Transfer pricing and developing countries

Final report

This project was commissioned by the European Commission within the framework of its Tax and Development policy agenda with support of the European Parliament

A project implemented by PwC

Contents

List of figures and tables .... **III**

Abbreviations and acronyms .... **IV**

1. Executive Summary **1**

2. Introduction **5**

3. About this report **6**

4. The importance and pitfalls of TP **8**

5. Activities by international organisations in the field of TP **10**

5.1. The OECD Guidelines 10

5.2. The UN TP Manual 12

5.3. The work of other international organisations 13

6. Preconditions for TP reform **13**

7. Selected countries and TP reform **15**

7.1. Introductory remarks 15

7.2. Economic and political preconditions 15

7.2.1. GDP growth, economic sectors and financial markets 15

7.2.2. Trade liberalisation and international business relationships 18

7.2.3. FDI and the importance of MNEs in local economies 19

7.3. Legal preconditions 20

7.3.1. Corporate income taxation and special tax regimes 20

7.3.2. Existing network of tax treaties 21

7.3.3. Existing TP legislation in selected countries 22

7.3.3.1. Introductory remarks: state of play in selected countries 22

7.3.3.2. TP legislation in selected countries 22

7.3.3.3. Scope of TP legislation in place 24

7.3.3.4. TP documentation requirements 25

7.4. Capacities of local tax administrations 26

7.4.1. Public debt and revenue collection 26

7.4.2. Structure and capacities of local tax administrations 26

7.4.3. Experience with TP enforcement, audits and penalties 27

7.4.4. Internal training facilities and communication channels 28

7.5. Interim conclusions: suitability for donor support in TP reform 29

8. Recommendations for future donor support in selected countries ... 31

8.1. Introductory remarks ... 31
8.2. Universal and country-specific recommendations ... 32
8.2.1. Universal recommendations for selected countries ... 32
8.2.2. Country-specific recommendations: Kenya ... 33
8.2.3. Country-specific recommendations: Ghana ... 34
8.2.4. Country-specific recommendations: Honduras ... 35
8.2.5. Country-specific recommendations: Vietnam ... 36

8.3. Costs of TP reform and potential impact of increased tax collections in selected countries ... 37
8.3.1. Interview/research findings for selected countries ... 37
8.3.2. Cost/impact estimations based on publicly available data ... 38

9. A general approach to TP reform in developing countries ... 39
10. Concluding remarks on TP and developing countries ... 41
References ... 43

Appendix A: List of developing countries ... 47
Appendix B: Country Study Honduras ... 50
Appendix C: Country Study Ghana ... 51
Appendix D: Country Study Kenya ... 52
Appendix E: Country Study Vietnam ... 53
Appendix F: Case Studies ... 54
Appendix G: Questionnaire ... 63
Appendix H: Required donor support in selected countries ... 66
Appendix I: Estimated impact on tax collections resulting from TP reform in selected countries ... 76
Appendix J: Examples from Kenya ... 89
Appendix K: Special tax and incentive schemes in selected countries ... 91
Appendix L: List of tax treaties signed by selected countries ... 94
Appendix M: Donor support to date in the selected countries ... 98
Appendix N: Cost-benefit analysis of TP reform in selected countries ... 101
Appendix O: In a nutshell – challenges/options/support ... 106

List of figures and tables

Figure 1: Basic preconditions for implementing TP reform 14
Figure 2: Overview of the preconditions for TP reform in selected countries 30
Figure 3: Staged approach to introducing TP reform 40
Figure 4: Roadmap to TP reform 42

Table 1: GDP growth levels for selected countries 16
Table 2: Tax revenues as a share of GDP (%) for selected countries 16
Table 3: Capital-intensive investments by Sector – Vietnam 17
Table 4: Estimated impact/cost from TP reform for selected countries 38

Abbreviations and acronyms

ADB	Asian Development Bank
AfDB	African Development Bank
APA	advance pricing agreement
ATAF	African Tax Administration Forum
CAIS	Central American Integration System
CIAT	Inter-American Center of Tax Administrations
COHPUCP	Colegio Hondureño de Profesionales Universitarios de Contaduría Publica
CPM	cost plus method
CUP	comparable uncontrolled price
DESA	United Nations' Department of Economic and Social Affairs
DR-CAFTA	Dominican Republic-Central America-United States Free Trade Agreement
DTA	double taxation agreements
EAC	East African Community
EC	European Commission
EITI	Extractive Industries Transparency Initiative
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
GBP	pound sterling
GDP	gross domestic product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit (formerly GTZ)
GTSP	Global Tax Simplification Program
GTZ	Gesellschaft für Technische Zusammenarbeit
HR	human resources
IADB	Inter-American Development Bank
IBFD	International Bureau of Fiscal Documentation
IFC	International Finance Corporation
IMF	International Monetary Fund
IT	Information Technology
ITC	International Tax Compact
JICA	Japanese International Cooperation Agency

JV	joint venture
LTO	Large Taxpayer Office
M&A	mergers and acquisitions
MAP	mutual agreement procedure
MDGs	Millennium Development Goals
MNE	multinational enterprise
OECD	Organisation for Economic Cooperation and Development
OECD Model Convention	OECD Model Tax Convention on Income and on Capital
OECD Guidelines	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax administrations
PSM	profit split method
RPM	resale price method
TIEA	tax information exchange agreement
TNMM	transactional net margin method
TP	transfer pricing
TP Manual	United Nations Transfer Pricing Practical Manual for Developing Countries
UAE	United Arab Emirates
UN	United Nations
UN Expert Committee	Committee of Experts on International Cooperation in Tax Matters
UN Model Treaty	UN Model Double Taxation Convention between Developed and Developing Countries
UK	United Kingdom
USA	United States of America
VAT	value added tax
WB	World Bank
we	PwC
WTO	World Trade Organisation

1. Executive Summary

The Communication of the European Commission ('EC') on 'Tax and Development – Cooperating with Developing Countries in Promoting Good Governance in Tax Matters' highlighted the need to support developing countries' capacity in mobilising domestic resources for development in line with the principles of good governance in taxation. It is in this context that PwC has been asked to conduct a study on transfer pricing ('TP') and developing countries. We welcome the initiative of the EC as it has the potential to promote a uniform set of TP practices which are adhered to globally. Such development would favourably affect the business environment for international trade and activities of multinational enterprises ('MNEs'), thereby further contributing to investment and growth in developing countries.

Generally, TP is high on the agenda because globalisation has lifted the level of cross-border trade between related entities to new heights. It is estimated that, worldwide, about 2/3 of all business transactions take place within a group.[1] This is particularly relevant for developing countries as their economies have recently opened up or are in the process of opening up, attracting large amounts of foreign direct investment ('FDI') from MNEs. In the absence of TP legislation,[2] both tax administrations and MNEs have only limited guidance they can refer to when determining TP in related-party transactions.

However, we find that developing countries encounter particular problems when dealing with TP. Local tax administrations are often inexperienced with regard to TP and lack basic understanding in the field. For substantiating TP, for example comparables are difficult to identify because there are fewer organised companies in any given sector in developing countries. In addition, there are no databases which allow information to be extracted on comparable transactions or companies in order to verify TP between related parties. Further problems exist in gathering taxpayer information due to the absence of documentation requirements or the inability to enforce existing requirements. Equally, tax administrations sometimes lack the capacity to process and evaluate such information, partly because of the lack of technical expertise or because they do not have the necessary resources at their disposal to process the data.

Several international organisations work actively on the provision of guidance in the area of TP, and some of them have particularly addressed the needs of developing countries. The Organisation for Economic Cooperation and Development ('OECD') has made considerable efforts to establish common ground in TP matters based on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD Guidelines'). The United Nations ('UN') published new working drafts of its envisaged United Nations Transfer Pricing Practical Manual for Developing Countries ('TP Manual') on 31 May 2011, which are concerned with the practical implementation of TP rules in accordance with the arm's

[1] WB (2011a), "Transfer Pricing Technical Assistance Global Tax Simplification Program", Presentation given by Rajul Awasthi in Brussels, 24 February 2011.
[2] For reasons of simplification, we use the term "TP legislation" for any kind of legally binding documents/laws issued by the local tax authorities as regards TP.

length principle. With respect to international organisations, the importance of platforms for tax administrations must be highlighted, as they help foster cooperation and the exchange of best practices, also in the area of TP.

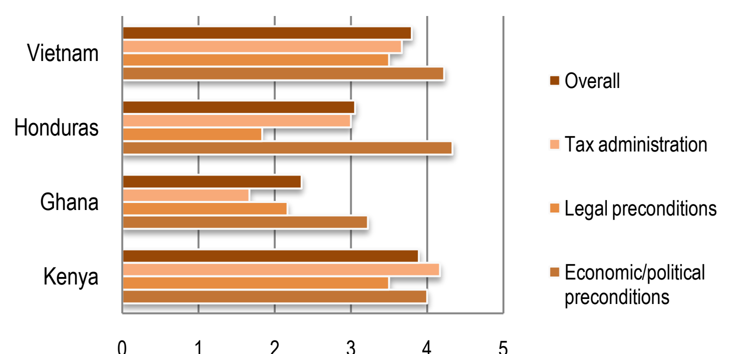
This report provides an overview on the possibilities for adopting and implementing TP legislation in developing countries and identifies possible ways to support developing countries with regard to its enactment. In order to carry out the study, we focused on four countries, which were selected by the EC. These countries are Ghana, Honduras, Kenya and Vietnam ('selected countries') and are all in different stages with regard to TP legislation. While Kenya and Vietnam have some kind of specific TP legislation in place, Honduras is about to adopt TP legislation shortly and Ghana currently has no TP-specific framework in place.

In order to provide sound recommendations on further action and assistance with regard to TP reform in the selected countries, we have developed a generally applicable framework of preconditions which should be considered before pursuing TP reform in developing countries. More precisely, the necessary preconditions encompass:

i. *economic and political preconditions* (e.g. economic growth and diversification, open economy, FDI);
ii. *legal preconditions* (e.g. comprehensive income tax law, tax treaty network, existing TP legislation if applicable);
iii. preconditions related to the *tax administration* (e.g. some level of specialisation within the tax administration).

We have structured our analysis around the preconditions selected for the purposes of this study and analysed the suitability of the selected countries for TP reform. With regard to existing TP legislation, our research indicates that, despite strong affinity to the OECD standards, the scope of existing TP legislation or draft TP legislation is in part significantly broader as regards the definition of related parties than is outlined in the OECD Guidelines. From a TP policy perspective, and despite the doubtlessly valid reasoning behind such provisions, defining 'related parties' very broadly may increase the administrative burden for both tax administration and taxpayers and thereby hamper investment and growth.

Our findings indicate that there are significant differences between the selected countries with respect to existence of the necessary preconditions, which has been influential in our conclusions and recommendations. While the current corporate income tax system in the selected countries would generally justify the initiation of TP reform, we feel that only Kenya and Vietnam can draw upon a sufficiently large treaty network and tax administration capacities to successfully pursue and implement comprehensive TP reform at the current stage. For Ghana and Honduras, we believe that donor support and assistance should



focus on improving certain preconditions as outlined in this report before the road to comprehensive TP reform is embarked upon.

Based on our field research, we suggest a comprehensive list of possible forms of assistance to the selected countries when pursuing or paving the way for TP reform. Based on these findings, we have estimated, based on assumptions, the possible costs of introducing TP reform, e.g. setting up a specialist TP team, providing specialist training courses, as well as the provision of required materials/facilities (if applicable). Due to the lack of statistical data on the potential benefits of introducing TP reform, we have carried out a high-level economic analysis to quantify the potential impact that TP reform can have on tax collections from MNEs. Even for our low-impact scenario, we find that the potential increase in tax collections should outweigh the anticipated costs of TP reform.

	Estimated benefit *(obtained figures)*	**Estimated benefit** (own calculations for 2012, low-impact scenario)	**Estimated benefit** (own calculations for 2012, low-impact scenario inc. growth in MNE contributions)	**Estimated cost** (own estimations)
Honduras	*EUR 301 mn*	EUR 4.4 mn	EUR 4.7 mn	EUR 836.357
Kenya	*n/a*	EUR 4.3 mn	EUR 4.7 mn	EUR 266.913
Ghana	*n/a*	EUR 7.9 mn	EUR 9.1 mn	EUR 964.388
Vietnam	*n/a*	EUR 25.4 mn	EUR 27 mn	EUR 444.126

Based on our findings and additional research we have carried out, we have developed a general framework setting out support activities we consider appropriate depending on the state of play with respect to TP in developing countries. However, it is generally important to closely assess the country-specific situation and determine the applicable stage for each developing country by reference to the catalogue of preconditions for TP reform as outlined in this report.

i. Developing countries with no TP legislation in place

We find that the demand for donor support in developing countries that have no TP legislation (i.e. neither adopted nor drafted) is high. Assistance should be provided to establish a fundamental understanding of TP principles, methods and tax treaties within the local tax administration. Assistance is also needed with respect to the drafting of TP legislation. In this context, it can be particularly helpful to provide tax administrations with examples of existing TP legislation in other countries. A selected group of tax officials should be given the possibility of deepening their understanding of TP, e.g. by observing TP practices in other countries during secondments.

ii. Developing countries close to adopting TP legislation

Developing countries that have already drafted local TP legislation require a different set of measures to support successful implementation. As both the tax administration and taxpayers are inexperienced in TP, countries could be assisted in

pursuing a phased approach. For that purpose, local tax administrations could be assisted in drafting mandatory questionnaires to gather the most-relevant taxpayer information on inter-company transactions or to gradually implement documentation requirements. Support will be necessary to ensure that this newly available data is processed efficiently. Shortly before/after implementation of the TP legislation, funding could be provided to facilitate and improve communication between taxpayers and tax administrations, e.g. to organise information sessions and support facilities. Given the lengthiness of the negotiations, tax administrations should furthermore be assisted in initiating/conducting negotiations for the conclusion of tax treaties.

iii. Countries that have TP legislation in place

The group of developing countries with TP legislation needs to be subdivided into those that have *TP legislation* and those that have published *TP rules* in the form of circulars. We generally recommend that countries should be assisted in adopting TP legislation, as this provides taxpayers with greater certainty. In general, for developing countries that already have some kind of TP legislation in place, it may be important to offer technical assistance to review and revise the existing legislation. Together with this, developing countries can be supported in drafting more-sophisticated TP legislation such as advance pricing agreements ('APA') and simplified compliance procedures.[3] Assistance is furthermore necessary to improve access to data on comparable transactions, e.g. by developing and administering own (regional) databases. The development of structured training programmes and the establishment of a physical training infrastructure can equally support developing countries at this stage. Also, countries can be assisted in enhancing their existing network of tax treaties and responding to new developments regarding trade flows.

* * *

Both the selected countries and developing countries in general to a large extent require technical assistance to build up TP expertise. We emphasise that there is a strong need for long-term assistance and ongoing cooperation on an international scale. The donor support initiatives should eventually aim at lifting the TP legislation and its application in developing countries to a common international standard. In our opinion, this is vital to reduce economic uncertainty and foster investment and growth. It is important to understand that TP reform should not be done under the guise of anti-abuse legislation but rather aim at improving the existing rules on corporate income taxation. The majority of taxpayers want to comply with local TP requirements in developing countries, and seek guidance on how to apply appropriate remuneration for related-party transactions to reduce tax risks.

[3] This refers to administrative simplification measures, e.g. statutory provisions that apply to a given category of taxpayers and relieve those taxpayers from certain obligations otherwise imposed by the tax rules by – usually – substituting simpler obligations ("safe harbours"). See OECD (2010a) TP Guidelines, nos. 4.93 *et seq.* and nos. 4.123 *et seq.* (APA).

2. Introduction

It is nowadays commonly acknowledged that taxation is an important factor for economic development and the relationship between states and their citizens.[4] Additionally, tax revenues are crucial for developing countries[5] in order to build basic structures and increase quality of life. However, tax policy choices are influenced by a country's economic structure and depend on administrative capacities, which significantly limits the options available to developing countries.[6] It is in this context that the growing involvement of MNEs in developing countries has put questions on TP high on the agenda for governments and international organisations that seek to promote growth, development and trade.

As a result of insufficiently sophisticated tax administration structures and processes, many developing countries capture only 40% of their tax potential.[7] Consequently, developing countries need to establish tax systems that are effective and efficient in mobilising revenue. This needs to be combined with minimising disincentives to investment and unbalanced costs of compliance, which lead to costly misallocations of resources. Developing countries need to ensure that they distribute the tax burden equitably.

In 2000, the world's political leaders agreed eight Millennium Development Goals ('MDGs') to tackle extreme poverty and share the benefits of globalisation more equitably.[8] In order to meet the goals by 2015, it is generally accepted that the initiative's success will require helping developing countries strengthen their tax systems and increase domestic revenues. Increasing domestic revenue not only creates additional space to support MDG-related spending; it also allows countries to assume ownership for their policy. A related EC Communication was adopted in April 2010,[9] highlighting the need to support developing countries' capacity in mobilising domestic resources for development in line with principles of good governance in the area of tax. This was supported by the Council in its conclusions of June 2010 and has been supported by the European Parliament.

In order to assist developing countries in the implementation of TP legislation, the EC has proposed to offer support in adopting the internationally accepted OECD Guidelines. This would help developing countries in increasing their domestic tax collection by processing tax information better and ensuring tax compliance for all economic actors, in line with international standards. While the importance of TP legislation and enforcement for the collection of tax revenues is generally acknowledged, donor support remains relatively limited in this regard.

[4] OECD (2008), "Governance, Taxation and Accountability- *issues and practices*", DAC Guidelines and Reference Series, www.oecd.org.
[5] For the term "developing countries", we refer to the classification of the World Bank, see Appendix A.
[6] Bird, R., and Zolt, E., (2003) "Introduction to Tax Policy Design and Development", Draft prepared for a course on Practical Issues of Tax Policy in Developing Countries, World Bank, 28 April-1 May 2003.
[7] International Tax Compact (2011), "Benefits of a computerized integrated system for taxation", iTax case study, Bonn, February 2011.
[8] UN (2000), Resolution adopted by the General Assembly, 55/2 United Nations Millennium Declaration, 8th plenary meeting, 8 September 2000.
[9] EC (2010), COM (2010) 163 final, "Tax and Development – Cooperating with Developing Countries on Promoting Good Governance in Tax Matters", 21 April 2010.

3. About this report

This study was commissioned by the European Commission within the framework of its Tax and Development Agenda and with the financial support of the European Parliament. It is in this context that PwC ('we') have been asked to conduct research on TP and developing countries. We feel that the rationale behind the study, i.e. the analysis of possible ways to support developing countries in enacting TP legislation, is vital from both a development and a business perspective. Several developing countries are planning to introduce TP legislation to capture additional income from international related-party transactions. If countries decide to introduce such legislation on their own, there is a danger that this will lead to the emergence of a large diversity in TP legislation in various countries across the globe. The study has the potential to promote a uniform set of TP rules that are adhered to globally. We are of the opinion that such development would favourably affect the environment for international trade and MNE activities, thereby further contributing to investment and growth in developing countries. It is for this reason that PwC decided to participate in this study and assist in verifying whether a common denominator is available in the field TP.

The main purpose of this report is to provide an overview on the possibilities for adopting and implementing TP legislation in developing countries and to identify possible ways to support developing countries in this respect. To perform the analysis, four developing countries in Asia (Vietnam), Africa (Kenya and Ghana) and the Americas (Honduras) were selected by the EC. While Kenya and Vietnam have some kind of specific TP legislation in place, Honduras is about to adopt TP legislation shortly and Ghana currently has no TP-specific framework in place.[10]

In order to carry out the analysis, we addressed the following issues:

- Why is TP important and what are the problems developing countries face with regard to TP?
- What international guidance exists for developing countries with respect to TP?
- What is the economic situation and general tax environment in the selected countries?
- What policies do selected countries currently pursue in the area of TP and what are the legal foundations?
- What experiences do the selected countries have with respect to tax reform processes?
- What likely impact of increasing tax collections and costs can the selected countries expect from TP reform?
- What kind of assistance have the selected countries already received in the area of TP and what would be the best forms of future donor assistance?

[10] It should be noted, however, that the arm's length principle is enshrined in Ghana's anti-avoidance legislation. Although the local tax administration already possesses some experience with regard to the arm's length principle, its application has been limited to an anti-avoidance context and hence is not regarded as formal TP legislation for the purpose of this study.

- What conclusions and recommendations can be drawn from the example of the selected countries with regard to TP and developing countries in general?

Methodology

A detailed work plan, including the different steps of this project, was agreed with the EC in October 2010 and was followed by launch of the study in January 2011. As indicated above, it was agreed to focus on four developing countries, which were selected to serve as illustrative examples for the different stages of TP reform. This report offers an overview on the findings of these individual country studies[11] and the additional research we have undertaken to gain an understanding of the tax environment, state of play with regard to TP legislation and audit practices, as well as reform capacities in the selected countries. This additional research also covered other developing countries such as China and India, for which we have prepared case studies. We have furthermore integrated a case study on the United States of America ('USA') to illustrate the timeline and development of TP reform over a longer period of time.[12]

We conducted local interviews with revenue authorities, donor organisations, civil society organisations, academics and business representatives from different industries, e.g. the automotive and pharmaceutical sector, during February to April 2011. To prepare for these interviews, we developed a standardised questionnaire addressing the topics mentioned above. This questionnaire was amended according to local circumstances and additional country-specific questions were raised based on these initial queries.[13] The interview partners were selected based on their functions in the revenue authorities or their experience/knowledge of the local tax and business environment. Based on our field interviews and our TP experience in the selected countries, we furthermore collected data on the assistance required by local tax administrations with regard to TP reform. These tables, which offer a comprehensive overview of our recommendations, provide an indication with regard to the estimated costs of introducing and implementing TP legislation in the selected countries.[14]

To provide an estimate of the budgetary impact of MNE activity and the possible increase of corporate income tax collections by introducing TP legislation, we have prepared calculations to quantify the potential impact of increasing tax collections by TP reform in the selected countries. For this purpose, we have taken publicly available sources of quantitative data and referenced these sources accordingly. We did not factor in the possible impact of increased tax collection on the local investment climate. Furthermore, our estimations of increased tax collections do not take into account possible additional revenues from other sources than corporate income tax, such as customs revenues. It should, therefore, be noted that these calculations cannot be seen as anything other than indicative estimates.[15]

---

[11] For the individual country studies, see Appendices B–E.
[12] For the individual case studies, see Appendix F.
[13] For the questionnaire, see Appendix G. Please refer to the individual country studies for information regarding the interview partners. For reasons of confidentiality, the information on interview partners could not be stated publicly in some cases.
[14] For the tables on required donor support, see Appendix H.
[15] For the estimated impact on tax collections, see Appendix I.

The draft study has been discussed with a group of stakeholders on 3 May 2011; the final study was presented to a larger group of stakeholders and representatives of the local revenue authorities from Ghana, Honduras and Vietnam on 5 July 2011. Based on our discussions and the comments we have received subsequently (*inter alia*, from the OECD and UN), we have incorporated further aspects into it. We would stress that, given the restraints regarding time and budget, our report's findings only give an outline of TP in the broader context of developing countries. Nevertheless, we believe that the four selected countries represent a suitable core group because they are at different stages of drafting, adopting or enforcing TP legislation in their respective jurisdictions. Hence, even though a broad statement on TP and developing countries based on this report might be inappropriate, the findings do provide a strong basis to assess the challenges faced by developing countries and distil recommendations regarding future action and donor support in the area of TP.

4. The importance and pitfalls of TP

Globalisation and economic growth have driven the level of inter-company transactions to new heights. It is estimated that more than 2/3 of all business transactions worldwide take place within groups, a figure that is likely to grow further in the future.[16] In particular, developing countries are observing immense growth in intra-group transactions due to the fact that their economies are still in the process of opening up and attract large amounts of FDI.

Therefore, TP is not only of importance to business but also for tax administrations, which have to implement or adapt their national TP legislation and practices accordingly. International consistency in TP is beneficial to creating a basic structure of taxable persons and events, which ensures proper application of the arm's length principle. The UN has stressed that "... *consistency is an important goal to be aimed at in terms of encouraging investment in a country and international trade that assists a country's development, although it is ultimately for each country to adopt an approach that works in its domestic legal and administrative framework, and is consistent with its treaty obligations*".[17] However, application of the arm's length principle[18] to the domestic realities of developing countries generates several questions. Not just the high level of MNEs' integration and their ever-evolving business models, but also the increase in intra-group trades in intangibles/services as well as the use of sophisticated financing arrangements pose difficult questions in practice.

[16] WB (2011a), "Transfer Pricing Technical Assistance Global Tax Simplification Program", Presentation given by Rajul Awasthi in Brussels, 24 February 2011.

[17] UN (2011), "Transfer Pricing Practical Manual for Developing Countries" (*TP Manual), Working Draft Chapter I,* n° 8.4, http://www.un.org/esa/ffd/tax/documents/bgrd_tp.htm.

[18] The arm's length principle represents the international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in article 9 of the OECD Model Tax Convention as follows: where "conditions are made or imposed between two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxes accordingly." See OECD (2010a), "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" (OECD Guidelines), 22 July 2010.

Developing countries often lack the necessary legal framework to enforce TP and sanction non-compliance and misconduct. This often includes the fact that local financial accounting provisions, which usually form the basis for tax accounting, are not sufficiently comprehensive. Furthermore, it is widely accepted that applying TP requires skill and judgment by both taxpayers and tax authorities. Especially regarding TP expertise, developing countries often face difficulties due to information 'gaps'. Local tax administrations may fail to collect necessary information due to the absence of documentation requirements, be unable to enforce such requirements or lack the capacity to process and evaluate such information. Additionally, there is the problem of human resource 'gaps', meaning that the few TP or large-taxpayer experts that there are within tax administrations may leave the organisation because of changes in governing structures or more competitive employment opportunities in the business environment.

The arm's length principle is furthermore becoming increasingly difficult and complex to administer as TP audits need to be performed on a case-by-case basis and are often costly tasks for both tax authorities and taxpayers.[19] One of the foundations of the arm's length principle is comparative pricing; however, proper comparability is often difficult to find in developing countries. The fact is that the traditional TP methods[20] rely directly on comparables, which have to be similar to those of the tested party. It is often extremely difficult, especially in developing countries, to obtain adequate information on comparables, for the following reasons:[21]

- There tend to be fewer organised companies in any given sector than in developed countries.
- Existing databases for TP analysis focus on data from developed countries. This data may not be comparable or useful in performing benchmarking studies for companies operating in developing countries (at least without resource and information-intensive adjustments) and, in any event, are usually costly to access.
- The economies of developing countries may just have opened up or be in the process of opening up. There are many 'first movers' who have come into existence in many sectors and areas hitherto unexploited or unexplored; in such cases, there is an inevitable lack of comparables.

In some cases, the problem of being unable to determine and justify the adequacy of related-party transactions is faced not only by tax administrations but also by taxpayers.[22] This often results in increasingly difficult tax audits. It is difficult to set down an exhaustive list of the common reasons for TP adjustments in tax audits in both developed and developing countries. However, these grounds usually include the deemed non-arm's length nature of inter-company transactions,[23] covering ongoing transactions relating to goods (tangible and intangible) and services to on/off transactions such as the

---

[19] See UN (2011), *op cit.*, no. 10.9.
[20] Comparable uncontrolled price method, resale price method, cost plus method; *see* OECD (2010a), TP Guidelines, Chapter II and section 5.1.
[21] See UN (2011), "Transfer pricing: practical manual for developing countries", Working Draft, no. 10.6, http://www.un.org/esa/ffd/tax/documents/bgrd_tp.htm.
[22] The difficulties of comparability in TP have also been recognised by the OECD in the past, see "Invitation to comment on comparability", May 2006, http://www.oecd.org/dataoecd/59/38/36651642.pdf.
[23] Norwegian Government Commission on capital flight from developing countries (2008), "Tax havens and development" (preliminary report), submitted 18 June 2009, see http://www.regjeringen.no/upload/UD/Vedlegg/Utvikling/tax_report.pdf.

transfer of property; and business restructurings are also implicated. Although the difference in the corporate income tax rate between the different parties in a transaction should not impact the arm's length nature of the dealings, it is often used by revenue authorities as a trigger for further scrutiny. In addition, some tax authorities, e.g. the Kenyan Revenue Authorities,[24] make use of non-publicly available information for validating TP, to the disadvantage of *bona fide* taxpayers that do not have access to such data and hence are not able to verify such comparisons. This generates legal and economic uncertainty for taxpayers, which potentially precludes commitments with respect to investment decisions and business development.

In cases of dispute between revenue authorities of two countries on an appropriate arm's length remuneration, mutual agreement procedures ('MAPs') are commonly used to avoid taxation of the same profits in two jurisdictions. However, these MAPs are usually based on bilateral double taxation agreements ('DTAs') and can likewise be time-consuming and technical in their nature. Resources, monetary and otherwise, may be limited not only for the tax administration but also for the taxpayer (especially for small and medium-sized enterprises), which may be subject to detailed TP documentation requirements. Taxpayers might not have the possibility to consult upfront with the tax administration to achieve compliance, which represents a problem in the absence of case law.

In addition, developing countries are also under pressure from developed countries where the counterparties of local companies involved in related-party transactions are subject to taxation. Developing countries are expected to improve TP enforcement and enhance the level of transparency with regard to related-party transactions. This also requires a robust information exchange mechanism between countries, which should be based on solid legal grounds and comply with international standards. Developing countries still lag behind in DTAs containing a clause on the exchange of information or specific tax information exchange agreements ('TIEAs'), which represent a relatively new tool to improve cooperation between tax authorities in TP matters. Generally, bilateral or multilateral exchange of information with developing countries is nonetheless negatively impacted by the information 'gaps' outlined above.

5. Activities by international organisations in the field of TP

5.1. The OECD Guidelines

The OECD has made considerable efforts in offering an international standard for levelling the playing field in the area of TP. The members of the OECD, which are mainly developed countries but also include some developing countries, have

[24] Wright, T.N., (2010) "Kenyan Practitioner decries government's aggressive tactics in transfer pricing audits", Tax Management Transfer Pricing Report 920, International Tax Centre, 13 January 2011. This refers to comparables derived from tax files and financial statements only available to the tax authorities.

agreed common methods and practices in the area of TP, which are outlined in the OECD Guidelines.[25] In particular, the OECD Guidelines outline five methods to determine the arm's length nature of transfer prices:

1. **Comparable uncontrolled price (CUP) method**; which is based on the comparison of prices charged in a controlled transaction to the price charged in an uncontrolled transaction in comparable circumstances for comparable products and services.
2. **Resale price method (RPM)**; which is based on the resale price at which a product purchased from a related party is sold to an independent enterprise. The transfer price of the inter-company transaction is calculated by deducting the resale price margin from the resale price in the uncontrolled transaction.
3. **Cost plus method (CPM)**; which uses the costs incurred by the supplier of property/services in a controlled transaction. A mark-up taking into consideration the functions performed, risks assumed and assets employed is added to the costs to determine the arm's length price in the controlled transaction.
4. **Transactional net margin method (TNMM)**; which examines the net profit margin relative to an appropriate base (e.g. cost, sales, assets) realised from a controlled transaction.
5. **Profit split method (PSM)**; which is based on identification and appropriate split of the profit realised by related entities from a controlled transaction.[26]

Due to the sophistication of the guidance and the economic importance of the participating countries, the OECD Guidelines have the potential to serve as a universally recognised approach to TP. Furthermore, the OECD has a Global Relations programme, which promotes global dialogue on TP and aims at promoting good practice, building country transfer pricing capacity and feeding non-OECD country views into the OECD's work in this area.

From an economic perspective, the establishment of global standards and methods in the area of TP should be clearly advocated. Overall, double taxation is detrimental to economic development and is more likely to occur if there are mismatches in country approaches to TP. Harmonisation of TP helps to facilitate bilateral and multilateral cooperation (e.g. in the area of exchange of information) and reduces the risk of double taxation through the promotion of advance pricing agreements ('APAs') and MAPs. It also provides MNEs with more certainty for estimating what kind of consequences their activities and transactions trigger in terms of local taxation. International adherence to the OECD Guidelines may help foster development through investment.

In this context, the OECD is actively advocating the development of a functional, efficient tax system in developing countries. Through the work of the Informal Task Force on Tax and Development, which was set up in January 2010,[27] the

[25] Developing countries which are currently members of the OECD include Chile, Mexico and Turkey. The OECD also closely works with developing countries in Africa, Asia and Latin America. The OECD's approaches to TP are adhered to by the OECD member states and in principle do not bind states that are not directly affiliated to the organisation.

[26] For the comprehensive provisions on the different methods, please refer to the OECD Guidelines. For the CUP method, Chapter II, nos. 2.13 *et seq.*; for the RPM, nos. 2.21 *et seq.*; for the CPM, nos. 2.39 *et seq.*; for the TNMM, nos. 2.58 *et seq.;* and for the PSM, nos. 2.108 *et seq.*

[27] OECD (2010b), Co-Chairs' Statement of Joint Meeting on Tax and Development between the Committee on Fiscal Affairs (CFA) and the Development Assistance Committee (DAC), 27 January 2010.

OECD aims to help developing countries in gathering the necessary data to analyse how their local tax administrations collect tax revenues and how good governance can be further strengthened. The OECD has published additional guidance with respect to the relation between governance and taxation,[28] which stresses the role of the taxation system in national development. Furthermore, the OECD has developed draft TP legislation for developing economies,[29] which is based on the international standards promoted through the OECD Guidelines.

The OECD is establishing a Global Forum on Transfer Pricing, which will meet for the first time in 2012. It is envisaged that this Forum will be designed to provide a place for government officials from OECD and non-OECD countries to share their expertise and exchange their views on theoretical and administrative aspects of TP. The OECD has also developed informal explanatory notes on a number of aspects of TP (the first five of these deal with TP methods, comparability, comparability adjustments, arm's length range and location savings (not yet finalised)).

5.2. *The UN TP Manual*

The United Nations ('UN') has produced the United Nations Model Double Taxation Convention between Developed and Developing Countries ('UN Model Treaty') in order to provide developing countries with a foundation when negotiating and signing DTAs with developed countries. In addition, the work of the UN Department of Economic and Social Affairs ('DESA') pursues the objective of assisting countries in their economic, social and environmental development. Within the DESA, the Committee of Experts on International Cooperation in Tax Matters ('UN Expert Committee') has been dedicated to working specifically on issues arising for developing countries with regard to TP and international cooperation.

In 2009, the UN Expert Committee initiated its work on the UN Transfer Pricing Manual for Developing Countries ('TP Manual') and published new working drafts on 31 May 2011.[30] The TP Manual is designed to respond to the specific needs of developing countries and offers a step-by-step approach to adopting and implementing TP legislation in developing countries. The different sections of the guide deal with the basic questions regarding TP, and provide information on how to draft TP legislation and set up special TP units, how to identify and work with TP databases, how to pursue simplified strategies for verifying the arm's length nature of a related-party transaction plus compliance strategies for different sized companies. In its draft, the UN Expert Committee establishes a clear reference to existing guidelines and endorses the various elements of the principles stated in the OECD Guidelines (e.g. the arm's length principle).

Conceptually, the TP Manual emphasises that TP as such is not necessarily abusive and should not therefore be regarded as a measure for tax avoidance.[31] It is important to highlight this since, in many developing countries, TP legislation is

[28] OECD (2008), Governance, Taxation and Accountability; OECD (2010c), "Citizen-State Relations: Improving Governance Through Tax Reform", Citizen-State Relations, http://www.oecd.org/dataoecd/19/60/46008596.pdf.
[29] OECD (2010d), "Transfer Pricing Legislation – A suggested approach", Centre for Tax Policy and Administration, November 2010, http://www.oecd.org/dataoecd/41/6/45765682.pdf.
[30] The working draft chapters, together with a note by the secretariat are publicly available on the UN website, see UN (2011), *op. cit.*
[31] UN (2011), *op. cit*, Draft Working Chapter I, no. 1.7.

introduced in conjunction with anti-avoidance regulations and therefore runs the risk of being generally regarded as a tool to circumvent taxation.

5.3. The work of other international organisations

In addition to the OECD and the UN, other international organisations have recognised the need to support developing countries in building capacity in taxation matters. The International Monetary Fund ('IMF') has committed to financing local projects in low-income countries to progress towards the MDGs. In that context, the IMF has provided advice and technical assistance to countries but also granted significant amounts of funding and helped mobilise donor support.

The World Bank ('WB') has also confirmed the need to support developing countries in adopting tax governance and TP legislation. For that purpose, the WB has initiated a Global Tax Simplification Programme ('GTSP') to improve the efficiency and simplicity of tax administration and processes, an area identified as one of the top-three major constraints that business faces in today's economic environment. On that basis, the GTSP provides technical assistance on setting up/improving TP legislation and including TP risk criteria in designing risk-based assessments for tax audits.

It is important to mention that capacity-building is also fostered by regional tax forums such as the Inter-American Centre of Tax Administrations ('CIAT') and the African Tax Administration Forum ('ATAF'). These platforms for mutual cooperation are used by tax administrations to share views on tax matters and best practices, and can make a substantial contribution towards levelling the playing field in the area of TP. As examples, Ecuador and Uruguay have introduced specific methods to evaluate the exportation of commodities based on experience shared by the Argentinean tax authorities. The ATAF, currently composed of 30 African member countries, was created as a programme addressing African needs and strategies. It seeks to encourage partnerships between African countries and receives support from donor partners like the African Development Bank ('AfDB') and the OECD. In the recent past, several seminars and training sessions organised by the ATAF have dealt with the subject of TP.

6. Preconditions for TP reform

As developing countries open up their economies, the need arises to establish a sound corporate income taxation system,[32] which is the foundation for TP legislation. To an even greater degree, certain preconditions and basic requirements with regard to a national tax system should be in place before introducing and implementing TP reform.

[32] See Tanzi, V., and Zee, H., (2001) 'Tax Policy for Developing Countries', International Monetary Fund, Economic Issues no. 27, March 2001, http://www.imf.org/external/pubs/ft/issues/issues27/index.htm; and Bird, Richard M., and Zolt, Eric M., (2003) *op cit*.

It is important to stress that TP only represents one of a number of different legislative and administrative measures that have an impact on related-party transactions. These measures include thin capitalisation rules,[33] money exchange controls and general anti-abuse legislation. Indeed, the existence of a general anti-abuse framework is often observed in countries that do not yet have comprehensive TP legislation in place (e.g. Ghana). However, in-depth analysis of these measures is not within the scope of this report.

The preconditions for TP reform can be divided into three main categories, which form the pillars of TP reform. These include the economic and legal preconditions, as well as the preconditions with regard to the organisation and capacities of the national tax administration (see Figure 1). The aptitude of developing countries for TP reform should be assessed in line with these items.

Figure 1: Basic preconditions for implementing TP reform

1. Economic and political preconditions

- political stability
- economic growth and diversification (*)
- open economy allowing significant export/import activity (*)
- large FDI and involvement of MNEs (current /outlook) (*)
- infrastructure (transport/ communication), skilled workforce/educational system

2. Legal preconditions

- comprehensive accounting rules
- comprehensive income tax law (*)
- understanding of administrative simplification measures
- adherence to the internationally accepted OECD taxation principles (neutrality, efficiency, certainty and simplicity, effectiveness and fairness, flexibility)
- legal system providing for cross-border flows of capital and assets
- tax treaty network (*)
- legal infrastructure: courts system, appeal procedures
- existing TP legislation (*if applicable*) (*)

3. Tax administration

- trained staff (*)
- competitive salary packages
- training facilities (*)
- language abilities (*)
- taxpayer education/assistance channels (*)
- effective processes of tax return filing and data processing
- effective tax collection processes

[33] Appendix J, Box 1 provides an illustrative example of the thin-capitalisation rules that apply in Kenya.

- monitoring of tax revenues
- effective tax procedures (administrative/ judiciary)
- tools for exchange of information within the tax administration
- information technology
- some level of specialisation within tax administration (*)
- internal controls
- experience with tax reform
- experience with TP enforcement and audits (*if applicable*) (*)
- bilateral/multilateral cooperation with other tax administrations

(*) Preconditions selected for further analysis in this study.

7. Selected countries and TP reform

7.1. Introductory remarks

The most important results of our study on TP in developing countries are outlined in this section. Please note that this section only gives a comparative overview and summarises our findings. For the full country studies that we have carried out, we refer to the more-detailed appendices, which are attached to this report.

In order to discuss the possibilities available to the selected countries with regard to TP reform, we structure our analysis along the lines of the clusters of preconditions for TP identified in the previous section, i.e. the economic and political preconditions, legal preconditions and capacities of local tax administrations. Our assessment will be impacted by the fact that a number of these preconditions are interrelated or out of the scope of this report. However, at the end of our analysis, we provide an opinion on the state of play in the selected countries and assess whether they can be regarded as suitable candidates for donor support for TP reform. Throughout the report, we integrate information on TP and other developing countries whenever feasible to provide a broader picture on TP in developing countries.

7.2. Economic and political preconditions

7.2.1. GDP growth, economic sectors and financial markets

The developing countries selected for the purpose of this study have shown overall steep growth levels in terms of their GDP over the past few years (see *Table 1*), however they have been affected by the global economic downturn or national crises (e.g. Kenya's post-election crisis in 2007-2008).

Table 1: GDP growth levels for selected countries[34]

Country	2006	2007	2008	2009	4-yr average
Ghana	4.6%	6.5%	8.4%	4.7%	**6.1%**
Honduras	6.7%	6.2%	4.1%	-2.1%	**3.8%**
Kenya	6.3%	7.0%	1.6%	2.6%	**4.4%**
Vietnam	8.2%	8.5%	6.3%	5.3%	**7.1%**

The tax to GDP ratio (see *Table 2*) in the selected countries has been subject to slight fluctuations over recent years but still remains low compared to the OECD average (34%–35%).[35] This was one of the reasons why this study was launched with a view to investigating how to increase the tax to GDP ratio in developing countries.

Table 2: Tax revenues as a share of GDP (%) for selected countries[36]

Country	2005	2006	2007	2008	4-yr average
Ghana	23.8%	22.9%	20.5%	21.3%	**22.1%**
Honduras	15.9%	16.3%	15.2%	14.5%	**15.5%**
Kenya	18.9%	17.9%	17.4%	18.7%	**18.2%**
Vietnam	26.2%	27.1%	26.2%	26.4%	**26.5%**

Historically, the selected countries have produced agricultural products, raw materials and minerals. In fact, agriculture still contributes to a significant share of GDP and export earnings in many areas.[37] It represents one of the five biggest industry sectors in Kenya, together with the wholesale, trade, transport, communications, manufacturing and education industries. Equally, in Ghana, agriculture represents a large proportion of national industry (30.2% of GDP), together with industry (18.6%) and services (51.1%). During the past few years, substantial oil and gas deposits have been found on the Ghanaian coast and are likely to significantly change the economic structure of that West African country. Overall, both Kenya and Ghana suffer from a large shadow economy.[38]

Agriculture also makes a large contribution to the economy of Honduras, and the country has historically depended on the export of commodity goods such as bananas, coffee, timber, shrimp, gold and palm oil. Today, Honduras' economy is

[34] Annual percentage growth rate of GDP at market prices based on constant local currency, see IMF (2011), World Economic Outlook database April 2011, http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx.

[35] OECD (2010), Revenue Statistics 2010 – Special feature: Environmental Related Taxation, OECD Publishing, http://dx.doi.org/10.1787/rev_stats-2010-en-fr.

[36] WB (2011b), "The World Bank Open Data Catalogue", Tax Revenue (% of GDP), www.data.worldbank.org.

[37] As an example, the agricultural sector in Kenya averaged about 23% of the country's GDP between 2006 and 2009 and contributed to more than 60% of export earnings; *see* Kenya National Bureau of Statistics (2010), Economic Survey 2010, http://www.knbs.or.ke.

[38] Estimates on the contribution of informal enterprises (i.e. the informal sector) to non-agricultural GDP is significant for both Kenya (25% in 1999) and Ghana (58% in 1988); see International Labour Organisation (2002), "Women and men in the informal economy – a statistical picture", Employment Sector, Geneva.

largely diversified due to high levels of international trading in agricultural commodities and manufacturing, making the country the most open economy in Central America.[39]

In Vietnam, the agricultural sector, including forestry and fishing, contributed to about 21% of GDP in 2009. This marks a decrease compared to 2000, when nearly 25% of the national economy was made up of agriculture, forestry and fishing, and is accompanied by an increase in industry and construction activities (from 37% in 2000 to 40% in 2009). Capital intensive investments in Vietnam are mainly observed in the manufacturing sector (49%), followed by the property (25%), construction and hotel/restaurant sectors (all 6%, see *Table 3*).

Table 3: Capital-intensive investments by Sector – Vietnam[40]

Sector	No. of projects	Registered capital in USD mn (in EUR mn)
Manufacturing	7,418	96,253.92 (68,576.46)
Property	353	48,209.85 (34,347.29)
Construction	705	11,634.35 (8,288.94)
Hotel and Restaurant	300	11,364.71 (8,096.83)
Electricity, gas, water production and distribution	63	4,870.37 (3,469.91)
IT	645	4,791.11 (3,413.44)
Art and Entertainment	125	3,461.36 (2,466.06)
Logistics	301	3,183.01 (2,267.75)
Agriculture, Forestry and Aquaculture	482	3,096.12 (2,205.84)
Mining	69	2,959.85 (2,108.76)
Wholesale and Retail	496	1,669.24 (1,189.26)
Finance, Banking and Insurance	73	1,321.48 (941.49)
Others	1,418	3,135.98 (2,234.24)

In line with economic growth, financial markets, financial services and insurance services in the selected countries have seen a considerable increase, triggering various reforms that have been carried out to improve the efficiency of the commercial banking system. For example, Vietnam restructured financial institutions and transformed state-owned banks into independent businesses starting in 1998. A number of additional changes in policies and regulations were announced in 2010 and aim to further modernise the sector by, *inter alia*, revising banking laws and introducing higher minimum capital requirements for banks. In Ghana, the regulation of banks and insurance companies is comparatively advanced today,

[39] WB (2011), "Honduras Country brief", http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/HONDURASEXTN/0,,contentMDK:21035522~pagePK:141137~piPK:141127~theSitePK:295071,00.html.
[40] As of 22 February 2011; Vietnam Investment Review (2011), "Investment Update", 28 March – 3 April 2011. We did not obtain similarly detailed data for the other selected countries.

making the issuance of licences to run such businesses and offer such services subject to a suitability process and constant monitoring once a licence is granted.

7.2.2. Trade liberalisation and international business relationships

In recent years, economic reforms and trade liberalisation have been driven forward in almost all developing countries to restructure economies, increase wealth and attract investment. In Vietnam, this tendency has resulted in a variety of different economic reforms, which have been implemented since 1986 under the 'Renovation' policy and aimed at building a multi-sector economy, whereby the focus lies on economic management and financial, monetary and administrative reforms. Since 1996, growing investments have been made in producing goods for export, infrastructure construction, producing import substitutes and in labour-intensive industries.

This tendency of opening up local economies has been further reinforced because some countries have actively pursued policies to increase cross-border trade by entering into FTAs or joining international trade organisations such as the WTO. For instance, in Honduras, trade liberalisation through a total of nine FTAs has facilitated the establishment of new industries such as pharmaceuticals, telecommunications and textile manufacturing, which increasingly make significant contributions to the GDP.

Honduras has furthermore signed a treaty creating a regional trading scheme, serving as a basis for regional trade agreements (Central American Integration System, 'CAIS'). Additionally, the country, together with other Central American States, has entered into multilateral FTA negotiations with strong trading nations/regions such as Canada and the European Union. The most important FTA Honduras has entered into is the DR-CAFTA,[41] which was signed among the central American states, the Dominican Republic and the United States. The agreement has eliminated tariffs and reduced barriers to the provision of services. The practice of increasing trade cooperation has also been observed in the case of developing countries in the region of South Asia, where a number of emerging economies, e.g. Vietnam, have become members of the Association of South East Asian Nations ('ASEAN') and signed a number of bilateral FTAs. Negotiations for an EU-ASEAN Free Trade Agreement commenced in May 2007.

Ghana mainly has trade relationships with Nigeria, China, the US, the United Kingdom, the Netherlands, Ivory Coast, France and India. Relatively weak regional trade integration in Africa, as a result of which more than 80% of Africa's total exports go to Europe, Asia and America,[42] also becomes apparent when looking at the trade relationships of Kenya. Its main trading partners are Uganda, the UK, Tanzania, the Netherlands, the United States and Pakistan. However, together

---

[41] Dominican Republic-Central America-United States Free Trade Agreement.

[42] Economic Commission for Africa (2010), "New Report on Assessing Regional Integration in Africa Features Intra-African Trade at the ADB Annual Meetings", Press Release No. 43/2010, http://www.uneca.org/eca_resources/press_releases/2010_pressreleases/pressrelease4310.html.

with four other African countries, Kenya has established the East African Community ('EAC'),[43] which launched its own common market in 2010 and seeks, *inter alia*, to boost intra-African trade.

7.2.3. FDI and the importance of MNEs in local economies

The assessment of MNE activity in the selected countries is an important step in the analysis for the need for TP reform. It not only allows conclusions to be drawn with regard to the relevance of TP and, hence, the potential impact on tax collections of investing in TP reform, it also highlights specific economic sectors that should potentially receive special attention when TP legislation is drafted. Certain sectors involve very specific business transactions of increasing complexity, such as the frequent transfer of intangible assets or finance transactions.

Overall, MNEs play a significant role in the economies of the selected countries. In Honduras, it is estimated that they represent approximately 24% of total GDP. In Kenya, it is estimated that MNEs account for a significant percentage of the large taxpayer population, which contributes to about 75% of total tax revenues.[44] Many MNEs in Kenya began their operations in the early 1990s, but a significant share of them already started to invest when the country attained independence (1963). In some industry sectors, especially agriculture, manufacturing, transport and financing, a strong MNE presence can be observed. Even though MNEs have traditionally operated as fully-fledged entrepreneurs in Kenya, some have recently opted to lower the risk profile of their local entities by transferring functions and value-addition processes out of Kenya. This is due to activities such as manufacturing being centralised in other countries like Egypt, South Africa and the United Arab Emirates ('UAE').

MNEs' activities and investments often target specific industries. In Ghana, in the past five years, MNEs have increasingly invested and are now mainly active in the sectors of transport and communication (49% of GDP), banking (18%), mining/quarrying (15%) and real estate (6%). Additional sectors of MNE importance include insurance, construction, manufacturing, distribution and oil/gas/petroleum. Most MNEs have 100% foreign-owned investments; however, those in the mining industry are not usually 100% owned, since the laws of Ghana require a minimum holding by the government. Related-party transactions include trade in tangible goods and intra-group financing, but MNEs also provide or receive management and technical services, know-how, patents and other property rights. In 2009, MNE contributed about 21.13% of the total revenues from corporate income taxation in Ghana.[45]

[43] The members of the EAC are Burundi, Kenya, Rwanda, Tanzania and Uganda, *see* http://www.eac.int/.
[44] Both direct and indirect taxation. Receipts from corporate income tax contribute 19% of total tax revenue (average 2005–2010) (estimates obtained from the Treasury Department of the Kenyan Ministry of Finance).
[45] Information obtained from the Larger Taxpayer Unit of the Ghanaian Revenue Authorities. Unfortunately, it was not possible to obtain figures on MNE contributions to GDP for all the selected countries.

In Vietnam, MNEs were observed to be increasingly active in the country following introduction of the Law on Foreign Investment in 1987. They have invested in a variety of different industries, ranging from manufacturing to water supply and waste management.

7.3. Legal preconditions

7.3.1. Corporate income taxation and special tax regimes

Most developing countries have implemented a tax on corporate profits and require taxpayers to calculate their tax base for corporate income taxation purposes. The countries selected for the study, Ghana (25%), Honduras (25%), Kenya (30%) and Vietnam (25%), all levy income tax on business profits (standard rates). In fact, many developing countries use multiple rates, which mostly apply to specific economic sectors, and also exclude some sectors completely from taxation (tax breaks). Some have noted that these special schemes are detrimental to the functioning of market forces in developing economies.[46]

Overall, the taxation systems have undergone considerable changes during the last few years, but it is not possible to identify a common pattern for the selected countries. For example, Vietnam lowered its corporate income tax rates from 32% in 2003[47] to 25% in 2009 in a conscious effort to reduce the level of company taxation. In contrast, Honduras comprehensively overhauled its tax system in 2010, *inter alia* by expanding the tax base and eliminating a large number of tax exemptions.

In order to encourage FDI, some developing countries have introduced tax incentives and special tax regimes, including temporary import regimes.[48] The ultimate intent behind these schemes is often to increase employment and the average skill levels of the local labour force. The existence of tax incentive schemes influences considerations on TP reform because, while partially successful in attracting investment, they lead to a fragmentation of the income tax regime. In particular, this can influence the effects of different pricing policies between related companies, even in a domestic context, and increase the benefit of implementing TP.[49]

---

[46] Tanzi, V., and Zee, H., (2000) "Tax Policy in Emerging Markets: Developing Countries", IMF Working Paper, WP/00/35.

[47] 25% for foreign-invested companies and foreign parties to business cooperation contracts.

[48] A very prominent example of this is Mexico, where, due to an in-bound programme set up in 1965 (commonly referred to as the "Maquila programme"), a large amount of FDI in manufacturing activities was attracted to the country. Tax incentives were given by way of an exemption from general income tax and VAT. See Mexican Bank for Foreign Trade (Bancomecxt) (2002), "Basic Guide for Foreign Investors 2002/2003", 4th edition, Mexico, http://portal.sre.gob.mx/singapur/pdf/BasicGuideForForeignInvestors.pdf. For an overview of existing tax incentive schemes in the selected countries, see Appendix K.

[49] It was not within the scope of this report to investigate the budgetary relation between tax incentive schemes and TP. However, due to the indicated interrelation of both measures and the high relevance for developing countries, it appears recommendable to undertake further research on this topic in the future.

In Honduras, which has implemented such special schemes since the early 1980s, it is estimated that approximately 90% of MNEs operate under them.[50] In Ghana, the growing industry sectors of oil/petroleum and mining equally benefit from the existence such incentive schemes.[51]

7.3.2. Existing network of tax treaties

Since 1954, Ghana has entered into eight DTAs, including with its main European trading partners (France, the Netherlands and the UK). In comparison, Kenya's tax treaty network is slightly larger, as the country entered into a number of DTAs at a relatively early stage (1970-1980). However, out of 12, only one income tax treaty is with a major trading partner. Vietnam has an extensive network of more than 50 DTAs in place, with both regional as well as European and global trade partners. In this respect, Honduras still lags behind, with no income tax treaty currently in force and only one cooperation and exchange of information agreement with the USA, signed in 1990.[52]

In sum, despite growing levels of international trade, we observe that many developing countries have not signed a corresponding network of DTAs with their most-important trading partners. However, this is crucial in order to provide taxpayers with a legal mechanism to question double taxation and to put in place the legal foundations for the exchange of information. In addition to the non-existence of specific TP legislation, developing countries often also lack domestic legislation which allows and accompanies cross-border exchanges of information. In this respect, general concerns on the treatment of exchanged information may negatively impact negotiations preparatory to signing DTAs.

Some developing countries have identified the need to sign DTAs and consciously aim at expanding their DTA networks. However, our research indicates that many developing countries still lag behind in this important aspect. In this context, developed countries should contribute their fair share by demonstrating that they are in principle prepared to enter into such negotiations. On the other hand, developing countries that have already signed a large number of DTAs often lack practice in their application.[53] Sometimes DTAs are regarded as potential obstacles to FDI, but scientific evidence suggests that, on the contrary, such agreements provide investors with security and stability and are seen as a commitment to stable, correct treatment of foreign investors in terms of taxation.[54]

[50] Unfortunately, no such data is available for the other selected countries.
[51] In particular, the beneficial regimes typically take the form of VAT and customs exemptions as well as increased capital allowances.
[52] However, Honduras is currently in the process of negotiating a DTA with Canada. For an overview on the tax treaties currently in force for the selected countries, see Appendix L.
[53] For example, as of 1 March 2010, Uzbekistan had effective DTAs with a total of 44 countries but, as of March 2010, there were no cases of known in which they had been applied. See PwC (2010), "International Transfer Pricing 2011".
[54] See Neumeyer, E., (2006) "Do double taxation treaties increase foreign direct investment to developing countries?", Journal of Development Studies, 43(8).

7.3.3. *Existing TP legislation in selected countries*

7.3.3.1. *Introductory remarks: state of play in selected countries*

In developing countries, specific TP legislation has been subject to considerably longer drawn-out discussion than in developed countries. The majority of countries considered are currently concentrating their efforts on the introduction and/or implementation of TP legislation. More advanced questions, such as APAs or simplified compliance procedures, have by and large not yet found their way into the local TP legislation of developing countries.[55] It should be noted that, in many countries, TP legislation is not only relevant for corporate income tax purposes but also for indirect taxation, e.g. some customs authorities challenge taxpayers in terms of customs duties, excise and VAT from a TP perspective. However, this is often based on customs guidance regarding the treatment of related-party transactions and is not specific TP legislation. The countries selected for this study are in very different stages of development with regard to TP. As is outlined in this section, especially Kenya and Vietnam have adopted and implemented TP legislation that in part leans heavily on the OECD's TP standards. In contrast, Honduras is currently on the verge of implementing TP legislation, whereas Ghana has not yet introduced any specific TP legislation.

With regard to business, our research indicates that a large number of MNEs regard compliance with local tax legislation as a priority. This is because parent companies are usually settled in jurisdictions where the level of TP enforcement is comparatively strict. The compliance culture often also percolates through to local entities in developing countries because, for internal risk management purposes, tax is considered a high-risk area. Some tax authorities in developing countries have stated that specific features of MNE TP policies have come to their attention, such as risk-stripping of distributors and manufacturers, transfers of locally created intangible assets for little or no consideration and over-compliance with developed countries' TP legislation to the detriment of tax revenues in developing countries.

7.3.3.2. *TP legislation in selected countries*

Many developing countries do not yet have specific TP legislation in place, but the number of jurisdictions analysing the possibility of introducing such legislation is increasing. As an example, China has already had local TP rules in place since the 1980s, but the promulgation of comprehensive TP legislation only took place in 2009. Examples of other developing countries that have recently introduced TP legislation include Turkey (2006), Uruguay and Kazakhstan (both in 2009), Uzbekistan (2010) and Georgia (2011).

Of our selected countries, Vietnam was the first to introduce specific TP legislation. The initial approach to TP was promulgated as early as 1997 with the guidelines for the implementation of DTAs, which allowed the tax administration to make adjustments to prices of related-party transactions with reference to article 9 ('associated enterprises') in Vietnam's

[55] However, it should be noted that some countries have recently implemented APA legislation, e.g. Turkey in 2007. India is currently in the process of implementing APAs (the Direct Taxes Code 2010 dealing with this will come into force in 2012).

DTAs. Four years later, in 2001, the Vietnamese authorities extended the TP legislation and specified the TP methods applying to transactions between related parties, referencing the three traditional methods advocated by the OECD. Since 2004, all such transactions have been subject to the arm's length principle, to which official reference is made in a 2010 Circular (66/2010/TT-BTC). Additionally, this Circular contains guidelines on subjects such as comparability analyses, TP methods, selection and application of the most appropriate method and TP documentation. The Circular outlines five applicable TP methods, which are very similar to the methods described in the OECD Guidelines (specific preference is expressed regarding the use of internal comparables whenever available).

Policymakers in Honduras recognised the need for specific TP legislation in 2004 and expressed a commitment to introduce it in the near future. Only very recently, at the end of 2010, was a new draft decree presented intended to specifically address questions relating to tax avoidance and TP ('Anti-evasion and TP Legislation').[56] The decree proposes changes to the existing Tax Code, and introduces TP legislation and anti-avoidance rules. In its approach, Honduras adheres to existing international standards by orienting itself towards the OECD Guidelines. The draft legislation refers to the arm's length principle and contains components that are typically addressed in TP legislation, such as definitions of related parties, inter-company transactions and a list of TP methods regarded as acceptable for corporate income tax purposes. These methods are consistent with the methods outlined in the OECD Guidelines.

In the case of Ghana, the need for TP legislation has been recognised, but none is expected to come into force before 2013. The Ghana Revenue Authority has set up a committee to advance the development of such legislation and initial draft documents are currently being discussed at high political levels. These discussions reflect the firm commitment of Ghana to introduce TP legislation in the near future. Interviews conducted with the tax authorities for the purpose of this study furthermore suggest that the new TP legislation will build on existing provisions, but will also have input from existing international case law, the OECD Guidelines and best practices in other countries. Until now, the tax authorities in Ghana have applied a general anti-avoidance rule contained in the current tax legislation, under which related-party transactions are valued by reference to industry practice. Transactions are re-characterised by the tax authorities if entered into as part of a tax-avoidance scheme and if their legal form is not in line with their economic substance. Furthermore, similar action as under specific TP legislation has been taken under the provisions of the Technology Transfer Regulations, which came into force in 1992. These regulations limit the amount of royalties and management and technical service fees as well as payments for know-how that can be paid by MNEs to related parties located outside of Ghana's jurisdiction. Payments are regarded as unacceptable if:

- the cost is duplicated and the service performed is readily available in Ghana;

[56] "Ley Para El Fortalecimiento Del Sistema Tributario, Aduanero, Medidas Antievasion y Precios de Transferencia" (Law for Strengthening the Tax System, Customs, Measures against Tax Evasion and Transfer Pricing), draft decree 2010.

- the management agreements are not registered with the Ghana Investment Promotion Centre, which administers the Technology Transfer Regulations;
- the management agreements are registered, but the limitations on transferable amounts are exceeded.

In 2006, Kenya adopted specific TP legislation in response to losing a TP case.[57] In fact, the Kenyan Income Tax Act (section 18(3)) now explicitly refers to the arm's length principle and provides tax authorities with a legal foundation to adjust transfer prices that they consider not to be at arm's length. Further guidance on application of the arm's length principle has been issued in separate TP legislation. Under this legislation, five methods can be applied to determine the appropriate transfer prices between related parties. These methods are in line with the OECD standard and, in principle, apply equally, though preference is given to transaction-based methods. The current TP legislation does not contain any thresholds or materiality clauses. Overall, the TP legislation is perceived as lacking clarity and giving rise to uncertainty.

7.3.3.3. Scope of TP legislation in place

It should be noted that, in the countries that have already introduced specific TP legislation, its ambit in terms of the definition of related party is sometimes substantially wider than in most OECD member countries. The OECD materials do not define control[58] other than as participation in the management control or capital of an enterprise. However, countries normally want to limit the scope and reach of their TP legislation to situations where one enterprise has the practical ability to dictate the terms and conditions under which transactions take place. A very broad scope of controlled transactions may result in transactions being brought within the scope of TP rules that, in reality, are subject to normal market forces and are conducted under arm's length conditions. This could result in an increased compliance burden for taxpayers, an increased compliance cost for tax administrations and a smaller pool of potentially comparable uncontrolled transactions.

While some countries have imposed low thresholds regarding capital participation compared to international standards, other developing countries have not imposed thresholds at all (e.g. Uzbekistan) or consider direct or indirect involvement in management as a decisive criterion (e.g. Turkey). In some developing countries, the definition of related parties furthermore includes cross-border transactions with third parties registered in tax havens (e.g. Kazakhstan and Turkey).

Vietnam has published TP guidance that applies not only to companies that are directly or indirectly related due to ownership or control criteria, but also to those that maintain extensive business relationships. In particular, the term 'related parties' is defined more broadly, e.g. with respect to the capital participation threshold for related parties (20%) or the inclusion of significant business relationships between unrelated parties.

[57] National Council for Law Reporting/Kenya Law Reports (2011), "Unilever Kenya Limited v. The Commissioner for Income Tax" (Income Tax Appeal No. 753 of 2003), www.kenyalaw.org. For more information on the case, please refer to Appendix J, Box 2.
[58] Article 9 of the OECD Model Convention contains the following phrase in relation to control: "participates directly or indirectly in the management control or capital" of an enterprise. This definition does not specify a minimum level of participation for the control criterion to be fulfilled.

The draft TP legislation currently being discussed in Honduras is mainly based on the definition of related parties as given in the OECD TP Guidelines, and applies to both cross-border and domestic inter-company transactions between related parties. Kenya's TP legislation is applicable to all that which have an enterprise located in Kenya and another enterprise located outside Kenya. Furthermore, the scope of the legislation includes transactions between permanent establishments and their head office/other related branches (branches are treated as separate enterprises). In a recent TP reform, Kenya has expanded the definition of related parties to include relationships between individuals.

7.3.3.4. TP documentation requirements

Many developing countries that have introduced TP legislation have included TP documentation requirements, which oblige the taxpayer to keep documented evidence on related-party transactions and to submit such documentation on request. This is also the case in Kenya, where taxpayers must submit TP legislation upon request (within one month following a formal request). Although local tax authorities have interpreted this in the past as an obligation for the taxpayer to prepare TP documentation, there is no official guidance regarding the frequency and process for preparing it. In 2010, the Kenyan tax authorities introduced a special schedule to the annual tax return, which requires related parties to declare whether they have entered into related-party transactions. If they have, they must further disclose the quantum of such dealings and whether or not they have prepared TP documentation.[59]

Together with legislation addressing the appropriateness of TP in related-party transactions, Vietnam has introduced specific legislation dealing with the documentation requirements for TP purposes. Taxpayers need to record and maintain *contemporaneous* TP documentation, which has to be submitted within 30 days if requested by the tax authorities. An official circular (Circular 660) also outlines the content of such TP documentation:

- general information on the business establishment and related parties;
- the business establishment's transactions;
- the methods of calculating the arm's length transfer price applied in related-party transactions.

In addition, taxpayers are required to disclose their related-party transactions on a standard form attached to the annual corporate tax return. This information must be submitted within 90 days following the end of the fiscal year. TP documentation rules are also likely to come into force in Honduras as they are contained in draft legislation that is currently under discussion. Information on taxpayers' related-party transactions must be provided to the local tax authorities on request. If taxpayers fail to meet this obligation, the tax authorities can assess and impose penalties.

[59] At the time this study was carried out, this additional schedule was only in place for the online version of the annual tax return, but not yet for returns in paper form, which is the form completed by the majority of taxpayers. Therefore, it is not certain to what extent the authorities can already make use of the information.

7.4. Capacities of local tax administrations

7.4.1. Public debt and revenue collection

Just like most developed nations, developing countries suffer from public debt and, in some cases, depend on foreign aid. For Honduras, the IMF approved the equivalent of USD 202 mn (EUR 145 mn) in finance in late 2010. Overall, the countries we have considered in our study face public debt due to a structural budgetary deficit, mainly caused by increased government spending and falling tax revenues. The latter are often a downside of the policies pursued to increase trade and foster the diversification and development of national economies, as outlined in the foregoing paragraphs.

In response to public debt and structural deficits, developing countries take very different measures, but many aim to increase the amount of public revenues by augmenting tax collections. We did not obtain this information for all countries in the sample, but some have carried out administrative reforms to increase the efficiency of their national tax authorities. For example, Kenya has addressed problems within the tax administration and carried out reforms to alter its structure and strengthen revenue collection.

7.4.2. Structure and capacities of local tax administrations

In the selected countries, the local tax administrations have been subject to reforms and reorganisations that often affect responsibilities with regard to corporate income tax collection and the administration of MNEs, requiring specialisation within the revenue authorities. In Kenya, the reforms referred to above involved transforming a largely tax-type-based institution into a revenue authority organised along functional lines.[60] This included offsetting up a large taxpayers office ('LTO') in 2006. By definition, companies with an annual turnover of more than USD 9 mn (EUR 6.4 mn) are dealt with by the LTO, currently amounting to 800 taxpayers. Within Kenya's LTO, a TP Unit has been set up with a team of about 12 tax officials, which it has been announced is to be increased to about 25 officials.[61] In general, the Kenyan recruitment programme is robust and the tax administration offers competitive salaries, resulting in generally well-qualified tax officials.

In Vietnam, the General Department of Taxes is divided into sections at central and local levels. At a central level, a particular department was set up for the administration of large enterprises. TP audits are under the responsibility of the Inspectorate department, as part of general tax audits. Similar organisational structures can be observed in the Honduran tax administration, where large taxpayers are under the administration of a special department. However, the definition of a large taxpayer is currently too narrow to efficiently limit the number of taxpayers administered by this department. As part of this specialisation effort, Honduras has hired in additional personnel and has been working with domestic and external training resources to develop more knowledge with regard to large taxpayers.

---

[60] Please refer to the individual country studies for the organisational charts of the local tax administrations.

[61] Bell, K., (2010) "Kenya to require taxpayers to report related-party transactions, methods", Tax Management Transfer Pricing Report 19, International Tax Centre, 6 May 2010. Overall, the Kenyan Revenue Authority has about 4,700 employees.

Due to the lack of specific TP legislation, the Ghanaian revenue authorities do not have staff exclusively working on TP. In the domestic tax division, there are about 4,000 employees, of whom 51 work in tax audits. Ghanaian tax officials are on average in charge of 360 cases/taxpayers.

Most of the tax administrations of the selected countries publicly offer information on their local tax system in English. This applies to Ghana and Kenya, as well as Vietnam, which provides an English version of the website of the Ministry of Finance. For procedures, TP documentation in Kenya must be in English, which simplifies compliance for MNEs. On the other hand, TP documentation in Vietnam must be in Vietnamese, and all supporting documents need to be translated accordingly.

7.4.3. Experience with TP enforcement, audits and penalties

In general, the countries we looked at in this study are relatively inexperienced in TP enforcement. The majority of developing countries seem not to conduct specific TP audits but rather challenge TP in a general tax audit. However, in many countries, the frequency of tax audits as such lags behind that of developed countries.[62] Many, such as Ghana, lack the necessary legal TP foundation to audit transfer prices applied in related-party transactions. The same appears to go for penalties, as many countries have not introduced special TP penalties.

In 2007, Vietnam became one of the few countries to initiate special TP audits. However, due to the lack of resources and expertise, only about five TP audits are conducted a year, and they usually form part of general tax audits. No specific audit procedure is set out for TP, nor is there any separate team of auditors within the Vietnamese General Department of Taxes to run such specialised TP audits. Even though a substantial part of the information submitted by taxpayers comes in electronic form, the tax authorities still lack the means to electronically screen and process this data in order to develop a risk-based audit strategy. Nevertheless, the tax authorities seem to make TP adjustments on a large scale.

It should be noted that, under Vietnamese law, there is currently no specific penalty if the taxpayer fails to comply with the arm's length principle when setting prices or profit margins in related-party transactions. However, under certain conditions (e.g. in the case of false information), the tax authorities have the right to assess the appropriate transfer prices and to make corresponding adjustments to the figures declared by the taxpayer. Another aspect which increasingly attracts the attention of tax authorities are historically loss-making companies. The authorities lack the resources and technical equipment to closely follow up on the figures reported by large companies.

This problem is also prevalent in Honduras, where insufficient technical knowledge, shortages of equipment and non-existent access to technology resources preclude the enforcement of tax provisions and audit of taxpayers operating under

[62] In Turkey, the probability of a company being subject to a tax audit is estimated to be 2-3% (may be higher if industry is targeted). See PwC (2010), "International Transfer Pricing 2011", p. 747.

special tax regimes. Only recently has a special division been created dealing specially with large taxpayers. However, the Honduran tax administration itself still suffers from high staff-turnover levels as the administration is strongly linked to the governing parties. In Honduras, penalties can be levied if a declaration of related-party transactions proves to be inaccurate or false. The draft legislation authorises the tax authorities to adjust the amounts of costs, deductions, revenues, profits or losses reported by a taxpayer if prices in related-party transaction fall foul of the arm's length standard. In these cases, the agreed remuneration or profit margin between the related parties can be adjusted to the median of the arm's length range. For that purpose, the draft legislation under discussion in Honduras also provides a list of TP methods that are regarded as suitable for establishing the arm's length price of an inter-company transaction.

In Kenya, the TP Unit established within the LTO has been increasingly asking taxpayers to disclose their TP documentation since 2009 (in total, over 300 requests). Overall, the resources allocated to transfer pricing team were increased in the second half of 2009, including more personnel, training, subscriptions to benchmarking databases as well as a new team in the Medium Taxpayers Office. In addition to TP queries during general tax audits, desk TP audits have been based on documentation submitted by taxpayers. These audits have not been carried out as specific TP audits but instead formed part of general tax audits.

7.4.4. Internal training facilities and communication channels

The capacity of tax authorities in developing countries to deal with TP reform processes varies depending on the general level of their experience of TP legislation. However, countries' ability to introduce tax reforms also greatly depends on the infrastructure already in place. This specifically encompasses training facilities for tax officials, networks for the interchange of information within the tax administration, automated systems to process new types of information/data, communication channels to inform and educate taxpayers, as well as the existence of bilateral or multilateral cooperation with other tax administrations.

Ghana currently has very little experience with TP reform as no legislation has been brought in to date. However, as indicated in the previous sections, the Ghanaian Revenue Authority has set up a committee to spearhead the development of TP legislation. In this context, the committee has also initiated the process of sending national tax officials abroad, especially to neighbouring countries in the region (such as South Africa and Kenya), in order to leverage on their experience. However, extensive, structured training still needs to be instituted. In the light of upcoming TP legislation in Ghana, local tax authorities have also focused their efforts on automating tax records and data. Currently, all records are managed manually, which means data is not readily and easily accessible. This is particularly problematic since different local tax offices are at this stage not able to share information. In the past, this has led to a number of lapses and taxpayers have often had to produce records of taxes paid to other tax offices. Clearly, introducing TP reform would require IT facilities allowing tax offices to share data and experience in order to ensure uniform application of the new TP legislation and limit the uncertainty for taxpayers.

In Kenya, the introduction of TP legislation in 2006 was the starting point for a number of reforms, enabling the tax administration to acquire certain experience. The reforms were mainly directed at capacity-building and administrative effectiveness, but were also aimed at creating appropriate TP legislation. Both the national tax administration and the ATAF identify the main challenges for African tax authorities as lying in a lack of capacity and expertise, which effectively prevents them from maximising the benefits from adopting TP legislation. For capacity-building purposes, the Kenyan Revenue Authority runs the 'Kenya Revenue Training Institute', which provides specialist training and educational events in cooperation with external institutions, e.g. universities. However, training seems to take place intermittently and, with respect to TP, has not been sufficiently targeted at a core TP team.

Internal capacity-building also remains a challenge in the case of Vietnam. Even though the country has been able to draw on the support of, *inter alia*, the Asian Development Bank and the Japanese National Tax Agency, there is still a fundamental lack of a structured training system and own training facilities. Currently, training is conducted on an *ad hoc* basis and provided to a large cross-section of tax officials rather than to a smaller group of officials to build TP expertise and specialised TP audit teams. This lack of targeted instruction could also hamper the successful implementation of TP reform. However, in the past, Vietnam has made promising approaches to taxpayer education. This is a vital step in promoting and implementing reforms as not only tax officials but also taxpayers must be made aware of the new compliance requirements. In particular, training materials for taxpayers have been made available on the website of the General Department for Taxes, and the TP legislation was announced both on the internet and through other media channels. The tax administration has set up a special structure to deal with TP queries from taxpayers and has moreover organised workshops to share experience relative to compliance needs with taxpayers and tax advisers.

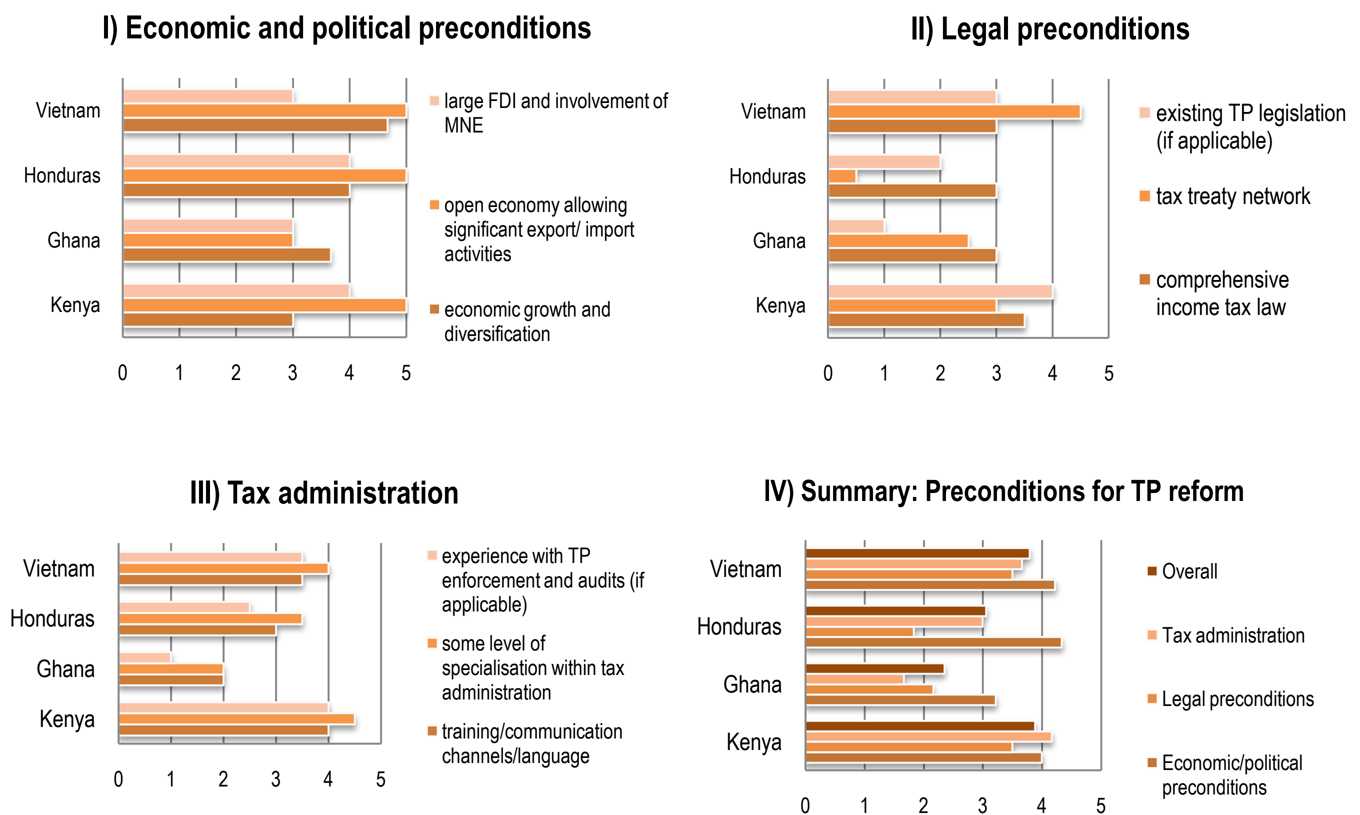
The tax authorities in Honduras are pursuing similar strategies with respect to their new TP legislation. In particular, the administration is currently preparing regulatory guidance for taxpayers, which is intended to reduce uncertainty with respect to the new TP legislation. In addition, the tax authorities are setting up technical TP training sessions based on cooperation with other regional tax authorities. The Honduran Executive Directorate of Income has been reorganised and has started an initiative for domestic and external training resources.

7.5. Interim conclusions: suitability for donor support in TP reform

In the course of this section, we have selected a number of preconditions for TP reform having regard to the relevant economic and legal circumstances, as well as the current capacities of the local tax administrations in the selected countries. Our analysis indicates that significant progress has been made in the past, but some items should still be given further consideration before extensive TP reform is implemented. While Honduras has received a considerable amount of donor support in the recent past, the country still lacks a treaty network with its main trading partners. The Ghanaian revenue authorities should still be receiving donor support to increase local capacities and efficiency, and we feel that TP reform should only be regarded as realistically possible in the mid- to long-term.

On the other hand, Kenya and Vietnam appear to be more-suitable candidates for TP reform. Both countries have experience with TP, but their current TP legislation should be redrafted in light of an analysis of the implications of some of its provisions and assess their usefulness and impact. Both countries have a number of tax treaties in place. Kenya has also become a member of the EAC, which will most likely boost cross-border trade and further increase the need for TP enforcement. The provision of donor support in conjunction with the close collaboration between the African administrations can foster the exchange of knowledge in the region (and in Africa through the ATAF). In addition, both Kenya and Vietnam have undertaken efforts to achieve a level of specialisation within the their tax administrations, simplifying the selection of target personnel for training and secondments and increasing the likelihood that donor resources for TP purposes would be used efficiently. The following charts offer an overview on the findings outlined above (see Figure 2).[63]

Figure 2: Overview of the preconditions for TP reform in selected countries



[63] Graphs I – IV are intended for illustrative purposes and are based on our conclusions with regard to the selected preconditions evaluated in the previous sections. We have applied a scale from 0 (precondition not met) to 5 (precondition fully met) to the results within this range, indicating that the preconditions are partially met.

8. Recommendations for future donor support in selected countries

8.1. Introductory remarks

As indicated in the previous sections, developing countries are often assisted by international organisations or other countries' tax administrations in developing their local TP legislation. For the selected countries, the extent of development cooperation has differed as regards both the organisations providing assistance and the amount of assistance received to date. It is important to point out that developing countries often undergo several reform projects simultaneously, including a number of projects that might be implemented in the area of tax. If such projects are supported by donors, TP reform processes should be scheduled and planned by taking into consideration such ongoing initiatives. This has implications for the level of coordination necessary for both donor organisations and local tax officials, and should influence the sequencing of action if developing countries are targeted for TP reform and donor support.

The amount of development support for the selected countries varies significantly, especially regarding the extent of the assistance provided and the number of active donors. In the cases of Honduras and Vietnam, a significant level of support has been granted by other tax administrations of more-developed countries in the same region, e.g. the USA, Argentina and Mexico (for Honduras). Support by international organisations such as the Inter-American Development Bank ('IADB'), Asian Development Bank ('ADB'), WB, International Finance Corporation ('IFC') and IMF has been substantial for some countries but often focused on more general aspects relative to development of a tax administration (e.g. automation processes, risk management, fraud) than the development and implementation of specific TP legislation.

For other developing countries, support has been limited. Until now, Ghana has only received limited assistance, and identifying best practices with respect to donor support is therefore difficult. Generally, there are a variety of different ways in which tax authorities in developing countries can be supported in successfully adopting and/or implementing TP legislation in their jurisdictions. This involves, *inter alia*, knowledge and experience sharing, training and performance-assessment support. An analysis of donor support to the selected countries up to the present forms the basis of our recommendations as outlined below.[64]

[64] For an overview on the donor support provided in the selected countries up to the present, see Appendix M.

8.2. Universal and country-specific recommendations

8.2.1. Universal recommendations for selected countries

Broadening of treaty networks and gaining practice in their application

As indicated above, the selected countries should particularly draw attention to the development of a network of DTAs. This can foster the local investment climate by providing a legal mechanism to address potential cases of double taxation. As a valid point for all the selected countries, assistance should be sought and given by donors and more-experienced tax administrations to help create the appropriate domestic framework for, amongst others, exchanges of information. When seeking assistance in negotiating tax treaties, developing countries should be encouraged to join international cooperation structures and processes such as the OECD's Global Forum on Transparency and Exchange of Information.[65]

Identification and pooling of local comparables

Future action with regard to TP should not only focus on drafting and enacting comprehensive TP legislation but also on ensuring that implementation of such provisions is feasible. This is particularly true with regard to the lack of local comparables to substantiate the arm's length nature of related-party transactions in case of application of certain TP methods. It could be worth pursuing the development of databases that contain information on comparables on a local or pan-regional level. Regional tax administration forums could drive such projects forward. Funding could be provided by donor organisations to finance the development and continuous updating of such databases.[66] However, development can prove difficult if no central repository for collecting financial data is in place, as is the case in some developing countries.

Building TP expertise, competitive working conditions and adequate control mechanisms

The selected countries should be assisted in the process of building a pool of well-trained, motivated specialists in the area of TP (a dedicated TP unit, judiciary). In addition, local tax administrations should also consider recruiting external TP specialists, e.g. from the private sector. For that purpose, strategic human resource ('HR') policies must be tailored in accordance with the needs of local tax administrations. Such HR policies should involve a hiring process that attracts talented, experienced people and aim at maintaining core staff by offering attractive working conditions. Clearly, as tax officials' salary levels are subject to budgetary constraints, HR policies must ultimately seek to build intrinsic motivation by means of appraisal mechanisms, career opportunities and possibilities for professional development, e.g. through training, secondment, etc. This could also help to reduce high levels of staff turnover, which are commonly observed in developing countries and pose a threat to continuous improvement and knowledge management. It is also important to ensure that revenue targets are not set on a short-term basis but rather support the mid- and long-term development of TP expertise.

---

[65] This idea is also promoted by the EC: see EC(2010), COM (2010) 163 final, p. 6. For more information on the Global Forum, see www.oecd.org/tax/transparency.

[66] For an illustrative estimate of the costs of developing and updating a local database in Kenya, see Appendix N. Based on local subscription costs to the existing Amadeus database, we estimate the investment costs at EUR 35,005 and further recurring costs at EUR 8,751 per annum.

In addition, suitable policies should be implemented to ensure tax officials' independence and prevent possible issues of discretion and potential links to corruption. This could, for instance, include annual independence and compliance checks, quality reviews by an internal audit division, continuous independence learning programmes, the development of a code of conduct as well as asset/wealth declarations. Taxpayers' files should be kept at a registry and only authorised staff should be allowed to consult files. Audits should be cross-checked by several senior tax auditors (at least two) and a rotation system with regard to audit assignments could help to avoid excessive familiarity with particular taxpayers.

Developing risk-based TP audit procedures

Furthermore, tax authorities in developing countries should be assisted generally in developing risk-based audit procedures. Overall, it appears recommendable to implement mandatory filing requirements for annual accounts, and to ensure that from a procedural perspective, requests to taxpayers to submit further TP documentation are sufficiently targeted and focussed on high-risk transactions. A general risk assessment for taxpayers could be envisaged, considering factors such as the size, structure and complexity of the business and its financing, the effective tax rate, the complexity of legal arrangements, openness and transparency and the history of cooperation with revenue bodies.[67] For that purpose, donor support could borrow from the experience of tax administrations in developed countries (EU platforms on administrative cooperation, CIAT, IOTA and ATAF could be used to gather such information). Examples of such risk-based selection criteria for TP audit purposes could, for instance, include transactions with tax havens and low-tax jurisdictions, back-to-back operations, structural losses, business reorganisations and management fees. The local economy and industry sectors should be taken into consideration when developing a system for choosing high-risk transactions and taxpayers that should then be considered as targets for TP audit purposes. It is important to ensure that the tax officials carrying out the TP audit are specialised/ aware of potentially problematic TP transactions in advance and comply with agreed time limits for audit procedures. The tax audit approach will always need to be tailored to the specific taxpayer (e.g. profit/loss situation, kinds of transactions, industry sector).[68] However, general aspects such as materiality thresholds and the information that should be provided/requested for audit purposes can form part of a more-general TP audit strategy.

8.2.2. Country-specific recommendations: Kenya

Even though Kenya has already introduced TP legislation, it should be offered assistance in revising its existing legislation and ensuring that it is adequately structured.[69] In this context, technical assistance could also be targeted at familiarising the local tax administration with the possibility of making statutory provision for APAs. Currently, there seems to be reluctance on the part of the revenue authorities in this regard, which could stem from the challenge posed in terms of resources and expertise. As a dry run on APAs, simplified compliance procedures have the potential to increase legal

[67] Please further refer to OECD (2007), Tax Intermediaries Study, Working Paper 5: Risk Management, http://www.oecd.org/dataoecd/59/59/39003865.pdf.
[68] For that reason, it may also be useful to offer the possibility of case-specific mentoring to tax administrations in developing countries. Such mentoring could be provided by more experienced tax administrations or international organisations such as the OECD or UN.
[69] See Appendix H for a detailed overview of the specific donor support recommended for Kenya, Ghana, Honduras and Vietnam.

certainty for taxpayers and create an amenable fiscal environment for them. However, due to the considerable impact they are likely to have, assistance should be offered by external experts in technically drafting them. We have channelled the additional recommendations for donor support into short-, and medium-/long-term areas of support:

Short-term areas of support:

- Facilitation of secondment/employment of experienced TP officials from more-experienced tax administrations to the Kenyan revenue authorities.
- Development of structured training programmes and assistance in the selection of appropriate resource persons.
- Provision of detailed, practical reference materials such as TP manuals and guides.

Medium- and long-term areas of support:

- Technical assistance in introducing legal reforms in order to scrutinise existing legislation. Donors could offer the Kenyan revenue authorities services in the form of reviewing their TP legislation as it currently stands.

8.2.3. Country-specific recommendations: Ghana

The local tax authorities in Ghana have indicated that they estimate their need for donor support as high. The main areas of assistance required are identified as follows (ranked in order of importance):

1) Technical support in the development and testing[70] of TP legislation.
2) Training of tax officials and possible secondments of TP experts to the Ghana Revenue Authority in order to provide on-the-ground additional support.
3) Performance assessment of the effectiveness of the TP legislation once implemented.
4) In general, funding is required to undertake the actions listed above.

The needs identified by the Ghana Revenue Authority already include assistance in the field of drafting TP legislation. We would endorse this list and stress that special attention should be given to the introduction of additional disclosure requirements for MNEs, as these will provide some of the information required for TP purposes. Ghana has signed up to the EITI and involvement with more such similar initiatives will also contribute towards successful implementation of TP legislation. Based on our research and the interviews we have conducted, we identify the following actions as possible administrative areas of future donor support:

[70] The idea of testing tax law has only recently come up and is currently under discussion, e.g. Ayres, I., Listokin, Y., and Abramowicz, M., (2010) "Randomizing Law". *Faculty Scholarship Series.* Paper 161. http://digitalcommons.law.yale.edu/fss_papers/161. However, we feel that, with regard to TP, such testing may not lead to substantial competitive distortions and its potential effects should be carefully evaluated.

- Investing in technical training for a significant number of local tax officials. Support should be obtained from the private sector and the donor community in terms of technical support, capacity building and funding to cover the costs of developing and taking training courses.
- Tax officials at the Ghana Revenue Authority could be allowed to participate in secondment programmes to tax authorities in other countries that are more experienced in TP.
- Computerisation of tax offices, taking the large taxpayer units as a starting point.

8.2.4. Country-specific recommendations: Honduras

Partially due to the assistance received in the past from national and international organisations as well as from foreign tax authorities, Honduras is making considerable progress in the area of improving its policies and action in the area of TP. However, further, continuing assistance is still necessary as TP enforcement and taxpayer behaviour increase in complexity.

The case for Honduras is very particular because the country is on the verge of introducing binding TP legislation. Based on the interviews carried out with government officials, international organisations and members of the Honduran business community, we make the following recommendations with respect to possible future donor support for Honduras:

- Assistance in scheduling and establishing a fixed training period for the Anti-evasion and TP Legislation, whereby the legislation will enter into force after a fixed period of time (e.g. one year) in order to ensure a smooth transition.
- Development of a phased approach to increase the compliance requirements for taxpayers step by step when the TP legislation comes into effect. Human capital and best practices will need to be developed and identified as well. A phased approach could be structured as follows:

    1) *Mandatory questionnaire*: Assistance in designing a basic TP questionnaire first be introduced to taxpayers, requesting relevant information surrounding a taxpayer's inter-company transactions

    2) *Implementation of contemporaneous TP documentation requirements:* Assistance in drafting and implementation.

    3) *Gradual introduction of APAs:* Building capacities and knowledge within the tax authorities prior to accepting APA applications, assisting in gaining a solid understanding of particular industries and particular TP methods.

- Assistance in drafting informational bulletins or hosting training and question & answer sessions for taxpayers.[71]

[71] The measure of public involvement has been very successful in countries like Uruguay, Chile, Bolivia and Argentina. Such meetings were often organised by third parties such as chambers of commerce and professional associations.

- Assistance in revising the initial TP legislation and evaluating whether all provisions included in the first draft are sound with regard to administrative burden and budgetary effects (e.g. definition of 'related parties').
- As an alternative to reducing the initial scope of the TP legislation, Honduras could make use of external auditors responsible for reviewing inter-company transactions reported by taxpayers.

8.2.5. Country-specific recommendations: Vietnam

Vietnam has received a substantial amount of donor support during the last few years, and two donor organisations have furthermore provided direct support in the field of TP (JICA and ADB). As with most other developing countries, there is therefore still a demand for both support to assist the country in improving the implementation of TP legislation:

- Legislative changes:
  - Assistance in legislative changes to introduce comprehensive TP legislation. Further assistance in introducing provisions on APAs, simplified compliance procedures and mutual agreement procedures.
  - Assistance in the introduction of necessary changes to the existing accounting provisions to better record related party transactions.
  - Assistance in designing TP documentation requirements, in particular in determining which type of information is necessary and should be reasonably collected from taxpayers.
  - Sharing issues and experience in relation to implementing new TP legislation.
- Building TP expertise:
  - Developing structured training programmes for all tax officials, including general awareness-raising training, training of treaty operations and coordination of joint audits.
  - Secondments for tax officials to tax administrations in other countries for on-the-job training.
  - Helping to build a physical infrastructure (tax academy) and to develop training programmes.
- IT infrastructure and support:
  - Assistance in automating the collection and evaluation of TP-related information submitted by taxpayers.
  - Assistance in developing and applying software to process TP-related information.
  - Training on the use of IT infrastructure and other software.

As indicated in the previous sections, the stages that the survey countries are at with regard to the introduction of TP legislation differ significantly. However, almost all of them have a real need for assistance from more-developed countries or international organisations.

8.3. Costs of TP reform and potential impact of increased tax collections in selected countries

8.3.1. Interview/research findings for selected countries

It is difficult to quantify the costs of TP reform and its impact on increased tax collections on the basis of the interviews we have conducted in the selected countries. Statistical data to measure the impact on tax revenues of introducing TP legislation is usually not available. Furthermore, some of the possible ramifications of TP reform, such as improved certainty and lower compliance costs for MNEs, which may attract additional investment, cannot be gauged within a quantitative assessment. However, it is also evident that substantial investment is necessary to adopt TP legislation. We elaborate below on the potential costs of TP reform process in the different countries and the expected cost drivers.

Despite the lack of overall cost/benefit figures, for Vietnam, there are sample results attributable to the introduction and enforcement of TP legislation. Only recently, the revenue authorities inspected a group of 127 FDI companies that had reported consecutive losses. The tax audits resulted in overall adjustments of USD 76.3 mn (EUR 54.4 mn), which yielded additional tax revenues.[72]

For Kenya, we did not obtain any specific figures with respect to the possible costs/benefits of TP reform. However, as outlined in the previous sections, the share of MNEs in total tax revenue is important, and hence the effect of increased efficiency in TP matters is likely to be material. Business representatives of MNEs have furthermore indicated that, in the light of future, strictly enforced TP legislation in Kenya, they expect overall increasing awareness and scrutiny in related-party transactions.

Similarly, the Ghana Revenue Authority has not done a full calculation of the additional costs occasioned by the TP legislation to be implemented in the next few years. The costs are expected to be mainly incurred in drafting the legislation, training staff abroad and developing a computerised tax system. The national tax administration in Ghana expects that the increase in tax collections due to TP reform will exceed the costs of implementation. Some sources estimate Ghana's revenue losses due to deemed non-arm's-length pricing in business transactions with the USA and the EU at EUR 83 mn.[73] Initiatives such as the Extractive Industries Transparency Initiative ('EITI')[74] have the potential to cover related TP issues and ensure appropriate pricing, but this must be adequately enforced through the implementation of TP legislation.

---

[72] We did not obtain official figures on the additional tax collections stemming from these adjustments, see Bang, H., (2011) "Brighter spotlight", Vietnam Economic Times, March 2011, pp. 12–13. Assuming taxation at the standard corporate income tax rate (25%) and disregarding any tax incentive schemes or interest/penalty payments, the additional revenue would amount to USD 19.1 mn (EUR 13.6 mn).

[73] See Christian Aid (2009), "False profits: robbing the poor to keep the rich tax-free", March 2009 report, http://www.christianaid. org.uk/Images/false-profits.pdf, p. 13; services not included.

[74] http://eiti.org/. Ghana was designated as EITI-compliant on 19 October 2010. In short, the EITI aims to increase transparency in financial transactions between governments and companies within the extractive industries. It involves the full publication and verification of company payments made to governments and of government revenues received from oil, gas and mining activities. These activities have the purpose of strengthening governance in resource-rich countries, with the spin-off effect that revenues from natural resources will be directed to government spending on health, education and other development priorities.

As an exception among the selected countries, the Honduras Ministry of Finance has done calculations and estimated that the introduction of TP reforms could enable local tax authorities to collect an additional HNL 8 bn in corporate income taxes annually (approx. USD 430 mn/EUR 301 mn, resulting in a 67% increase in income taxes).[75] Moreover, local tax administrations expect that the implementation of TP legislation will boost customs revenues as many MNEs currently class their inter-company transactions with Honduran subsidiaries as services rather than goods. Therefore, the TP reform process is widely regarded as a means to assist Honduras in meeting its overall goals of strengthening tax revenue collection and the tax administration's internal capacity to control, analyse and collect revenue.

8.3.2. Cost/impact estimations based on publicly available data

In order to provide an indication of the possible costs of TP reform in the selected countries, we summarise the different items required for donor support (training, materials and other support) and done a quantification based on the information received from the relevant local tax administration and our experience in the field of TP. Subsequently, we compare these cost estimates with different growth scenarios for tax collections from MNEs stemming from the introduction of TP reform.[76] Even for low-growth scenarios, we find that the potential increase in tax collections from introducing TP reform clearly outweighs the costs of TP reform in the selected countries (see *Table 4*).

Table 4: Estimated impact/cost from TP reform for selected countries

	Estimated benefit *(obtained figures)*	**Estimated benefit*** (own calculations for 2012, low-impact scenario)	**Estimated benefit*** (own calculations for 2012, low-impact scenario inc. growth in MNE contributions)	**Estimated cost**** (own estimations)
Honduras	*EUR 301 mn*	EUR 4.4 mn	EUR 4.7 mn	EUR 836.357
Kenya	*n/a*	EUR 4.3 mn	EUR 4.7 mn	EUR 266.913
Ghana	*n/a*	EUR 7.9 mn	EUR 9.1 mn	EUR 964.388
Vietnam	*n/a*	EUR 25.4 mn	EUR 27 mn	EUR 444.126

* Based on historic data, assuming an increase in tax collections from MNEs due to the introduction of TP reforms.
** Based on data obtained from local tax administrations and own estimations. The figures include investment costs as well as operating costs for one year.

[75] This figure was obtained from the Honduran tax authorities (unfortunately, we have no further information in this respect). Honduras collected HNL 11.9 bn or USD 641.2 mn in income taxes in 2010.
[76] For the detailed calculations and the assumptions made, see Appendices N and O. We would emphasise that increased tax collections may be affected by other factors. However, we believe that the estimations are valid for an overall assessment of the scale of the possible costs and benefits from TP reform.

9. A general approach to TP reform in developing countries

Given the differing levels of progress in some countries by comparison with others, it is difficult to set down a one-size-fits-all approach. Accordingly, the costs of technical assistance programmes for different countries can vary significantly. A thorough analysis of the specific needs for each developing country with regard to its TP practices is necessary in order that available donor resources are used as efficiently as possible. However, prior to donor support being provided, it should be analysed at what stage of development the country is with regard to both the preconditions and TP-specific legislation (see Figure 3). Experience from other countries such as the USA, China and India[77] show that the process of TP reform is lengthy and that it requires ongoing training and support.

In general, developing countries without any kind of TP experience should be assisted in becoming acquainted with the arm's length principle on a high level. Based on this, a TP strategy should be developed that takes into account country-specific circumstances and outlines the different steps in introducing TP legislation. Special attention should be paid to the recruitment and training of specialised TP staff. Issues such as risk-assessment procedures for audit purposes and APA or simplified compliance procedures are equally important, but should form part of subsequent efforts.[78]

Stage 1: Countries that do not have TP legislation in place

Naturally, the demand for donor support in countries without any TP legislation, is high. However, it is important to thoroughly evaluate the country-specific situation. TP-specific assistance should be scheduled and tailored according to the outcome of this initial mapping exercise. Technical assistance should be provided initially to establish a fundamental understanding of TP principles and methods within the local tax administration. Assistance is also needed with respect to the drafting and testing of TP legislation. In this context, it can be particularly helpful to provide the tax administration with examples of existing TP legislation in other countries. A select group of tax officials should be given the possibility of deepening their understanding of TP either in external training sessions or by attending on-the-job training, e.g. secondments.

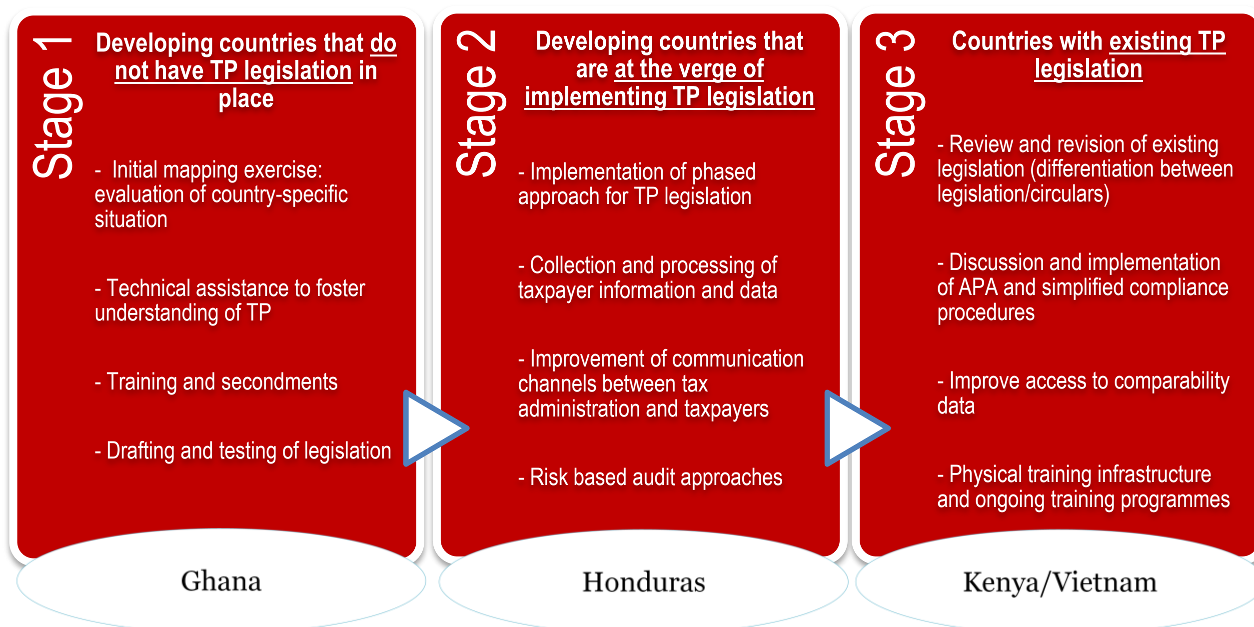
Stage 2: Countries that are on the verge of adopting TP legislation

Developing countries that have already drafted TP legislation require a different set of measures to support successful implementation. As both the tax administration and taxpayers are inexperienced in applying the new legislation, countries could be assisted in pursuing a phased approach, with compliance and documentation requirements increasing over a

[77] For the detailed case studies on China, India and the USA, see Appendix F.
[78] For a summary of the challenges faced, options available and support required by and to be given to developing countries, see Appendix O.

specified period of time. Support, both technical and financial, will be necessary to ensure that the newly available taxpayer information is processed efficiently. This can be achieved by training on how to use data obtained for audit purposes (risk assessments) or assistance in IT infrastructure and systems. Shortly before/after implementation of the TP legislation, financial funding could be provided to facilitate and improve communication between taxpayers and tax administrations, e.g. by organising information sessions and establishing support channels/facilities.

Figure 3: Staged approach to introducing TP reform



Stage 3: Countries with existing TP legislation

The group of developing countries that already have TP legislation in place needs to be subdivided into countries that have *TP legislation* and those that have published *TP rules* in the form of circulars. We recommend that countries should be assisted in adopting TP legislation as this provides taxpayers with greater certainty. In general, it is important to offer assistance in reviewing and revising existing legislation. To ensure the smooth application of TP legislation, developing countries should be offered assistance on the use of foreign comparables and pan-regional data. In particular, tax administrations should receive assistance and training on necessary comparability adjustments. It is important to ensure that comparability analyses performed by tax authorities are transparent and understandable to the taxpayer. Together with this, developing countries can be supported in drafting more-sophisticated TP legislation, such as APA and simplified compliance procedures, and in negotiating DTAs with important trading partners. The development of structured training programmes and the establishment of a physical training infrastructure, such as a tax academy, also appear to be useful ways to support developing countries at this stage.

10. Concluding remarks on TP and developing countries

As a result of globalisation, developing countries are increasingly faced with questions on the adequate pricing of related-party transactions in a cross-border context. In this report, we address different issues surrounding TP and developing countries. Given the stage of their economic and administrative development, developing countries often face problems due to the lack of coherent TP legislation and the fact that local tax administrations have little or no expertise in the field of TP. Problems commonly encountered include the non-existence/inaccessibility of comparable data on third-party transactions and the shortage of basic IT systems for audit purposes and to conduct benchmarking studies.

A number of international organisations have put the issue of TP in developing countries high on their agendas. The OECD Guidelines could serve as common global standards for TP and we would advocate that developing countries orient themselves to these standards when adopting and implementing TP legislation. The UN TP Manual supports this move and underpins the arm's length principle. From a business and growth perspective, this development is welcome as it increases certainty and thus helps foster investment in emerging economies.

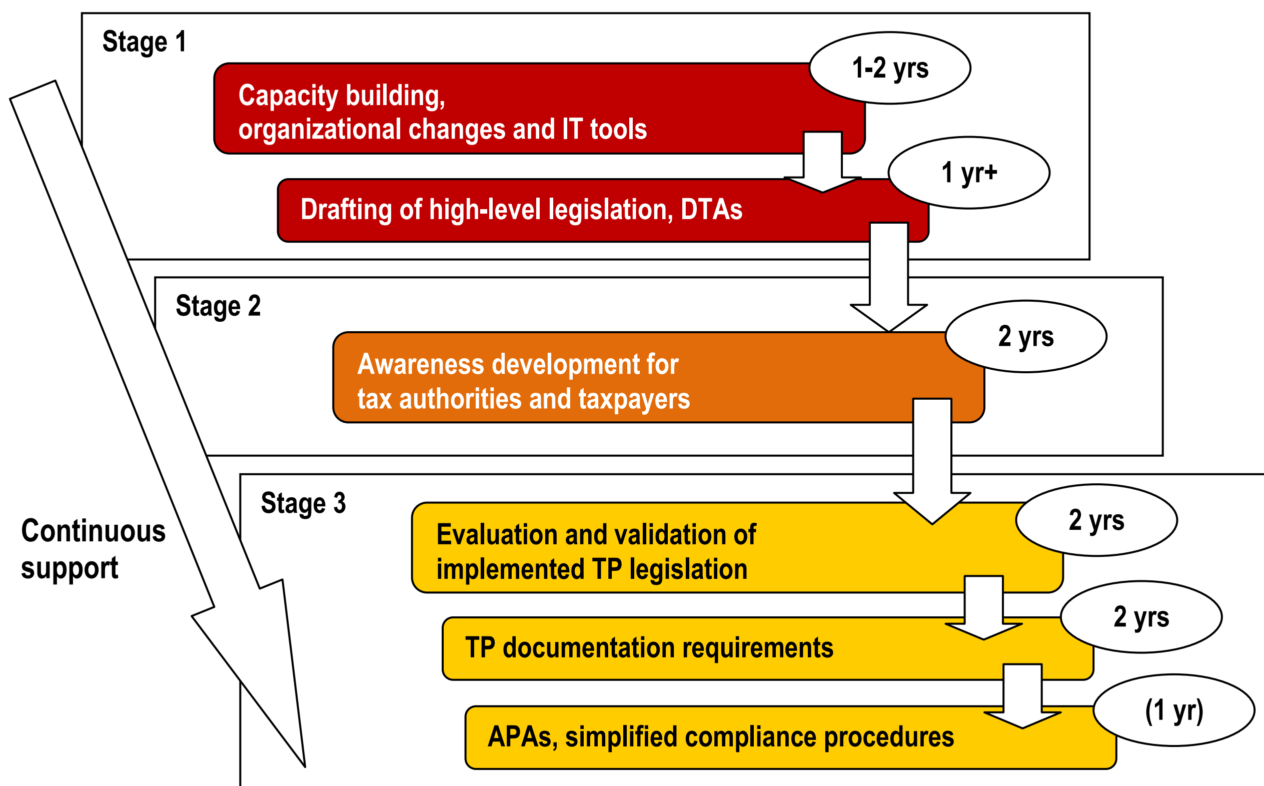
One of the main points we draw attention to is that TP reform in developing countries should always be preceded by an analysis of local circumstances. In order to pave the way for TP, developing countries should ensure that they fulfil the basic economic and political preconditions (e.g. infrastructure, international trade, qualified workforce) as well as legal preconditions (e.g. comprehensive accounting rules, legal system allowing cross-border flows of capital and assets, tax treaty network). Furthermore, the organisation and capacity of the current local tax administration (e.g. educated staff, monitoring of revenues, training facilities) should be taken into consideration. In the absence of such preconditions, we feel that the introduction of comprehensive TP legislation could be premature and that donor support should rather focus on improving the general economic, legal and administrative conditions.

Our analysis with regard to the countries selected for the purpose of this study in essence confirms this premiss. As an example, our field research in Ghana indicates that the country's local tax administration still faces capacity problems in data processing and sharing. Accordingly, and, from our perspective, rightly, TP legislation has not yet been implemented, but merely envisaged. Our study suggests the assistance that might be required and indicates that the amount of required donor support is indeed large. However, our findings also suggest that the possible benefits of TP reform in terms of an increase in tax collections would tend by far to outweigh the anticipated costs.

As a general assessment for developing countries, assuming that the necessary preconditions are met, further analysis should be carried out to identify at what stage of TP reform the country currently is. According to the outcome of this mapping exercise, the country should be classed into one of three stages (countries that have no TP legislation in place;

those that are on the verge of implementing TP legislation; those with existing TP legislation). Donor support should thereafter prioritise the proposed action for each of the different stages outlined in this report (see Figure 4).

Figure 4: Roadmap to TP reform



We would emphasise that developing countries should be assisted such as allows them to gradually build up administrative capacities and TP expertise. There is a need for long-term assistance, which will not necessarily result in a big change all at once. The assistance could better be viewed as a coaching or partnership model, meaning that developing countries can ask for assistance when it is needed. International support must eventually aim at lifting the TP legislation of developing countries to a common international standard. Overall, there is a need to create far-reaching TP legislation in developing countries in order to reduce economic and legal uncertainty and foster investment and growth. It is important to understand that TP reform should not be framed as anti-abuse legislation but should rather aim at improving the existing rules on corporate income tax. The majority of taxpayers want to be compliant with local TP requirements, and seek guidance on how to apply the appropriate remuneration for related-party transactions. For TP and developing countries, comprehensive TP legislation and consistent, efficient implementation can create considerable benefits but, at the current stage, require properly targeted, ongoing donor support.

References

Ayres, I., Listokin, Y., and Abramowicz, M. (2010), "Randomizing Law". *Faculty Scholarship Series.* Paper 161. http://digitalcommons.law.yale.edu/fss_papers/161.

Bang, H. (2011), "Brighter spotlight", Vietnam Economic Times, March 2011, p12-13.

Bell, K. (2010), "Kenya to require taxpayers to report related-party transactions, methods", Tax Management Transfer Pricing Report 19, International Tax Centre, 6 May 2010.

Bird, R., and Zolt, E. (2003), "Introduction to Tax Policy Design and Development", Draft prepared for a course on Practical Issues of Tax Policy in Developing Countries, World Bank, April 28-May 1 2003.

Christian Aid (2009), "False profits: robbing the poor to keeping the rich tax-free", March 2009 report, http://www.christianaid.org.uk/Images/false-profits.pdf.

EC (2010), COM (2010) 163 final, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, "Tax and Development - Cooperating with Developing Countries on Promoting Good Governance in Tax Matters", 21 April 2010.

Economic Commission for Africa (2010), "New Report on Assessing Regional Integration in Africa Features intra-African Trade at the ADB Annual Meetings", Press Release No. 43/2010, http://www.uneca.org/eca_resources/press_releases/2010_pressreleases/pressrelease4310.htm.

Hazelhurst, E. (2011), "Global brewer under tax lens", Business report 6 May 2011, see http://www.iol.co.za/business/companies/global-brewer-under-tax-lens-1.1065154.

IMF (2011), World Economic Outlook database April 2011, http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx.

International Labour Organization (2002), "Women and men in the informal economy – a statistical picture", Employment Sector, Geneva.

International Tax Centre (2011), "China announces gains of $1.57 billion from transfer pricing enforcement in 2010", Tax Management and Transfer Pricing Report 2011 by Kevin A. Bell (20/8), 05.05.2011.

International Tax Compact (2011), "Benefits of a computerized integrated system for taxation", iTax case study, Bonn, February 2011.

Kenya National Bureau of Statistics (2010), Economic Survey 2010, http://www.knbs.or.ke/.

Mexican Bank for Foreign Trade (Bancomecxt) (2002), "Basic Guide for Foreign Investors 2002/2003", 4th edition, Mexico, http://portal.sre.gob.mx/singapur/pdf/BasicGuideForForeignInvestors.pdf.

National Council for Law Reporting/ Kenya Law Reports (2011), "Unilever Kenya Limited –vs.- The Commissioner for Income Tax" (Income Tax Appeal No. 753 of 2003), www.kenyalaw.org.

Neumeyer, E. (2006), "Do double taxation treaties increase foreign direct investment to developing countries?", Journal of Development Studies, 43(8), pp. 1501-1519.

Norwegian Government Commission on capital flight from developing countries (2009), "Tax havens and development" (preliminary report), submitted 18 June 2009, see http://www.regjeringen.no/upload/UD/Vedlegg/Utvikling/tax_report.pdf.

OECD (2007), Tax Intermediaries Study, Working Paper 5: Risk Management, *see* http://www.oecd.org/dataoecd/59/59/39003865.pdf.

OECD (2008), "Governance, Taxation and Accountability- *issues and practices*", DAC Guidelines and Reference Series, http://www.oecd.org/dataoecd/52/35/40210055.pdf.

OECD (2010), Revenue Statistics 2010 – Special feature: Environmental Related Taxation, OECD Publishing. http://dx.doi.org/10.1787/rev_stats-2010-en-fr.

OECD (2010a), "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" (OECD Guidelines), 22 July 2010.

OECD (2010b), Co-Chairs' Statement of Joint Meeting on Tax and Development between the Committee on Fiscal Affairs (CFA) and the Development Assistance Committee (DAC), 27 January 2010.

OECD (2010c), "Improving Governance Through Tax Reform", Citizen-State Relations, http://www.oecd.org/dataoecd/19/60/46008596.pdf.

OECD (2010d), "Transfer Pricing Legislation – A suggested approach", Centre for tax policy and administration, November 2010, *see* http://www.oecd.org/dataoecd/41/6/45765682.pdf.

OECD (2011), "Statistics portal/ National accounts", http://www.oecd.org/topicstatsportal/0,3398,en_2825_495684_1_1_1_1_1,00.html.

PwC (2010), "International Transfer Pricing 2011", up to date as of March 2010.

Tanzi, V., and Zee, H. (2000), "Tax Policy in Emerging Markets: Developing Countries", IMF Working Paper, WP/00/35.

Tanzi, V., and Zee, H. (2001), 'Tax Policy for Developing Countries', International Monetary Fund, Economic Issues no. 27, March 2001 (accessible under http://www.imf.org/external/pubs/ft/issues/issues27/index.htm)

The Heritage Foundation (2011), "Vietnam information on economic freedom – Fiscal freedom", http://www.heritage.org/index/country/Vietnam#fiscal-freedom.

UN (2000), Resolution adopted by the General Assembly, 55/2 United Nations Millennium Declaration, 8th plenary meeting, 8 September 2000.

UN (2011), "Transfer Pricing Practical Manual for Developing Countries" (TP Manual), Working Draft Chapters, 31 May 2011, http://www.un.org/esa/ffd/tax/documents/bgrd_tp.htm.

Vietnam Investment Review (2011), "Investment Update", March 28 – April 3, 2011.

WB (2011), "Honduras Country brief", http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/LACEXT/HONDURASEXTN/0,,contentMDK:21035522~pagePK:141137~piPK:141127~theSitePK:295071,00.html.

WB (2011a), "Transfer Pricing Technical Assistance Global Tax Simplification Program", Presentation given by Rajul Awasthi in Brussels, 24 February 2011.

WB (2011b), "The World Bank Open Data Catalogue", www.data.worldbank.org.

Wright, T. N. (2010), 'U.N. Groups Fund Online Courses for African Tax Officials in Nine Countries', Tax Management Transfer Pricing Report 548, International Tax Centre, 9 September 2010.

Wright, T. N. (2011), "Kenyan Practitioner decries government's aggressive tactics in transfer pricing audits", Tax Management Transfer Pricing Report 920, International Tax Centre, 13 January 2011.

Appendices

Appendix A: List of developing countries

Appendix A: List of developing countries

As referred to in the report based on the World Bank classification[79]

East Asia and Pacific

American Samoa
Cambodia
China
Fiji
Indonesia
Kiribati
Korea, Dem. Rep.
Lao PDR
Malaysia
Marshall Islands
Micronesia, Fed. Sts
Mongolia
Myanmar
Palau
Papua New Guinea
Philippines
Samoa
Solomon Islands
Thailand
Timor-Leste
Tuvalu
Tonga
Vanuatu
Vietnam

Europe and Central Asia

Albania
Armenia
Azerbaijan
Belarus
Bosnia and Herzegovina
Bulgaria
Georgia
Kazakhstan
Kosovo
Kyrgyz Republic
Lithuania
Macedonia, FYR
Moldova
Montenegro
Romania
Russian Federation
Serbia
Tajikistan
Turkey
Turkmenistan
Ukraine
Uzbekistan

Latin America and the Caribbean

Antigua and Barbuda
Argentina
Belize
Bolivia
Brazil
Chile
Colombia
Costa Rica
Cuba
Dominica
Dominican Republic
Ecuador
El Salvador
Grenada
Guatemala
Guyana
Haiti
Honduras
Jamaica
Mexico
Nicaragua
Panama
Paraguay
Peru
St. Kitts and Nevis
St. Lucia
St. Vincent and the Grenadines
Suriname
Uruguay
Venezuela, RB

[79] Country and Lending Groups; http://data.worldbank.org/about/country-classifications/country-and-lending-groups.

Middle East and North Africa

Algeria
Djibouti
Egypt, Arab Rep.
Iran, Islamic Rep.
Iraq
Jordan
Lebanon
Libya
Morocco
Syrian Arab Republic
Tunisia
West Bank and Gaza
Yemen, Rep.

South Asia

Afghanistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

Sub-Saharan Africa

Angola
Benin
Botswana
Burkina Faso
Burundi
Cameroon
Cape Verde
Central African Republic
Chad
Comoros
Congo, Dem. Rep.
Congo, Rep
Ivory Coast
Eritrea
Ethiopia
Gabon
Gambia, The
Ghana
Guinea
Guinea-Bissau
Kenya
Lesotho
Liberia
Madagascar
Malawi
Mali
Mauritania
Mauritius
Mayotte
Mozambique
Namibia
Niger
Nigeria
Rwanda
São Tomé and Principe
Senegal
Seychelles
Sierra Leone
Somalia
South Africa
Sudan
Swaziland
Tanzania
Togo
Uganda
Zambia
Zimbabwe

Appendix B: Country Study Honduras

(Please see separate file attachment *‘Appendix B_Country Study Honduras_epub’*)

Appendix C: Country Study Ghana

(Please see separate file attachment *‘Appendix C_Country Study Ghana_epub’*)

pwc

Appendix D: Country Study Kenya

(Please see separate file attachment *'Appendix D_Country Study Kenya_epub'*)

Appendix E: Country Study Vietnam

(Please see separate file attachment *‘Appendix E_Country Study Vietnam_epub’*)

Appendix F: Case Studies
China – India – USA

Case Study 1 – China

1. Development of local TP legislation

China is one of the first developing countries to have had national TP legislation in place, introduced in the early 1990s (a set of local TP rules had already been observed in the 1980s). However, the first comprehensive TP legislation, which was based on and included all previous rules with regard to TP, was promulgated in January 2009.[80] Previously, in 2008, China had enacted a new corporate income tax law, which stipulates the arm's length principle as the guiding principle for related-party transactions and enables the Chinese revenue authorities to adjust taxable income if related-party remunerations are not found to be at arm's length. During development of its TP legislation, external consultants were contracted to conduct research on other developing countries' legislation and were invited to comment on the draft legislation.

2. Scope of TP legislation, documentation requirements and TP audit practices

With regard to the definition of related parties, China follows international standards as contained in the OECD Guidelines. Taxpayers are required to maintain contemporaneous TP documentation and have to provide such documentation, if requested, within 20 days. However, the Chinese legislation contains some administrative simplification measures, which relieve taxpayers from this obligation if:[81]

(1) Volume of related-party transactions	The annual amount of related-party purchases/sales < RMB 200 mn (EUR 21,4 mn) and for all other types of transactions < RMB 40 mn (EUR 4,3 mn)
(2) Existence of an APA	The related-party transactions are covered by an APA
(3) Shareholding	The foreign shareholding of the enterprise is < 50%, and the taxpayer has only domestic related-party transactions

Chinese tax authorities focus increasingly on nationwide (companies within a group) and industry-wide[82] TP audits. Circular 2 also provides an overview of taxpayer characteristics that will typically trigger a specific TP audit. These include:

- Significant amount or numerous types of related-party transactions (no threshold);
- Long-term consecutive losses, low profitability or fluctuating pattern of profits/losses;
- Lower profitability compared to other taxpayers in the same industry or compared to the functions/risks of the company;
- Business dealings with related parties in tax havens;
- No contemporaneous TP documentation or incomplete TP-related tax return disclosures; and

---

[80] Circular Guo shui fa [2009] No. 2, hereinafter 'Circular 2'.

[81] The following administrative simplification measures are not applicable to loss-making entities with limited functions and risks (they automatically have to submit contemporaneous TP documentation to the tax authorities).

[82] In particular, revenue authorities have targeted office automation and computer contract manufacturing industries. The automotive sectors and the pharmaceutical industry receive increasing attention. This can be explained partly by the fact that transactions involving royalties and service fee remittances are increasingly targeted. Furthermore, the Chinese revenue authorities have announced in their TP enforcement plan for 2011 that trading, services and finance activities will be focused on.

- Other situations indicating breach of the arm's length principle.

3. Experience with TP reform/structure of tax administration

China's anti-tax avoidance officials are organised as follows: at central level (SAT level, a designated team), provincial level/municipal level (a designated team is available), city level (in most cases, a designated team is available) and local level (usually no designated team). The SAT gives instructions in terms of TP enforcement to all lower-level tax authorities; the provincial level/municipal level tax authorities may give instructions to their lower-level tax authorities. A TP audit needs to be approved by the SAT before it is formally initiated even though local-level, city-level and provincial-level tax authorities may already have done a significant amount of analysis or assessment. A settlement needs to be initiated at local/city level and approved at provincial level, and then by the SAT. In general, depending on the nature of the tasks, the SAT mostly acts just as a technical adviser and approver while the provincial/city/local tax authorities act as enforcers, although sometimes the provincial level also serves as a technical adviser and as a middle-man between the city/local authorities and the SAT. At SAT level, the anti-avoidance division consists of six people, and a corresponding number at provincial/city level. The total number of tax officials specialised in anti-tax avoidance is 228. Chinese tax authorities organise their own training, but TP practitioners are often invited. Some anti-tax avoidance tax officials have been sent to the US Internal Revenue Service or other tax authorities for overseas training. Nevertheless, there are still knowledge gaps between China and countries/territories more experienced in TP. In addition, the resources of the tax administration seem to be scarce. However, in 2009, it announced the appointment of a specialised team of 500 officials. Since 2009, there has been at least one further national training course on a specific industry in TP issues.

4. TP Adjustments in China

The budgetary impact of TP enforcement in China is illustrated by the scale and increase of TP adjustments over recent years (see table on TP adjustments, below). In general, Chinese tax authorities have developed a trend of focusing on larger transactions for TP audits. This "quality over quantity" approach has turned out to be highly effective and resulted in a significant increase in adjustments due to larger adjustments being made in individual cases.

Year	2005	2006	2007	2008	2009	2010
No. of cases	361	257	192	152	167	178
Adjustments to taxable income (total)	RMB 4.2 bn (EUR 442 bn)	RMB 5.8 bn (EUR 610 bn)	RMB 9.0 bn (EUR 946 bn)	RMB 15.8 bn (EUR 1.66 bn)	RMB 16.1 bn (EUR 1.69 bn)	RMB 16.5 bn (EUR 1.73 bn)
Adjustments to tax payable	RMB 0.5 bn (EUR 53 mn)	RMB 0.7 bn (EUR 74 mn)	RMB 1.0 bn (EUR 105 mn)	RMB 1.2 bn (EUR 126 mn)	RMB 2.1 bn (EUR 221 mn)	RMB 2.3 bn (EUR 242 mn)

In addition, the mutual agreement procedure processes seem to be very effective. In 2010, Chinese revenue authorities helped MNEs to eliminate RMB 5.029 bn (EUR 529 mn) in double taxation. They are also actively involved in international activities, such as OECD events and assignment programmes.

Case Study 2 – India

1. Development of local TP legislation

India witnessed immense growth and liberalisation during the 1990s, putting TP high on the agenda. In response, the Central Government formed an Expert Group, which was responsible for formulation of the TP legislation. External agencies, industry bodies and company representatives assisted in developing the TP legislation. The TP legislation was approved by the Indian parliament in 2001, and came into force as from financial year 2001. The legislation was issued along with Rules notified by the Central Board of Direct Taxes (CBDT). The basic framework of the legislation was based on the OECD guidelines, with certain exceptions in terms of the use of mean values, the +/-5% range, maintenance of contemporaneous documentation, filing of an accountant's certificate, etc.[83]

2. Scope of TP legislation, documentation requirements and TP audit practices

The Indian TP legislation contains an extensive definition of associated enterprises. While adhering to the OECD convention in terms of participation and control, India has put in place more-specific parameters, including:

- advancement of a loan by an enterprise that constitutes 51% or more of the total book value of the assets of the borrowing enterprise;
- complete dependence of an enterprise (in carrying on its business) on the intellectual property licensed to it by another enterprise;
- substantial purchase of raw materials/sale of manufactured goods by an enterprise from/to the other enterprise at prices and conditions influenced by the latter.[84]

Indian TP law requires maintenance of contemporaneous documentation and requires application of the "most appropriate" of the five methods for determining TP. The prescribed methods are as outlined in the OECD Guidelines. TP audits are conducted in the course of regular tax assessments by specialised transfer pricing officers. Internal administrative guidelines provide that, in general, all taxpayers with a total value of related-party international transactions above INR 150 million[85] (EUR 779,862) can be subject to TP audits.

---

[83] This rule has been amended in India's Finance Bill 2011, whereby an allowable variation will be notified for different business activities and types of transactions. The new rule will be applicable form April 2012 (assessment year 2012/2013). The government had initially proposed to have 'safe harbour' rules, but instead has introduced the concept of 'allowable variation'. Therefore, in respect of financial years beginning on or after 1 April 2011, no margin will be available to the taxpayer until such time as the government gives notice of the margin.
[84] Effective from June 2011, entities located in tax havens will be treated as an associated enterprise (this provision was introduced by India's Finance Bill 2011, which has now been approved by the Parliament).
[85] The amount was INR 50 million, which was raised by means of an internal circular.

3. Experiences with TP reform/structure of tax administration

Within the Indian Revenue authorities, there is a special unit dedicated to TP, which deals with TP-related questions in the course of tax assessments. Overall, the Indian authorities pursue an active approach with regard to training its TP staff, including sending them overseas for conferences. These initiatives have been highly effective and have resulted in a steep learning curve. The TP unit was set up comprising senior-level tax officials, known as transfer pricing officers (TPOs), drawn from the grades of assistant directors and joint directors of income tax (transfer pricing) and is stationed across the country. The contingent of TPOs in each jurisdiction is headed up by a director of income tax (TP), under the aegis of the Director General of International Tax. The TPOs are subject to internal transfers within the Department to different locations in the country. TPOs have wide-ranging powers, including inspection, survey and inquiry. They are assisted by inspectors and officers attached to the TP unit. In 2007, the Revenue department faced an acute shortage of skilled officers for carrying out TP audits (each TPO handled about 250 TP cases a year) and, in the following year, the TP authorities significantly expanded the headcount to 70.[86]

In addition, during 2009 (pertaining to the TP assessment of AY 2006-07), a special unit was created called the Dispute Resolution Panel (DRP), consisting of a collegium of three tax officers: Director of Income Tax (TP), Director of Income Tax (International Taxation) and Commissioner of Income Tax. However, in the DRP's first year, in almost all cases the DRP upheld the adjustment; this led to more cases being brought before the Tax Tribunal. It had been announced that safe harbour rules would be issued for non-core services in 2009, but their implementation was not driven forward due to feasibility discussions.

4. TP adjustments in India

The amounts of adjustments as a consequence of TP assessments have been steadily increasing since the introduction of TP legislation in 2001. Although current figures are difficult to obtain, there are estimates regarding the proportion of adjusted cases and total amounts for 2002 – 2005:[87]

Assessment Year	2002–2003	2003–2004	2004–2005
Cases assessed/ Cases adjusted	1061/ 239	1501/ 337	1768/ 471
Percentage	23%	22%	27%
Total TP adjustments (in USD mn)	305	572	858

Indian Revenue authorities have targeted transfer pricing aggressively and the rise in TP disputes has resulted in existing transactions being subjected to higher adjustments and new transactions being challenged. All of this has resulted in a

[86] TP Week, India creates dedicated team of 70 transfer pricing officers, 17 April 2008.
[87] TP Week, 24% of Indian TP audits lead to adjustment, 19 February 2008.

potentially large tax outflow for MNEs. Adjustments to transfer prices have been disputed by taxpayers and, more often than not, both sides have appealed matters to the tax courts. Challenges have been that TP is a subjective matter and economic principles guide pricing, hence the courts, which generally interpret application of law, have not necessarily provided consistent answers on TP disputes. This is where the DRP, as a settlement body, is expected to play an important role going forward.

5. The future of TP legislation in India

The government has expanded the scope of TP to cover companies having transactions with countries that are reluctant to exchange information and are typically low-tax jurisdictions. Though various tax treaties with India provide for resolution of double taxation through MAP, the increasing number of cases has prompted the Finance Ministry to propose the institution of APAs as part of the DTC to mitigate and/or reduce litigation and provide certainty to MNCs in their TP arrangements. The Direct Tax Code already contains general provisions relating to APA, and some further norms will most likely come into effect in April 2012.

In February 2011, the Indian Finance Minister acknowledged that the TP legislation was not yet as comprehensive as in developed countries. For that reason, a committee was set up to evaluate possibly upgrading the TP legislation in order to provide information on TP aspects and the treatment of intangible assets.

Case Study 3 – USA

1. Development of local TP legislation

The application of the arm's length principle for TP purposes in the United States dates back to 1934, and the U.S. Internal Revenue Service ('IRS') has issued additional regulations in 1968, 1986, 1994, 2003, and 2009. During the last three decades, the IRS has served as one of the 'trend-setters' in the area of TP, and its approaches to TP regulation have provoked controversy on a global scale given the importance of the U.S. market for MNEs. In general, the TP regulatory framework in the United States is very detailed due to the characteristics of the U.S. corporate tax system.

2. Scope of TP law, TP documentation requirements, and TP audit practices

Transfer pricing is applicable to all controlled taxpayers in the United States. According to the IRS, control is defined as two or more organizations being owned or controlled, managerially or operationally, directly or indirectly, by the same interests. Generally the threshold for control in the United States is considered to be at least 50%, but it can be less when the entity is effectively controlled.

In the United States, the burden of proof is generally placed on the taxpayer. Therefore, taxpayers should maintain sufficient contemporaneous TP documentation to prove that the transfer price and the selected TP method are consistent with the arm's length standard. The regulations do not require documentation to be in place prior to filing the tax return, but filing documentation after the tax return is filed would not provide for penalty protection in case of a dispute with the IRS. The IRS typically requests taxpayers to produce supporting TP documentation, and taxpayers have to submit such documentation within 30 days of any such request. TP regulations outline in detail which documents and information should form part of such documentation.

The IRS routinely reviews the inter-company prices and TP policies of the U.S. tax returns of MNEs, and this review is not limited to cases where avoidance is suspected. Neither the IRS nor the Treasury publishes any statistics on the number of cases or the amount of dollars associated with TP issues.

The IRS approaches transfer pricing tax audits on a case-by-case basis, and the number of examiners assigned to a case generally varies from one to four. There are about 600 international examiners nationwide and about 140 economists. These IRS personnel handle the bulk of the TP cases.

3. The structure of the Internal Revenue Service

The IRS has a separate division dealing with Large Business and International ('LB&I'), which is organized along six industries and one examination support function. These include:

- Communications, Technology and Media;
- Financial Services;
- Heavy Manufacturing and Transportation;
- Natural Resources and Construction;
- Retailers, Food, Pharmaceuticals and Healthcare;
- Global High Wealth; and
- Field Specialists.[88]

The IRS considers its employees to be one of its most important assets. The recruitment, development, and retention of highly skilled and satisfied staff constitute one of the IRS's strategic initiatives. For that purpose, the IRS provides tax personnel with special training in different areas to help them identify and understand issues in a complex and cross-border international environment, including economic analysis. Besides training employees, the IRS also focuses on training tax practitioners and tax preparers to increase the level of compliance.

4. Costs and benefits of TP in the United States

The IRS does not provide a breakdown of the income generated through TP audits. However, the IRS continues to direct resources toward enforcement. In 2007, the IRS collected USD 12.60 for every dollar spent on enforcement. Additionally, the number of IRS economists with transfer pricing expertise has increased by 50% over the last two years, which is a signal that more in-depth audits can be expected.

A 2007 Report to Congress states that verification of compliance by taxpayers is facilitated when IRS examiners have access to contemporaneous documentation that describes the methodology used by the taxpayer to apply the arm's length standard.[89] When documentation is generated by taxpayers and analyzed by the IRS, it tends to increase the overall efficiency of the examination, because it becomes possible to identify key transfer pricing issues early in the process. Early identification of issues allows the IRS to concentrate examination resources on those controlled transactions that raise the most substantial issues.

[88] IRS, Large Business and International Division at-a-glance, 2011, http://www.irs.gov/irs/article/0,,id=96387,00.html.

[89] Department of the Treasury, *Report to Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties*, November 28, 2007, http://www.treas.gov/offices/tax-policy/library/ajca2007.pdf.

One of the largest transfer pricing disputes with the IRS in recent years was the Glaxo SmithKline case. A settlement was announced in that case in 2006 with a single payment of USD 3.4 bn. The case covered the period 1985 to 2005 and involved the treatment of intangibles related to R&D and Marketing.

Appendix G: Questionnaire

Appendix G: Basic questionnaire used for local interviews

1. How important are MNEs in Ghana/ Kenya/Honduras/Vietnam in terms of contribution to tax revenue and GDP?
2. Can you comment/ describe on their general behaviour in terms of tax compliance?
3. How adequate are Ghana's/ Kenya's/ Honduras'/ Vietnam's current TP rules particularly in the face of the current surge in MNEs through the main sector in their respective countries?
4. In Honduras and in Ghana, do you think specific TP rules should be adopted? What contribution would their adoption make to domestic tax revenue in both the short term and long term?
5. How much is Ghana/ Kenya/Honduras/ Vietnam investing in TP adoption and development? Which areas are the investments being channelled towards (staff training, computerisation, and subscription to databases)?
6. For the countries that already have TP legislation, what proposed amendments are the tax authorities considering and are these going to be in the form of dedicated TP regulations or amendments to the existing legislation? When are these expected to be in force?
7. What input, if any, will the OECD Guidelines have in development of TP rules in Ghana/ Kenya/ Honduras/ Vietnam?
8. What difficulties do the tax authorities in Ghana/Kenya/Honduras/Vietnam anticipate in implementing extensive TP rules? Is the donor community expected to play a role in this?
9. Have the tax authorities undertaken any tax audits specifically relating to transfer prices of MNEs in Ghana/ Kenya/ Honduras/ Vietnam?
10. Have the tax authorities conducted any studies on TP in Ghana/ Kenya/ Honduras/ Vietnam which may be useful to us?
11. How much do you anticipate it will cost to implement TP rules in Ghana/ Kenya/ Honduras/ Vietnam, and will the benefits justify this cost?
12. What mechanisms for dispute resolution with respect to double taxation do the tax authorities have with other countries?
13. Have the tax authorities invested in training any local officers abroad on recent trends in TP?
14. Have the tax authorities obtained or solicited private sector support with respect to the development of TP rules in Ghana/ Kenya/ Honduras/ Vietnam?
15. What challenges do the tax authorities anticipate with respect to developing TP rules and what recommendations do you have on mitigating these challenges?
16. Are the TP rules being developed have any input from case law, statutory law or tax treaties?
17. What IT and other infrastructure including databases and information exchange have the tax authorities put in place to support the TP set up in Ghana/Kenya/Honduras/ Vietnam?

18. In which of these areas do the tax authorities wish to have more donor support – financial, technical, training, people or performance assessment?
19. To what extent will the tax authorities take part in the exchange of information, country-by-country-reporting and other initiatives which will enhance the TP base?
20. Are the tax authorities going to accept APA or TP documentation?
21. Which industry groups will TP target?
22. Which TP method do you propose to use: comparable uncontrolled price method, cost plus method, resale price method, transactional net margin method or profit split method?
23. Will the tax authorities educate the MNEs and the public before the introduction of the TP rules?
24. Are the tax authorities going to develop their own TP database or will they subscribe to SMART, Amadeus or other database?
25. Will the tax authorities be conducting benchmarking studies to develop their own database?
26. Will MNEs be required to provide annual information on the basis on which their transfer prices were determined?

Appendix H: Required donor support in selected countries

Appendix H: Required donor support in selected countries

1. Donor support recommendations Kenya*

*** list not intended to be exhaustive**

Possible Donor Support		Provider	Recipient	Format	Timing (estimated)	Resources needed
1. Training	Accounting practices (not recommended)					
	General tax (not recommended)					
	Transfer pricing	OECD / Independent transfer pricing consultant	KRA TP team - estimated staff number 15	Secondment/Face-to-face training	Continuous	Secondee with vast TP experience/Placement
	Economics/Statistics and related knowledge	OECD / independent economist consultant		Face-to-face training		Physical training facilities
	Audit practices and effective management (e.g. data processing)	OECD				
	Tax administration (not recommended)					
	APA mechanism/ MAP procedure	OECD / ATAF	KRA TP team - estimated staff number 15	Face-to-face training	Continuous	Physical training facilities
	Language courses (not recommended)					

2. Materials	IT hardware / infrastructure support (not required - KRA has required IT infrastructure to support its TP activities)					
	Databases for comparables	Third-party database providers such as BVD	ATAF / KRA/ Tax payers	Development of database	1 year	To be determined on-site
	Macroeconomic analysis	Third-party specialist economists	Ministry of Finance / KRA	Research report	3 months	
	Manuals and technical training materials	EC financing of ATAF TP taskforce on putting together training materials and manuals	Support to be provided to ATAF TP taskforce	Online or face-to-face interaction	6 months	Decided cases, Experience of tax authorities in more advanced countries etc.
	Draft legislation	Independent TP consultant with legislative drafting background or tax legislation drafting expert from the UK	Ministry of Finance / KRA	Draft legislation	3 months	Tax legislation drafting expert
	Databases for tax administrations (e.g. online forum)	Third-party IT consultants	ATAF / KRA	Provision of required infrastructure	1 month	Internet accessibility
3. Other materials	Knowledge databases for Tax administration and tax payers (available in other support areas)					
	Public accessibility to legislation and administrative guidelines (Not required - KRA has a comprehensive website where materials and documents are constantly posted)					
4. Other support	Secondments	See TP training in "1" above				

2. Donor support recommendations Ghana*

*** list not intended to be exhaustive**

Possible Donor Support		Provider	Recipient	Format	Timing (estimated)	Resources needed
1. Training	Accounting practices	Institute of Chartered Accountants, Ghana; University of Ghana Business School	Officials and members of the Ghana Revenue Authority, taxpayers	Face-to-face training and introduction to international accounting standards, online access to training materials	Continuous	Training facilities, materials and financial resources
	General tax	Institute of Chartered Accountants, Ghana; Chartered Institute of Taxation, Ghana; University of Ghana Business School		Face-to-face training, online access to training materials		
	Transfer pricing	Chartered Institute of Taxation, Ghana; Institute of Chartered Accountants, Ghana	Officials and members of the Ghana Revenue Authority, MNEs			
	Income Tax	Chartered Institute of Taxation, Ghana	Officials and members of the Ghana Revenue Authority, taxpayers			
	Economics/Statistics and related knowledge	University of Ghana Business School, Department of Economics, Department of Statistics - University of Ghana	Ministry of Finance and Economic Planning, officials of the Ghana Revenue Authority			
	Audit practices and effective management (e.g. data processing)	Chartered Institute of Taxation, Ghana; Institute of Chartered Accountants, Ghana	Officials and members of the Ghana Revenue Authority, taxpayers			
	Tax administration (audit procedure, internal structure of tax administration checks & balances)	Ghana Revenue Authority and other Tax administration	Officials of the Ghana Revenue Authority, Ministry of Finance and Economic Planning	Face-to-face training		
	APA mechanism/ MAP procedure	External consultants	Officials of the Ghana Revenue Authority, taxpayers	Introduction the APA and MAP procedure and training		

2. Materials	IT hardware / infrastructure support	External consultants	Tax authorities	Materials (e.g. computer, software) and technical assistance	Continuous	Donor support and financial resources
	Databases for comparables	Third party database providers such as BVD and development of regional databases	Officials of the Ghana Revenue Authority	Development of databases and training		
	Macroeconomic analysis	Ministry of Finance and Economic Planning		Development of databases and training		Financial resources
	Manuals and technical training materials	Kenyan Revenue Authority; South African Revenue Service	Officials of the Ghana Revenue Authority, Ministry of Finance and Economic Planning	Textbooks for training purposes (including for transfer pricing and general income tax training)	3 - 6 months	
	Draft legislation	International Monetary Fund	Ministry of Finance and Economic Planning	Face-to-face training		
3. Other materials	Knowledge databases for Tax administration and tax payers	Kenyan Revenue Authority; South African Revenue Service	Officials and members of the Ghana Revenue Authority	Development of / access to online platform	3 - 6 months	Financial resources
	Public accessibility to legislation and administrative guidelines	n/a			Continuous	Donor support and financial resources
4. Other support	Secondments	Kenyan Revenue Authority; South African Revenue Service	Officials of the Ghana Revenue Authority		3 months	Donor support and financial resources

3. Donor support recommendations Honduras*

*** list not intended to be exhaustive**

Possible Donor Support		Provider	Recipient	Format	Timing (estimated)	Resources needed
1. Training	Accounting practices	External consultants	Honduran Executive Directorate of Income ("DEI") and Colegio Hondureño de Profesionales Universitarios de Contaduría Publica ("COHPUCP")	Classroom	Continuous	Physical training facilities, two instructors, books, other training materials
	General tax					
	Transfer pricing					
	Income Tax					
	Economics/Statistics and related knowledge					
	Audit practices and effective management (e.g. data processing)					
	Tax administration (audit procedure, internal structure of tax administration checks & balances)					
	APA mechanism/ MAP procedure					
	Language courses			Classroom and/or online course		Physical training facilities, two instructors, books, other training materials, online courses

2. Materials	IT hardware / infrastructure support	Local hardware/infrastructure distributor	DEI and COHPUCP	IT and infrastructure hardware	n/a	Computers for each TP analyst and for COHPUCP for training purposes, network infrastructure, servers, IT support, software updates
	Software programs needed to implement transfer pricing legislation	Microsoft, statistical analysis software provider	DEI	Software license for Microsoft Office applications and statistical analysis		Financial resources
	Technical publications	Tax Analysts, BNA	DEI and Ministry of Finance ("MoF")	Subscriptions to technical publications		Unlimited access to transfer pricing and other related publications
	Databases for comparables	Compustat, Bureau van Dijk, Moody's, Bloomberg	DEI	License for database		License to databases for access to financial information from independent comparable companies or transactions
	Macroeconomic analysis	External consultants	DEI and MoF	n/a		Financial resources
	Manuals and technical training materials	External consultants	DEI and COHPUCP	Textbooks for training purposes (including for transfer pricing and general income tax training)	New textbooks every two years	Textbooks for training purposes (including for transfer pricing and general income tax training)
	Draft legislation	External consultants and international institution	DEI and MoF	n/a	6 months plus additional time to draft revisions to legislation	Personnel to assist with drafting of legislation
3. Other materials	Knowledge databases for tax administration and taxpayers	Third party databases	DEI and MoF	Licenses/subscriptions	n/a	Financial resources
	Public accessibility to legislation and administrative guidelines	Third party website developer		Design website, pay for domain fees, site maintenance		Website developers, domain name, personnel to maintain/update website with recent legislation and guidelines

4. Other support	Creation of central forum for approval of special tax regimes	External consultants	Honduran Government	Feasibility study	6 months	Personnel to conduct study on how to implement said forum. The forum will be led by the DEI or MoF
	Secondments	External consultant, foreign tax authority, international institution	DEI	Send personnel abroad to foreign tax authorities or receive personnel in Honduras from foreign tax authorities	n/a	Personnel with experience of transfer pricing in the region, transportation costs, per diem, and other compensation for services

4. Donor support recommendations Vietnam*

*** list not intended to be exhaustive**

Possible Donor Support		Provider	Recipient	Format	Timing (estimated)	Resources needed
1. Training	Accounting practices	Subject matter experts (individuals)	Central tax level - Tax Policy Department, Tax Reform & Modernisation Dept, International Cooperation Dept & Inspectorate	Face-to-face classroom training/On-the-job training	Continuous	Physical training facilities, instructors, translators & financial assistance
	General tax	Subject matter experts (individuals)				
	Economics/Statistics and related knowledge	IBFD & OECD	Provincial tax offices who will be handling TP cases			
	Transfer pricing (General & basic principles as espoused in OECD)	Professional Service Firms	Central tax level - Tax Policy Department, Tax Reform & Modernisation Dept, International Cooperation Dept & Inspectorate			
	Audit practices and effective management (e.g. procedures in conducting TP audits)	Other tax administrators from Asia Pacific region				
	APA mechanism/ MAP procedure					
	Language courses - English language courses	Vietnamese translators required for training sessions				

	Databases for comparables	BvD		ORIANA or Osiris database etc		
	Macroeconomic analysis	External consultants				Donor support - Financial resources
2. Materials	Draft legislation	Other tax administrators from Asia Pacific region	Tax authorities	Face-to-face	On-going process	
	Databases for tax administration	External consultants & other tax administrators from Asia Pacific region				
	Manuals and technical training materials	Other tax administrators from Asia Pacific region		n/a		n/a
3. Other materials	Knowledge databases for Tax administration	External consultants & other tax administrators	Tax authorities	Intranet	On-going process	Donor support - Financial resources
	Public accessibility to legislation and administrative guidelines for tax payers	MoF	Taxpayers	MOF website & printed legislation		
	Guidance to review and amend the legislative authority	Other tax administrators from Asia Pacific region		Face-to-face		
4. Other support	Secondments	Foreign tax authorities, international institutions	Tax authorities	n/a	On-going process	Donor support - Financial assistance
	Translators	External consultants		Face-to-face		

Appendix I: Estimated impact on tax collections resulting from TP reform in selected countries

1.1 Contributions of MNE to total tax revenues Ghana (*)

	2005	2006	2007	2008	2009	2010	Average	Source
GDP in Ghs mn	**17.891,0**	**18.705,0**	**19.913,0**	**21.592,0**	**22.598,0**	**23.894,0**		IMF (World Economic Outlook Database, April 2011)
in EUR mn	*8.321,4*	*8.700,0*	*9.261,9*	*10.042,8*	*10.510,7*	*11.113,5*		Own calculation (1 Eur = 2.15 Ghs)
GDP growth	**6,2%**	**4,5%**	**6,5%**	**8,4%**	**4,7%**	**5,7%**	**6,06%**	IMF (World Economic Outlook Database, April 2011)
Tax/GDP ratio	**21,30%**	**12,80%**	**13,90%**	**13,90%**	**12,5%**		**14,88%**	World Bank (Tax to GDP)
Total tax collection in Ghs mn	**3.811**	**2.394,24**	**2.767,91**	**3.001,29**	**2.824,75**			Own calculation
in EUR mn	*1.772*	*1.113,6*	*1.287,4*	*1.395,9*	*1.313,8*			Own calculation
Tax collection growth rate	n/a	**-37,17%**	**15,61%**	**8,43%**	**-5,88%**		**-4,75%**	Own calculation
Corporate Income Tax revenues (CIT) in Ghs mn	n/a	**733,4**	**910,2**	**1.234,2**	**1.783,9**			Ghana - Large taxpayer office
in EUR mn	n/a	*341*	*423*	*574*	*830*			
CIT/Total tax	n/a	**30,63%**	**32,88%**	**41,12%**	**63,15%**		**41,95%**	Own calculation
MNE contribution/CIT	n/a	**18,63%**	**20,30%**	**18,88%**	**21,13%**		**19,74%**	Ghana - Large taxpayer office
MNE contribution/Total tax	n/a	**5,71%**	**6,68%**	**7,76%**	**13,34%**		**8,37%**	Own calculation
MNE contribution total in Ghs mn	n/a	**136,6**	**184,8**	**233,0**	**376,9**			Own calculation
in EUR mn	n/a	*63,5*	*85,9*	*108,4*	*175,3*			Own calculation

(*) Estimates.

1.2 Tax growth model Ghana - Scenario 1 (*)

Base scenario									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in Ghs mn	22.598,0	23.894,0	27.160,0	29.146,0	30.938,0	32.867,0	34.948,0	36.502,0	IMF (World Economic Outlook Database, April 2011)
in EUR mn	10.510,7	11.113,5	12.632,6	13.556,3	14.389,8	15.287,0	16.254,9	16.977,7	Own calculation (1 EUR = 2,15 Ghs)
GDP growth	2,60%	5,74%	13,67%	7,31%	6,15%	6,24%	6,33%	4,45%	IMF (World Economic Outlook Database, April 2011)
Average tax/GDP ratio	12,50%	14,88%	14,88%	14,88%	14,88%	14,88%	14,88%	14,88%	Own calculation (average 2005-2009)
Average CIT/Total tax	63,15%	41,95%	41,95%	41,95%	41,95%	41,95%	41,95%	41,95%	Own calculation (average 2005-2009)
Average MNE contribution/CIT	**21,13%**	**19,74%**	**19,74%**	**19,74%**	**19,74%**	**19,74%**	**19,74%**	**19,74%**	Own calculation (average 2005-2009)
Average MNE contribution/Total tax	13,34%	8,37%	8,37%	8,37%	8,37%	8,37%	8,37%	8,37%	Own calculation (average 2005-2009)
Expected total tax Ghs mn	2.824,8	3.555,4	4.041,4	4.336,9	4.603,6	4.890,6	5.200,3	5.431,5	Own calculation
MNE contribution total (in Ghs mn)	376,8	297,6	338,3	363,0	385,3	409,3	435,3	454,6	Own calculation
Estimated revenue from MNE in EUR (in mn)	**175,3**	**138,4**	**157,3**	**168,8**	**179,2**	**190,4**	**202,4**	**211,4**	Own calculation (1 EUR = 2,15 Ghs)

Increase CIT collections from MNEs (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0%	0%	0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0%	0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0%	0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total contribution (in EUR mn)								
Base Scenario	**175,3**	**138,4**	**157,3**	**168,8**	**179,2**	**190,4**	**202,4**	**211,4**
Low Impact Scenario	175,3	138,4	157,3	176,7	191,5	204,6	218,7	229,9
Medium Impact Scenario	175,3	138,4	157,3	184,6	204,2	219,4	235,9	249,6
High Impact Scenario	175,3	138,4	157,3	200,3	230,7	253,4	278,2	301,1

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.
(**) For 2009, 2009 data was used (not average). This is the reason for the decrease in estimated revenues from MNE in 2010 (138,4) compared to 2009 data (175,3). For 2010, we have used the 2006-2009 average for CIT/Total tax (41,95%) and MNE contribution/CIT (19,74%); resulting in a lower estimated MNE contribution/Total tax for the years 2010 – 2016 (8,37%) than in 2009 (13,34%).

1.3 Tax growth model Ghana - Scenario 2 (*)

Scenario 2 : Base scenario + Annual 1% increase in MNE activities (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in Ghs mn	22.598,0	23.185,5	27.160,0	29.146,0	30.938,0	32.867,0	34.948,0	36.502,0	IMF (World Economic Outlook Database, April 2011)
in EUR mn	10.510,7	10.784,0	12.632,6	13.556,3	14.389,8	15.287,0	16.254,9	16.977,7	Own calculation (1 EUR = 2,15 Ghs)
GDP growth	2,60%	5,74%	13,67%	7,31%	6,15%	6,24%	6,33%	4,45%	IMF (World Economic Outlook Database, April 2011)
Average Tax/GDP ratio	12,50%	14,88%	14,88%	14,88%	14,88%	14,88%	14,88%	14,88%	Own calculation (average 2005-2009)
Average CIT/Total tax	63,15%	41,95%	41,95%	41,95%	41,95%	41,95%	41,95%	41,95%	Own calculation (average 2005-2009)
Average MNE Contribution/CIT	**21,13%**	**22,13%**	**23,13%**	**24,13%**	**25,13%**	**26,13%**	**27,13%**	**28,13%**	Own calculation + 1% growth (assumption)
Average MNE Contribution/Total tax	13,34%	9,28%	9,70%	10,12%	10,54%	10,96%	11,38%	11,80%	Own calculation (average 2005-2009)
Expected Total Tax KSh mn	2.824,8	3.555,4	4.041,4	4.336,9	4.603,6	4.890,6	5.200,3	5.431,5	Own calculation
MNE Contribution total (in KSh mn)	376,8	330,1	392,1	439,0	485,3	536,1	591,8	640,9	Own calculation
Estimated revenue from MNE in EUR (in mn)	**175,3**	**153,5**	**182,4**	**204,2**	**225,7**	**249,3**	**275,3**	**298,1**	Own calculation (1 EUR = 2,15 Ghs)

Increase CIT collections from increased MNE activity (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0%	0%	0,0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0%	0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0%	0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total contribution (in EUR mn)								
Base Scenario	**175,3**	**153,5**	**182,4**	**204,2**	**225,7**	**249,3**	**275,3**	**298,1**
Low Impact Scenario	175,3	153,5	182,4	213,3	240,2	266,2	294,8	320,6
Medium Impact Scenario	175,3	153,5	182,4	222,4	255,1	283,8	315,4	344,6
High Impact Scenario	175,3	153,5	182,4	240,7	286,3	324,2	366,3	407,5

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.
(**) For 2009, 2009 data was used (not average). This is the reason for the decrease in estimated revenues from MNE in 2010 (153,5) compared to 2009 data (175,3). For 2010, we have used the 2006-2009 average for CIT/Total tax (41,95%); resulting in a lower estimated MNE contribution/Total tax for the years 2010 – 2016 (9,28% – 11,80%) than in 2009 (13,34%).

2.1 Contributions of MNE to total tax revenues Honduras (*)

	2005	2006	2007	2008	2009	2010	Average	Source
GDP in Hnl bn	**133.886,0**	**142.789,0**	**151.678,0**	**157.920,0**	**154.555,0**	**158.841,0**		IMF (World Economic Outlook Database, April 2011)
in EUR mn	*5.024,79*	*5.358,92*	*5.692,53*	*5.926,79*	*5.800,50*	*5.961,36*		Own calculation (1 EUR = 26,6451 Hnl)
GDP growth	**6,1%**	**6,6%**	**6,2%**	**4,1%**	**-2,1%**	**2,8%**	**3,9%**	IMF (World Economic Outlook Database, April 2011)
Tax/GDP ratio	**14,50%**	**15,20%**	**16,30%**	**16,00%**	**14,40%**	**n/a**	**15,3%**	World Bank (Tax to GDP Table)
Total tax collection in Hnl	**19.413**	**21.703,9**	**24.723,5**	**25.267,2**	**22.255,9**	**n/a**		Own calculation
in EUR mn	**9.030**	*814,56*	*927,88*	*948,29*	*835,27*	*n/a*		Own calculation (1 EUR = 26,6451 Hnl)
Corporate Income Tax revenues (CIT) in Hnl	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**		
Tax collection growth rate		**11,80%**	**13,91%**	**2,20%**	**-11,92%**	**n/a**	**4,00%**	Own calculation
CIT/Total tax	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**19,30%**	Assumption based on Honduras Ministry of Finance available data
MNE contribution/ CIT	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**		
MNE contribution/Total tax							**9,34%**	Assumption based on other country studies
MNE contribution total		**n/a**	**n/a**	**n/a**	**n/a**	**n/a**		

(*) Estimates.

2.2 Tax growth model Honduras -Scenario 1 (*)

Base scenario (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in Hnl mn	154.555,0	158.841,0	164.324,0	170.897,0	177.733,0	184.842,0	192.236,0	199.925,0	IMF (Wold Economic Outlook Database, April 2011)
in EUR mn	5.800,5	5.961,4	6.167,1	6.413,8	6.670,4	6.937,2	7.214,7	7.503,3	Own calculation (1 EUR = 26,6451 Hnl)
GDP growth	-2,10%	3,45%	4,00%	4,00%	4,00%	4,00%	4,00%	4,00%	Own calculation (verage 2005-2009)
Average tax/GDP ratio	14,40%	15,50%	15,50%	15,50%	15,50%	15,50%	15,50%	15,50%	Own calculation (average 2005-2009)
CIT/Total tax	19,30%	19,30%	19,30%	19,30%	19,30%	19,30%	19,30%	19,30%	Own calculation (average 2005-2009)
Average (E) MNE contribution/Total tax	9,34%	9,34%	9,34%	9,34%	9,34%	9,34%	9,34%	9,34%	Own calculation (average 2005-2009)
Expected total tax Hnl mn	22.255,9	24.620,4	25.470,2	26.489,0	27.548,6	28.650,5	29.796,6	30.988,4	Own calculation
MNE contribution total (in Hnl mn)	2.078,7	2.299,5	2.378,9	2.474,1	2.573,0	2.676,0	2.783,0	2.894,3	Own calculation
Estimated revenue from MNE in EUR (in mn)	**78,0**	**86,3**	**89,3**	**92,9**	**96,6**	**100,4**	**104,4**	**108,6**	Own calculation (1 EUR = 26,6451 Hnl)

Increase CIT collections from MNEs								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0,0%	0,0%	0,0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0,0%	0,0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0,0%	0,0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total contribution (in EUR mn)								
Base Scenario	**78,0**	**86,3**	**89,3**	**92,9**	**96,6**	**100,4**	**104,4**	**108,6**
Low Impact Scenario	78,0	86,3	89,3	97,3	103,5	108,4	113,5	118,8
Medium Impact Scenario	78,0	86,3	89,3	101,8	110,6	116,7	123,0	129,6
High Impact Scenario	78,0	86,3	89,3	110,7	125,5	135,6	146,4	157,9

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.

(**) For 2009, 2009 data was used (not average).

pwc

2.3 Tax growth model Honduras -Scenario 2 (*)

Base scenario + Annual 1% increase in MNE activities (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in Hnl mn	154.555,0	158.841,0	164.324,0	170.897,0	177.733,0	184.842,0	192.236,0	199.925,0	IMF (Wold Economic Outlook Database, April 2011)
in EUR mn	5.800,5	5.961,4	6.167,1	6.413,8	6.670,4	6.937,2	7.214,7	7.503,3	Own calculation (1 EUR = 26,6451 Hnl)
GDP growth	-2,10%	3,45%	4,00%	4,00%	4,00%	4,00%	4,00%	4,00%	Own calculation (average 2005-2009)
Average Tax/GDP ratio	14,40%	15,50%	15,50%	15,50%	15,50%	15,50%	15,50%	15,50%	Own calculation (average 2005-2009)
Average CIT/Total tax	19,30%	19,30%	19,30%	19,30%	19,30%	19,30%	19,30%	19,30%	Own calculation (average 2005-2009)
Average MNE Contribution/CIT	**48,39%**	**49,39%**	**50,39%**	**51,39%**	**52,39%**	**53,39%**	**54,39%**	**55,39%**	Own calculation (average 2005-2009) +1% (assumption)
Average MNE Contribution/Total tax	9,34%	9,53%	9,73%	9,92%	10,11%	10,31%	10,50%	10,69%	Own calculation
Expected Total Tax Hnl mn	22.255,9	24.620,4	25.470,2	26.489,0	27.548,6	28.650,5	29.796,6	30.988,4	Own calculation
MNE Contribution total (in Hnl mn)	2.078,7	2.347,1	2.477,2	2.627,4	2.785,7	2.952,4	3.128,0	3.313,0	Own calculation
Estimated revenue from MNE in EUR (in mn)	**78,0**	**88,1**	**93,0**	**98,6**	**104,5**	**110,8**	**117,4**	**124,3**	Own calculation (1 EUR = 26,6451 Hnl)

Increase CIT collections from increased MNE activity (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0%	0%	0,00%	5,00%	2,50%	1,00%	1,00%	1,00%
Medium Impact Scenario	0%	0%	0,00%	10,00%	5,00%	2,00%	2,00%	2,00%
High Impact Scenario	0%	0%	0,00%	20,00%	10,00%	5,00%	5,00%	5,00%
MNE total contribution (in EUR mn)								
Base Scenario	**78,0**	**88,1**	**93,0**	**98,6**	**104,5**	**110,8**	**117,4**	**124,3**
Low Impact Scenario	78,0	88,1	93,0	103,3	111,8	119,2	126,9	135,1
Medium Impact Scenario	78,0	88,1	93,0	107,9	119,2	127,9	137,0	146,7
High Impact Scenario	78,0	88,1	93,0	117,2	134,9	147,9	161,8	176,9

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.
(**) For 2009, 2009 data was used (not average).

3.1 Contributions of MNE to total tax revenues Kenya (*)

	2005	2006	2007	2008	2009	2010	Average	Source
GDP in KSh mn	**1.155.516,0**	**1.228.598,0**	**1.314.555,0**	**1.334.975,0**	**1.369.578,0**	**1.437.820,0**		IMF (World Economic Outlook Database, April 2011)
in EUR mn	*9.479,2*	*10.078,7*	*10.783,9*	*10.951,4*	*11.235,3*	*11.795,1*		Own calculations (1 EUR = 121,9 KSh)
GDP growth	**6,0%**	**6,3%**	**7,0%**	**1,6%**	**2,6%**		**4,7%**	IMF (World Economic Outlook Database, April 2011)
Tax/GDP ratio	**18,7%**	**17,4%**	**17,8%**	**19,1%**	**19,6%**		**18,5%**	World Bank (Tax to GDP)
Total tax collection (KSh)	**216.081**	**213.776,1**	**233.990,8**	**254.980,2**	**268.437,3**			Own calculation
in EUR mn	1.773	*1.753,7*	*1.919,5*	*2.091,7*	*2.202,1*			Own calculation (1 EUR = 121,9 KSh)
Tax collection growth rate	**n/a**	**-1,07%**	**9,5%**	**9,0%**	**5,3%**		**5,7%**	Own calculation
Corporate Income Tax revenues (CIT) in KSh mn	n/a	**40.125,8**	**41.322,8**	**49.440,7**	**50.197,8**			Own calculation
in EUR mn	n/a	*329,2*	*339,0*	*405,6*	*411,8*			
CIT/Total tax	n/a	**18,77%**	**17,66%**	**19,39%**	**18,7%**		**18,63%**	Ratio: Calculation based on Kenya National Bureau of Statistics data
MNE contribution/CIT	n/a	**20,0%**	**20,0%**	**20,0%**	**20,0%**		**20,0%**	Assumption based on other country studies
MNE contribution/ Total tax	n/a	**3,8%**	**3,5%**	**3,9%**	**3,7%**		**3,7%**	Own calculation
MNE contribution total	n/a	**8.025,2**	**8.264,6**	**9.888,1**	**10.039,6**			Own calculation
in EUR mn	n/a	*65,8*	*67,8*	*81,1*	*82,4*			Own calculation (1 EUR= 121,9 KSh)

(*) Estimates.

3.2 Tax growth model Kenya - Scenario 1 (*)

Base scenario (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in KSh mn	1.369.578,0	1.437.820,0	1.520.051,0	1.619.352,0	1.729.717,0	1.847.720,0	1.971.167,0	2.100.775,0	IMF (World Economic Outlook Database, April 2011)
in EUR mn	11.235,3	11.795,1	12.469,7	13.284,3	14.189,6	15.157,7	16.170,4	17.233,6	Own calculation (1 EUR= 121,9 KSh)
GDP growth	2,60%	4,98%	5,72%	6,53%	6,82%	6,82%	6,68%	6,58%	IMF (World Economic Outlook Database, April 2011)
Average tax/GDP ratio	19,60%	18,50%	18,50%	18,50%	18,50%	18,50%	18,50%	18,50%	Own calculation (average 2005-2009)
Average CIT/Total tax	18,70%	18,63%	18,63%	18,63%	18,63%	18,63%	18,63%	18,63%	Own calculation (average 2005-2009)
Average MNE contribution/CIT	**20,00%**	**20,00%**	**20,00%**	**20,00%**	**20,00%**	**20,00%**	**20,00%**	**20,00%**	Own calculation (average 2005-2009)
Average (E) MNE contribution/Total tax	3,74%	3,73%	3,73%	3,73%	3,73%	3,73%	3,73%	3,73%	Own calculation (average 2005-2009)
Expected total tax KSh mn	268.437,3	265.996,7	281.209,4	299.580,1	319.997,6	341.828,2	364.665,9	388.643,4	Own calculation
MNE contribution total (in KSh mn)	10.039,6	9.911,0	10.477,9	11.162,4	11.923,1	12.736,5	13.587,5	14.480,9	Own calculation
Estimated revenue from MNE in EUR (in mn)	**82,4**	**81,3**	**86,0**	**91,6**	**97,8**	**104,5**	**111,5**	**118,8**	Own calculation (1 EUR= 121,9 KSh)

Increase CIT collections from MNEs (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0,0%	0,0%	0,0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0,0%	0,0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0,0%	0,0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total contribution (in EUR mn)								
Base Scenario	**82,4**	**81,3**	**86,0**	**91,6**	**97,8**	**104,5**	**111,5**	**118,8**
Low Impact Scenario	82,4	81,3	86,0	95,9	104,5	112,2	120,3	128,9
Medium Impact Scenario	82,4	81,3	86,0	100,2	111,4	120,3	129,7	139,6
High Impact Scenario	82,4	81,3	86,0	108,8	125,9	138,8	152,8	167,7

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.

(**) For 2009, 2009 data was used (not average).

3.3 Tax growth model Kenya -Scenario 2 (*)

Base scenario + Annual 1% increase in MNE activities (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in KSh mn	1.369.578,0	1.437.820,0	1.520.051,0	1.619.352,0	1.729.717,0	1.847.720,0	1.971.167,0	2.100.775,0	IMF (World Economic Outlook Database, April 2011)
in EUR mn	11.235,3	11.794,8	12.469,4	13.284,0	14.189,3	84.370,8	90.007,6	95.925,8	Own calculation (currency: 1EUR= 121,9 KSh)
GDP growth	2,60%	4,98%	5,72%	6,53%	6,82%	6,82%	6,68%	6,58%	IMF (World Economic Outlook Database, April 2011)
Average Tax/GDP ratio	19,60%	18,23%	18,23%	18,23%	18,23%	18,23%	18,23%	18,23%	Own calculation (average 2005-2009)
Average CIT/Total tax	18,70%	18,63%	18,63%	18,63%	18,63%	18,63%	18,63%	18,63%	Own calculation (average 2005-2009)
Average MNE contribution/CIT	**20,00%**	**21,00%**	**22,00%**	**23,00%**	**24,00%**	**25,00%**	**26,00%**	**27,00%**	Own calculation (average 2005-2009)
Average MNE contribution/Total tax	3,74%	3,91%	4,10%	4,28%	4,47%	4,66%	4,84%	5,03%	Own calculation (average 2005-2009)
Expected total tax KSh mn	268.437,3	262.042,7	277.029,3	295.126,9	315.240,9	336.747,0	359.245,2	382.866,2	Own calculation
MNE contribution total (in KSh mn)	10.039,6	10.251,9	11.354,3	12.645,9	14.095,1	15.684,0	17.401,1	19.258,6	Own calculation
Estimated revenue from MNE in EUR (in mn)	**82,4**	**84,1**	**93,1**	**103,7**	**115,6**	**128,7**	**142,7**	**158,0**	Own calculation (currency: 1EUR= 121,9 KSh)

Increase CIT collections from increased MNE activity (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0,0%	0,0%	0,0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0,0%	0,0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0,0%	0,0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total contribution (in EUR mn)								
Base Scenario	**82,4**	**84,1**	**93,1**	**103,7**	**115,6**	**128,7**	**142,7**	**158,0**
Low Impact Scenario	82,4	84,1	93,1	108,4	123,0	137,3	152,7	169,5
Medium Impact Scenario	82,4	84,1	93,1	113,1	130,6	146,2	163,3	181,8
High Impact Scenario	82,4	84,1	93,1	122,4	146,5	166,9	189,3	214,0

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.

(**) For 2009, 2009 data was used (not average).

4.1 Contributions of MNE to total tax revenues Vietnam (*)

	2005	2006	2007	2008	2009	2010	Average	Source
GDP in VND mn	**393.030.768,0**	**425.373.269,0**	**461.342.860,0**	**490.459.000,0**	**516.565.749,0**	**551.600.000,0**		IMF (World Economic Outlook Database, April 2011)
in EUR mn	*13.511,2*	*14.623,0*	*15.859,5*	*16.860,4*	*17.757,9*	*18.962,3*		Own calculation (1 EUR= 29.089,34VND)
GDP growth	**8,4%**	**8,2%**	**8,5%**	**6,3%**	**5,3%**	**6,8%**	**7,3%**	IMF (World Economic Outlook Database, April 2011)
Tax/GDP ratio	**26,2%**	**27,1%**	**26,2%**	**26,4%**			**26,57%**	Own calculation
Total tax collection (VND)	**102.974.061**	**115.276.156**	**120.871.829**	**129.481.176**	**-**			Assumption based on Vietnam country study
in EUR mn	*3.540*	*3.963*	*4.155*	*4.451*				Own calculation (1 EUR= 29.089,34VND)
Tax collection growth rate		**10,67%**	**4,85%**	**7,12%**			**7,5%**	Own calculation
(A) CIT/Total tax	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**			
(B) MNE Contribution/Total tax	**8,4%**	**9,2%**	**9,9%**	**10,5%**	**n/a**		**9,5%**	Assumption based on Vietnam country study
Revenues from MNE in VND mn	**8.649.821**	**10.605.406**	**11.966.311**	**13.595.523**				Own calculation
in EUR mn	*297,4*	*364,6*	*411,4*	*467,4*				Own calculation (1 EUR=29.089,34)

(*) Estimates.

4.2 Tax growth model Vietnam - Scenario 1 (*)

Base scenario (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in VND mn	516.565.749,0	551.609.000,0	586.132.624,0	625.705.580,0	670.913.391,0	720.792.571,0	774.815.386,0	832.887.166,0	IMF (World Economic Outlook Database, April 2011)
in EUR mn	17.757,9	18.962,6	20.149,4	21.509,8	23.063,9	24.778,6	26.635,7	28.632,0	Own calculation (1 EUR= 29.089,34 VND)
GDP growth	5,30%	6,26%	6,75%	7,23%	7,43%	7,49%	7,49%		IMF (World Economic Outlook Database, April 2011)
Average tax/GDP ratio	26,55%	26,55%	26,55%	26,55%	26,55%	26,55%	26,55%	26,55%	Own calculation (average 2005-2009)
CIT/Total tax	29,70%	29,70%	29,70%	29,70%	29,70%	29,70%	29,70%	29,70%	Assumption based on data available from the Ministry of Finance
MNE Contribution/ CIT	**32,02%**	**32,02%**	**32,02%**	**32,02%**	**32,02%**	**32,02%**	**32,02%**	**32,02%**	Own calculation
Average MNE contribution/Total tax	9,51%	9,51%	9,51%	9,51%	9,51%	9,51%	9,51%	9,51%	Own calculation (average 2005-2009)
Expected total tax VND mn	137.148.206,4	146.452.189,5	155.618.211,7	166.124.831,5	178.127.505,3	191.370.427,6	205.713.485,0	221.131.542,6	Own calculation
MNE contribution total (in VND mn)	13.042.794,4	13.927.603,2	14.799.291,9	15.798.471,5	*16.939.925,8*	18.199.327,7	19.563.352,4	21.029.609,7	Own calculation
Estimated revenue from MNE in EUR (in mn)	**448,4**	**478,8**	**508,8**	**543,1**	**582,3**	**625,6**	**672,5**	**722,9**	Own calculation (1 EUR= 29.089,34 VND)

Increase CIT collections from MNEs (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0,0%	0,0%	0,0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0,0%	0,0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0,0%	0,0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total Contribution (in EUR mn)								
Base Scenario	**448,4**	**478,8**	**508,8**	**543,1**	**582,3**	**625,6**	**672,5**	**722,9**
Low Impact Scenario	448,4	478,8	508,8	568,5	622,0	671,5	725,1	782,8
Medium Impact Scenario	448,4	478,8	508,8	594,0	662,9	719,5	780,7	846,8
High Impact Scenario	448,4	478,8	508,8	644,9	748,6	829,3	917,7	1.013,9

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.

(**) For 2009, 2009 data was used (not average).

pwc

4.3 Tax growth model Vietnam - Scenario 2 (*)

Base scenario + Annual 1% increase in MNE activities (*)									
	2009 (**)	2010 (forecast)	2011 (forecast)	2012 (forecast)	2013 (forecast)	2014 (forecast)	2015 (forecast)	2016 (forecast)	Source
GDP in VND mn	516.565.749,0	551.609.000,0	586.132.624,0	625.705.580,0	670.913.391,0	720.792.571,0	774.815.386,0	26.635,7	IMF (World Economic Outlook Database, April 2011)
in EUR mn	17.757,9	18.962,6	20.149,4	21.509,8	23.063,9	24.778,6	26.635,7	28.632,0	Own calculation (1 EUR= 29089,34 VND)
GDP growth	5,30%	6,26%	6,75%	7,23%	7,43%	7,49%	7,49%	n/a	IMF (World Economic Outlook Database, April 2011)
Average tax/GDP ratio	26,55%	26,55%	26,55%	26,55%	26,55%	26,55%	26,55%	26,55%	Own calculation (average 2005-2009)
CIT/Total tax	29,70%	29,70%	29,70%	29,70%	29,70%	29,70%	29,70%	29,70%	Assumption based on data available from the Ministry of Finance
Average MNE contribution/CIT	**32,02%**	**33,02%**	**34,02%**	**35,02%**	**36,02%**	**37,02%**	**38,02%**	**39,02%**	Own calculation
Average MNE contribution/Total tax	9,51%	9,81%	10,10%	10,40%	10,70%	11,00%	11,29%	11,59%	Own calculation (average 2005-2009)
Expected total tax VND mn	137.148.206,4	146.452.189,5	155.618.211,7	166.124.831,5	178.127.505,3	191.370.427,6	205.713.485,0	221.131.542,6	Own calculation
MNE contribution total (in VND mn)	13.042.794,4	14.362.566,2	15.723.664,1	17.278.643,7	19.056.080,5	21.041.178,5	23.229.166,7	25.626.934,5	Own calculation
Estimated revenue from MNE in EUR (in mn)	**448,4**	**493,7**	**540,5**	**594,0**	**655,1**	**723,3**	**798,5**	**881,0**	Own calculation (1 EUR= 29089,34 VND)

Increase CIT collections from increased MNE activity (*)								
	2009	2010	2011	2012	2013	2014	2015	2016
Low Impact Scenario	0,0%	0,0%	0,0%	5,0%	2,5%	1,0%	1,0%	1,0%
Medium Impact Scenario	0,0%	0,0%	0,0%	10,0%	5,0%	2,0%	2,0%	2,0%
High Impact Scenario	0,0%	0,0%	0,0%	20,0%	10,0%	5,0%	5,0%	5,0%
MNE total contribution (in EUR mn)								
Base Scenario	**448,4**	**493,7**	**540,5**	**594,0**	**655,1**	**723,3**	**798,5**	**881,0**
Low Impact Scenario	448,4	493,7	540,5	621,0	697,6	772,9	855,8	946,8
Medium Impact Scenario	448,4	493,7	540,5	648,0	741,5	824,6	916,3	1.017,1
High Impact Scenario	448,4	493,7	540,5	702,1	833,4	943,3	1.065,7	1.201,4

(*) Estimates. The low, medium and high impact scenarios for the possible increase in CIT collections from MNEs were selected for illustrative purposes to offer an insight into potential revenue effects depending on the impact of TP reform assumed.

(**) For 2009, 2009 data was used (not average).

pwc

Appendix J: Examples from Kenya

Appendix J: Examples from Kenya

Box 1: Thin-capitalisation rules in Kenya

Thin-capitalisation rules in Kenya apply where financial assistance is provided to a resident company by a related non-resident company that controls the resident company, and when the loan exceeds the greater of:

- three times the sum of revenue reserves and the issued, paid-up share capital;

- the sum of all loans acquired by the company prior to 16 June 1986 and still outstanding at the time of assessing of the company's capitalisation.

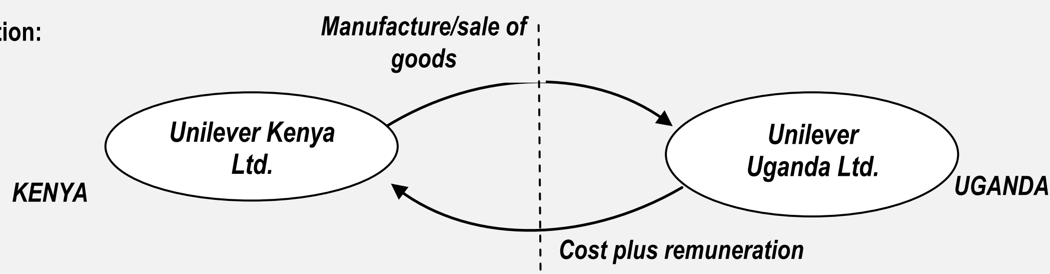
An interest payment on that part of the loan that exceeds the permissible ratio of 3:1 is not deductible for tax purposes. If, however, the entity is within the permissible ratio, the payments are deductible.

Box 2: Kenyan Revenue Authorities v. Unilever Kenya Ltd. (2005)

In 2005, the Kenyan revenue authorities lost a landmark court case, which forced the Ministry of Finance to quickly develop TP legislation (which was enacted only one year later, in 2006).

In the case, Unilever Kenya Ltd. had manufactured and sold various household goods to Unilever Uganda Ltd. (both entities are part of the UK-based Unilever group and related parties under section 18 of the then Kenyan Income Tax Act). The Kenyan Revenue Authorities argued that, as regards the years 1995 and 1996, the prices were not at arm's length and they furthermore challenged the TP method the companies had applied by reference to the OECD Guidelines (cost plus method).

Illustration:



The feature of the case was that the presiding judge argued, on a technicality, that, in the absence of clear TP rules, the taxpayer was entitled to rely on the OECD Guidelines or other international best practice. Hence, disregarding the economics of the case, the judge ruled that the then section 18(3) of the Income Tax Act was inadequate to guide the taxpayer and that, therefore, the revenue authorities could not rely on these rules when enforcing transfer pricing.

Appendix K: Special tax and incentive schemes in selected countries

Appendix K: Special tax and incentive schemes in selected countries

Ghana	• carry-forward of losses for a 5-year period for companies engaged in agro processing, mining, tourism, software development, manufacturing mainly for export and farming • reduced corporate income tax rates ranging from 0% to 20% for agro-processing businesses depending on their location • corporate income tax holidays of 10 years for companies engaged in tree crop farming, cattle farming, and of 5 years for agro processing, livestock, fish and cash crop farming • accelerated capital allowances of up to 80% of capital costs incurred in the 1st year of acquisition for companies in the mining industry • capital allowances at 20% on all expenditure incurred for the purposes of petroleum operations from the year in which the petroleum contractor first produces petroleum for sale
Honduras	• temporary import regimes, maquila regimes or special processing zones (*'Ley de Zonas Industriales de Procesamiento para Exportaciones'*) • special tax incentives to spur tourism (*'Ley de Incentivos al Turismo'*) • advantaged industries: agriculture, tourism, telecommunications, infrastructure, alternative energy, maquila sector • approx. 90% of MNEs operate under tax preference regimes (2010)
Kenya	• export processing zones: companies located in an approved export processing zone, principally to export goods, are taxed at a zero rate of income tax for 10 years from commencement of trading and at a rate of 25% for the next 10 years • investment deduction: qualifying investments exceeding KES 200 million (USD 2.38 mn/ EUR 1.70 mn) incurred outside Nairobi/municipalities of Mombasa or Kisumu are allowed an investment deduction of 150%; all other qualifying investments are allowed a 100% investment deduction in the year the asset is put into service • industrial building allowance: hostels and certified education buildings qualify for an industrial building allowance at a rate of 50% on a straight-line basis/qualifying leased residential or commercial buildings qualify for an industrial building allowance at a rate of 25%/other qualifying buildings qualify for an industrial building allowance at a rate of 10% • wear and tear allowance: expenditures incurred on heavy earth-moving equipment qualify for a wear and tear allowance at a rate of 37.5%, while other self-propelled vehicles (including aircraft) qualify for a wear and tear allowance at a rate of 25%. Computers and peripheral computer hardware qualify for a wear and tear allowance at a rate of 30%. Capital allowances were

	introduced, effective 1 January 2010, at a rate of 20% for computer software and 20% for telecommunications equipment not falling within the 12.5% category referred to below, purchased and used by telecommunications operators. Both these allowances are computed on a straight-line basis. All other machinery (including ships) qualifies for a wear and tear allowance at a rate of 12.5% • listed companies: companies listed at the Nairobi Stock Exchange are entitled to reduced rates of income tax for a period, depending on the proportion of share capital listed
Vietnam	• tax incentives are based on the location of the enterprise (Decree 24/2007/ND-CP) • export-based incentives accorded to the textile and garment sectors were abolished in 2007 (accession to WTO), subject to certain exceptions • reduced income tax rates of 10% and 20% apply for a 10-15 year period for enterprises set up in encouraged sectors or locations • tax exemptions are available from 2–4 years and a 50% reduction for a further period of 2–9 years for eligible taxpayers (which are subject to the standard tax rates following this period) • where the taxpayer fails to make a profit within 3 years from the year of revenue generation, the period of tax exemption and reduction will be calculated from the 4th year

pwc

Appendix L: List of tax treaties signed by selected countries

Appendix L: List of tax treaties signed by selected countries

based on United Nations Conference on Trade and Development ("UNCTAD") [90]

Ghana

Total number of tax treaties signed, 1 June 2010

Partner	Type of agreement	Date of signature
Belgium	Income and Capital	20-Jun-05
Denmark	Income and Capital	22-Dec-54
France	Income and Capital	5-Apr-93
Italy	Income	19-Feb-04
Netherlands	Income	10-Mar-08
Serbia	Income and Capital	25-Apr-00
South Africa	Income and Capital	2-Nov-04
United Kingdom	Income and Capital	20-Jan-93

Honduras

Total number of tax treaties signed, 1 June 2010

Partner	Type of agreement	Date of signature
United States	Cooperation and Exchange of Information	27-Sep-90

Kenya

Total number of tax treaties signed, 1 June 2010

Partner	Type of agreement	Date of signature
Canada	Income and Capital	27-Apr-83
Denmark	Income and Capital	13-Dec-72
France	Income	4-Dec-07
Germany	Income and Capital	17-May-77
India	Income and Capital	12-Apr-85
Italy	Income and Capital	15-Oct-79
Italy	Protocol	18-Feb-97

[90] As of 1 June 2010, see http://www.unctad.org/Templates/Page.asp?intItemID=4505&lang=1. We have not checked the accuracy of this data and have not investigated whether all of the DTAs listed have been ratified.

Norway	Income and Capital	13-Dec-72
Sweden	Income and Capital	28-Jun-73
United Kingdom	Income and Capital	31-Jul-73
Zambia	Income and Capital	27-Aug-68

Vietnam

Total number of tax treaties signed, 1 June 2010

Partner	Type of agreement	Date of signature
Algeria	Income and Capital	5-Dec-99
Australia	Income and Capital	13-Apr-92
Austria	Income and Capital	2-Jun-08
Bangladesh	Income	22-Mar-04
Belarus	Income and Capital	24-Apr-97
Bulgaria	Income	24-May-96
Canada	Income and Capital	14-Nov-97
China	Income and Capital	17-May-95
Cuba	Income	26-Oct-02
Czech Republic	Income and Capital	23-May-97
Denmark	Income and Capital	31-May-95
Finland	Income	21-Nov-01
France	Income and Capital	10-Feb-93
Germany	Income and Capital	16-Nov-95
Hong Kong, China	Income	16-Dec-08
Hungary	Income and Capital	26-Aug-94
Iceland	Income and Capital	1-Apr-02
India	Income and Capital	7-Sep-94
Indonesia	Income	22-Dec-97
Ireland	Income	10-Mar-08
Israel	Income and Capital	4-Aug-09
Italy	Income	26-Nov-96
Japan	Income and Capital	24-Oct-95
Korea, DPR	Income	3-May-02
Korea, Republic of	Income	20-May-94
Lao PR	Income	14-Jan-96
Luxembourg	Income and Capital	4-Mar-96
Malaysia	Income and Capital	7-Sep-95
Mongolia	Income and Capital	9-May-96
Myanmar	Income	12-May-00
Netherlands	Income and Capital	24-Jan-95

Norway	Income and Capital	1-Jun-95
Pakistan	Income	25-Mar-04
Philippines	Income	14-Nov-01
Poland	Income and Capital	31-Aug-94
Qatar	Income	8-Mar-09
Romania	Income and Capital	8-Jul-95
Russian Federation	Income and Capital	1-Jan-02
Seychelles	Income	4-Oct-05
Singapore	Income and Capital	2-Mar-94
Slovakia	Income	27-Oct-08
Spain	Income	7-Mar-05
Sri Lanka	Income	2-Nov-05
Sweden	Income and Capital	24-Mar-94
Switzerland	Income and Capital	6-May-96
Taiwan Province of China	Income and Capital	6-Apr-98
Thailand	Income and Capital	23-Dec-92
Ukraine	Income and Capital	8-Apr-96
United Kingdom	Income and Capital	9-Apr-94
Uzbekistan	Income and Capital	28-Mar-96

pwc

Appendix M: Donor support to date in the selected countries

Appendix M: Donor support up to the present in selected countries

Ghana	• GIZ (formerly GTZ) provided technical support in the area of TP • GIZ/UN Development Programme's Special Unit on South-South Cooperation provided funding for online courses for tax officials from several African states (inc. Ghana) on international taxation (fundamentals of tax treaties, residence, permanent establishments and passive income)[91] • Christian Aid published independent reports on TP in Ghana and its potential implications in the form of lost revenue and the impact on the quality of life of the poor in Ghana • Participation of tax officials in multilateral dialogue events on TP (OECD Global relations programme)
Honduras	• Tax officials have attended training events sponsored by - US Treasury Department - Argentinean Federal Administration of Public Revenues - Mexican *Institutor Mexican de Contenders Publics* - Inter-American Development Bank (IADB) • Cooperation with domestic partners such as the Central Bank of Honduras and the *Colegio Hondureño de Profesionales Universitarios de Contaduría Publica* (COHPUCP)
Kenya	• Kenya has received assistance in the area of indirect taxation, namely in preparation for the introduction of VAT. The local authorities state that this assistance was key to successfully implementing VAT • Participation of tax officials in multilateral dialogue events on TP (OECD Global relations programme) • GIZ/UN Development Programme's Special Unit on South-South Cooperation provided funding for online courses for tax officials from several African states (inc. Kenya) on international taxation (fundamentals of tax treaties, residence, permanent establishments and passive income)[92]
Vietnam	• The Japanese International Cooperation Agency (JICA) assisted Vietnam in - conducting training whereby one/two tax experts from the Japanese National Tax Agency trained tax officials on TP in Vietnam - funding study tours to Japan for tax officials (e.g. one-week intensive on-the-job training

[91] Wright, T. N., (2010) 'U.N. Groups Fund Online Courses for African Tax Officials in Nine Countries', Tax Management Transfer Pricing Report 548, International Tax Centre, 9 September 2010.
[92] Wright, T. N., (2010) *op. cit.*

at the offices of the Japanese National Tax Agency or three-month intensive on-the-job training)

- The Asian Development Bank (ADB) conducted TP training classes for tax officials during introduction of the TP circulars
- Participation of tax officials in multilateral dialogue events on TP (OECD Global relations programme)
- In addition, assistance of a more general nature was provided by
  - the UN Development Programme (UNDP)
  - the World Bank (tax administration and modernisation)
  - Department for International Development (DFID)
  - the IMF (developing and modernising the administrative infrastructure, including IT)
  - the International Finance Corporation (IFC, models, techniques for ratio analysis of unincorporated businesses, risk-based auditing techniques for tax audits)
  - the EU Delegation in Vietnam
  - the US Embassy (assistance in areas of improving collections and auditing; banking money supervision and anti-money laundering), the US Treasury and the US Trade and Development Agency
  - specific countries: Germany, France and Luxembourg

Appendix N: Cost-benefit analysis of TP reform in selected countries

1. Cost estimation of TP reform in Kenya*

Anticipated cost	Hours	Cost/hour	Investment costs (€)	Recurring costs (€)
1. Training				
1.1 Transfer pricing	150	490	73.511	18.378
1.2 Economics/Statistics and related knowledge	16	490	7.841	1.960
1.3 Audit practices and effective management (e.g. data processing)	16	490	7.841	1.960
1.4 APA mechanism/ MAP procedure	18	490	8.821	2.205
2. Materials				
2.1 Databases for comparables			35.005	8.751
2.2 Macroeconomic analysis			24.504	6.126
2.3 Manuals and technical training materials			7.001	1.750
2.4 Draft legislation			7.001	1.750
2.5 Databases for tax administrations (e.g. online forum)			14.002	3.501
3. Other support				
3.1 Secondments (estimated cost for 6 months)			35.005	
Subtotals			**220.532**	**46.382**
Total anticipated costs (€)				**266.913**

* The following figures represent rounded high-level estimations, which have been initially prepared in USD. For the currency conversion, we have used the USD/EUR exchange rate of 30 May 2011 (0,7001). It should be noted that this estimation does not take into consideration further administrative costs linked to the TP team/unit, or other items linked to TP reform, such as costs related to the legislative approval of TP reform or the costs of related judiciary.

2. Cost estimation of TP reform in Ghana*

Anticipated cost			Investment costs (€)	Recurring costs (€)
1. Setting up of a Transfer Pricing unit/team				
1.1 Personnel selection				
▪ Anticipated number of staff required		6		
▪ Estimated cost per FTE**		3.501	21.003	
1.2 Transfer Pricing unit/team				
▪ Anticipated number of staff required		16		
▪ Estimated cost per FTE**		7.001	112.016	
** FTE = Full-time employee				
2. Training				
	Hours	**Cost/hour**		
2.1 General tax and accounting practices	100	490	49.007	12.252
2.2 Transfer pricing	600	490	294.042	73.511
2.3 Economics/Statistics and related knowledge	70	490	34.305	8.576
2.4 Audit practices and effective management (e.g. data processing)	50	490	24.504	6.126
2.5 Tax administration (audit procedures, internal structure, checks and balances)	50	490	24.504	6.126
2.6 APA mechanism/ MAP procedure	80	490	39.206	9.801
3. Materials				
3.1 IT Hardware /infrastructure support			35.005	8.751
3.2 Databases for comparables			35.005	8.751
3.3 Macroeconomic analysis			24.504	6.126
3.4 Manuals and technical training materials			7.001	1.750
3.5 Draft legislation			21.003	5.251
3.6 Databases for tax administrations (e.g. online forum)			14.002	3.501
4. Other materials				
4.1 Knowledge databases for tax administration and taxpayers			21.003	5.251
4.2 Public accessibility of legislation and administration guidelines			14.002	3.501
5. Other support				
5.1 Secondments (estimated cost for 6 months)			35.005	
Subtotals			**805.115**	**159.273**
Total anticipated costs (€)				**964.388**

* See remark in section 1 (Kenya).

3. Cost estimation of TP reform in Honduras*

Anticipated cost			Investment costs (€)	Recurring costs (€)
1. Setting up of a Transfer Pricing unit/team				
1.1 Transfer Pricing unit/team				
▪ Anticipated number of staff required		10		
▪ Estimated cost per FTE**		28.004	280.040	
** FTE = Full-time employee				
2. Training				
	Hours	**Cost/hour**		
2.1 General tax and accounting practices	60	490	29.404	7.351
2.2 Transfer Pricing	300	490	147.021	36.755
2.3 Income tax	80	490	39.206	9.801
2.4 Economics/Statistics and related knowledge	36	490	17.643	4.411
2.5 Audit practices and effective management (e.g. data processing)	30	490	14.702	3.676
2.6 Tax administration (audit procedures, internal structure, checks and balances)	30	490	14.702	3.676
2.7 APA mechanism/ MAP procedure	40	490	19.603	4.901
2.8 Language courses	30	245	7.351	1.838
3. Materials				
3.1 IT Hardware/infrastructure support			35.005	8.751
3.2 Databases for comparables			35.005	8.751
3.3 Macroeconomic analysis			24.504	6.126
3.4 Manuals and technical training materials			7.001	1.750
3.5 Draft legislation			7.001	1.750
3.6 Databases for tax administrations (e.g. online forum)			14.002	3.501
4. Other materials				
4.1 Knowledge databases for tax administration and taxpayers			2.450	613
4.2 Public accessibility of legislation and administration guidelines			2.450	613
5. Other support				
5.1 Secondments (estimated cost for 6 months)			35.005	
Subtotals			**732.095**	**104.262**
Total anticipated costs (€)				**836.357**

* See remark in section 1 (Kenya).

4. Cost estimation of TP reform in Vietnam*

Anticipated cost	Hours	Cost/hour	Investment costs (€)	Recurring costs (€)
1. Training				
1.1 General tax and accounting practices	70	490	34.305	8.576
1.2 Transfer pricing	180	490	88.213	22.053
1.3 Economics/Statistics and related knowledge	60	490	29.404	7.351
1.4 Audit practices and effective management (e.g. data processing)	60	490	29.404	7.351
1.5 APA mechanism/ MAP procedure	60	490	29.404	7.351
1.6 Language courses	70	245	17.152	4.288
2. Materials				
2.1 Databases for comparables			35.005	8.751
2.2 Macroeconomic analysis			24.504	6.126
2.3 Manuals and technical training materials			7.001	1.750
2.4 Draft legislation			14.002	3.501
2.5 Databases for tax administrations (e.g. online forum)			14.002	3.501
3. Other materials				
3.1 Knowledge databases for tax administration and taxpayers			2.450	613
3.2 Public accessibility of legislation and administration guidelines			2.450	613
4. Other support				
4.1 Secondments (estimated cost for 6 months)			35.005	
Subtotals			**362.302**	**81.824**
Total anticipated costs (€)				**444.126**

* See remark in section 1 (Kenya).

pwc

Appendix O: In a nutshell – challenges/options/support

Appendix O: In a nutshell – challenges/options/donor support[93]

Challenges faced by developing countries		Options	Donor support
Resources			
(1)	**Lack of qualified and experienced staff**	Setting up a specialist TP unit, training existing staff, hiring in external experts	Recommendations regarding structures and organisational aspects, also with respect to collaboration by national, regional and local administrations; development of HR strategies and choice of suitable staff; setting up training schedules/facilities and choice of training providers; implementation of internal risk management, sharing best practices.
(2)	**Lack of in-depth understanding of TP and lack of awareness of available information**	Reference to international standards v. local approach	Provision of available guidance (preparation of a "TP package") and international standards with respect to definitions (e.g. related parties); assistance in identifying local specialties, if necessary (e.g. dominance of certain industry sectors).
(3)	**Promotion of good governance and independence within the tax administration and the TP unit**	Implementation of risk management frameworks, independence requirements, control mechanisms	Development and implementation of appropriate, efficient HR strategies; provision of examples of risk management frameworks and independence requirements; assistance in building intrinsic motivation and incentive schemes; sharing best practices.
(4)	**Non-availability of resources and tools to collect and process necessary information**	Collection of data and post-evaluation based on locally developed criteria v. selection of information required for assessment and audit purposes and gradual implementation of IT tools	Assistance with respect to the evaluation of taxpayer information; identification of necessary information and setting up IT systems including training on how to use these systems; sharing best practices with respect to risk analysis and identification of appropriate criteria to determine high-risk transactions.
Legal Framework			
(1)	**Existing local accounting standards need to serve as starting point for general tax and TP accounting**	Use of accounting provisions as a foundation for TP legislation v. creation of a different set of standards	Assistance in evaluating and assessing local accounting standards; amendments and improvement of existing provisions based on international standards or other national accounting frameworks.

[93] This overview focuses on possibilities of future donor support. For a non-exhaustive overview of donor support received to date, see Appendix M.

(2)	**Non-existence of TP legislation**	Orientation towards legislation existing in other (developing) countries v. local approach	Assistance in drafting TP legislation oriented towards international standards, provision of examples of existing TP legislation in local language and illustration of implications and experience. Development of a phased approach and prioritisation of action with regard to the implementation of TP legislation.
Endorsement			
(1)	**Preparation and assistance of taxpayers and involved stakeholder groups with respect to new local TP legislation**	Top-down approach v. involvement of selected parties and taxpayers	Development of phased approaches with respect to the implementation of TP legislation; share of experience with respect to taxpayer involvement and funding of workshops and discussion platforms.
(2)	**Non-existence of sufficient local comparables to evaluate the arm's length nature of transactions and no access to commonly used databases**	Use of international databases and country-adjustments, collection of local comparables/creation of local databases	Financing access to internationally used databases in the area of TP, provision of guidance on how to use comparables and how to carry out necessary adjustments, e.g. with respect to country-specific adjustments if no local comparables are available (e.g. as applied between Latin America and the USA); possible third-party research contracted to assess the comparability of economic environments between geographically remote (developing) countries.
(3)	**Evaluation and validation of TP legislation adopted and review of administrative implementation, in particular regarding TP audits**	Review and, if necessary, amendment of legislation as implemented; review of tax audit practices and refining audit strategies	Assistance by more-experienced tax administrations; joint investigations; sharing of risk assessment approaches; selection and analysis of TP audit outcomes.
(4)	**Implementation and enforcement of adequate TP documentation requirements**	Scope of TP documentation; contemporaneous documentation v. regular reviews of existing documentation; mandatory submission of TP documentation v. submission on request; penalty schemes	Discussion of implications of policy choices and identification of necessary changes with regard to organisational structures and allocation of resources; provision of examples of legislation in force and experience with respect to penalty schemes.
(5)	**Integration of further measures to ensure and facilitate taxpayer compliance**	Implementation of specific measures such as APA and simplified compliance procedures, e.g. for small and medium-sized taxpayers	Introduction to available tools, legislative and administrative implications, costs and benefits. More-experienced tax officials should assist in drafting rules or guide local tax officials through the concept and use of these measures.
International integration			

(1)	**Non-existence of sufficient DTA and TIEA**	Signature of DTAs during the preparation of TP legislation v. preparing negotiations once TP legislation is in place	Offering assistance on signing DTAs, selection of partners and choice of model convention; fostering understanding of implications and application of provisions, guidance on legal and procedural implications (e.g. of dispute resolution mechanisms, exchange of information).