# AN OVERVIEW OF TRANSFER PRICING IN EXTRACTIVE INDUSTRIES INTANZANIA

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***Abstract***

The extraction of natural resources such as minerals and petroleum is expected to create a stream of tax revenues to the government. However, Multi-national Corporations (MNCs) in the extractive industry devise several techniques to avoid paying taxes in countries where they operate. One of the techniques adopted by MNCs to avoid tax is transfer mispricing. This article examines the legal mechanisms in Tanzania applied to deal with transfer pricing issues in the extractive sector. In its analysis, the article starts by providing a general overview of the concept of transfer pricing and how it may result into abusive transfer pricing. Then, the article examines the transfer pricing regime applicable to both Mainland Tanzania and Zanzibar. Finally, the article identifies the pitfalls in the Tanzanian transfer pricing regime and recommends the appropriate remedial measures.

***Key words****: transfer pricing, extractive industry, arm's length, anti-tax avoidance*

## 1. INTRODUCTION

The extraction of natural resources such as minerals and petroleum is expected to create a stream of revenues to the government through taxes, levies and royalties imposed on

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extractive companies.[1] Subsequently, the revenues collected are used to enhance socio-economic development through the provision of social services and infrastructure.[2] However, some factors impede on the Government ability to collect such revenues.[3] For one, the multinational corporations (MNCs) in the extractive sector devise several techniques to avoid paying taxes.[4] Consequently, tax administration systems all over the world are struggling to contain the conducts of the MNCs trying to avoid

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1 Johnston, D., *International Petroleum Fiscal Systems and Production Sharing Contracts,* Oklahoma: PennWell Corporation, 1994, at pp.5-6; Parra, F., *Oil Politics: A Modern History of Petroleum,* New York: I.B. Taurus & Co Ltd, 2004, at pp.6, and 14-19; Hannesson, R., *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production*, Praeger, 1998, at p.109; Blinn, K Duval, C Le Leuch, H and Pertuzio, I*nternational Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1st edn) **(New York: Barrows Company Inc.,** 1986, at p.15;Mclaren, J "Petroleum and Mineral Resource Rent Taxes: Could These Taxation Principles Have A Wider Application?" 10 *Macquarie Law Journal*, 2012, at p.46;Sunley, EM, Baunsgaard, T and Simard, D *Revenue from the Oil and Gas Sector: Issues and Country Experience,* Washington DC: The World Bank, 2002,at pp. 2-3.

2 The objective of taxation is to raise funds to finance Governmental expenditure. See Calder, J., *Administering Fiscal Regimes for Extractive Industries: A Handbook*, Washington DC: International Monetary Fund, 2014, at p.51; Luoga, F.D.A.M., *A Sourcebook of Income Tax Law in Tanzania*, Dar es salaam: Dar es salaam University Press, 2000, at p.9; Nakhle, C., *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow*, New York: Routledge, 2008, at p. 7.

3 Otusanya OJ, Ajibolade, SO and Akerele, EK., "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria", 2(4) *African Journal of Economic and Sustainable Development,* 2013, 309-333, at p. 312.

4 The United Republic of Tanzania *Report of the Presidential Mining Review Committee to Advise the Government on Oversight of the Mining Sector*, 2008 ("Bomani Report"), at pp. 29-33, available at https://www.policyforum-tz.org/sites/default/files/BomaniReport-English_0.pdf (15 May 2020). See also Foster, J.J., & Bills, J.H., "Comparison of the impact of the fiscal regime on the gold projects in Tanzania and Burkina Faso", 111:3 *Applied Earth Science*, 195-199, at p. 197-198; Hilson, G & Maconachie, R., "Good Governance" and the Extractive Industries in Sub-Saharan Africa", 30:1 *Mineral Processing and Extractive Metallurgy Review*, 2008, 52-100, at p.90.

taxes.[5] In this regard, Tanzania is not an exception. For instance, Resolute Tanzania Limited, a mining company that operated from 1997 to 2012, exported gold and silver worth US$ 1.5 billion, but paid corporate tax only once, three years before it closed its operations.[6] During this period, the company paid royalties amounting to US$ 47.3 million and other Government taxes and levies amounting to US$ 82.5 million.[7] All these payments only amounted to only 8.6% of the total revenues generated from the project.[8] Similarly, in the case of *African Barrick Gold Plc v*

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5 See International Consortium of Investigative Journalists *The Panama Papers: Politicians, Criminals and the Rogue Industry That Hides Their Cash* (3 April 2016) see details at https://panamapapers.icij.org/ (last visited on 22 July 2017). See also Readhead, A., *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016) 1 available at http://www.resourcegovernance.org/sites/default/files/documents/nrgi_transfer-pricing-study.pdf (Accessed on 07 February 2017) See also Fuest et al *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform*, ZEW Centre for European Economic Research Discussion Paper No. 13-078, 2013, at p.1. available at http://dx.doi.org/10.2139/ssrn.2343124(24 May 2020); The effective tax rates on foreign profits of Google Inc. and Apple Inc., for example, have been reported to be 3% and 1%, respectively. See also Ault, H and Arnold, B., *Protecting the Tax Base of Developing Countries: An Overview*, Paper on Selected Topics in Protecting Tax Base of Developing countries, United Nations Draft Paper No. 1, 2013, at p. 2.

6 Commissioned in 1998 and was officially closed in February 2014.In its 15 years operations, the mine produced 2.2 million troy ounces of gold and 207,803 troy ounces of silver. See the Tanzania Minerals Audit Agency *Annual Report 2014* (2015) 2 available at http://www.tmaa.go.tz/uploads/ANNUAL_REPORT_2014.pdf. (accessed 20 November 2016) Another report quotes the total revenues generated by the mine to be US$ 3.5 billion. This indicates the inconsistency that may occur between the Government and other independent organizations. See Readhead, *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector,* above note 5, at p.9.

7 Ibid.

8 Calculation by the author based on the Tanzania Mineral Audit Agency note 6 above. Total revenues earned by Resolute is US$ 1.5 billion against revenues received by the Government (royalties and taxes) US$ 128.9 million.

*Commissioner General of TRA,*[9] a parent company paid dividends to its shareholders in London while its subsidiaries in Tanzania, which were the sole source of income, were declaring losses.[10] The net effect of these tax avoidance schemes is that resource-rich countries, such as Tanzania, lose the would-be tax revenues and thus lack of revenue to fund developmental projects. This is partly the reason that despite the ongoing extraction of oil/gas and minerals, most resource rich countries in Africa are placed in the list of poorest countries in the world.[11]

Principally, one of the techniques adopted by MNCs to avoid, reduce or minimize the tax liability in countries where they operate is transfer mispricing.[12] This article examines the legal mechanisms in Tanzania applied to deal with transfer pricing issues in the extractive sector. In doing so, the article starts by providing a general overview of the concept of transfer pricing and how it may result into abusive transfer pricing. Then, the article examines the transfer pricing regime in Tanzania. Tanzania, being

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9 Tax Revenue Appeals Tribunal Appeal No. 16 of 2015 (unreported). This decision was upheld by the Court of Appeal of Tanzania in the *African Barrick Gold PLC vs Commissioner General Tanzania Revenue Authority*, Civil Appeal No. 144 of 2018 (unreported).

10 Dividends were paid back-to-back for four years 2010 to 2014 amounting to U$D 818,431,285, The Tax Tribunal held that this was a tax avoidance scheme and the dividends were subject to payment of withholding taxes.

11 See generally Humphreys M, Sachs J and Stiglitz J "Introduction: What is the Problem with Natural Resource Wealth?" in Humphreys M, Sachs J and Stiglitz J (eds.) *Escaping the resource curse* (Irvington, NY: Columbia University Press, 2007, at pp. 1-6; Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's Natural Resources for All* 2013, at p.14 available at https://static1.squarespace.com/static/5728c7b18259b5e0087689a6/t/57ab29519de4bb90f53f9fff/1470835029000/2013_African+Progress+Panel+APR_Equity_in_Extractives_25062013_ENG_HR.pdf (10 May 2020).

12 Beebeejaun, A., "The Efficiency of Transfer Pricing Rules as a Corrective Mechanism of Income Tax Avoidance" 7 *Journal of Civil and Legal Sciences*, 2018 at p.3.

a union of two countries namely Tanganyika (now referred as Mainland Tanzania) and Zanzibar, all matters pertaining to income tax, custom duty and excise duty are union matters.[13] Notably, while under the constitution, oil and gas form part of the union matters, each constituent part of the union has its own oil and gas regulatory framework.[14] Similarly, minerals are not part of union matters.[15]

Since transfer pricing regime is primarily based on income taxation, the discussion of Tanzania in this article refers to both Mainland Tanzania and Zanzibar. However, for the sake of clarity, the article will cover specific transfer pricing issues in relation to the petroleum and mining legislation. In this regard, specific reference to Zanzibar is limited to how the Oil and Gas (Upstream Sector) Act 2016[16] regulates the transfer pricing for purposes of calculating royalties. Similarly, specific reference to Mainland Tanzania is limited to how the Mining Act 2010[17] and the Petroleum Act 2015[18] regulate transfer prices for purposes of calculating royalties payable for sales of minerals or oil and gas products in Mainland Tanzania. Finally, the article identifies the pitfalls in the Tanzanian transfer pricing regime and recommends the appropriate remedial measures.

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13 These are among the list of 22 union matters enumerated in the First Schedule to the Constitution of the United Republic of Tanzania 1977.

14 Zanzibar has the Oil and Gas (Upstream Sector) Act 2016, Act No. 6 of 2016 and Mainland Tanzania has the Petroleum Act 2015.

15 The Mining Act 2010, Act No. 14 of 2010 applies only to Mainland Tanzania.

16 Act No. 6 of 2016

17 Act No. 14 of 2010.

18 Act No. 21 of 2015.

## 2. GENERAL OVERVIEW OF THE CONCEPT OF TRANSFER PRICING

Generally, the term "transfer pricing" refers to a price set for a transaction between two companies that are part of the same group of companies for exchange of goods, services, and intangible property among one another.[19] The MNCs have integrated global operations and operate through complex webs of interrelated subsidiaries most of which are domiciled in low-tax and secrecy jurisdictions.[20]For example, Ophir Energy Plc Group of Companies (a parent company for Ophir Tanzania Ltd- a holder of a Production Sharing Agreement) has 86 subsidiaries all over the world of which 22 are incorporated in Jersey, 13 in British Virgin Island, 3 in Bermuda and 3 in Delaware.[21] Also the defunct Acacia Mining, incorporated in the UK (a holder of Mining Development Agreements (MDAs) in Tanzania), had 3 subsidiaries in the Cayman Islands, 1 in Mauritius and 1 in Barbados and 3 subsidiaries in Tanzania.[22]

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[19] Shay, S.E., "An overview of transfer pricing in extractive industries", in Daniel, P., etal *International Taxation and the Extractive Industries*, New York: Routledge, 2017, at p.43. See also Elliott, J.; Emmanuel & Clive R *International Transfer Pricing: A Study of Cross border Transactions,* London: CIMA (2000), at p.1; Urquidi, J., "An Introduction to Transfer Pricing",3(1) *New School Economic Review,* 2008, at pp. 27-28.

[20] Ostwal, T.P and Vijayaraghavan, V., "Anti-avoidance Measures" 22(2) *National law School of India review,* 2010,59-103, at p.90. Baunsgaard, T., *Primer on mineral taxation*, IMF Working Paper WP/01/139, 2001, at p. 21; Calder, J., "Transfer pricing – special extractive industry issues", in in Daniel, P., etal *International Taxation and the Extractive Industries*, New York: Routledge, 2017, at p. 80.

[21] These are famous tax havens. See Ophir "Annual Report and Accounts 2016" Appendix A, pp 143-146 available at https://cdn-ophir-energy.azureedge.net/wp-content/uploads/2017/04/Ophir-Annual-Report-2016-Web.pdf (accessed on 01 August 2017)

[22] See Acacia Mining Plc "Annual Report & Accounts 2017", at p. 118. Available at https://www.acaciamining.com/~/media/Files/A/Acacia/reports/2018/2017-acacia-annual-report-accounts.pdf (accessed 15 May 2019).

Through their network subsidiaries, the MNCs transfer large quantities of goods among operating subsidiaries in different countries and engage in a range of transactions relating to services, intangible property rights, technical or financial services, sale of mineral or petroleum rights as well as mineral/oil and gas products.[23] It is estimated that intra-company transactions constitute around 30% of global trade.[24] While transfer pricing is not always illegal or abusive, the challenge it poses is that value of goods or services charged in a related-party transaction does not always reflect market values.[25] This is because a related-party transaction takes place in absence of market friction.[26] This is exacerbated by the fact that MNCs have operations in tax havens that do not tax income or that permit arrangements that deliberately under tax.[27] In doing so, the MNCs use intermediary companies to accomplish the tax avoidance objectives.[28] This makes transfer pricing one of the key strategies for MNCs to avoid taxes.

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23 Natural Resource Governance *Transfer Pricing in the Mining Sector: Preventing Loss of Income Tax Revenue* (2016) at pp. 2-3 available at https://resourcegovernance.org/sites/default/files/documents/nrgi_primer_transfer-pricing.pdf (10 May 2020).

24 United Nations *Practical Manual on Transfer Pricing for Developing Countries,* New York: United Nations, 2017, at p. 23. Other studies indicate that transactions represent about 60%-70% of the global businesses and trade. See http://www.taxjustice.net/topics/corporate-tax/transfer-pricing

25 OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,* OECD Publishing, 2010, at p. 31.

26 Bath, G., *Transfer pricing, Tax Havens and Global Governance* Deutsches Institut für Entwicklungspolitik, Discussion Paper /; 7/2009, at p. 1; Shay, "An overview of transfer pricing in extractive industries", above note 14, at p. 44.

27 Examples include Bermuda, the British Virgin Islands, the Cayman Islands, the Channel Islands), Cyprus, Malta, Ireland, Luxembourg, Mauritius, Switzerland. See Shay, "An overview of transfer pricing in extractive industries", above note 14, at p.45.

28 Ibid.

The conduct of MNCs to abuse or manipulate transfer pricing with a view to reduce, defer or avoid tax liability, is referred to as transfer mispricing.[29] In these arrangements, the price between related parties is different from the one that would have been set between unrelated parties engaged in the same or similar transaction under the same or similar circumstances.[30] It implies that transfer pricing has the potential of resulting into a distortion between transaction values and market values as the MNCs may intentionally or artificially distort the price at which the transaction is recorded, the ultimate objective being minimization or avoidance of tax.[31] Consequently, transfer pricing becomes a tool for profit shifting and thus erosion of the country's tax base.[32] This is because the MNCs prefer disclosing higher profits in low tax jurisdictions and low or nil profits in in high tax countries.[33] In practice, transfer mispricing is effected through different techniques such as under-invoicing for example through selling

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[29] Haufler, A and Schjelderup, G., "Corporate Tax Systems and Cross Country Profit Shifting", 52(2) *Oxford Economic Papers,* 2000, 306-325, at pp. 308-312.

[30] Van Herksen, M., "Introduction" in Bakker, A., and Obuoforibo, B., *Transfer Pricing and Customs Valuation: Two Worlds to Tax as One*, IBFD, 2009 at 18.

[31] Tang, Y.S., *The International Trade Policy for Technology Transfers: Legal and Economic Dilemmas on Multilateralism versus Bilateralism,* Kluwer Law International, SLP edition, 2009, at p.51; Urquidi, J. "An Introduction to Transfer Pricing" (2008) 3(1), *New School Economic Review* at 27-28; Shay "An overview of transfer pricing in extractive industries", above note 14, at p 43; Read head, *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector,* above note 5, at p.1.

[32] See the general discussions of Base Erosion and Profit Shifting (BEPS) at http://www.oecd.org/tax/beps/

[33] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's Natural Resources for All*, above note 11, at p.65; Bernard, JT and Weiner R J "Multinational Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry" in Razin, A and Slemrod, J (eds) *Taxation in the Global Economy,* Chicago: Chicago University Press,1990, at p.123; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation,* 2012, at 37, available at https://www.imf.org/external/np/pp/eng/2012/081512.pdf (20 May 2020); IMF *Spillovers in International Corporate Taxation*, 2014, at p.11, available at https://www.imf.org/external/np/pp/eng/2014/050914.pdf (20 May 2020).

goods, services, or intangibles to a related company at a below-market price.[34] It may also involve over-invoicing through buying goods, services, or intangible property rights from a related company at a higher-than-market price.[35]

In the tax context, transfer pricing raises one of the serious issues in tax administration. For example, if not properly addressed, transfer pricing has the potential of resulting into substantial revenue loss to governments, especially in developing countries.[36] In this regard, most countries impose requirements to comply with the arm's length principle (ALP).[37] In a nutshell, the ALP requires that the transfer price (price for a transaction between related parties) must reflect the market price of the goods or services exchanged. It means that related companies should transact or trade with each other as if they were not related.[38]Thus, the marketplace comprising independent entities is the measure or benchmark for verifying the transfer prices for intra-entity or intra-group transactions.[39]Where the transaction violates the ALP, the tax authority has powers to adjust the price and charge taxes and penalties accordingly.[40] In this regard, one of the objectives for

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34 United Nations, *Practical Manual on Transfer Pricing for Developing Countries,* above note 19, at p.2.

35 Ibid.

36 Shay "An overview of transfer pricing in extractive industries", above note 14, at p. 50.

37 OECD, *Dealing Effectively with the Challenges of Transfer Pricing,* Paris: OECD Publishing, 2012, at p.20.

38 Ibid. See also Shay "An overview of transfer pricing in extractive industries", above note 14, at p 54.

39 Shay "An overview of transfer pricing in extractive industries", above note 14, at p 54.

40 Natural Resource Governance *Transfer Pricing in the Mining Sector: Preventing Loss of Income Tax Revenue* (2016) at p.3 available at https://resourcegovernance.org/sites/default/files/documents/nrgi_primer_transfer-pricing.pdf (10 May 2020)

ALP is to ensure that government collects a fair share of revenue from natural resources extracted.[41] The next section provides a brief analysis of the legal regime for transfer pricing rules in Tanzania.

## 3. LEGAL REGIME FOR TRANSFER PRICING RULES IN TANZANIA

Tanzania adopts the ALP by imposing an obligation on taxpayers, when dealing with associated persons (related-party transactions) to adhere to the arm's length principle.[42]The arm's length principle requires that all transactions between or among constituent entities of the MNC to reflect the market value and it should be seen as transaction between unrelated parties.[43] The legal regime for transfer pricing in Tanzania is discussed in detail below.

### 3.1 Tax legislation

The transfer pricing regime in Tanzania is reflected in several tax laws and regulations. These laws include the Income Tax Act, Tax

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41 Shay "An overview of transfer pricing in extractive industries" above note 14, at p. 52.

42 Section 33 (1) of the Income Tax Act, Cap 332, R.E 2008; Regulation 4(1) of the Tax Administration (Transfer Pricing) Regulations, 2018 (G.N No. 166 of 2018). See also discussions by Ault and Arnold "*Protecting the tax base of developing countries: an overview*", above note 5, at pp. 10 &14.

43 See Keen, M & Mullins, P., "International corporate taxation and the extractive industries Principles, practice, problems", in Daniel, P., etal *International Taxation and the Extractive Industries*, New York: Routledge, 2017, at pp. 13, 19. Readhead, *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector,* above note 5, at p.8. IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)37; Bernard, JT and Weiner R J "Multinational Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry" in Razin, A and Slemrod, J (eds) *Taxation in the Global Economy* (Chicago: Chicago University Press1990) 123. IMF *Spillovers in International Corporate Taxation* (2014) 31United Nations *Practical Manual on Transfer Pricing for Developing Countries* (New York, United Nations, 2013) 26-27.

Administration (Transfer Pricing) Regulations, 2018, Income Tax Regulations 2004 and the Transfer Pricing Guidelines 2014. The next section discusses the transfer pricing provisions of these laws and Regulations.

*3.1.1 Income Tax Act, (Cap.332 R.E 2008)*

The Income Tax Act requires that all "arrangements" between associates (related parties) must be at arm's length.[44]The Act defines an "arrangement" as an action, agreement, course of conduct, dealing, promise, transaction, understanding, or undertaking whether express or implied, whether or not enforceable by legal proceedings and whether unilateral or involving more than one person.[45] The law imposes a further requirement that in any arrangement between persons who are associates, the persons must quantify, apportion, and allocate amounts to be included or deducted in calculating income between the people as is necessary to reflect the total income or tax payable that would have arisen further if the arrangement had been conducted at arm's length.[46] This provision reinforces the arm's length principle.

The Act further vests the Commissioner with powers to adjust transfer prices where the transactions are not at arm's length. In so doing, the Commissioner may either re- *characterize the sources and type of any income, loss amount or payment*; or *apportion and allocate expenditure incurred* by one person in conducting a business to the person and the associate based on

[44] Income Tax Act, Cap. 332, s. 33.
[45] Id. s. 3.
[46] Id. s. 33.

the comparative turnover of the businesses.[47]Moreover, where the Commissioner General has a reason to believe that any rate of interests imposed is not at arm's length, the Commissioner General may make adjustments by imputing the interest rate.[48]These powers of the Commissioner are used as specific anti-tax avoidance measures.

*3.1.2 Tax Administration (Transfer Pricing) Regulations 2018*

These Regulations address several transfer pricing issues. The Regulations, when read together with section 33 of the Income Tax Act 2004,[49] have a wider scope as they apply to controlled transactions between a person who is assessable and chargeable to tax in Tanzania and any other person(s) who is a party to the transaction in Tanzania or outside Tanzania.[50] A controlled transaction is defined as a transaction between associates which includes a relationship between an individual and his relatives, partners in the same partnership and an entity and interposed entity or entities that control or may benefit from 50% or more of the rights to income or capital or voting power of the entity.[51]The Regulations also apply to transactions between a permanent establishments (PE) and its head office or other related branches. In this regard, a branch ("branch person") is deemed to be a separate and distinct person from the person in respect of whom it is a branch ("headquarters" person). The Regulation further deems a branch person and a headquarters person associates.[52]

47 Ibid.
48 Tax Administration (Transfer Pricing) Regulations 2018, Reg.15.
49 Id. Reg. 2(1).
50 Id. Reg. 2(2).
51 Reg. 3 read together with s. 3 of the Income Tax Act, Cap. 332.
52 Tax Administration (Transfer Pricing) Regulations 2018, Reg. 8.

The Regulations state arm's length principle (ALP) as a rule that requires the price charged between associates must be same as if the parties were not related.[53] Thus, the Regulations impose a general obligation on a taxpayer to determine the transfer price based on the ALP.[54] In establishing whether or not the price used is at arm's length, the Regulation have six transfer pricing methodologies.[55] These methods include: (a) Comparable Uncontrolled Price (CUP); (b) Resale Price Method; (c) Cost Plus Method; (d) Profit Split Method; (e) Transactional Net Margin Method; and (f) any other method as may be prescribed by the Commissioner from time to time.

The taxpayer is obliged to apply the first three methods (a), (b), and (c) (referred to in the Regulations as "Traditional Transactional Methods").[56] The methods (d) and (e), termed as "Transactional Profit Methods" can be used only when traditional transactional methods cannot be reliably applied or exceptionally cannot be applied at all.[57] Where both the traditional transaction method and the transactional profit method cannot be applied, then the taxpayer is required to apply another method prescribed by the Commissioner General.[58] Further to that, a taxpayer is permitted to apply a transfer pricing method other than those listed in the Regulation where there is evidence, to the satisfaction of the Commissioner General, that none of the listed methods can reasonably be applied to determine whether a controlled transaction is consistent with arm's length principle; and the

53 Id. Reg. 3.
54 Id. Reg. 4(1)
55 Id. Reg. 5(1)
56 Id. Reg. 5(2).
57 Id. Reg. 5(3).
58 Id. Reg. 5(4).

method used gives rise to a result that is consistent with that between independent persons engaging in comparable uncontrolled transactions in comparable circumstances.[59]

Under the Regulations, a taxpayer who participates in a controlled transaction exceeding Tanzanian shillings 10 billion in a taxable year[60] is required to prepare contemporaneous transfer pricing documentation.[61] Contemporaneous transfer pricing documentation are documentation brought into existence when a taxpayer is developing or implementing any controlled transactions.[62]The documentation provides TRA with the information necessary to conduct an informed transfer pricing risk assessment as well as a thorough audit of the transfer pricing practices of entities. Other taxpayers, who do not reach the Tanzanian shillings 10 billion benchmark, must have the documentation in place by the due date for filing corporate income tax return for that year.[63] It is notable that the Commissioner may require taxpayers, by a notice, to produce any other information, within the time specified in the notice.[64]The documentation must include information such as:[65] organisation structure; nature of the business or industry and market conditions; description of the controlled transactions including volumes and values involved; strategies and assumptions regarding factors that influenced the setting of transfer pricing policies; the actual computational workings carried out in determining transfer prices; details of the functions performed, assets employed and risks assumed by each

59 Id. Reg. 5(6).
60 Id. Reg. 7(3)(a).
61 Id. Reg. 7(1).
62 Id. Reg. 3.
63 Id. Reg. 7(3)(b).
64 Id. Reg. 7(5).
65 Id. Reg. 7(2).

person in relation to the controlled transaction; comparability analysis; selection and application of transfer pricing method, tested party and financial indicator, financial statements for the parties to the controlled transactions; documents that provide the foundation for or otherwise support or were referred to in developing the transfer pricing analysis; index to document; and any other information, data or document considered relevant by the commissioner.

As regards to intra-group services, the Regulations impose an obligation on the tax payer to apply the appropriate transfer pricing methodology to determine the arm's length transfer price for intra group services.[66] Concerning to intra group financing, the Regulations require a taxpayer, in a controlled transaction, who provides or receives intragroup financing directly, with or without consideration, to determine the arm's length rate for such assistance.[67]There is a further obligation to demonstrate that the intra group services have been actually rendered; such services has conferred economic benefit or commercial value to the business that enhance its commercial position, and that the charge for the intra group service is justifiable and at arm's length.[68] It is notable that certain services are excluded if they involve:[69] shareholder or custodial activities, duplicative services, services that provide incidental benefits or passive association benefits, on call services and any other service the Commissioner may deem not appropriate.

66 Id. Reg. 10(1)(a)(b) &(c).
67 Id. Reg. 10(3).
68 Id. Reg. 10(1)(a)(b) &(c).
69 Id. Reg. 10(2).

Regarding selling or licensing of intangible property, the taxpayer is obliged to demonstrate that the owner of the intangible property charged an arm's length price and that the value of that intangible property to the purchaser or licensee is commensurate with benefits that the intangible property is expected to generate.[70] A person is deemed to be the owner of an intangible property and is entitled to any income attributable to that property if he/she bears expenses and risks associated with development such intangible property.[71] In this regard, the owner of locally developed intangible property that is subsequently transferred outside Tanzania must be compensated appropriately at the time of transfer.[72] Similarly, a developer of an intangible property is entitled to arm's length consideration for development of such of such property.[73] Further to that a marketer of intangible property is entitled only to an arm's length consideration for undertaking such marketing activities from the owner of intangible property.[74]

It is common for related-party transactions to involve exchange commodities. As a general rule, for a controlled commodity transaction the mandatory appropriate transfer pricing method is comparable uncontrolled price method (CUP).[75] Taxpayers are also obliged to apply spot quoted prices in all their commodity transactions.[76] However, if the price agreed by the parties is higher than the quoted spot price, such agreed price is considered as the sale price.

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70 Id. Reg. 11(1).
71 Id. Reg. 11(7).
72 Id. Reg. 11(6).
73 Id. Reg. 11 (4).
74 Id. Reg. 11 (5).
75 Id. Reg. 12(1).
76 Id. Reg. 12(4), the "*quoted spot price*" refers to the price of the commodity in the relevant period obtained in a domestic or internation commodity exchange market or price reporting or statistical agencies or governmental price setting agencies.

A taxpayer is permitted request the Commissioner to enter into an Advance pricing arrangement (APA) for establishing an appropriate set of criteria for determining the ALP for certain future controlled transactions to be undertaken by the taxpayer over a fixed period of time.[77] Advance pricing arrangement (APA) refers to an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria for the determination of transfer pricing over a fixed period.[78] The major of objective of entering into an APA is to avoid the unnecessary confusion and disputes when it comes down to selecting an appropriate method for transfer pricing in the future. An application for APA must provide details on taxpayer's activities, controlled transactions, proposed scope and duration of APA; a proposal on how ALP will be determined, identification of any other country or countries that the person wishes to participate in the APA.

The APA may be entered between the Commissioner and single taxpayer or together with competent authorities of the country or countries of the taxpayer's associates.[79] The APA will be subject to review within a period of five years.[80] However, APA may be cancelled where failure to comply with fundamental terms of the APA, material breach of the critical assumptions underlying the APA, change in tax law that is materially relevant to the APA, and APA was entered into based on a misrepresentation, mistake or omission by the person.[81]While the APA process is voluntary but once an APA is entered into, it becomes binding for both the taxpayer and the TRA. It is notable, however, that the TRA is not

77 Id. Reg. 13(1).
78 Id. Reg. 3.
79 Id. Reg. 13(6).
80 Id. Reg. 13 (9).
81 Id. Reg. 13(10).

entering into APAs at the moment due to lack of capacity to negotiate them.[82]

Further to that, TRA conducts transfer pricing audits to ensure compliance with transfer pricing requirements. The main objectives of the audit is to determine and establish whether the prices charged between associated companies under common control are at arm's length.[83] The burden of proof lies on the taxpayer to provide sufficient explanation and documentation that the price charged in a controlled transaction is consistent with the arm's length principle.[84] If the audit findings reveal that taxpayer did not comply with the ALP, the Commissioner will make the necessary adjustments to ensure that the income and expenditures resulting from a related-party transaction are consistent with the arm's length principle.[85] Similarly, where any price including the rate of interest imposed or would have been imposed in a controlled transaction is not at arm's length the Commissioner may make adjustments to reflect the arm's length price or interests.[86]Adjustments will be made where consideration is less than the consideration that would have been received or receivable in an arm's length arrangement; no consideration has been charged to the associated person for the supply of property

[82] Transfer pricing issues are handled by International Tax Unit (ITU) within the TRA. As of December 2018, the ITU had only 12 members of staff. This is a small number compared to the magnitude of work required to manage transfer pricing issues including Advance Pricing Arrangement (APA).

[83] S. 33 of Income Tax Act, Cap. 332 and Reg. 4(1) of the Tax Administration (Transfer Pricing) Regulations 2018.

[84] Ibid.

[85] Tax Administration (Transfer Pricing) Regulations 2018, Reg. 4(2).

[86] Id. Reg. 15(1).

or services; where the economic substance of a transaction differs from its form.[87]

After completion of the audit exercise, TRA are required to issue its audit report that outlines the initial findings. The taxpayer is given time to consider the potential adjustment and to respond with corrections to any incorrect facts, or clarifications to the functional profile of the business. After lapse of the time given to the taxpayer to respond to audit report, TRA will proceed to issue an assessment that either agrees with the taxpayer's position or that disregards the taxpayer's position.[88] TRA will also impose a penalty for any transfer pricing adjustment made as part of a tax audit which is 100% of the adjusted amount.[89]

*3.1.3 Income Tax Regulations 2004 (G.N 464 of 2004)*

Income Tax Regulations 2004 (G.N 464 of 2004) under its Regulation 6 read together with section 9 of the Tax Administration Act 2015 (previously under section 130 of Income Tax Act 2004) vests the Commissioner with powers to prepare transfer pricing guidelines. In doing so, on 1 May 2014 the Commissioner issued Transfer Pricing Guidelines.

*3.1.4 Transfer Pricing Guidelines 2014*

The Guidelines[90]provide taxpayers with guidance about the procedures to be followed in the determination of arm's length

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87 S.33 Income Tax Act, Cap. 332 and Reg. 15(1) of the Tax Administration (Transfer Pricing) Regulations 2018.

88 Tax Administration Act 2015 (Act No. 10 of 2015), s. 48.

89 Tax Administration (Transfer Pricing) Regulations 2018, Reg. 4(5).

90 This was earlier on provided for under Regulation 15 of the repealed Income Tax (Transfer Pricing Regulations) 2014. This requirement is now provided for under

prices. The guidelines therefore a general over view as well as a practical guidance on issues and factors to be considered in arriving at an acceptable arm's length price. These include among others:- the rationale for adoption of arm's length principle; the framework on which application of the acceptable transfer prancing method is based; the general principles of comparability which form the foundation of transfer pricing analysis; documentation by taxpayers which should be prepared and maintained in support of their determination of the arm's length price; treatment of intra group transactions; and the underlying principle adopted in these guidelines has their basis on our own tax statutes and the OECD/UN guidelines.

*3.1.5 Tax Administration Act 2015 (Act No. 10 of 2015)*

As a general rule, the taxpayer is required to keep sufficient records to enable the Commissioner to ascertain income or loss from the business.[91] The law specifies the type of information and documents required to be kept by a taxpayer as well as the documentation required to explain information to be provided in a tax return or any other document to be filed with the Commissioner.[92] There is also an obligation on the taxpayers to disclose the identities of contractors and subcontractors as well as the work done.[93]All records as well as recorded details from which the taxpayer's tax returns were prepared, are to be retained for a period of five years from the end of the year of income or years of income to which they are relevant unless the Commissioner

Regulation16 of the Tax Administration (Transfer Pricing Regulations) 2018 and new Guidelines have not been issued to date.

91 Tax Administration Act 2015, s.35.

92 Id. ss. 35, 42, and 44.

93 Id. s.44 A.

otherwise specifies by notice in writing.[94] These provisions are also applicable to transfer pricing documentation requirements.

Section (8)(1) of the Tax Administration Act, considered as General Anti-Tax Avoidance Rules (GAAR) empowers the Commissioner General to intervene, where the Commissioner is of the view that there exists a scheme by the taxpayer that is intended solely for obtaining undue tax benefit, may subject that scheme to tax assessment as if no such scheme exists. In doing so, the Commissioner has powers to adjust the company's tax returns if he is satisfied (of the opinion) that the taxpayer has engaged in a tax avoidance scheme.

*3.1.6 Tax Revenue Appeals Act Cap. 408. R.E 2008*

This Act provides for the procedures and mechanisms for settlement of tax disputes. In this regard, a taxpayer who is aggrieved by an assessment or adjustments made by the Commissioner General of TRA as a result of a transfer pricing audit is required object against such assessment or adjustments by filing an objection to the Commissioner within 30 days from the date of service of the assessment.[95] An objection to a tax decision shall be made in writing stating the grounds upon which it is made.[96] The objection must be accompanied with payment of tax which is not in dispute or one third of the assessed tax whichever the amount is greater.[97] It is notable that the Commissioner discretion, where there exist good reason warranting, reduction, or

94 Id. s. 35.
95 Id. s. 51(1).
96 Id. s. 51(4).
97 Id. s. 51(5).

waiver, to waive the amount to be paid or accept a lesser amount.[98]

Where the taxpayer is aggrieved by the final determination of the Commissioner on the objection, may file an appeal to the Tax Revenue Appeals Board (TRAB).[99] The taxpayer is required to serve a notice of appeal to the Commissioner within 30 days after receiving the final determination from the Commissioner.[100] Thereafter, the appeal must be lodged with the Board within 45 days of the receipt of the final determination by the Commissioner.[101] The notice appeal must give details relating to the tax assessment and all correspondences between the taxpayer and the Commissioner General.[102]

If either TRA or the taxpayer is not satisfied with the decision of the Board, may prefer an appeal to the Tax Revenue Appeals Tribunal (TRAT) within 30 days from the date of the decision of the Board.[103] The Appellant must serve a notice to the other party within 15 days after the filing the notice of appeal to the Tribunal.[104] All appeals against the decision of the Tribunal lie to the Court of Appeal of Tanzania.[105] It is notable that only appeals on points of law can be preferred to the Court of Appeal.[106]

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98 Id. s. 51(6).
99 Id. s. 53(1).
100 Tax Revenue Appeals Act, Cap. 408, R.E 2008, S. 16(3)(a).
101 Id. s.16(3)(b).
102 Tax Revenue Appeals Board Rules, 2018 (G.N No. 217 of 2018), Rule 6
103 Tax Revenue Appeals Act Cap. 408, s. 16(4).
104 Id. s. 16(4).
105 Id. s. 25(1).
106 Id. s. 25(2).

## 3.2 Sectoral legislation

Apart from tax legislation, there are sectoral legislation that have provisions dealing with transfer pricing issues. The discussion of these pieces of legislation follows.

### *3.2.1 Petroleum Act 2015 (Act No. 21 of 2015)*

There is no express provision in the Petroleum Act 2015 requiring royalties to be calculated according to the arm's length principle. This means that the Minister of Energy does not have authority to make adjustments for prices that are not at arm's length. This is a serious omission. Apart from this omission, the Petroleum Act requires that all arrangements for debt financing must be approved by PURA.[107] The approval requirement is mandatory, and where there is non-compliance all costs in respect of unapproved loans are not allowable or deductible expenses for tax purposes.[108]

It is also notable that the law introduces a requirement to sign an integrity pledge for all licensees in Tanzania prohibiting them from undermining, prejudicing the country's financial and monetary system or inhibiting economic objectives.[109] This is taken as a general obligation against tax avoidance and tax evasion schemes. Non-compliance with integrity pledge is deemed as a breach of conditions of license and may result into withdrawal or cancellation of the license.

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[107] Petroleum Act 2015 (Act No. 21 of 2015), s 116(6).
[108] Ibid.
[109] Id. s. 224.

*3.2.2 Oil and Gas (Upstream) Act 2016) – Zanzibar*

Under this law royalties are payable based on gross production of the petroleum produced.[110] While this method avoids the complications of deducting the expenses incurred by the oil companies in marketing and transportation of minerals, there is no express provision that the price charged for sales of petroleum must be at arm's length. Similarly, there is no provision where the Revolutionary Government of Zanzibar may dispute the price set by the petroleum companies. This also implies that the Government does not have powers to make adjustment where there is transfer mispricing on prices for oil and gas products.

*3.2.3 Local Content Regulations in the extractive sector*

The Petroleum (Local Content) Regulations 2017[111] and the Mining (Local Content) Regulations 2018[112] oblige the mining/oil and gas companies (and their subcontractors) to utilize services or goods locally available in Tanzania, use of local insurance and financial services and use of legal services to be provided only by local legal practitioners or local law firms. In case of goods or services not available in Tanzania, foreign companies will be required to enter into a mandatory joint venture arrangement with local Tanzanian companies owning 15-20% of stake.[113] The Joint Venture Company/ entity must have an office in Tanzania and must be operated from Tanzania.[114] The Regulations also require that procurement of goods works and services to be conducted

[110] Section 101(1), read together with the Second Schedule to the Oil and Gas (Upstream Act) 2016.
[111] GN. No. 197 of 2017.
[112] GN. No. 3 of 2018.
[113] Reg. 15 of the Petroleum (Local Content) Regulations 2017 and Reg. 8 of the Mining (Local Content) Regulations 2018
[114] Reg. 15 (5) of the Mining (Local Content) Regulations 2018.

through competitive bidding.[115] Notably, failure to comply with local content requirements attracts hefty criminal and administrative sanctions.[116] These local content requirement reduce the interaction of MNCs with its related companies located offshore. They also increase transparency in the conduct of procurement processes as local entities are involved.

### *3.2.4 Mining Act 2010, Cap. 123, R.E 2018*

Royalties shall be calculated based on gross value of minerals at the point of sale.[117] This method avoids the complications of deducting the expenses incurred by the mining companies in marketing and transportation of minerals. The law empowers the Minister of Minerals to give notice to the mining that the price charged for sale of minerals (or mineral products) is not at arm's length.[118] The market price after this notice can be established by an agreement between the Minister and the mining company. Where no agreement is reached, the matter shall be referred for determination by an independent expert appointed as prescribed in the Mining Regulations.

In addition, require that all won raw minerals shall be mined, sorted and valued in the presence of Mines Resident Officer, an Officer from TRA and relevant institutions of state organs.[119] The Government can reject valuation done by the mining company. The Government of Tanzania also an option to buy the minerals at

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[115] Reg.16(1)(b) &18 of the Mining (Local Content) Regulations 2018 and Reg. 30 & 31 of the Petroleum (Local Content) Regulations 2017

[116] Reg. 49 of the Mining (Local Content) Regulations 2018 and Reg. 47 of the Petroleum (Local Content) Regulations 2017.

[117] Mining Act 2010, (Act No. 14 of 2010), s 87(1).

[118] Id. s. 87(3).

[119] Id. ss. 100A & 100B.

the declared value.[120] All these measures minimizes transfer pricing risks.

The law introduces an integrity pledge for all licensees in Tanzania prohibiting them from undermining, prejudicing the country's financial and monetary system or inhibiting economic objectives.[121] This is taken as a general obligation against tax avoidance and tax evasion schemes. Non-compliance with integrity pledge is deemed as a breach of conditions of license and may result into withdrawal or cancellation of the license.

### 3.3 Contractual Arrangements (PSAs & MDAs)

Both the Mining Act 2010 (before the amendments in 2017)[122] and the Petroleum Act 2015[123] vest the Minister of Energy and Minerals with powers to enter into agreements with investors with the view to grant them the right to undertake mining or petroleum operations.

The Petroleum Act vests the Minister of Energy and Minerals with powers to enter into an agreement, on behalf of the United Republic, with any person with respect a licence to explore or produce oil/gas and state the conditions attached thereto (referred to as Production Sharing Agreements –PSAs).[124] The PSA covers issues such as taxes payable by a contractor (International Oil Company), valuation of oil or gas produced from the Contract

[120] Id. s. 8.

[121] Id. ss 28(3) & 106(1).

[122] The Written Laws (Miscellaneous Amendments) Act, 2017, Act No. 7 of 2017 amended section 10 of the Mining Act by abolishing the use of Mineral Development Agreements.

[123] Petroleum Act 2015, Ss. 5(1)(c) and 47.

[124] Section 47 of the Petroleum Act 2015 (previously section 14 of the Petroleum (Exploration and Production) Act 1980.

Area. General the Model PSA provides that oil/gas produced from the Contract Area should be valued at an average fair international market price which, in the case of arm's lengths sales, the average realized price. The PSA also contain detailed accounting provisions and finally the model PSA requires a performance guarantee against work programme and budget. Currently, there are 24 PSAs are different levels.

Article 13 of the Model PSA 2013 (which is the latest Model PSA) provides that the valuation and sales of petroleum must be determined at arm's length "been third party arm's length sales". Since there is only one PSA which available in public[125], it is difficult to ascertain whether or not the PSAs have provisions for transfer pricing that are in line with both the Income Tax Act and the Petroleum Act. Article 10.1 of the PSA between Pan African Energy Tanzania (PAET) and the Government of Tanzania (GOT) provides that in establishing the revenues PAET must act in good faith and the sales must be at arm's length basis. And "Where sales have not been at arm's length, GOT may, in its reasonable discretion, impute revenues based on market prices, on behalf of TPDC and for purposes of calculating the Additional Profits Tax". Article 11(5) also provide that crude oil must be marketed based on third party arms' length sales transacted in foreign exchange and the fair market valuation for all Crude Oil.

The Minister of Energy and Mineral was vested with powers to enter into Mining Development Agreements with holders of, or an applicant for, a mineral rights.[126] The Mining Act of 1979

[125] Available at https://www.resourcecontracts.org/contract/ocds-591adf-1440947345/view#/pdf (25 May 2020).
[126] S. 10 of the Mining Act 2010 (before the amendments in 2017).

introduced the concept of MDA. The practice has been that the MDA are signed with holders of Special Mining License (SML). There are 6 MDAs signed between the Government and mining companies.[127] It is notable that all these MDAs do not have provisions on transfer pricing. Worse still, even the Model Mining Development Agreement contained in the Third Schedule to the Mining (Mineral Rights) Regulations[128] does not have a provision on transfer pricing.

### 3.4 Administrative Measures addressing transfer mispricing

There are several administrative measures that can be used to address, directly or indirectly, transfer pricing issues. For example, the law empowers the Commissioner General of TRA to request information and details from the registrar of companies for purposes of carrying out a tax investigation.[129] This makes it easier for the Commissioner to identify if there is any relationship between the companies under investigation so as to raise transfer pricing compliance requirements.

Also EWURA prescribes, both domestic and exports, rates, tariffs, charges of oil or gas produced in Tanzania.[130] Likewise, PURA has powers to set up prices for oil and gas products for the upstream sector. Similarly, the law vests the Mining Commission with powers to produce indicative prices of minerals with reference to prevailing local and international markets for the purpose of

[127] Resolute LTD- 1997, & Samax Resources Ltd & Mabangu Mining Ltd African Barrick Gold - 1999, Samax Resources Ltd & Ashanti Goldfields (Tanzania) Ltd - 1999, Afrika Mashariki Gold Mines Ltd- 1999, Pangea Minerals Limited- 2003, Pangea Minerals Limited (Buzwagi)- 2007.

[128] 2010, GN 405 of 2010

[129] S. 458 (6) Companies Act (Cap 212) as amended by s. 6 of the Finance Act 2016 (Act No.2 of 2016).

[130] S. 163(3)&(4) of the Petroleum Act 2015.

assessment and valuation of minerals and assessment of royalty.[131] In addition, the Mining Commission has powers to verify the forecasted capital investment for purposes of ascertaining mis-invoicing or any other form of malpractice in respect of mining licence and special mining licence holders and providing the same to the TRA within twelve months after the issuance of such licences. All these powers, if properly exercised, will minimize transfer mispricing risks.

In addition, PURA, Mining Commission and TRA have power to audit the books of account of all companies engaged in the extractive sector. The Commissioner General of TRA has powers to audit or investigate the extractive company's tax affairs to ascertain compliance or non-compliance with tax laws or existence of tax payable.[132] In doing so, the Commissioner has power to access any information, vessel, premises, or documents.[133] Similarly, PURA and the Mining Commission (previously it was TMAA) have the mandate to audit all matters relating to assessment and collection of oil and gas revenues.[134] In addition, PURA and the Mining Commission audits the costs on exploration, development, production, and sale of oil and gas.[135] Arguably, the existence of an audit provision means the Government controls and monitors the investor's records on expenditures and profits.[136]

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[131] S. 22 of the Mining Act 2010.
[132] S. 45(1)-(2) of the Tax Administration Act 2015.
[133] Id. s. 42(1).
[134] Section 13(2)(a) of the Petroleum Act 2015, before the enactment of the Petroleum Act this was done by TPDC.
[135] Id. S.13(2)(b).
[136] The Boston Consulting Group *Benchmarking report* (2012) 23 available at http://www.petroleum.nic.in/sites/default/files/benchmark.pdf (accessed on 18 March 2014).

Furthermore, there are several measures to enhance administrative capacity in addressing tax avoidance and tax evasion. One of the notable measures is the establishment of an International Tax Unit (ITU) within Large Taxpayers Department of TRA in 2011.[137] The ITU is dedicated to managing transfer pricing and double taxation agreements. In the same connection, TRA has subscribed to the transfer pricing database namely Orbis since 2014.[138] This pricing database is used for benchmarking prices, thus an effective tool to counteract transfer-pricing manipulation.[139] Moreover, Tanzania is a member of several global initiatives, such as the Multi-lateral Convention on Mutual Administrative Assistance in tax matters, OECD global forum on the exchange of information and transparency as well as African Tax Administrators Forum (ATAF).[140] All these measures enhance cooperation in tax matters.

It is also noteworthy that the Natural Wealth and Resources (Permanent Sovereignty) Act 2017[141] prohibits arrangements/agreements that provide for beneficiation of minerals/petroleum outside Tanzania. The Act also requires all earnings from disposal or dealings must be retained in Tanzanian banks. These provisions reduce the risk of transfer pricing for unprocessed/semi-processed minerals/oil/gas products as well as all records on transactions will be maintained by local banks. Similarly, the Natural Wealth Natural Wealth and Resources

[137]Msike, C and Mabula E "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (14-17 November 2016) at. p.3 http://www.un.org/esa/ffd/wp-content/uploads/2016/11/2016TP_Tanzania_CountryPresentation-en.pdf (accessed on 15 September 2016).

[138] Ibid.

[139] Ibid.

[140] Ibid.

[141]Act No. 5 of 2017

Contracts (Review and Re-Negotiation of Unconscionable Terms) Act 2017[142], empowers the National Assembly to advise the Government to initiate re-negotiation of the agreement with a view to rectifying the any unconscionable terms therein. Interestingly, the definition of unconscionable terms is very wide as it includes all terms that restricts periodic review of arrangement or agreement which purports to last for life time or those securing preferential treatment designed to create a separate legal regime to be applied discriminatorily for the benefit of a particular investor. This is a good speed governor on the applicability of stabilization clauses.

## 4. PITFALLS IN THE TRANSFER PRICING REGIME

The discussions and analysis of the transfer pricing regime demonstrate that there are several challenges facing the regime. It is notable that the Tanzania's anti-transfer pricing regime is still at its nascent stages.[143] There is still a need for qualified and competent personnel to enforce the arm's length rule. At the moment there are no sufficient resources and expertise to identify and address transfer pricing risks.[144] TRA has a limited number of auditors with expertise in transfer pricing to identify transactions involving abusive transfer pricing. Also the existence of stabilization clauses in the MDAs and PSAs limit the future legislative powers to amend the fiscal terms. This means even the

[142] Act No.6 of 2017, S. 5.

[143] The repealed Transfer Pricing Regulations only passed in 2014. See Msike and Mabula, "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study", above note 132, at p.4.

[144] Transfer pricing issues are handled by International Tax Unit (ITU) within the TRA. As of December 2018, the ITU had only 12 members of staff. See details under footnote 115.

most recent amendments to the Mining Act do not apply to existing PSAs and MDAs.

There are also deficiencies in the law on some key transfer pricing issues. For one, the definition of transfer pricing does not capture transactions with a non-associate that form part of a wider agreement involving an associate of extractive companies. For example, the extractive companies may enter into restrictive trade agreement with certain unrelated companies to use them as conduits for transfer mispricing. Further to that, the Income Tax Act 2004 does not set up a cap on how much the companies in the extractive sector may deduct for repayment of loans from sister companies. This encourages excessive reliance on related party loans.

Furthermore, both the Petroleum Act 2015 and the Upstream Petroleum Act 2016 (for Zanzibar) do not provide for the principle of arm's length in establishing royalties' payable by the oil and gas companies. This poses a risk that the oil and gas companies may engage in transfer mispricing so as to reduce the amount of royalties payable.

In addition, since most of the transactions are cross-border, occurring in countries that do not have cooperation in exchange of tax information, determination of prices that is at arm's length is difficult.[145] This makes it difficult for TRA to access information on the offshore entity that is party to the transaction. There is also

[145] Bajungu, C "Fairness in Taxing Multinationals and Extractive Industries": Tanzanian Perspective" (2013) 16-17. A paper presented on a conference organized by tax justice network (3-4 October 2013) available at https://en.xing-events.com/eventResources/T/Z/NrPHZSvfGUAnRs/Charles_Bajungu.pdf (accessed 20 October 2016).

lack of domestic database especially with respect to transfer pricing taxation. The existing database is insufficient to ensure the comparability of company profits and incomes. Use of foreign data is limited by market conditions such as geographical or locational factors (such as “locational savings”) would be so different.

## 5. CONCLUSIONS AND RECOMMENDATIONS

This article examined the transfer pricing regime in the Tanzanian extractive industry. In doing so the article has identified five transfer pricing risks that are likely to occur at any stage of the extractive industry value chain in Tanzania. These risks include: profit shifting through fragmentation of the supply chain and strategic location of subsidiaries such as the formation of offshore marketing procurement companies or branches or offshore hedging companies; overreliance on debt financing from related parties (thin capitalization); intra-group charges (e.g. technical fees and management fees) and the use of intellectual property from sister companies.

The Income Tax Act 2004 and the Tax Administration (Transfer Pricing) Regulations 2018 are the major legal instruments regulating transfer pricing in Tanzania. These laws provide that any income or expense arising from an international transaction between associated enterprises shall be computed having regard to the arm’s length price (ALP). It is notable, however that the transfer pricing regime does not address industry-specific issues, but serves to provide general guidance on technical aspects such comparability analysis and transfer pricing methodologies. It should be noted that transfer pricing is only one aspect of a multifaceted problem. There are other techniques such as treaty

shopping, thin capitalization, tax incentives, controlled foreign corporations (CFC), and indirect transfer of rights. This implies that addressing under taxation in the extractive industry needs a holistic approach.

This article recommends amendments to the Income Tax Act 2004. First, the law should set up a cap on management fees. In doing so the management fees should be limited to a maximum percentage of total operating costs or total revenues. For example, in Guinea, management fees, royalties, and similar payments to parent companies are deductible if they are reasonable and, in total, do not exceed five percent (5%) of annual turnover, or twenty percent (20%) of general expenses. The law should include "earnings stripping rule" that restricts interest deductibility to between 10 percent and 30 percent of a company's earnings (defined as EBITDA – earnings before interest, tax, depreciation and amortization) when the interests are charged by a related party. Third, section 33 of the Income Tax Act should be amended to require that all companies in the extractive sector to provide the following information at the time of applying for license: countries in which it operates; names of all subsidiaries and affiliates; the tax charge included in its accounts of each subsidiary and affiliate, details of the cost and net book value of its fixed assets located in each country in which it operates.

The Petroleum Act 2015 and Oil and Gas (Upstream) Act 2016) should be amended to include the arm's length principle, like it is for the Mining Act 2010, in determination of oil/gas prices for purposes of calculating royalties. The laws should also empower the government to adjust prices that are not at arm's length. Furthermore, the Mining Act 2010 and Petroleum Act 2015 should

be amended to adopt reference prices as the basis for valuing all mineral/oil/natural sales, regardless of whether they are controlled or not. The Government should introduce special Transfer Pricing Guidelines for the extractive industry. Also, the Government should subscribe shares to the parent companies (to address asymmetry of information) in order to be informed on the real profits the companies are earning.

While TRA subscription to Orbis is considered a major step ahead, there is still a need for TRA to devise mechanisms to verify the authenticity and credibility of data contained therein. The aim is to ensure that the prices posted in Orbis system reflect the real market price of commodities and machinery. For example, TRA should verify the prices of machinery from the manufacturers instead on relying on prices quoted in the international databases such as Orbis. The Government should come up with monitoring and evaluation systems ensure compliance with integrity pledge by the extractive companies. Further to that, in the spirit of integrity pledge, transfer mispricing must regarded as one of the most serious violations which should result in revocation of license.