu & Wealth [21].

There was a general feeling especially among ZIMRA officials, that despite the current ineffectiveness of ATAF in creating TP guidelines for African countries, it was the ideal body to guide the African continent on the matter. This thought has been shared by the Kabala & Ndulo [16] suggesting that ATAF can have a register

to document the needs of African countries in relation to TP and seek assistance from the OECD, World Bank, and IMF in a more focused way.

Kabala & Ndulo [16] express that there is need to assess the appropriateness of the OECD guidelines for developing countries and Africa and formulate TP guidelines that are more focused on addressing challenges that are unique to the African continent. The researchers further explain that ATAF can be the right organisation to spearhead the project.

There was a general acceptance among interviewees (TCs and ZIMRA officers) that notwithstanding the adoption of the OECD guidelines in Zimbabwe, there was an irrefutable need to keep evaluating them for applicability, relevance and effectiveness and taking corrective measures where necessary.

#### **4.2. Challenges of TP in Zimbabwe**

The major objective of TP is to prevent or reduce BEPS by equipping revenue authorities with appropriate legal and administrative measures to do so. However, it remains problematic how the efforts to protect the tax base can be balanced with the need to maintain a favourable investment climate to foster international trade and continue to be a destination of choice for FDI [25].

Theme 2 dealt with the challenges of TP in Zimbabwe. After a detailed discussion of the challenges under literature review (Section 2), it was important to empirically explore these challenges in the Zimbabwean context. Zimbabwe presents a developing country context but is unique in terms of the economic, legal, and political settings. Literature tabled various challenges such as the shortage of resources, weak capacity, non-availability of comparable databases, weak legal systems, complex legislation, and complexity of MNEs transactions among others [30; 31].

This study categorised the challenges into two broad groups: Challenges relating to TP legislation (4.2.1) and those relating to implementation capacity constraints (4.2.2).

**4.2.1. Challenges Relating to TP Legislation**

This study, through a deductive coding data analysis approach, categorised the challenges into three broad groups: Lack of comparability databases, unclear documentation requirements and unclear TP legislation as presented in Figure 3.

The MOF officials indicated that they were not the best target participants on the challenges as they liaise more with ZIMRA on the implementation issues as the administrators of tax policy, so it was best to get information on the challenges from ZIMRA officials and tax consultants. For this reason, results presented relate to ZIMRA and TCs.

Different reasons appeared topical and ranking top as fundamental constraints, as viewed from the perspectives of the different stakeholder groups (interviewees). For example, for TCs (100%) the major stumbling block to effectively implementing TP regulations is the lack of clarity in legislation, yet only 30% of ZIMRA officials acknowledged it as a hurdle. For ZIMRA officers, the biggest challenge was the lack of comparability databases (90% in agreement) and 71% of TC were in acknowledgement.

These have all been alluded to in literature as challenges to TP by different researchers such as Kabala & Ndulo [16], Sebele-Mpofu et al. [7] and Oguttu [6]. The only difference, in this case, is the significance attached to them by interviewee groups thus, reflecting the multiple views of participants’ experiences, occupational challenges, and their different orientations as the taxpayers (TCs) and the regulator (ZIMRA).

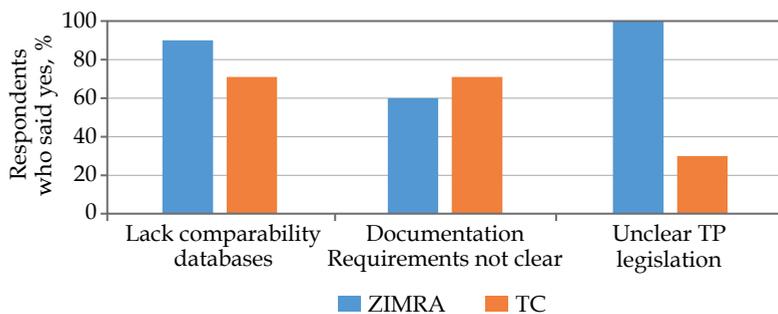
This resonates well with the interpretivism literature that argues the world is subjective and must be viewed from the perspective of those who experience the subject matter [35; 36] and McKerchar [40] who argues that challenges and solutions in the tax discipline will depend on the perspective of the stakeholder studied.

The differing opinions are reflective of the subjective views of the phenomenon built from interactions and relationships between MNEs, TCs and ZIMRA. As for the inadequacy or unclear documentation, the majority from both groups were of the view that indeed documentation was lacking (71% of TCs and 60% of ZIMRA officers). TC1 explained that the lack of legislative clarity was frustrating to MNEs and other taxpayers.

*Unclear TP legislation.* The lack of legislative clarity was highlighted in several developing countries [18; 24] and in African countries [7; 16]. Given this background and the fact that it was pointed out by interviewees. It was necessary to further unpack it in the Zimbabwean context. TCs and ZIMRA officials acknowledged that Zimbabwe still needed to do a lot in simplifying and clarifying the TP regulations.

TC3 expressed that: “In my view, the TP rules have not been a game changer; we just took the bare bones of TP very shallow in terms of content and not aligned to the Zimbabwean setting. I don’t think it has impacted on FDI; however, it is an important aspect of FDI”.

ZIMRA officers also shared concern on the lack of legislative clarity, with ZIMRA8 asseverating that: “There is an outcry



**Figure 3. Challenges Relating to TP Legislation**

on the legislation being difficult to comprehend and I don't know how foreign investors will take it and I don't think transfer pricing is really a hindrance to foreign investment, the issue of language must be simplified. Some taxpayers were saying, whose standard are you using and what standard of transfer pricing are you using to say this is a comparable transaction?"

This suggests the need to make the adopted OECD guidelines more aligned to the Zimbabwean situation and to educate taxpayers more on TP regulation.

Legislation clarity or lack of it was further explored under the following sub-themes: Existence of clear deadlines and penalties, the use of APAs, Effectiveness of the Fiscal Appeal Court and consistency in the application of TP legislation. The results are presented in Table 3.

*Inconsistency in the application of TP legislation and the inexistence of effective deadlines for submission of TP documentation.* Only 20% of ZIMRA officials pointed to the existence of effective deadlines, with the majority clearly stating that they did not have a clear deadline on when the TP documentation should be lodged with ZIMRA. All the TCs argued that the deadlines were non-existent.

This is contrary to the suggestions by researchers such as Lohse & Riedel [41], Nguyen et al [42] and Luhende [23], who emphasise the need to have clear documentation requirements and deadlines for submission to enhance TP as a tool to reduce profit shifting, aggressive tax planning and tax evasion.

The TCs indicated that their clients kept the TP documentation as part of the risk management and tax planning strate-

gies to minimise the tax exposure in case ZIMRA comes for TP audits.

*Unavailability of an Effective penalty system.* Despite the emphasis by Lohse & Riedel [41] on the criticalness of having specific and clear penalties for TP abuse, it is clear in Table 1 that most African countries fall short of this legislative need. Zimbabwe is no exemption. Zimbabwe is experiencing a similar problem as 90% of the ZIMRA officers acknowledged the weakness and all the TCs agreed.

ZIMRA officers indicated that they applied general penalties as outlined in Section 46 of the ITA, Chapter 23:06. The lack of penalties makes tax administration ineffective. This problem of penalties was alluded to by Lohse & Riedel [43] and by Shongwe [28] in most African countries.

The discretionary nature of penalties in most African countries leads to the abuse of power, exploitation of taxpayers and corruption as indicated by Kabala & Ndulo [16]. The statutory Instrument 109 of 2019 has sought to make improvements in these areas [7].

*Ineffective use of APAs.* The APAs were argued to be ineffective in Zimbabwe. The majority of ZIMRA officers pointed out that they have never used or invoked APAs at any point in time since the introduction of TP in 2016. TCs argued that APAs were non-existent in Zimbabwe.

TC3 expressed that: "maybe we can talk about DTAs in Zimbabwe, otherwise APAs are not there. The DTAs are also ineffective and provide not much guidance or information in dispute resolutions".

*Ineffectual Fiscal Court of Appeal.* ZIMRA officers indicated that in the absence of specific deadlines and penalties for TP

**Table 3. Legislative measures and the perceptions on their effectiveness**

Measure	ZIMRA (% of those acknowledging)	TCs (% of those acknowledging)
Inconsistency in application of TP legislation	86	90
Ineffective use / non-availability of APAs	90	100
Inexistence of effective deadlines	80	100
Non-availability of an effective penalty system	90	86
Ineffectual Fiscal Court of Appeal	100	86

and the use of general penalties covered in Section 46 of the ITA, the implication was that even in dispute resolution; the general procedures for assessing income tax disputes were applied. This led to interviewees admitting that the fiscal court was ineffective.

The TCs acknowledged that dealing with this court was frustrating because many of their cases were still pending resolution. The TCs suggested that the ineffectiveness could be linked to three things: the court being understaffed, lack of clear and effective legislation and lack of legal expertise to handle the complex TP cases.

TC1 was of the view that the one judge who dealt with tax cases be it the income tax, capital gains or Value Added Tax (VAT) cases was swamped by too much work. The lack of clear legislation and expertise compounded the difficulties in effective dispute resolution.

Sebele-Mpofu et al. [7] highlighted this while studying the effectiveness of TP audits and dispute resolution in Zimbabwe. This ineffectiveness in the legal system leads to ZIMRA losing cases and robs it of a chance to self-assess its legislative and administrative capacity and having a legal precedence foundation to improve on. It is also prejudicing taxpayers, burdening them with uncertainty and leading to them losing trust in tax administration. Trust in government and its institutions, is an important determinant of the willingness of taxpayers to pay their tax obligations [11].

*Lack of Comparability Databases.* The challenge of lack of comparable databases was found to be weighing heavily on the effectiveness of TP legislation in Zimbabwe as evidenced by the study results in Figure 3. The problem cuts across most developing countries [6; 24; 30] and African countries [7; 16].

The ZIMRA officers explained that they rely on international TP databases such as “One source” and “KT Mine” for comparability information. TCs highlighted that though using foreign databases was permissible by law, it did not provide accurate results. This reliance on other foreign databases was not without challenges,

the officers indicated that it was expensive and took too much time and effort.

Referring to ZIMRA TC1 pointed out that: “Unfortunately, they don’t have many comparables from Zimbabwe or Africa, they are basically getting comparables from around the world, but we all know that the economic situations are different because we can’t say that Zimbabwe is on the same scale as Europe. Foreign databases mainly give comparables which are not in Africa. Remember in Africa transfer pricing is still work in progress, so the databases do not have comparables from Africa, but we still use them for comparability and that’s why we use the median and advise our clients to charge a price that is closer to the median”.

The poor economic situation in Zimbabwe heightens the problem as more and more companies close or move out of Zimbabwe, leaving only a few companies or even one company in certain lines of business. It thus becomes an arduous task to find comparable data or even query the TP used by the taxpayer leading to the ability of ZIMRA to curb BEPS through TP being curtailed.

#### 4.2.2. Implementation Capacity Constraints

Implementation capacity constraints have been alluded to in most tax literature on the challenges of tax administration in developing countries [10] and with respect to TP [23; 30].

As shown in Figure 4, it was clear that indeed ZIMRA was incapacitated in various aspects to deal with TP effectively. Five broad issues on capacity became the centre of discussion during the interviews: inadequate experience, scarcity of financial resources, lack of expertise, unsound staffing policy and the lack of a specific team dedicated to TP.

From Figure 4, that TCs and ZIMRA officers were of the view that indeed there were capacity limitations at ZIMRA.

*Inadequate experience and Lack of expertise.* Most of the TCs pointed out the lack of sufficient experience (86%) and expertise (71%) as some of the major limitations facing ZIMRA in dealing with TP. ZIMRA officers shared the same views with 50%

and 30% acknowledging the issues respectively. The differences in the emphasis on the matters reflect the perspectives of the taxpayer and regulator and are expectedly varied.

ZIMRA believes they are not far off when it comes to experience and expertise as they undergo some learning and training yet TCs argue that ZIMRA still has a long way to go in addressing the two areas. On the contrary, TC2 argued: “ZIMRA is incapacitated; it doesn’t have the right personnel to challenge the pricing by MNEs and even to get a proper understanding of these rules. I have said this before”.

The TCs argue that they are more knowledgeable than ZIMRA officers on TP issues, indicating this is mostly the reason why ZIMRA loses TP cases in courts as they (TCs) exploit the loopholes in TP legislation.

One wonders whether this does not create a conflict of interest for the TCs. When faced with a conflict of interest, whose interest do they serve those of ZIMRA or those of MNEs? The possibility of a conflict-of-interest overexposing or sharing of information arising due to consulting tax consultants, other tax authorities, the private sector and developed countries [7]. It is necessary to strike a balance between consultation and conflict of interest.

On the weaknesses in expertise, TC6 was concerned especially with the inadequacy in scrutinising the activities of the mining sector yet it is the most vulnerable area to BEPS. He explained that: “In

tackling this problem, it is not enough to have accountants and economists at ZIMRA dealing with TP, there is a need for lawyers and geologists who have a better understanding in some respects that the tax officers lack. And to minimise overreliance on outsourced skills”.

The challenge was further emphasised by TC8, saying that: “ZIMRA doesn’t have the capacity to establish or scrutinize mining transactions to see whether the losses are genuine which is a limitation as mining operations require a lot of expertise and most of ZIMRA staff are just accountants who don’t know the geophysical knowledge, the geological movements and how the mining operations take place”.

The mispricing and mis-invoicing risk in the mining sector was emphasised, with respect to Zimbabwe by Kwaramba et al. [44].

*Scarcity of financial resources.* The scarcity of financial resources has been lamented as the biggest stumbling block to effective capacitation of ZIMRA by interviewees (ZIMRA 3, 7 and 10) in this study and the majority of TCs (86%) and researchers such as Sebele-Mpofu and Mususa (29) and Wealth et al (20).

This is reiterated by ZIMRA 3, stating that: “The issue of resources where we are saying these are cross border transactions and for us to be able to really interrogate and probe them, we also now need to send officers maybe to other tax jurisdictions. That means resources and honestly resources are what we don’t have as a country”.

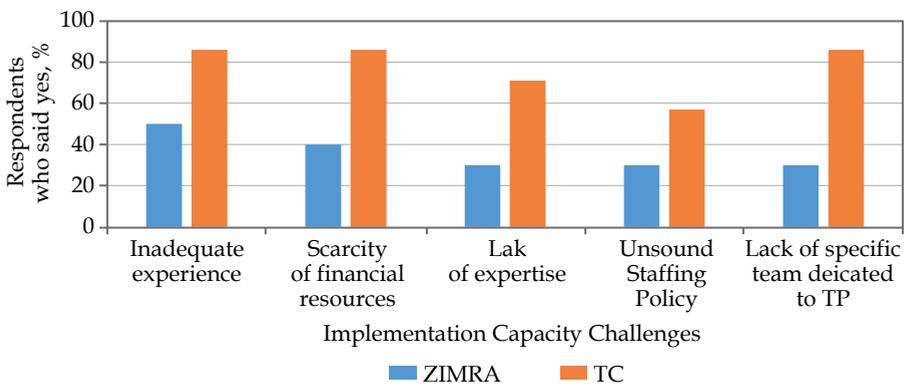


Figure 4. TP implementation Capacity Challenges

In developing countries, financial constraints have been pointed out by several scholars [44]. The lack of adequate financial resources compounds the other challenges. For example, improving experience and expertise requires investment in the continuous development of employees through training, secondment to other revenue authorities in the region or in developed countries so that understudy systems and learn or even hiring experts from experienced revenue authorities such as SARS or those in the OECD countries.

In addition, due to the lack of financial resources developing countries and Zimbabwe included, failed to retain qualified and experienced personnel [8; 23].

This was emphasised by TC2: “In as much as ZIMRA does training programmes the challenge is in ZIMRA there is high staff turnover, I for one received training from Australia and I left ZIMRA due to poor salaries. Apart from training, they need to have practical exposure to countries that have started this thing a long time ago for example South Africa. In my experience at ZIMRA, I was lucky to get exposure. I was based at Sunninghill Megawatt building with South African Revenue Services, where we would carry out joint audits. Theory is easy for anyone even if you were to write an exam you would pass but practical implementation requires exposure and experience. They also transfer staff very often; you find that someone who specialized in transfer pricing but is transferred to do customs work”.

The issue was emphasised by Ogutu [9], who stressed that developing countries’ tax authorities need to address the loss of staff quickly and urgently, through competitive and market-related remuneration of their staff. The problem is compounded by the misuse of funds by government officials as pointed out TCs 2 and 3. This poor governance quality was highlighted by Sebele-Mpofu [10] as responsible for poor tax morale in Zimbabwe.

*Unsound staffing policy and lack of specific team dedicated to TP.* ZIMRA officers in their totality acknowledged that staffing that matches the person’s expertise and

experience with the job or department needs was lacking. They suggested that policies on the ground were not conducive especially, the constant transfers and increased staff turnover. The challenge was also affirmed by TCs and was also referred to in literature by Mashiri et al. [8].

Interviewees from both the stakeholder groups (ZIMRA and TCs) indicated that ZIMRA was poorly staffed, and that most of the staff members were trainees who often grapple with complex TP transactions and issues and even with other tax administration issues in general. There was dissatisfaction also with the lack of a dedicated department to deal with TP issues.

Further to this ZIMRA officers and TCs highlighted that the centralisation of dealing with TP issues in Harare was rather unfair and ill-advised. They recommended a need for decentralisation and for having TP experts and auditors in all the ZIMRA regional offices to speed up resolution of TP issues and for convenience to taxpayers (TCs 2, 4, 5 and 6).

#### 4.3. Suggested Solutions to the challenges of TP

To build on the recommendations made from the study, interviewees were asked to make suggestions on the possible solution to alleviate the challenges they pointed out in the discussions. These were grouped into improving clarity in legislation, creation of databases capacitation and improving national, regional, and international cooperation issues of TP and tax administration in general. The results are presented in Table 4.

**Table 4. Solutions Suggested by Interviewees to the Challenges of TP, %**

Suggested Solutions	TCs	ZIMRA
Improving legislative clarity	100	90
Creation of databases	71	100
Improving cooperation on national, regional and international level on TP	86	90
Capacitation	100	100

As presented in Table 4 interviewees emphasised the need to improve TP legislation as they alluded to the lack of clarity in legislation as well as the difficulties in comprehending and consistently applying the TP regulation. There was a general concurrence with almost all interviewees agreeing to this important fact (100% of TCs and 90% of ZIMRA officers).

The need for capacity building at ZIMRA was unanimous. Participants agreed that a lot needs to be improved in relation to capacity and the most topical areas were training and development, expertise development and exposure, remuneration and retention of employees and above all provision of adequate financial resources to make the capacitation efforts a success.

The creation of databases was also emphasised, along with the improvements in cooperation on a national, regional, and international scale. The creation of databases is important and requires regional or continental cooperation. For example, the creation of an African TP dataset for African countries as suggested by [16; 30].

While Kabala & Ndulo [16] avow that “African countries should participate in the global rulemaking so that African voices, interests and experiences are reflected in emerging global rules”, Sebele-Mpofu et al. [30] posit the efforts towards improving TP legislation enforcement need to be considered from the legislative, administrative, and political perspectives.

The others suggestion from various participants were the need for political will and commitment, reduced political interference in tax administration, improvement and capacitation of the fiscal court, taxpayer education and awareness programmes and the need for stakeholder consultation on TP matters.

## **5. Discussion**

This paper sought to explore the legislative regime associated with international TP as well as the challenges faced in implementation, particularly in Zimbabwe. It emerged that while Zimbabwe has made significant strides, putting in place some TP regulatory measures, it remains challenged in a number of ways ranging from

legislative capacities and implementation capacities as MNEs continue manipulating the existing systems. The existing legislation is marred by a lack of clarity and inconsistencies in the application.

Wealth et al [20] buttressed this by emphasizing the burdensome of the laws to local companies hence giving a competitive advantage to MNEs. ZIMRA is also limited in its capacity to enforce these laws by the lack of comparability databases, non-availability of APAs, non-availability of an effective penalty system, inadequate experience, scarcity of financial resources, lack of expertise, unsound staffing policy and an ineffective Fiscal Court of Appeal. This limited capacity poses a high transfer pricing risk to the nation through the exploitative behaviour of MNEs [33].

The literature and primary findings show that these challenges are not without remedy. Zimbabwe is recommended to improve the clarity of its legislation by also adopting what other tax jurisdictions have done.

Shongwe [28] also highlights the need to modernise legislation and train auditors who are dedicated to TP since MNEs’ transactions are intricate and complex. The Zimbabwean Government is also expected to capacitate its revenue agent by equipping it with all the resources that it requires to fulfil its mandate.

While creating local databases that will assist with comparability analysis, compared to ALP, Oguttu [16] suggests possible alternative methods that could substitute the glorified ALP. These methods may be worth exploring in Zimbabwe to ensure a custom-made system that addresses Zimbabwe’s special needs. Improving cooperation on a national, regional, and international level on TP is also emphasized to abate this long-standing problem of TP abuse.

The paper established that Zimbabwe was facing challenges of TP manipulation by MNEs operating in the country due to several challenges. While some of the challenges were directly linked to weak tax administration institutions, some of them were indirectly linked but were more inclined to the governance and po-

litical environments in the country. From the paper, it was evident that economic incentives in the form of lower tax rates, tax incentives, tax exemptions and certain allowable deductions create opportunities for MNEs to manipulate TP, resulting in base erosion and profit shifting. This reduces the taxable income of MNEs, thus leading to revenue losses for the country. Weak TP regulations coupled with lack of resources make it challenging for developing countries like Zimbabwe to enforce TP legislation effectively. The lack of clear documentation compounds the problem.

It was also clear that there is lack of capacity and expertise within tax authorities to effectively identify and address TP manipulation. The capacity and technical expertise inadequacies affects TP legislation administration and enforcements, audits and investigation. Therefore, the need for investments in digital infrastructure and digital transformation of tax administration can contribute significantly to strengthening tax administration and reducing the vulnerability of developing countries and Zimbabwe in particular to TP manipulation by MNEs.

The study makes several recommendations.

*Firstly*, there is need for improvements in TP legislation and the use of DTAs and APAs. Borrowing from reviewed literature and echoed by study participants, this study recommends a continuous evaluation of the OECD and UN guidelines for adequacy, relevance, and reasonableness in a developing country context and for policymakers to strive to customise these to their national settings. ATAF should continue to work towards the creation of TP regulations by Africa for Africa. The creation of databases is another matter that must be addressed with urgency and requires partnership, communication, respect, and cooperation among nations. This can be done through regional bodies such as ATAF, ECOWAS and SADC among others or international organisations such as the IMF and World Bank. The use of APAs and DTAs is encouraged especially as a way of minimising disputes or putting in measures for dispute

resolution, but care must be exercised as previously, these have been exploited by powerful developing countries to the disadvantage of developing countries. It is, therefore, imperative that these countries should only enter into those agreements when capacity building has been done to support them especially, the APAs. As for the DTAs developing countries and especially African nations should investigate these, appraise their impacts on revenue mobilisation, otherwise “the impact of the DTAs might challenge the legitimacy of tax regimes, legal institutions and democratic processes” [16].

*Secondly*, Capacitation of ZIMRA in terms of technological resources, technical skills, and human resources. The need of capacity building in developing country revenue authorities, including ZIMRA cannot be overemphasised because participants lamented the weak capacities of the revenue authority.

*Thirdly*, increased cooperation is key to improving the effectiveness of TP legislation in developing countries. TP is a global phenomenon and not a country problem, so no country can do it alone. Hence information sharing and exchange are important pillars to cooperation. Resources can also be shared on a regional, continental, or international basis through bodies such the UN and OECD to foster effective cooperation. *Fourthly*, the study recommends continuous research on TP. Research is an important tool to improving policy, thus there is need for continued research and research collaborations on the issues of TP on developing and African countries to learn, implement and improve TP. Revenue authorities, tax consultants, the judiciary, other professionals, and academics should all contribute to this research because the issue of IFFs cannot be ignored.

*Lastly*, the paper recommends the need for increased stakeholder education, awareness, and engagement on TP issues. Stakeholder engagement and taxpayer education and awareness programmes should be undertaken to communicate TP policy in order to have a stakeholder buy in the policy.

## 6. Conclusions

As outlined in the introductory section, the paper had three main objectives. These were to investigate the challenges enabling TP manipulation in a developing country context, to explore the possible solutions to address the problem of TP manipulation in developing countries and to come up with recommendations towards reducing the vulnerability of developing countries to TP manipulation by MNEs. To attain these objectives, the paper discussed the challenges that emanated from the research, and these encompass the complexity of MNEs' transactions, weak and fragile tax administration systems, capacity constraints, weak legislation and limited financial resources.

On the second objective, the solutions identified include enhancement of legislative clarity, creation of arm's length price databases, increased national and international cooperation as well as capacity building for revenue authorities in developing countries.

Concerning the third objective recommendations for alleviating the vulnerability of developing countries to TP abuse by MNEs, the study proposed the harnessing of digital technologies in tax administration, stakeholder consultation, strengthening of legislation, capacitation of tax authorities and revisiting the economic incentives awarded to MNEs.

The study concludes that TP is an important concept in BEPS and accordingly governments should seek to understand the challenges of TP and work towards reducing their impact on developing economies.

The study identified several challenges from literature review and empirical research, and these include lack of databases, lack of legislative clarity, weak judicial and court systems that are not in tandem with the efforts of the tax authorities in TP dispute resolutions, lack of adequate TP knowledge among various stakeholders as well as weak capacities. This could be possibly linked to the fact that TP regulation, adoption and application are still in their infancy in Zimbabwe. There is room for improvement in the future.

The empirical evidence extends some of the views shared by other researchers as discerned from the literature review and summarised in the conceptual framework. The findings from the study could be grouped in line with the conceptual framework. For example, the legislative challenges could cover the level of adoption of TP legislation, the lack of clarity in the legislation, inadequate documentation as well as unclear policy on penalties. These challenges also affect the administration and enforcement part of TP regulation especially when it comes to monitoring, audit, and dispute resolution.

On the other hand, the administrative challenges encompass the difficulties in applying the arm's length principle due to the lack of comparable information and the unavailability of databases. These administrative challenges are further compounded by power imbalances between developed and developing countries as well as the lack of political will and commitment to enforcing TP legislation among developing countries. The capacity constraints challenges include the lack of financial resources, human capital, and technical expertise to effectively implement, monitor, audit and penalise accordingly. Therefore, efforts to improve TP should focus on addressing these seemingly deficient areas.

This study contributes to policymaking and to the theoretical body of knowledge on TP. For example, due to the differences in the economic, legal, and political environments in countries, contradictions and complexities surrounding the TP concept can stimulate further research that can change the TP narrative and regulation. Policymakers can also be influenced into building effective and robust TP frameworks and effectual fiscal courts and ultimately reduce BEPS and its negative impacts.

The conceptual framework is also a contribution to knowledge on the TP debate and can also be used as a guiding tool for policymakers on the focal variables that need focusing on in addressing the TP legislation enforcement challenges.

The study had the following *limitations*.

Firstly, the qualitative nature of the study and the fact that the study adopts interviews as the data collection method means the study suffers from data reliability weaknesses as well as the lack of generalizability of findings. This weakness could be addressed by future researchers by adopting interdisciplinary methods such as the pragmatic approach which allows for combining both the qualitative and quantitative approaches through the mixed method research design.

Secondly, the exploratory setting of the study as well as the use of purposive sampling which is viewed as both powerful and subjective at the same time are both notable limitations. Thirdly, due to the sensitivity of tax issues, hypocrisy, and the management of impressions (opinions) by the different stakeholder groups cannot be overruled as well as their influence on information subjectivity. In their subjectivity, the opinions of these different interviewees were pivotal

to this research, in giving an insight into TP in developing countries and Zimbabwe as well as laying a foundation for future research.

Considering the findings and recommendations of the study, further research is recommended in the following areas: (1) TP for intangibles since it was pointed out as one of the problematic areas for TP regulation and the most abused as well as management fees; (2) research to advance TP rules in Zimbabwe with a special focus on the vulnerable mining sector. Commodity pricing in the extractive industry is an important area for research in African countries as the greater part of BEPS happens in this industry; (3) African countries need to do more research on the creation of the African TP and databases; (4) on the opportunities and challenges of the recently introduced digital service taxes in mobilising revenue from digital MNEs and reducing tax avoidance and evasion in developing countries.

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### Information about the authors

Wealth Eukeria – Senior Lecturer, Department of Tax and Auditing, School of Accounting, University of Namibia, Windhoek, Namibia (93Q5+48Q, University of Namibia, Windhoek, Namibia), Department of Financial Intelligence, College of Accounting Sciences, University of South Africa, Pretoria, South Africa (Universiteit van Pretoria, Privaatsak X20, Hatfield, Pretoria 0028); ORCID: <https://orcid.org/0000-0002-8888-7798>; e-mail: ewealth@unam.na

*Favourate Yelesedzani Mpfu* – Professor, Accounting, Faculty of Commerce, National University of Science and Technology, Bulawayo, Zimbabwe (RJPR+75X, Cnr. Cecil Avenue & Gwanda Road, Bulawayo, Zimbabwe); ORCID: <https://orcid.org/0000-0002-6309-1697>; e-mail: fsfsebele@gmail.com

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### Информация об авторах

*Веалтх Еукериа* – старший преподаватель кафедры налогообложения и аудита факультета бухгалтерского учета Университета Намибии, г. Виндхук, Намибия (93Q5+48Q, University of Namibia, Windhoek, Namibia), факультет финансовой разведки Колледжа бухгалтерских наук Университета Южной Африки, Претория, Южная Африка (Universiteit van Pretoria, Privaatsak X20, Hatfield, Pretoria 0028); ORCID: <https://orcid.org/0000-0002-8888-7798>; e-mail: ewealth@unam.na

*Фавоурате Йелеседзани Мпфу* – Профессор бухгалтерского учета, факультет коммерции, Национальный университет науки и технологий, г. Булавайо, Зимбабве (RJPR+75X, Cnr. Cecil Avenue & Gwanda Road, Bulawayo, Zimbabwe); ORCID: <https://orcid.org/0000-0002-6309-1697>; e-mail: fsfsebele@gmail.com

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