

Diffusion of OECD Transfer Pricing Regulations in Eastern Africa: Agency and Compliance in Governing Profit-Shifting Behaviour

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Summary of Working Paper 85 by Cassandra Vet

Kenya, Uganda and Rwanda introduced transfer pricing regulations into national law in 2006, 2011 and 2020 respectively, and invested in transfer pricing audits to reduce profit shifting by multinational enterprises (MNEs). These countries used the dominant OECD transfer pricing guidelines as a template for reform – the wisdom of this approach is contested. Critical authors stress that Western states largely dominate rule-setting procedures, and that costly transfer pricing enforcement drains the scarce resources of revenue authorities. How can we reconcile the critical perspective in global debates with the roll-out of OECD-type transfer pricing regimes on the ground?

Network effects

Network effects help explain their choice of OECD-based transfer pricing rules. The widespread adoption of OECD transfer pricing norms across the globe creates a network effect. Related-party transactions take place in at least two jurisdictions, and it is easier for taxpayers when these two jurisdictions have similar rules – this creates a compatibility advantage. Network effects make it more expensive for countries to adopt alternative transfer pricing norms, because of the expected reduced foreign direct investment (Dagan 2018; Baistroicchi 2013). This explanation of the appeal of the OECD norms, however, glances over the agency of those intervening on behalf of institutional stability (Dean 2021), or national divergence while reproducing global norms (Eden et al. 2001).

This study puts forward a more bottom-up perspective on how domestic coalitions drive support for the OECD framework by mobilising ideational and economic network effects. Case study evidence collected in these countries reveals that policymakers prefer anti-avoidance measures that are widespread and considered global practice. OECD rules remain such an authoritative focal point for policymakers as interested social groups leverage concerns on investor attractiveness, and because there are few effective coalitions challenging the OECD framework.

Call to action

The three governments acted after their revenue authorities informed them that their country's legal framework was inadequate for holding multinationals accountable when they detected profit-shifting activities. Although revenue officials are aware of the obstacles to implementing OECD standards, this does not stand in the way of their support for the OECD rules. Tax officials rely on other experts when drafting policy advice for their Ministry of Finance – often providers of technical assistance from abroad. These transnational experts guide tax officials' early thinking on transfer pricing (Hearson 2021), and advise tax officials on the content of amendments and guidelines for transfer pricing rules. In addition, auditors observed aggressive avoidance behaviour, which provided plenty of 'low-hanging fruit' to be plucked – even with suboptimal technologies.

Globally, civil society organisations (CSOs) have mobilised in favour of more holistic approaches to taxing MNEs, and in particular for unitary taxation with formulary apportionment (ActionAid 2015; Oxfam 2000; Tax Justice Network 2020). Yet, in the case study countries CSOs highlighted the need for urgent anti-avoidance measures without proposing alternatives to the OECD approach. National tax avoidance scandals proved an important tool for mobilising civil society. But CSOs deliberately avoided using technical and complex knowledge when politicising tax avoidance to create political salience – this, however, reduced their policy influence, because they seemed not to be experts. CSOs, despite their critical stance towards the OECD guidelines at a global level, did not coalesce around a specific alternative, and instead raised the need for more public revenue.

Safeguarding investor attractiveness

In response to growing calls for action, the tax advisory industry – accountants and lawyers specialised in international taxation – leveraged concerns on taxpayer certainty to support OECD-type enforcement. MNEs,

aware that measures were unavoidable, stressed the need for common norms based on the multi-jurisdictional nature of transfer pricing, and ring-fencing against more 'aggressive' anti-avoidance measures. All three jurisdictions consulted major accountancy firms when drawing up fiscal legislation – these had close contact with tax officials at the revenue authority. The discourse on taxpayer certainty therefore increased, and framed, government concerns on investor attractiveness when anti-avoidance measures were evaluated.

A government's dilemma

The Ugandan and Rwandan governments developed strategies on transfer pricing policy, and balanced demands to raise revenue with investor attractiveness (primary data on government decision-making in Kenya is missing from this dataset). In Uganda, a member of the Ministry of Finance agreed that simplified measures would be useful, but only saw this as a viable policy option if

other countries used them as well. This would generate their compatibility bonus through network effects. In Rwanda, the publication of the transfer pricing rules was delayed because the government was concerned that the strict documentation requirements created a competitive disadvantage, and might scare off foreign investors. Tax competition leads governments to adopt transfer pricing rules that are widely used, as these create less compliance costs for investors than lesser-known simplified methods (Dagan 2018). Calls to adopt unilateral simplified measures should therefore go hand in hand with efforts to promote alternative network products, or should counter the narrative of tax competition.

“How can we reconcile the critical perspective in global debates with the roll-out of OECD-type transfer pricing regimes on the ground?”

Further reading

ActionAid (2015) *Levelling Up: Ensuring a fairer share of corporate tax for developing countries*, ActionAid Report, https://actionaid.org/sites/default/files/levelling_up_final_0.pdf

Baistrocchi, E. (2013) 'The International Tax Regime and the BRIC World: Elements for a Theory', *Oxford Journal of Legal Studies* 33(4): 733–766, <https://www.jstor.org/stable/24562799>

Dagan, T. (2018) *International tax policy: between competition and cooperation*, UK: Cambridge University Press

Dean, S. (2021) 'A Constitutional Moment in Cross-Border Taxation', *Journal on Financing for Development* 1: 1–15

Eden, L., Dacin, M. and Wan, W. (2001) 'Standards across borders: crossborder diffusion of the arm's length standard in North America', *Accounting, Organizations and Society* 26(1): 1–23

Hearson, M. (2021) *Imposing standards: the north-south dimension to global tax politics*, Cornell University Press

Oxfam (2000) *Tax Havens: Releasing the Hidden Billions for Poverty Eradication*, Oxfam Briefing Paper, <https://oxfamlibrary.openrepository.com/bitstream/handle/10546/114611/bp-tax-havens-010600-en.pdf?sequence=1>

Tax Justice Network (2020) *Unitary Taxation*, <https://taxjustice.net/topics/unitary-taxation/>

Citation: Vet, C. (2023) *Diffusion of OECD Transfer Pricing Regulations in Eastern Africa: Agency and Compliance in Governing Profit-Shifting Behaviour*, ICTD Working Paper 164, Brighton: Institute of Development Studies. DOI: [10.19088/ICTD.2023.022](https://doi.org/10.19088/ICTD.2023.022)

Credits

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The ICTD is funded with UK aid from the UK Government, Norad and by the Bill & Melinda Gates Foundation; however, the views expressed herein do not necessarily reflect the UK Government's official policies, nor those of the Bill & Melinda Gates Foundation. Readers are encouraged to quote and reproduce material from the series. In return, ICTD requests due acknowledgment and quotes to be referenced as listed.



ICTD is based at the Institute of Development Studies, Brighton BN1 9RE UK.

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DOI: [10.19088/ICTD.2023.024](https://doi.org/10.19088/ICTD.2023.024)

ICTD is proudly funded by

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