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# Unsuccessful Implementation of the OECD Transfer Pricing Guidelines in Low Income Countries: The Case of Ethiopia

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## Abstract

*Much international technical assistance is directed towards increasing the capacity of tax authorities in low-income countries to understand and effectively implement the OECD Transfer Pricing Guidelines, and thus retain their fair share of revenue from the transnational economic transactions of multinational enterprises. The outcome of such assistance, although varied, has been generally disappointing. Constraints on material capability are considered the main explanations for the failure of low-income countries to implement transfer pricing rules in practice. By taking Ethiopia as a case study, this article builds on the capacity explanation and shows that capacity is only a generic explanation that needs to be accompanied by context-specific explanations that are not bound to material capability. Despite more than a decade of effort, and nearly two decades since the initial introduction of transfer pricing rules in the tax system, the Ethiopian tax administration has not successfully completed a single transfer pricing audit. This article identifies three country-specific factors that explain the abysmal record of implementation of transfer pricing rules in Ethiopia: the inability of tax officers to depart from long-standing practices that run counter to OECD Guidelines; institutional ambiguity and rivalry among tax policy and enforcement organs; and the possibility of mock compliance with international standards without in practice there being any such compliance. In combination, these factors show that procedures recommended by the OECD for dealing with transfer pricing issues are so far removed from what are in fact the existing practices of the Ethiopian national tax administration that the formal adoption of OECD Guidelines has resulted in little more than organisational re-labelling.*

## (1) Introduction

Transfer pricing refers to the technique of ascertaining the value or price of business transactions between related parties for tax purposes. The price of transactions between business entities that are related to each other (for example, a subsidiary and a parent company) is subject to a special assessment regime (that is, transfer pricing) because such a price is susceptible to being artificially set and therefore at variance with what would have been obtained in the case of comparable transactions between unrelated parties. Multinational enterprises (MNEs) operating in multiple jurisdictions engage in such artificial pricing of transactions between entities within their group to shift taxable profits out of jurisdictions where tax liabilities are higher. In response, international tax rules allow national tax authorities to reassess whether transactions between related parties

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are undertaken on the basis of the so-called arm's length principle (that is, resembling transactions between unrelated parties) and to make tax adjustments where necessary.

The globally predominant guidelines on transfer pricing (and tax in general) are those developed by the Organisation for Economic Co-operation and Development (OECD) and are encapsulated in its Transfer Pricing Guidelines (OECD Guidelines)[1] and Model Tax Convention.[2] The Guidelines provide a detailed manual on how to apply the arm's length principle, particularly by detailing five transfer pricing methods that tax authorities and economic actors can use to assess or demonstrate the arm's length principle.[3]

There is a polarised debate on the role of the OECD Guidelines in low-income countries.[4] On one side, mainstream international technical assistance programmes, championed by intergovernmental financial and development organisations, endorse the OECD Guidelines on transfer pricing as useful for low-income countries.[5] This camp frames the challenges such countries face in implementing effective transfer pricing regimes as primarily implementation capacity deficit, such as insufficient personnel in proportion to number of cases and inability to motivate and retain staff. For sure, tax administrations and MNEs in low-income countries, particularly in Africa, are faced with problems of "availability and quality of financial data" on comparable transactions and on financial performance of MNEs operating in their territories.[6] Nonetheless, according to this "capacity thesis", the OECD standards could be made to work in low-income countries if sufficient technical assistance were provided to tax authorities.

On the other side of the debate, a critical camp questions the fit between the OECD Guidelines and the realities that face low-income countries, both in terms of process and substance. This camp argues that the process of norm-development at the OECD is skewed against the meaningful participation of developing countries due to deeper structural factors, even after the major inclusivity reforms, such as the creation of the Inclusive Framework, that were undertaken in recent years.[7] This camp contends that, substantively, the OECD Guidelines, in particular the

[1] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017* (Paris: OECD Publishing, 2017), *https://doi.org/10.1787/tpg-2017-en* [Accessed 22 April 2023].

[2] OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version)* (OECD Model 2017) (Paris: OECD Publishing, 2019), *https://doi.org/10.1787/g2g972ee-en* [Accessed 22 April 2023].

[3] These methods are: 1) comparable uncontrolled price method; 2) resale price method; 3) cost plus method; 4) transactional net margin method; and 5) transactional profit split method.

[4] Low-income countries refers to those with lowest gross national income (GNI) per capita, as classified by The World Bank annually. The Bank uses four categories to classify economies by income: low-income, lower middle income, upper middle income, and high income. For fiscal year 2023, low-income countries are defined as those with GNI per capita of $1,085 or less. See The World Bank, "The World by Income and Region", *World Development Indicators*, *https://datatopics.worldbank.org/world-development-indicators/the-world-by-income-and-region.html* [Accessed 22 April 2023].

[5] IMF, OECD, United Nations and World Bank, *Supporting the Development of More Effective Tax Systems: A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank* (2011), *https://www.oecd.org/ctp/48993634.pdf* [Accessed 22 April 2023]. See the work of the Platform for Collaboration on Tax (*https://www.tax-platform.org* [Accessed 22 April 2023]) and the Advisory Group on Capacity Development of the UN ECOSOC Committee of Experts on International Cooperation in Tax Matters.

[6] African Tax Administration Forum, Policy Brief, *Cross-Border Taxation: Implications for Africa: African Priorities on Base Erosion and Profit Shifting (BEPS)* (December 2014), *https://events.ataftax.org/index.php?page=documents&func=view&document_id=90&token=f6678d9746a6c13793ed81641385b13d&thankyou* [Accessed 22 April 2023], p.11.

[7] Rasmus Corlin Christensen, Martin Hearson and Tovony Randriamanalina, "At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations" (2020) ICTD Working Paper 115, *https:/*

five methods of applying the arm's length principle, are too complex to implement.[8] Proponents of this "complexity thesis" consider that the OECD Guidelines are too cumbersome and complicated to be effectively implemented by tax administrations of even developed countries.[9] The Guidelines are, therefore, even more difficult to implement for low-income countries that lack transfer pricing expertise and capacity.[10] Therefore, on this view, low-income countries, particularly the least-developing African countries, are bound by an unfavourable global transfer pricing consensus over which they have little influence.

This article intervenes in this debate by showcasing the practical realities that exist in low-income countries that do not easily fall into one or the other camp. The article shows that the OECD Guidelines' fundamental problem of fit with low-income countries (the complexity thesis) is compounded by country-specific institutional problems that cannot be resolved by simply increasing capacity assistance. The explanation of capacity would lead us to presume that, with enough international technical assistance, low-income countries should be able to run an effective transfer pricing system. Granted, this would not be a quick process as setting up an effective transfer pricing audit system takes a minimum of three to five years.[11] But, ultimately, the presumption would be that technical input should translate to capacity output. The Ethiopian case complicates this picture. Despite more than a decade of activity and international technical assistance, the country has not undertaken a single complete transfer pricing audit following any of the five methods adopted by the OECD Guidelines.

The Ethiopian experience shows, as this article will bring to light, that the lack-of-capacity thesis is not a sufficiently specific explanation of why low-income countries fail to implement transfer pricing rules. Instead, unpacking the "capacity" issue by investigating the specific country context is important to understand why a particular low-income country fails to implement OECD Guidelines on transfer pricing. In other words, yes, capacity matters, but the capacity question could have varying, non-material components in specific low-income countries. This article focuses specifically on understanding the conceptual and institutional playing field that local tax authorities must navigate in order to implement transfer pricing rules. The article departs from the premise that local tax authorities play a decisive role as interlocutors between global norms and the law-in-action on the ground. By taking the agency of these governmental actors seriously, the article investigates how these actors reconcile their established knowledge and

*/www.ictd.ac/publication/at-table-off-menu-assessing-participation-lower-income-countries-global-tax-negotiations /* [Accessed 22 April 2023].

[8] Michael Durst, *Taxing Multinational Business in Lower-Income Countries: Economics, Politics and Social Responsibility* (Brighton: Institute of Development Studies, 2019); Lorraine Eden, "The Arm's Length Standard" in Thomas Pogge and Krishen Mehta (eds), *Global Tax Fairness* (OUP, 2016); Alexander Ezenagu, "Safe Harbour Regimes in Transfer Pricing" (2019) ICTD Working Paper 100, pp.6–10; Sol Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" (2018) ICTD Working Paper 86; Martin Hearson, *Imposing Standards: The North-South Dimension to Global Tax Politics* (Cornell University Press, 2021), p.4.

[9] Joseph Andrus and Richard Collier, *Transfer Pricing and the Arm's Length Principle After BEPS* (OUP, 2017).

[10] Martin Hearson, Joy W. Ndubai and Tovony Randriamanalina, "The Appropriateness of International Tax Norms to Developing Country Contexts" (2020) FACTI Background Paper 3; UN-DESA, *United Nations Practical Manual on Transfer Pricing for Developing Countries*, 2nd edn (New York: United Nations, 2017), B.1.3.11.

[11] Joel Cooper, et al., *Transfer Pricing and Developing Economies: A Handbook for Policy Makers and Practitioners* (Washington DC: World Bank, 2016).

institutional interests with their new responsibility of translating global transfer pricing standards into domestic practice.

*(a) The catch 22: neither resisting nor implementing the OECD Guidelines*

Low-income countries are often neither able to pivot away from nor effectively emulate the OECD orthodoxy in transfer pricing. Simplified transfer pricing methods that pivot away from the OECD Guidelines have emerged, particularly in Latin America and Asia.[12] Notable examples include Brazil's adoption of fixed profit margins—that is, the tax rules predetermine the percentage of profit markup for transactions—when using transfer pricing methods that are calculated by taking costs and adding markup (cost-plus method) or the difference between the purchase and onward sale of a product (resale price method).[13] In other instances partial adjustments to the application of the OECD methods were made, such as use of referential profit margins whereby tax authorities rely on pre-defined profitability margins that approximate to those found in the open market, and geographical market adjustments that capture the difference between jurisdictions/economies of varying characters.[14] The development of alternative methods, however, has not gained significant traction in Africa. Instead, the prevalent trend is recognition of the OECD Guidelines in domestic legal systems, either by law or by fait accompli. In the limited jurisprudence in Africa on transfer pricing we see that some judiciaries endorse the OECD Guidelines as applicable rules de facto, even in the absence of their formal incorporation into domestic law.[15] International technical assistance in setting up transfer pricing administration capacity in developing states is also concentrated on implementing the OECD Guidelines in those countries.

Although critical work in political economy has shed light on the misfit between the OECD Guidelines and the needs and capabilities of developing countries, adherence to the Guidelines continues to be the norm.[16] The ability of developing states to depart from the OECD Guidelines is constrained due to deep structural factors. The key structural factors include political path

[12] e.g. Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" (2018) ICTD Working Paper 86; Ezenagu, "Safe Harbour Regimes in Transfer Pricing" (2019) ICTD Working Paper 100; Martin Hearson and Wilson Prichard, "China's Challenge to International Tax Rules and Implications for Global Economic Governance" (2018) 94(6) *International Affairs* 1287.

[13] Marcelo Ilarraz, "Drawing upon an Alternative Model for the Brazilian Transfer Pricing Experience: the OECD's Arm's Length Standard, Pre-fixed Profit Margins or a Third Way?" [2021] B.T.R. 218; OECD and Receita Federal do Brasil, *Transfer Pricing in Brazil: Towards Convergence with the OECD Standard* (2019), *www.oecd.org/tax/transfer-pricing/transfer-pricing-in-brazil-towards-convergence-with-the-oecd-standard.htm* [Accessed 22 April 2023].

[14] Hearson, Ndubai and Randriamanalina, "The Appropriateness of International Tax Norms to Developing Country Contexts" (2020) FACTI Background Paper 3; Hearson and Prichard, "China's Challenge to International Tax Rules and Implications for Global Economic Governance" (2018) 94(6) *International Affairs* 1287; Carlos Pérez Gómez Serrano, Enrique Bolado Muñoz and Isaác Gonzalo Arias Esteban, "Cocktail of measures for the control of harmful transfer pricing manipulation, focused within the context of low income and developing countries" (CIAT/GIZ, 2019) *Inter-American Center of Tax Administrations*, *https://www.ciat.org/Biblioteca/Estudios/2019_cocktail_TP_ciat_giz.pdf* [22 April 2023].

[15] e.g. *Unilever Kenya Ltd v The Commissioner of Income Tax*, High Court of Kenya, Appeal No. 753 [2005]; see also, Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" (2018) ICTD Working Paper 86, p.21.

[16] Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" (2018) ICTD Working Paper 86, p.19.

dependency by developing countries, consolidation of the epistemic "communities of practice"[17] committed to OECD orthodoxy, the risks of competitive disadvantage when countries diverge from globally dominant tax practices, and the difficulty of devising alternative systems.[18] The path dependency in particular arises from the fact that the OECD Guidelines occupy a "hegemonic"[19] or "canonical"[20] position in global tax governance. The Guidelines are accepted as a de facto legal standard, without technically being a binding instrument.[21] In low-income countries where adopting the OECD Guidelines is accepted as the only option, actually implementing it is also a problem. African states face key capacity constraints such as building and sustaining expertise, accessing resources such as databases, and information exchange mechanisms.[22] The capacity problem is compounded by the fact that the OECD-led regime undergoes constant updates, which makes keeping pace an even greater challenge.[23]

*(b) Ethiopia as a case study*

Ethiopia is relatively new to transfer pricing. The legislative instrument that nominally introduced transfer pricing was the Income Tax Proclamation No.286 of 2002.[24] A Transfer Pricing Directive (TP Directive) with detailed rules on transfer pricing was adopted 13 years later in 2015,[25] and a transfer pricing unit (TP Unit) was established under the Large Taxpayers Office of the Ministry of Revenue in 2016. The Ministry of Revenue has since restructured the organisation and set up the TP Unit under the General Tax Audit Directorate.

Ethiopia is a case study of interest due to its large economic size in Africa, its fast economic growth, and recent market liberalisation reforms in the country that have dramatically increased its openness for MNEs.[26] The country is the second most populous in Africa with close to 115 million people.[27] It has one of the fastest growing economies in Africa, having registered an average 9.4 per cent growth per year between 2010–11 and 2019–20.[28] Following governmental

[17] Lynne Oats and Helen Rogers, "Communities of Practice" in Lynne Oats (ed.), *Taxation: A Fieldwork Research Handbook* (London, New York: Routledge, 2012), pp.107–113; Peter M. Haas, "Epistemic Communities and International Policy Coordination" (1992) 46(1) *International Organization* 1.
[18] Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" (2018) ICTD Working Paper 86, p.19.
[19] Hearson, Ndubai and Randriamanalina, "The Appropriateness of International Tax Norms to Developing Country Contexts" (2020) FACTI Background Paper 3.
[20] Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" (2018) ICTD Working Paper 86, p.19.
[21] Hearson, *Imposing Standards: The North-South Dimension to Global Tax Politics* (2021); Sol Picciotto, "Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation" (2015) 24 *Social & Legal Studies* 165; Fritz Brugger and Rebecca Engebretsen, "Defenders of the Status Quo: Making Sense of the International Discourse on Transfer Pricing Methodologies" (2020) 29(1) *Review of International Political Economy* 307.
[22] IMF, OECD, United Nations and World Bank, *Supporting the Development of More Effective Tax Systems: A Report to the G20 Development Working Group* (2011).
[23] African Tax Administration Forum, *The place of Africa in the shift towards Global Tax Governance: Can the taxation of the digitalised economy be an opportunity for more inclusiveness?* (2019), *https://events.ataftax.org/index.php?page=documents&func=view&document_id=35#* [Accessed 22 April 2023].
[24] Income Tax Proclamation No.286/2002 art.29. The Proclamation is subsequently replaced by Income Tax Proclamation No.979/2016.
[25] Transfer Pricing Directive (TP Directive) No.43/2015.
[26] World Bank country overview for Ethiopia, *https://www.worldbank.org/en/country/ethiopia* [Accessed 22 April 2023].
[27] World Bank country overview for Ethiopia.
[28] World Bank country overview for Ethiopia.

reform in 2018, the country has embarked on a so-called "Homegrown Economic Reform", an ambitious market liberalisation and opening agenda supported by international financial institutions.[29] This means the country is poised for a significant influx of MNEs and exposure to attendant transfer pricing issues.

As a newly established transfer pricing administration system within a large developing country, the Ethiopian tax regime provides a practical and intellectual case-study of how actors in low-income countries can translate formal policy into action. The study refines our understanding of the broad administrative and legislative constraints placed upon low-income countries, which have been identified in existing literature, by highlighting issues arising from the peculiarities of working practices and institutional set ups in the country's tax governance. This article will show that, while the general capacity constraint thesis remains valid, the Ethiopian case study qualifies this thesis by showing three distinct factors that explain why the country has failed to follow the OECD Guidelines. The first factor concerns the inertia of existing long-held tax practices that contradict the OECD Guidelines, the second relates to the peculiar institutional ambiguities and contradictions within the broader tax governance architecture that hinder implementation of transfer pricing rules on the ground, and the third factor is the possibility of shadow playing or "mock compliance" with international standards that has distracted attention from the actual implementation of transfer pricing rules.

### *(c) Methodology and structure*

The study is conducted through a desktop review of literature, legal analysis of Ethiopian legislation, and semi-structured qualitative interviews and focus group sessions with elite informants in Ethiopia. The literature review covered an assessment of transfer pricing experiences and broader trends in the developing world. Ethiopian legislation is juxtaposed against the OECD Guidelines to highlight the influence of the latter on the design of the Ethiopian transfer pricing regime. The elite interviews and focus group sessions were essential to understanding the functioning of the Ethiopian transfer pricing administration and the perceptions of government officials who implement the transfer pricing laws.

All interviews and focus group sessions were undertaken between the last week of August and the end of September 2021 with officials (heads of units) from the Ethiopian Ministry of Revenue (the Transfer Pricing Audit Unit), Ministry of Finance (Legal Service and Tax Policy Directorates), Customs Commission Valuation Office, current and former legal and audit staffers of select MNEs operating in Ethiopia, and a senior private consultant who had formerly been involved in the initial work of setting up the Ethiopian transfer pricing regime. The interviews were in-depth qualitative explorations of the issues surrounding the implementation of the Ethiopian transfer pricing legislation, semi-structured with guiding themes and questions. The focus group brought together representatives of the above-mentioned government organs for an interactive discussion based on the initial input they had provided during interviews.

[29] IMF, press release No.19/486, *IMF Executive Board Approves US$2.9 Billion ECF and EFF Arrangements for Ethiopia* (20 December 2019), *https://www.imf.org/en/News/Articles/2019/12/20/pr19486-ethiopia-imf-executive-board-approves-ecf-and-eff-arrangements* [Accessed 22 April 2023].

The use of interpretive research methods such as qualitative interviews and focus groups in tax research reflects the growing recognition of the "social and institutional" characteristics of tax practice.[30] There is a rich literature in which tax law and practice are studied from a variety of interdisciplinary interpretive perspectives, opening up the domain for non-positivistic research methods.[31] This approach recognises tax systems as not only technical fields of study that can be grasped through quantitative methods—such as anonymised interviews and surveys—but also as (inter)subjective constructs that should be investigated through the lens of subjects with direct lived experience in those systems. In this regard, semi-structured elite interviews and focus group sessions, guided by open-ended questions, allow engagement in a free-flowing, in-depth discussion with subjects and privileged access to their viewpoints.[32] Elite subjects are generally defined in terms of their "proximity to power" or "professional expertise".[33] In this research, the subjects are elite in the sense of both expertise (tax administrators and practitioners) and power (high-level civil servants).

These interpretive methods are not without their limitations. Primary limitations relevant to this study include securing a satisfactory number of interviewees, and soliciting their authentic voices, unburdened by their need to propagate the official narratives of the governmental offices they represent. Although in elite interviews the number of interviewees is not necessarily an indicator of the quality of the research, the greater the number of interviews, the more chance there is of finding subjects that can provide informative content.[34] To secure as many subjects as possible, the authors tapped into the professional network of one of the authors, who is a mid-level official at the Ethiopian Ministry of Finance. This provided access to multiple experts and policy-makers at the Ministry. The authors snowballed from their contacts at the Ministry of Finance to reach other government departments, in particular the Ministry of Revenue, including the team leader and staffers of the TP Unit, and the Customs Commission. With respect to the authenticity of voices, elite interviewees are well aware of their favourable power-relations vis-à-vis researchers and could seek to run their own agendas or public relations goals through scholarly interviews.[35] In this case, a particular concern was that interviewees, as government officials, would care more about crafting narratives that put them and their institutions in the best possible light or would performatively regurgitate official narratives rather than divulge their authentic experiences and views. To mitigate this possibility, the authors reached out independently to experts that had been formerly involved in the initial establishment of the country's transfer pricing regime, and who had since gone into private practice or had become private sector representatives in the country. Interviews with these independent experts and

[30] Oats, "Tax as a Social and Institutional Construct" in Oats (ed.), *Taxation: A Fieldwork Research Handbook* (2012), pp.3–8.
[31] Oats, "Tax as a Social and Institutional Construct" in Oats (ed.) *Taxation: A Fieldwork Research Handbook* (2012).
[32] On elite interview in tax research, see David Richards, "Elite Interviewing: Approaches and Pitfalls" (1996) 16(3) *Politics* 199.
[33] Kari Lancaster, "Confidentiality, anonymity and power relations in elite interviewing: conducting qualitative policy research in a politicised domain" (2017) 20(1) *International Journal of Social Research Methodology* 93; Zoë Slote Morris, "The Truth about Interviewing Elites" (2009) 29(3) *Politics* 209.
[34] William S. Harvey, "Methodological Approaches for Interviewing Elites" (2010) 4(3) *Geography Compass* 193, 197.
[35] Lancaster "Confidentiality, anonymity and power relations in elite interviewing: conducting qualitative policy research in a politicised domain" (2017) 20(1) *International Journal of Social Research Methodology* 93.

private sector representatives served as a counterweight to the official governmental narrative that was likely to be espoused by the interviewed incumbent civil servants.

The structure of the article is as follows. Section 2 provides an overview of the legal and institutional framework governing transfer pricing in Ethiopia. It shows that the normative framework draws heavily on the OECD template. Section 3 is the core discussion that presents the findings of the study. The discussion in this section is divided into the three main findings of the article, that is, factors related to existing practices (section 3(a)), institutional issues (section 3(b)), and mock compliance (section 3(c)). Concluding remarks are offered in the final section, section 4.

## (2) Overview of the Ethiopian transfer pricing regime

The Ethiopian Income Tax Proclamation has always required that transactions between related persons be conducted in accordance with the established arm's length principle and is largely aligned with the OECD Guidelines. The Ethiopian TP Directive provides guidance on how the arm's length principle is to be implemented in assessing and adjusting prices for transactions between related enterprises. [36] It recognises the five transfer pricing methods adopted under the OECD Guidelines: 1) the comparable uncontrolled price method; 2) the resale price method; 3) the cost-plus method; 4) the transactional net margin method; and 5) the transactional profit split method. The TP Directive also provides taxpayers with the option of using an additional method, provided that none of the five approved methods can reasonably be applied and that the additional method's result is consistent with the arm's length principle.[37] Moreover, in selecting the method most appropriate to specific cases, the TP Directive replicates the criteria for consideration provided under the OECD Guidelines.[38] The TP Directive also stipulates standard factors determining comparability,[39] which are consistent with OECD Guidelines.

When reporting to the tax authority, taxpayers are required to present transactions made with related enterprises in documentary form. The TP Directive further sets out certain elements that are to be included in the documentation requirements.[40] The documentation itself is to be prepared in English or in the local language (Amharic), but taxpayers are not required to report documents automatically within a specific time period. The TP Directive simply empowers the tax authorities

[36] "Transaction between related parties" is defined in Ethiopian tax law as transactions between resident taxpayers and their related non-resident entities (international transactions), or those between two related resident taxpayers having an annual turnover of more than 500,000 Ethiopian Birr (ETB), which is around US$10,000. See TP Directive 43/2015 art.3, read in tandem with art.79 of Income Tax Proclamation 979/2016. On 5 December 2017, the Ministry of Finance and Economic Cooperation (MoFEC) issued a directive (No.T/C/5/161) that increased the mandatory value added tax (VAT) registration threshold from ETB 500,000 to ETB 1 million.

[37] TP Directive 43/2015 art.6(2).

[38] TP Directive 43/2015 art.5. These are: 1) strength and weaknesses of the method; 2) the nature of the controlled transaction; 3) availability of reliable data needed to apply selected method; and 4) degree of comparability between controlled and uncontrolled transactions.

[39] These are: characteristics of the goods or services; functional analysis; contractual terms; economic conditions and market circumstances; and business strategies. See TP Directive 43/2015 art.5.

[40] TP Directive 43/2015 art.15(3). The elements are: 1) the taxpayer's business operations and organisational chart; 2) the group's structure; 3) the controlled transaction; 4) explanation of selected method; 5) comparability analysis; 6) industry and economic analysis; 7) details of any APA or other agreements; 8) justification of consistency with ALP; and 9) any other relevant information.

to request the disclosure of such documents—and any other documents—and does not stipulate any penalty for failure to comply.

In terms of institutional framework, the Ethiopian Ministry of Finance is mandated with formulating policy and laws on taxes, while the Ministry of Revenue administers taxes and custom duties. The Customs Commission is situated within the Ministry of Revenue. The Ministry of Revenue is mandated with the administration of both tax and customs together with other non-tax revenue streams. The Ministry was formerly a special agency, known as the Revenue and Custom Authority, accountable to the Prime Minister.[41] After a governmental restructuring in 2018,[42] it has become an independent ministry within the Prime Minister's cabinet. This restructuring has ostensibly given the Ministry more political power as it now has a say in policy-making deliberations at the cabinet level. However, the Ministry still does not enjoy full political power within its remit as ultimate policy-making power on tax and revenue matters belongs to the Ministry of Finance. The Ministry of Revenue can only initiate policy, and issue directives for the implementation and administration of policy.[43]

A core branch within the Ministry of Revenue, known as the Domestic Tax Revenue stream, houses a General Tax Audit Directorate. The Ethiopian TP Unit, the chief audit unit responsible for administering the TP Directive, is a department within the General Tax Audit Directorate. The General Tax Audit Directorate is well supported human resource-wise, while the TP Unit, as will be discussed later, is a highly under-staffed unit.[44]

Although the TP Unit and the General Tax Audit Directorate seem designed to deal with transfer pricing and general tax auditing respectively, there is some confusion as to which unit deals with transfer pricing cases, as will be elaborated upon later. The TP Unit perceives its mandate as including the undertaking of transfer pricing audits, but it has not so far been able to undertake one due to factors to be explained later.[45] Partly because the TP Unit has not undertaken any audit work so far, and partly because of mandate ambiguity, the General Tax Audit Directorate deals with multinational taxpayers with potential transfer pricing issues, but relies on general tax provisions when rejecting and accepting expenses incurred in transactions between related parties as deductible expense. As such, it does not apply the arm's length principle for the purposes of such assessment, nor the "fair market value"[46] principle which gives the tax authority the power to adjust prices for transactions between unrelated parties.[47]

Regarding the settlement of disputes between taxpayers and the tax administration, the following layers of dispute settlement mechanism are in place. A taxpayer may file a Notice of Objection to a Tax Decision in written form within 21 days after a decision is delivered whenever a taxpayer disputes the tax authority's audit report-based tax decision.[48] A Tax Review Unit,

[41] Proclamation 587/2008 (Ethiopian Revenue and Customs Authority Establishment Proclamation) art.3.
[42] Proclamation 1097/2018 (Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation).
[43] Proclamation 587/2008 (Ethiopian Revenue and Customs Authority Establishment Proclamation).
[44] Interview with TP Unit staffers, August-September 2021.
[45] Interview with TP Unit staffers, August-September 2021.
[46] Tax authority applies "fair market value" to determine the cost of an asset under Income Tax Proclamation 979/2016 art.68, determination of the disposal of an asset under art.70, and the valuation of amounts derived in-kind under art.75.
[47] Proclamation 983/2016 (Ethiopian Federal Tax Administration Proclamation) art.3.
[48] Proclamation 983/2016 (Ethiopian Federal Tax Administration Proclamation) art.54.

which is placed within the Ministry of Revenue, will then make a decision in response to the Notice of Objection and provide recommendations to the tax authority or the taxpayer.[49] Such a decision will contain a statement of findings on the material facts, the reasons for the decision, and information about the right to appeal to an independent tribunal known as the Tax Appeal Commission.[50] The Commission is accountable to the Prime Minister. The judiciary (Federal High Court and Supreme Court)[51] serves as a last recourse for the settlement of tax disputes. So far, the researchers have not found any transfer pricing-related case pending in court.[52]

### (3) Beyond the capacity problem

This article principally reveals that intangible, non-material (that is, non-economic) dimensions of capacity are the constraints that hinder the implementation of the OECD Transfer Pricing Guidelines. However, this does not mean that material capability is an irrelevant or unimportant factor. On the contrary, the Ethiopian tax system has a severe material capacity problem. The country's transfer pricing system is, in terms of expertise and resource, at a near non-existent level. Currently the TP Unit of the Ministry of Revenue is staffed by a handful auditors (at the time of interview in September 2021, only three auditors),[53] who are in charge of all aspects of transfer pricing in the country beginning with the conduct of risk analysis to the undertaking of audits into specific multinational enterprises. This small team has mostly been busy investigating and compiling data on the type and number of MNEs functioning in Ethiopia (about 179 MNEs have been identified) and has not yet undertaken a full transfer pricing audit.[54] Although training was provided by the OECD when the TP Unit was established, staffers admit they do not have sufficient knowledge to perform the arm's length assessment using any of the standard methods. The last substantive training was provided about ten years ago, and those that were trained have since left the Ministry of Revenue.[55] However, there have since been some capacity building projects run by the OECD, the IMF and the International Bureau of Fiscal Documentation (IBFD).[56] Demands for subsequent training by international experts are met with a lack of response from policy-makers, due, among others things, to a suspicion that foreign experts will exploit the legal gaps in the system if given intimate access to it.[57]

The TP Unit also has neither a well-organised structure nor access to any database or advanced information processing technology. Foundational steps such as developing a structure, manuals and procedures for undertaking transfer pricing have not been carried out, except for a rudimentary

[49] Proclamation 983/2016 (Ethiopian Federal Tax Administration Proclamation) art.55.
[50] Proclamation 983/2016 (Ethiopian Federal Tax Administration Proclamation) arts 55 and 56.
[51] Appeal to Federal High Court and Supreme Court shall be made on a question of law only, and the notice of appeal shall state the question of law that will be raised on the appeal (Proclamation 983/2016 arts 57 and 58).
[52] Since its establishment in 2018, the Tax Appeal Commission has received and dealt with 2,215 customs and 1,654 tax appeals. As of September 2021, it has 358 pending cases. None of the completed and ending cases directly identify transfer pricing as a disputed issue.
[53] Interview with TP Unit leader, August-September 2021.
[54] Interview with TP Unit staffers, August-September 2021.
[55] Interview with TP Unit staffers and a consultant to the Ministry of Revenue involved in the initial setting up process, August-September 2021.
[56] Interview with Ministry of Finance staffers, August-September 2021; see also database of Platform for Collaboration on Tax, *https://www.tax-platform.org/country/ethiopia* [Accessed [Accessed 22 April 2023].
[57] Interview with a consultant to the Ministry of Revenue, August-September 2021.

organogram internally prepared by the TP Unit.[58] All research and investigation, including information on the nature and activities of taxpayers, is undertaken using open-source materials and regular internet searches.[59] Furthermore, databases necessary for comparability assessment are not in use. There have been discussions about purchasing subscriptions to certain databases (for example, Orbis) that could be shared with other units of the Ministry of Revenue, but a decision has not been made mainly due to the high cost of these databases and their poor fit within the Ethiopian context.[60] In the absence of such formal sources of information and data, the TP Unit is not in a position to manage MNEs' transaction audits.

The capacity problem is compounded by practical obstacles. One example is the issue of language. The TP Directive is heavily influenced by the principles elaborated upon in the OECD Guidelines. Article 18 of the TP Directive specifies that the OECD Guidelines are a source of interpretation for the Directive. The OECD Guidelines are, however, too complex for local experts to grasp. The TP Unit staffers state that much of the English vocabulary and the concepts in the Guidelines are simply too difficult to understand and implement. Some interviewed tax accountants also state that this is a serious challenge not only for tax officers, but also for private consultants who in general possess greater expertise than the TP Unit staffers. Together with the OECD Guidelines, the TP Directive prepared in the local Amharic language is also described as not easy to understand. It is worthy of note that in the preparation of the TP Directive, undertaken by OECD consultants with World Bank funding, a first draft was rejected as too complex, and that the final text of the TP Directive is a second version that was presumed to further simplify the OECD Guidelines. Reference to the OECD Guidelines would, however, still be necessary to interpret the TP Directive. In light of this, there have been local efforts made to translate the OECD Guidelines into the local language (Amharic). This effort has not materialised, however, as the task has proved too difficult and would require significant investment. Moreover, translation into unfamiliar local terms would not reduce the complexity problem and would therefore be unhelpful.[61]

The dire capacity constraints referred to above are not, however, particularly unique to Ethiopia. Low-income countries face largely similar material challenges.[62] A closer study of the working practices of Ethiopian tax officers reveals that other context-specific non-material factors are also at play in blocking the translation into action of transfer pricing rules as they appear in the books. This article identifies three such major factors: 1) long-standing tax practices that contradict transfer pricing rules; 2) institutional ambiguity and rivalry; and 3) mock compliance. The following sections discuss each factor.

[58] Interview with TP Unit staffers, August-September 2021.
[59] Interview with TP Unit staffers, August-September 2021.
[60] Interview with TP Unit staffers, August-September 2021.
[61] Interview with TP Unit staffers and a consultant to the Ministry of Revenue involved in the initial setting up process, August-September 2021.
[62] UN-DESA, *United Nations Practical Manual on Transfer Pricing for Developing Countries*, 3rd edn (New York: United Nations, 2021).

*(a) Long-standing practices: the case of abuse of permanent establishment rules*

Departing from a long-established working practice and embracing transfer pricing rules is a critical challenge for Ethiopian tax officers. The challenge of inertia arising from long-standing tax practice is most visible in the context of taxation of payments for technical and management services rendered by foreign entities without a local permanent establishment (PE). When the service provider is a related party to the local service recipient, the tax treatment of the payment is in practice ambiguous. Tax authorities' practice, borne out of the desire to prevent PE abuse, runs contrary to the OECD rules that allow for such payments to be tax deductible as long as they are in keeping with the arm's length principle. Existing practice is to largely dismiss headquarters' expenses as non-deductible, and this makes it difficult to apply transfer pricing rules.[63]

Interviews with revenue and tax authority personnel reveals that the artificial avoidance of permanent establishment is perceived to be a critical point of revenue loss for the country. In particular, technical and management services provided by a parent or related company to an establishment in Ethiopia is a very common point of dispute between taxpayers and tax authorities. There is a general belief among tax policy-makers and administrators that the practice of related/parent entities abroad undertaking technical and management services in Ethiopia through non-PE local agents, whereby the local agent's business profit is allocated to the related entity abroad, is a key vulnerability through which significant tax base erosion occurs in the country.

This entrenched suspicion of MNEs' transactions has led to unjustified refusal to recognise legitimate technical and management services rendered by parent organisations abroad as tax deductible by tax administrators. Ethiopian tax law provides a generic recognition of all expenses "incurred for the purpose of earning, securing and maintaining" a business income and does not include payments for technical and management services under non-deductible items.[64] The legal interpretation is, therefore, that expenses incurred by local taxpayers for services received from a related party/headquarter abroad are tax deductible, subject to the normal transfer pricing condition that the transaction must have been undertaken at an arm's length. In practice, however, the General Tax Audit summarily rejects such expense items in its tax assessment. Interviews with experts representing agricultural exporters and manufacturers have also shown a similar pattern. Tax administrators do not apply transfer pricing rules and instead simply reject expense deductions on the grounds of general tax law, or on the basis that the particular expense item is not recognised under the general tax rules.[65] The common justification provided is a customary view that services provided by parent companies cannot be regarded as expenses of the PE.[66] In other instances, the rejection arises from the belief that such deductibles cannot be granted in the absence of a tax regime regulating those specific expense items by way of setting limits or thresholds. By the "tax regime", the reference is to the Income Tax Proclamation, not the TP

[63] Interview with representatives of large taxpayers and TP Unit staffers, August-September 2021.
[64] Income Tax Proclamation 979/2016 arts 20 and 21.
[65] Interview with legal counsels of flower growers and exporters, and pharmaceutical manufacturers, August-September 2021.
[66] Interview with private auditors, representatives of large taxpayers, and officials at the Legal Directorate of the Ministry of Finance, August-September 2021.

Directive. In other words, the General Tax Audit puts aside the TP Directive entirely and seeks to evaluate these expenses by reference to the general income tax regime.

In one illustrative case, following such rejection by tax authorities, a dispute between taxpayers and the Ministry of Revenue has been brought to the policy-making body (Ministry of Finance) for a ruling. Company X was withholding a 15 per cent technical services fee for payments made to its parent company. However, all the technical services fees were rejected following an audit undertaken in accordance with a general tax audit. The taxpayer claimed that if technical and management services are not recognised as independent transactions with the parent or related company, then the 15 per cent withholding tax originally paid on that transaction should be refunded to them. The Ministry of Revenue brought a request for an advance ruling at the level of policy to the Ministry of Finance, which ruled that the withholding tax should indeed be refunded to the taxpayer. Interviews with the pertinent Ministry of Finance officials revealed that the policy-makers appreciated that the matter should have been assessed in accordance with the TP Directive stipulations and that the technical and management services fees should have been recognised as tax deductible expenses, subject to the usual arm's length precondition. However, the policy-makers reasoned that they could not overrule the Ministry of Revenue's individual tax assessments as they did not have an administrative mandate, and that their advance ruling only clarified the policy that withholding tax cannot be imposed on a transaction that is not recognised as occurring between two separate entities. But what this ruling creates is a general precedent whereby tax administrators simply put aside transfer pricing rules when rejecting technical services fees as expenses, in which case taxpayers can request the refund of the withholding tax they have already paid. This example shows the kind of challenge being faced by both the tax administration and taxpayers

In circumstances in which the related party in the transaction is a resident of a jurisdiction with which Ethiopia has agreed a double taxation avoidance treaty (DTA), the local receiver of the service/or the payer asserts its right to not pay withholding tax altogether. The anxiety Ethiopian tax administrators describe is that when expenses arising from transactions with parent or related companies are taken as expenses, in accordance with the TP Directive, and the withholding tax on such transactions is also waived due to a DTA, then the country would be losing revenue double-fold. The customary impulse to reject such transactions as expenses also arises from this anxiety.

*(b) Institutional ambiguity and rivalry*

Certain tensions that exist in the operation of the various entities and organs that are involved in transfer pricing policy-making and administration also contribute to the overall paralysis in Ethiopia's transfer pricing regime. The ambiguity and the rivalry between relevant tax authorities result in confusion for taxpayers. There is a disconnect between the administrative level (TP Unit) and the policy level (the Ministry of Finance). Within the administrative level, there is an overlap between the mandates of the Transfer Pricing Audit Unit and the General Tax Audit departments of the Ministry of Revenue, and a disconnect between the mandates of the Ministry of Revenue and the Customs Commission.

(i) The TP Unit v general tax audit

The TP Unit is an independent audit unit established under the Large Taxpayers Office of the Ministry of Revenue. As mentioned earlier, the TP Unit is positioned under the Ministry of Revenue's General Tax Audit department which, as the name implies, has a general remit. There is a certain mandate ambiguity and rivalry between the TP Unit and the General Tax Audit unit. The TP Unit is mandated to undertake TP audits as a supplement to the general audit and is driven by its own risk analysis. Interviews with key informants from the General Tax Audit, however, revealed that there is a tendency among higher management at the Ministry of Revenue to perceive the mandate of the TP Unit as being only for data processing and analysis feeding investigation reports on transactions between related parties to the General Tax Audit, and not as an audit unit in itself—despite the naming of the TP Unit as an "audit process unit". The TP Unit, on the other hand, asserts its role as an audit unit.

The fact that the TP Unit is so far not implementing the TP Directive, but is instead attempting to apply general tax legislation, complicates the demarcation between the functions of the TP Unit and the General Tax Audit. The General Tax Audit personnel believe that the transfer pricing auditing task cannot be detached from the regular tax auditing work carried out in their department. They assert that the TP Unit's role should only be confined to identification of MNEs with potential transfer pricing transactions and supply inputs for the General Tax Audit as required. The TP Unit personnel, on the other hand, perceive their role to be as comprehensive tax auditors specialising in select taxpayers, that is, MNEs with related party transactions. As such, the TP Unit appears to engage in the same activity as the General Tax Audit. Given this similarity of roles and the lack of progress in operationalising the TP Directive, some within the Ministry of Revenue suggest that the TP Unit needs to be dismantled altogether and/or merged with the General Tax Audit.[67]

(ii) Tax administration versus tax policy

A disconnect between the policy-making and administration levels of transfer pricing is also observable. At the policy-making level, particularly within the Ministry of Finance's Legal and Tax Policy Directorates, there is an expectation that the administrative unit, that is the TP Unit, should simply take up and operationalise the TP Directive. There is some appreciation that implementing the TP Directive as it stands is beyond the technical capability of the TP Unit. Accordingly, there is ongoing study to further simplify the TP Directive, although that work has been disrupted by ongoing COVID-19 challenges.[68] Nevertheless, the general perception is that the TP Unit primarily has only itself to blame for not implementing the TP Directive.

The TP Unit staffers, on the other hand, claim they are hindered from applying the TP Directive by the absence of further guidance from the policy-making level. In particular, they state, there is lack of guidance as to how to assess technical and management service fees and in such circumstances they resort to customary tax practice of "fair market value" assessment, that is, accepting or rejecting deductibles based on the tax officer's assessment of whether an expense appears to be suspiciously inflated or not. The Income Tax Proclamation does not include specific

[67] Focus group discussion with officials at the Ministry of Revenue, 10 September 2021.
[68] Interview with Ministry of Finance officials, August-September 2021.

regulations regarding such expenses, nor are there particular thresholds or limitations for deductible expenses. When taxpayers declare large sums of money as technical or management service fees paid to a related or parent company abroad, the TP Unit, similar to the General Tax Audit, will simply reject such expenses as not tax deductible.

The TP Unit does not apply the arm's length assessment under the TP Directive, nor does it apply the fair market value assessment applicable under general income tax law. The TP Unit is unable to apply the arm's length principle due to the complexity of the applicable methods, and it is unable to apply the fair market value assessment because it is not legally applicable to transfer pricing. The current practice of the TP Unit is, therefore, to reject such expenses either automatically as non-deductible expenses or, in a few instances, after making a vague fair market value determination that such expenses are exaggerated. This practice is rationalised by a partial reading of the TP Directive which states that in cases of ambiguity or clash between the OECD Guidelines and the Income Tax Proclamation, the latter takes precedence.[69] Although the Income Tax Proclamation is applicable when interpreting and applying the TP Directive, it is instead invoked to disapply the TP Directive and fall back on the Income Tax Proclamation.

This approach is also compounded by the fact that the TP Unit harbours a general distrust of taxpayers and a tendency towards risk avoidance, traits common across Ethiopian tax audit units in general. There is a general suspicion that large amounts of funds are being declared as expenses without the necessary means to verify them. This suspicion is only strengthened by the fact that oftentimes large taxpayers do not present well-documented invoices for their expenses. For example, for a management service fee between related parties, internal receipts and email correspondence between the companies is presented as an invoice. To assess whether an expense is justified, auditors rely on the general tax provision that allows expenses incurred specifically for "earning", "securing", and "maintaining" the business income of an establishment.[70] Tax auditors also often use their judgement when determining the validity of expenses, and in ambiguous cases they prefer to get a case off their hands instead of approving an expense and then taking responsibility for that approval.[71] This results in a tendency to reject expenses that are deemed unjustified summarily and let the dispute settlement process take care of it, that is, to "pass the buck" onto judicial bodies.

### (iii) General tax audit/TP Unit v Customs Commission

Customs valuation is an indirect component of the country's transfer pricing control system as import transactions between related parties should be subject to the arm's length principle. While the focus of transfer pricing is on the taxation of income generated within a country's jurisdiction and customs deals with the valuing of imports from abroad, the World Customs Organization's guidelines on transfer pricing stipulate that both processes are meant to ensure prices between related parties are "set as if the parties were not related".[72] Customs authorities assess whether

[69] TP Directive 43/2015 art.18.
[70] Proclamation 983/2016 art.20.
[71] Focus group discussion with officials at the Ministry of Revenue, 10 September 2021.
[72] World Customs Organization, *Guide to Customs Valuation and Transfer Pricing* (WCO, 2018), p.57.

the value of imported goods is not influenced by the relationship between the trading parties,[73] and in doing so use valuation methods that closely resemble the OECD's transfer pricing methods.[74]

The Ethiopian Customs Commission is an organ of the Ministry of Revenue, the same Ministry to which the tax administrators General Tax Audit and the TP Unit belong. The Customs Commission functions independently of the tax administrators, and there is minimal interaction between these organs.[75] The primary concern of the Customs Commission is tackling import under-invoicing as that results in less customs duty liability for the importer. Under-invoicing of imports is a common occurrence aimed at evading or reducing import tariffs. The Customs Commission carries out some investigation of transactions between related parties, but such investigation is triggered only when there are suspicious cases of under-valuation. [76] Over-invoicing, on the other hand, has the reverse effect (that is, it boosts import tariffs), and therefore the Commission does not actively monitor it.

The issue of customs mis-invoicing is linked to the issue of transfer pricing in that import transactions between related parties do not undergo appropriate arm's length assessment, and this will impact the transfer pricing assessments when the importers subsequently re-export their products to related parties abroad. Taxpayers engaged in re-export business in particular have reason to over-invoice their imports in order to ultimately pay less tax on their exports or make their business profit appear reduced—and the Customs Commission is incentivised to not scrutinise this closely. This becomes problematic as the tax administrators assume prices/invoices that are accepted by the Custom Commission are final or not subject to adjustment when applying transfer pricing rules during re-exportation using the imported goods. The re-exported goods would have artificially inflated pricing that would not have been obtained had the transaction been taking place between unrelated parties. Consequently, reliance on over-invoiced prices for tax assessment leads to artificially reduced tax liability. As such, the respective focus of the customs and the tax administrators is at odds one with the other.

The scheme of over-invoicing imports to reduce ultimate tax liability is a critical area of revenue loss for low-income countries as industrial development-driven incentive regimes offering minimum or no customs liability for exporters are common practices. In Ethiopia, for example, the import of raw materials for re-export purposes is free from customs duty.[77] Most multinational enterprises, for example in the pharmaceutical and horticultural sectors, import products or industry inputs from a related company abroad, and some re-export their products as well to a related party.[78] In such cases, the importers would pay minimal or no customs duty on the over-invoiced import and, after exporting their final product, benefit from significant deductibles in their business profit tax liability due to the inflated price of the relevant import.

[73] For a country survey, see Deloitte, *The Link between Transfer Pricing and Customs Valuation: 2018 Country Guide* (Deloitte, 2018).
[74] World Customs Organization, *Guide to Customs Valuation and Transfer Pricing* (2018), p.58; World Trade Organization Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994.
[75] Interview with Customs Commission officials, August-September 2021.
[76] Proclamation 768/2012 (Export Trade Duty Incentive Schemes Proclamation).
[77] Proclamation 768/2012 (Export Trade Duty Incentive Schemes Proclamation).
[78] Interview with representatives of pharmaceutical manufacturers and flower exporters, August-September 2021.

The seeming clash between the priorities of the customs and tax administrators is exacerbated by the fact that the two sides do not have a direct working relationship. The tax administration sometimes asks for clarification of price valuations from the Customs Commission when there are suspicious cases. But in most cases the tax administration simply assumes that the prices accepted by Customs Commission upon declaration by the taxpayer are final. Resort to Customs Commission valuations, which effectively results in the Commission being a transfer pricing control mechanism, is also ultimately not an efficient solution as the Commission is positioned at the end of the import process. Furthermore, the Commission undertakes adjustments to increase prices, but it does not have a practice of adjustment to decrease prices—it is also legally unclear if the Commission can undertake decrease adjustments.

*(c) Mock compliance*

Another factor compounding Ethiopia's lag in implementing transfer pricing rules is the possibility of mock compliance[79] without decisive implementation of the rules. The lack of ability and the lacklustre political commitment to the implementation of transfer pricing rules exists side-by-side with the need to appear to be implementing the rules by enacting the necessary legislative frameworks. This can be seen in two ways. The first is with respect to the country's haphazard approach to DTAs that have a direct impact on transfer pricing application. The second is the lack of enforcement of procedures necessary for transfer pricing audit, in particular in relation to documentation and information exchange. The following sections elaborate upon both illustrations.

(i) Haphazard double taxation treaties

As at December 2021, Ethiopia had signed 33 (23 in force) DTAs with both developed and developing countries.[80] These DTAs are not entered into in pursuit of a deliberate tax policy, but rather for a host of haphazard reasons, including political symbolism. A prominent factor are requests from the national airline to reduce its tax liability in countries it flies to.[81] There are currently several pending requests from the airline for the signing of DTAs with, among others, Nigeria, Mali, Philippines, and Djibouti.[82] However, requests from the airline are not the exclusive or even the most decisive factor in the signing of DTAs. The DTAs serve the airline in a limited way only; there is a separate set of treaties, known as air service agreements, that Ethiopia has signed with several countries covering certain taxation aspects of aviation activities.[83]

[79] Florence Dafe and Rebecca Elisabeth Husebye Engebretsen, "Tussle for Space: The Politics of Mock-Compliance with Global Financial Standards in Developing Countries" (2021) *Regulation & Governance* (early view online, *https://doi.org/10.1111/rego.12427* [Accessed 22 April 2023]).

[80] The DTAs are signed with: China, Cyprus, Czech Republic, Egypt, France, India, Iran, Ireland, Israel, Italy, Kuwait, Malta, Mozambique, Netherlands, North Korea, Palestine, Poland, Portugal, Qatar, Romania, Russia, Republic of Korea, Saudi Arabia, Seychelles, Slovakia, South Africa, Sudan, Switzerland, Tunisia, Turkey, UK, United Arab Emirates, Yemen. See KPMG, *Ethiopia Fiscal Guide 2019* (March 2020), *https://assets.kpmg/content/dam/kpmg/za/pdf/pdf2020/ethiopia-fiscal-guide-2019.pdf* [Accessed 22 April 2023].

[81] Interview with officials at the legal directorate of Ministry of Finance, August-September 2021.

[82] Interview with officials at the legal directorate of Ministry of Finance, August-September 2021.

[83] As of 2020, 41 air service agreements are signed and 56 more initialed.

Ethiopia has also signed DTAs with countries to which the airline does not fly, and in which it does not have a commercial interest, such as Palestine and Malta. This goes to show the involvement of non-aviation related factors in the signing of DTAs. Political considerations are a prominent factor, as observed also in the case of other African countries.[84] Often, DTAs are signed as manifestations of political solidarity with another country. When the highest political leadership of a particular country visits a friendly nation, or vice versa, DTA signing can follow as a political statement, sometimes without much deliberation as to the content of such treaties.[85] In other instances, the political push comes from the other country; for example, in the case of Ethiopia's DTA with Palestine, the latter had an interest in using the treaty as a sign of state recognition under international law.[86] The initiative for DTAs, therefore, could be led by the Ministry of Finance (in economic cases) or the Ministry of Foreign Affairs (in political cases).

In yet other cases, capital-exporting states (for example, the UK) and tax haven jurisdictions (for example, Mauritius) have pushed for the signing of DTAs with Ethiopia.[87] In such cases, the problem of the technical and management services highlighted above becomes relevant. In the likely scenario that the country's transfer pricing administration remains dormant or weak for the foreseeable future, DTAs with such countries become key vehicles of revenue loss as technical and management services are grounds for reducing business profit tax liability and are often not subject to withholding tax.

The tax and transfer pricing implications of DTAs have recently become increasingly recognised by Ethiopian policy-makers. A recent DTA signed with Switzerland allows the country to retain withholding taxes for technical and management services rendered by a related party.[88] The treaty's definition of business profits excludes "profits derived from the rendering of any service of a managerial, professional, technical or consultancy nature". Instead, echoing article 12A(5) of the UN Model Double Taxation Convention,[89] article 21(4) of the DTA signed with Switzerland provides that such service fees shall be deemed to arise in the source state if the payer for the service is a resident of that state. There is also now discussion at the level of policy within the Ministry of Finance on the need to revise and renegotiate all DTAs, and on

[84] Catherine Ngina Mutava, "Review of Tax Treaty Practices and Policy Framework in Africa" (2019) ICTD Working Paper 102, *https://opendocs.ids.ac.uk/opendocs/handle/20.500.12413/14900* [Accessed 22 April 2023].
[85] Interview with officials at the legal directorate of Ministry of Finance, August-September 2021.
[86] Interview with officials at the legal directorate of Ministry of Finance, August-September 2021.
[87] Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Federal Democratic Republic of Ethiopia for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains (HMSO, 2013), Cm.8585. A draft DTA between Ethiopia and Mauritius is prepared and currently under consideration. On capital exporting and developing states' tax treaty relationship generally, see Hearson, *Imposing Standards: The North-South Dimension to Global Tax Politics* (2021).
[88] Convention between The Swiss Confederation and the Federal Democratic Republic of Ethiopia for the Avoidance of Double Taxation with Respect to Taxes on Incomes and The Prevention of Tax Evasion and Avoidance, signed on 29 July 2021, *https://www.sif.admin.ch/sif/en/home/documentation/specialist-information/dta-ethiopia.html* [Accessed 22 April 2023].
[89] United Nations Model Double Taxation Convention between Developed and Developing Countries 2021, *https://www.un.org/development/desa/financing/what-we-do/ECOSOC/tax-committee/thematic-areas/UN-model-convention* [Accessed 22 April 2023].

whether future DTAs must include a similar treatment of technical services as a matter of principle.[90]

(ii) Nominal observation of documentation and information exchange

Ethiopian tax officers have a practice of undertaking purely nominal performance of some transfer pricing procedures. Although the TP Directive requires taxpayers to document and disclose information on transactions with related parties, in practice this requirement is simply not observed by taxpayers.[91] The obtaining of information on cross-border transactions between related parties (controlled transactions) through the exchange of information with foreign tax authorities or documentation from taxpayers is a major gap in Ethiopia's transfer pricing system. Ethiopia is not a party to the relevant multilateral conventions that facilitate information exchange between tax authorities, such as the OECD Convention on Mutual Administrative Assistance in Tax Matters. However, not being party to such mechanisms is not the real obstacle. Instead, interviews with tax officials and policy-makers reveal that there would be no tendency to utilise such mechanisms even if they were available. Further proof of this is the fact that the numerous bilateral DTAs that contain information exchange clauses are hardly utilised. Both the General Tax Audit and the TP Unit admit that they have never utilised exchange of information processes based on DTAs to investigate or obtain more information on related entities of MNEs. The few instances of DTA-based information exchange practices are limited to issues such as certification of tax residence, tax records, and financial status, most of which are only incoming requests for information.[92]

Documentation requirements for taxpayers are stipulated by law as a matter of box ticking—those stipulations are not enforced in reality. In addition to the documentation requirement described in section 2 above, the Ministry of Revenue also requires taxpayers to complete and submit an annual TP Declaration form. Taxpayers with international controlled transactions exceeding an annual aggregate of ETB 500,000 are required to complete the form, which collects details about the taxpayer's principal business activities, their international controlled transactions, and the transfer pricing method used.[93] Both the general documentation requirements and the additional TP Declaration are not observed in practice by taxpayers, and the requirements are also not enforced by the Ministry of Revenue, partly for fear of arbitrariness as there is no comprehensive data on MNEs in the country engaged in international controlled transaction.[94] Crucially, TP Unit personnel state that the enforcement mechanism for the documentation requirements is not clearly set under the TP Directive. In cases of taxpayer failure to keep or provide such documentation it is unclear what measures can be taken or what penalties can be imposed by the tax authority. The Income Tax Proclamation generally stipulates a penalty of ETB 100,000 for such enforcement measures[95]; this penalty amount is, however, too small to

[90] Interview with officials at the legal directorate of Ministry of Finance, August-September 2021.
[91] Interview with TP Unit staffers, August-September 2021.
[92] Interview with officials at the legal directorate of Ministry of Finance, August-September 2021.
[93] Tariku Adugna Raya, "The Application of Ethiopian Transfer Pricing Rules on Multinational Enterprise: Consistency of the Practice with the Ethiopian Transfer Pricing Rules" (Dissertation, Addis Ababa University, 2019), p.50.
[94] Focus group discussion with officials at the Ministry of Revenue and interview with TP Unit staffers, 10 September 2021.
[95] Income Tax Proclamation 286/2002 art.97(2)(b).

be considered anything other than a nominal gesture against non-compliant MNEs, and even then, there is vagueness as to the relevant accrual period (that is, if it is per month, per year or any other period).

## (4) Conclusion

The implementation of the OECD Transfer Pricing Guidelines by low-income countries' is constrained by their capacity limitations. By focusing on the law and practice of Ethiopia, this article provides a context-specific and more qualified exposition of the capacity thesis to explain the unsuccessful implementation of OECD rules in low-income countries. While showing that the capacity constraint is a serious factor, the article illustrates that material capacity is not the only explanation. Instead, it identifies three other factors of a social and institutional nature. The first factor is the inability of tax officers to depart decisively from long-established tax practices that run counter to the OECD transfer pricing rules. The second factor can be found in the myriad institutional mandate ambiguities and rivalries that exist within tax administration organs, and also between the tax administration and tax policy organs. The third factor is the possibility that countries will engage in the appearance of compliance with international guidelines (mock compliance) without in fact seriously applying the relevant stipulations on the ground. These findings imply that improving Ethiopia's compliance with the OECD Guidelines requires not merely increasing capacity assistance to resolve the material constraints, but also resolving questions of habit, clarity, and commitment at the levels of working practice, institutional organisation and policy-making.

The above findings imply that improving the ability of low-income countries to administer transfer pricing effectively needs to be a local process that involves the relevant tax policy-makers and administrators in the design of the transfer pricing regime. It also shows that resolving some of the critical challenges, in particular the institutional ambiguities and rivalries, requires not only external technical assistance, but also decisive internal political and technocratic leadership. Furthermore, the challenge of path dependency in the working processes of tax administrations means that building an effective transfer pricing regime might require setting up an entirely new team or institutional framework that would not be beholden to customary tax practices.