Case Study
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Transfer Pricing in the Extractive Sector in Tanzania

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EXECUTIVE SUMMARY

As one of the new hotspots for oil and gas exploration in Africa, Tanzania's economy will likely grow exponentially over the next decade. Gold has traditionally been the primary mineral export for Tanzania, however offshore gas reserves look to be more promising for commercial production and export, with the latest estimate at around 55 million trillion cubic feet (tcf). With commercial production of gas yet to commence, extractive sector revenues already account for a significant portion of government revenue. According to the Tanzania Extractive Industries Transparency Initiative (TEITI), extractive sector revenues were 11.91 percent and 12.39 percent of total government revenue in 2012 and 2013 respectively.[1] However, civil society organizations contend that these figures would be far higher if not for illicit financial flows and tax incentives. According to their estimates, Tanzania may have foregone US $1.07 billion in revenue in recent years due to tax incentives, illicit financial flows, inflated claims for expenditure, mis-reporting of sales and losses and so on.[2] While these are only estimates, it is clear that the challenge for the government of Tanzania (GoT) will be to manage its new natural resources for sustainable growth, unlike the mining industry where governance has been poor.

Transfer pricing is the mechanism by which prices are chosen to value transactions between related legal entities within the same multinational enterprise (MNE). These are referred to as "controlled transactions" and may include the purchase and sale of goods or intangible assets, the provision of services, the provision of financing, cost allocation, and cost sharing agreements. As long as the price that is set matches the "arm's length" price at which a transaction would have taken place between unrelated parties, this is not problematic. However, transfer pricing may become abusive or illegal when related parties seek to distort the price as a means of reducing their overall tax bill. In these instances the practice may be referred to as "transfer mis-pricing."

This case study investigates the barriers to implementation of transfer pricing rules in the extractive sector in Tanzania. It forms part of a series of five country case studies including Ghana, Guinea, Sierra Leone, and Zambia. The result of this study is a number of recommendations that aim to provide guidance on practical steps to improve transfer pricing enforcement in the extractive sector. The focus is primarily on mining given that the petroleum sector is still under development. The

1 Tanzania Extractive Industry Transparency Initiative, *2010 Extractive Industry Reconciliation Report* (2010), 10

2 Mark Curtis, Dr. Prosper Ngowi and Dr. Attiya Warris. *The One Billion Dollar Question: How can Tanzania Stop Loosing So Much Tax Revenue* (Interfaith Standing Committee on Economic Justice and the Integrity of Creation, 2012), 8.

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recommendations can be broadly grouped into four categories: transfer pricing legal framework, administrative arrangements, knowledge and skills, and information.

Overview of recommendations

		Recommendation	Responsibility
Legal framework	1	Amend the transfer pricing regulations to state whether OECD or UN guidance should be followed where inconsistencies arise regarding interpretation of the regulations.	Ministry of Finance
	2	Introduce separate tax treatment of hedging to limit the risk that extractive companies engage in abusive hedging to offset income.	Ministry of Finance
	3	Use advance pricing agreements (APAs) as provided for in the transfer pricing regulations. If properly negotiated with support from technical experts, APAs provide an opportunity for the Tanzania Revenue Authority (TRA) to develop their transfer pricing expertise and gain access to valuable information.	Ministry of Finance and international partners
	4	Introduce a rule to limit interest deductibility as a function of a company's earnings. The OECD Final BEPS Report recommends to limit interest deductions between 10 and 30 per cent of earnings before interest, tax, depreciation and amortization (EBITDA).	Ministry of Finance
Administrative arrangements	5	Limit transfer pricing audits and enquiries to high-income taxpayers and high value transactions, at least while the ITU is still building expertise, manpower, and credibility.	Tanzania Revenue Authority (TRA)
	6	Improve cooperation between the extractive industry regulators and the TRA by (a) establishing a formal inter-agency coordination mechanism to oversee tax and non-tax revenue collection, and (b) give the new Oil and Gas Advisory Bureau an oversight function regarding coordination of audits in the petroleum sector.	Government of Tanzania (GoT)
	7	Monitor the transfer of audit responsibilities from the Tanzania Petroleum Development Corporation (TPDC) to the new Petroleum Upstream Regulatory Agency (PURA) to ensure that the TPDC's conflict of interest as "player and referee" is finally resolved and that the TRA obtains full cooperation from PURA.	Civil society organizations
	8	Inform the Ministry of Finance, the Ministry of Energy and Minerals, and through them the TRA and TMAA, on all aspects of the Liganga iron ore and steel project. Both the TRA and TMAA have limited knowledge of this project. This is problematic given that the iron ore is to be sold between related parties within Tanzania for the purpose of producing steel for sale domestically and internationally.	National Development Corporation
	9	Issue a directive that any transfer pricing issues identified during the course of a general audit by the extractive industries audit team should be referred to the ITU so that they can be dealt with thoroughly and consistently.	Head of the Large Taxpayers Office (LTO)
Information	10	Develop an online information-sharing platform where all information concerning exploration, development, and production of mineral and petroleum resources is made automatically available to the TRA.	Ministry of Finance Ministry of Energy and Mineral Development
	11	Develop a transfer pricing risk matrix specific to the extractive sector. This will strengthen monitoring and evaluation of potential transfer pricing risks in the extractive industry value chain, and improve selection of cases for audit.	International Tax Unit (ITU) and the extractive industry audit team
Knowledge and skills	12	Ensure that the TMAA and PURA receive training on transfer pricing so that they are able to identify and evaluate transfer pricing risks regarding non-tax revenue, cost deductions.	GoT and international partners
	13	Ensure that the ITU receives specialized training on transfer pricing as it relates to the extractive sector, as well as further capacity building on taxation of extractive industries generally. This will equip the ITU with the expertise and confidence to conduct transfer pricing audits in the extractive industry.	GoT and international partners

TRANSFER PRICING LEGAL FRAMEWORK

Status of transfer pricing rules

In 2014, Tanzania became one of the few countries in sub-Saharan Africa to introduce transfer pricing regulations through Government Notice No. 27. Until this time, Tanzania had been relying on Section 33 of the Income Tax Act (ITA) to regulate transfer pricing between related companies. Section 33 requires persons who are associates to calculate chargeable income as if the arrangement had been conducted at arm's length. While the onus is on taxpayers to apply the arm's length principle, the Commissioner of the Tanzanian Revenue Authority (TRA) is empowered to make adjustments where taxpayers fail to comply. In addition to the specific section on transfer pricing, Section 35 of the ITA offers an all-encompassing provision that authorizes the Commissioner to adjust any arrangement that is considered to be for the purpose of tax avoidance. This provision is extremely broad, however it has only been invoked in court once. This was in relation to Tanzania Leaf Tobacco: the company refused to disclose the price at which tobacco was being sold to parent and associate companies, in addition to which they were receiving interest free loans from the parent/associate with no specific time for recovery.

A similarly broad "integrity pledge" has since been included in the new Petroleum Act of 2015. According to Section 224, oil and gas companies are prohibited from engaging in any arrangement that undermines, or is in any way prejudicial, to the country's financial and monetary systems, or is inconsistent with the country's economic objectives. MNEs are understandably concerned about the broad and potentially subjective nature of this provision. According to the government, the clause is a response to problems of low tax collection in the mining sector. It remains to be seen whether this provision will be widely used.

To establish a more robust legal framework for transfer pricing, the TRA introduced specific regulations in February 2014. The transfer pricing regulations apply to transactions where at least one or both parties are assessable in Tanzania, thereby covering instances of domestic transfer pricing. While the regulations broadly adhere to OECD guidelines, there are some slight deviations. For example, the regulations do not accept foreign tested parties unless the information is sufficient and verifiable. This differs from the OECD guidelines which contain no limits on the identity of the tested party, as long as the chosen transfer pricing method can be applied reliably, and accurate comparables identified. This variation reflects the challenges Tanzania faces in accessing information from other tax jurisdictions and from international markets more generally. Consequently, the TRA prefers to apply domestic comparables where they are available. While it is entirely appropriate that the TRA adapt transfer pricing rules to suit the local context, former technical advisors to the International Tax Unit (ITU) are concerned that Section 9 of the regulations, which allow both OECD and UN guidelines to be applied in the event of any inconsistencies, creates uncertainty. Flexibility may be in the government's favor, but this is also true for taxpayers who may seek the most beneficial personal solution while shifting between OECD and UN interpretations.

There is no turnover threshold to trigger compliance with the transfer pricing regulations, however in practice they have been applied to large taxpayers by virtue of the ITU's location in the Large Taxpayers Office (LTO) of the TRA. This focus may expand given growing demand from small to medium tax offices within the TRA for the ITU to review cases relating to other taxpayers. While some other countries do not specify a turnover threshold for transfer pricing regulations, if the practical scope of application is going to change significantly the TRA may want to consider whether the compliance burden is reasonable for small to medium taxpayers and how this might be managed. The transfer pricing regulation imposes a 100 percent penalty for non-compliance with the arm's length principle, as well as a fixed penalty of six months imprisonment or TZS50 million for non-compliance with documentation requirements.

Transfer pricing rules and extractive industry legislation

Transfer mispricing is explicitly prohibited in both the mining and petroleum legislation. As of 2010, the Mining Act requires royalties to be calculated based on gross value at point of sale, rather than netback. This is due to difficulties in evaluating the deductions, discounts, and commissions included in the calculation of royalties. Where the realized sale price does not correspond with the arm's length price, Section 87(3) of the act empowers the minister of mines to notify the license holder, and the market value is to be settled by agreement, or referred for determination by an independent expert. This provision has been used as a basis to amend royalty payments. In the case of petroleum, there is no explicit requirement in the Petroleum Act that royalties be calculated according to the arm's length principle, however, the ITA is presumed to apply to the calculation of taxable income. The updated Petroleum Act is explicit with regards to tax treatment of direct or indirect transfer of rights, as well as loans from third parties. The transfer of rights under a petroleum agreement is subject to capital gains tax, regardless of the beneficiary type of transaction. For loans from third parties to be considered tax deductible they must first be approved by the new Petroleum Upstream Regulatory Authority (PURA), and the interest rate cannot exceed the lowest market rate available. The act also includes specific penalties for failure to provide information: no less than TZS50 million or imprisonment for two years, or both.

There is no formal requirement that mining and petroleum contracts be made public. This means it is difficult to determine whether the transfer pricing provisions in the primary legislation are reflected in individual contracts. However, based on the mining contracts that have been leaked, most calculate royalties based on the "netback value" which is understood as the market value FOB, less various deductions and discounts. While this is at odds with the Mining Act of 2010, this is not surprising given that most available contracts were signed under the former Mining Act of 1979 or the Mining Act of 1998. Regardless, the use of the netback approach remains problematic given the potential for transfer mispricing to take place in the area of transportation costs and refinery fees, thus reducing royalty payments.

Petroleum agreements are yet to be made available either formally or informally. However, there is a model production sharing agreement (PSA) for petroleum that gives some insight in to how transfer pricing is likely to be treated in individual agreements. Article 13(2)(ii) of the model PSA requires that where less than 50 percent of the crude oil produced and saved from the contract area is sold in "third party sales", the fair market valuation will be determined by both the weighted average of the sale price per barrel sold in third party sales, and the average price of a selection of major competitive crude oils sold in international markets during the same period. In the event that there is a dispute about pricing, an expert will be appointed by the parties or by the British Energy Institute. In terms of natural gas, an independent expert must determine the fair market value for sales to affiliates.

Impact of the 2014 transfer pricing regulations: before and after

Before the introduction of transfer pricing regulations in 2014, the ITU completed three to four transfer pricing audits as part of the business plan for the LTO. These audits resulted in minimal tax adjustments, hampered by the absence of a legal framework and limited transfer pricing expertise. Prior to the ITU, no specific transfer pricing audits occurred despite the tax avoidance provision in the primary legislation. However, the general audit team in the LTO occasionally resolved small transfer pricing issues during integrated tax audits.

Since transfer pricing regulations came into force in 2014, the ITU has undertaken 15 transfer pricing audits and managed to complete five, with another three cases in the final stage. So far, the impact of the regulations on the extractive sector has been limited. It is only in 2016 that the ITU has begun transfer pricing audits in the extractive sector, with four cases underway, the Tanzania Minerals Audit Agency (TMAA), Tanzania Petroleum Development Company (TPDC), and other agencies that might reasonably be expected to apply the transfer pricing regulations to cost audits and royalty assessments, are "yet to feel the impact," according to a TMAA official. The extractive industry audit team in the LTO continue to identify and resolve minor transfer pricing issues during the course of general audits.

Since the transfer pricing regulations were introduced in 2014 the International Tax Unit has completed five transfer pricing audits, collecting approximately TZS 232 billion in additional tax. The final amount is likely to be higher, however some audits are still under dispute.

While transfer pricing audits having only just begun in the extractive sector, the ITU has undertaken a number of audits in manufacturing, tourism, and telecommunications. Of the five audits that have so far been concluded, the ITU has made tax adjustments of approximately TZS232 billion. The audit findings are under dispute by the relevant taxpayers, preventing the full adjustment from being collected, however the Commissioner has the power to collect one third of the value before the outcome is decided. The ITU's success has led the small and medium size tax offices at the TRA to request support from the ITU on transfer pricing issues relating to other taxpayers.

According to ITU employees, the legal framework provided by the regulations has made them feel more confident to pursue taxpayers, as they can now refer their findings to the law. The regulations have also functioned to create a more concrete and consistent approach to the application of transfer pricing methods. According to civil society activists, both the ITU and the regulations have brought considerable attention to the issue of transfer pricing, whereas previously it was "not on the TRA's radar" and there were no trained specialists. The regulations also serve to "create an environment of fear" that encourages taxpayer compliance.

However, the ITU acknowledges that there is still a long way to go before the impact of the regulations is fully realized. Civil society is concerned that the ITU is not prepared to implement the regulations and that they should have waited to build capacity before moving ahead. While it is clear that the ITU must continue to build transfer pricing capacity, civil society also lack knowledge of recent audits, tax adjustments, and the considerable transfer pricing expertise now in place. The ITU admits that for the transfer pricing regulations to have an impact they must improve reporting from taxpayers by sensitising them on specific documentation requirements, retain trained staff, strengthen penalties, and continue to lobby for exchange of information with other tax jurisdictions. These implementation challenges currently limit the potential of the regulations, and the ITU is actively working to address them.

The cost of reform

Since the ITU was established in 2011 the primary recurring expense has been subscription to the transfer pricing database Orbis, at approximately €45,000 per year. Including the database subscription, the total annual budget for the unit ranges between TZS250-300 million. Having generated approximately TZS242 billion in tax adjustments, the ITU is already proving to be extremely cost effective. Timely dispute resolution mechanisms and strategic case selection will be critical to ensuring that the unit remains cost effective.

Box 1. Transfer pricing reform process in Tanzania

Over the last five years the East African Revenue Authorities Technical Committee (EARATC) have increasingly begun to discuss the tax challenges associated with MNEs, and the need to prepare for an influx of oil and gas companies into the sub-region. These discussions inspired the commissioner general of the TRA to establish the ITU in 2012. There was resistance at first, with some people saying that a separate unit was unnecessary and would potentially duplicate the role of the LTO. However, the commissioner insisted on setting up the ITU, selecting a small number of officials from within the LTO, and eventually recruiting more staff from the Domestic Tax Department and Financial Investigations. Initially, ITU officials were seconded to transfer pricing teams in Kenya and South Africa to learn how their transfer pricing units were working.

Once the ITU was up and running the TRA recognized the need to establish a clear legal framework to deal with transfer pricing. Again, the EARATC and other forums discussed the difficulties of dealing with MNEs without a legal framework, namely the Unilever case in Kenya, prompting the TRA to develop the transfer pricing regulations.

Mbeya Cement Ltd vs. TRA

The importance of a clear regulatory framework was highlighted in the case of Mbeya Cement, the Tanzanian subsidiary of a French cement company, Lafarge. The TRA had adjusted the Value Added Tax (VAT) owing on imported technical and management services which Mbeya had received from Lafarge since 2005. The TRA made the adjustment based on the view that these services provided by Lafarge were not in accordance with arm's length prices. Mbeya contested the TRA's claims based on an audit report prepared by PricewaterhouseCoopers (PwC) that stated that the services had been costed according to OECD transfer pricing guidelines. The judge ruled in favour of the TRA on this issue stating that: "the report of PwC on issues of arm's length pricing was based on the OECD guidelines which had no binding effect." Specifically, the TRA had the right to demand details of the services provided by Lafarge to Mbeya, which allowed them to be paid huge sums of money annually. Failure of Mbeya to provide these details gave the TRA the right under Section 33(2) of the ITA to make the necessary tax adjustments. Despite the judge being adamant that Mbeya could not refer to a model that was not enforceable by law in Tanzania, ultimately the case was decided in favour of the taxpayer. This experience was a catalyst for the regulations passed in 2014.

Key success factors in the development of the transfer pricing regulations were (i) the knowledge of transfer pricing within the ITU, and (ii) the strong leadership provided by the commissioner general. The ITU was established in 2011, prior to the regulations being in place. This gave staff the opportunity to visit and learn from other countries, to participate in transfer pricing trainings, and to begin conducting transfer pricing audits, all before finalizing the regulations.

No major challenges arose during the drafting of the regulations. There was a hold-up at the finance ministry, which the ITU now recognizes might have been avoided had the ministry been more involved in drafting the regulations. Lobbying by taxpayers was also limited, perhaps because of the opportunity given to private tax consultancies to contribute to the development of the regulations.

Relevant anti-tax avoidance rules

Thin capitalization

The 1973 Income Tax Act had allowed for unlimited debt finance deductibility. In 2004 the Act was amended to limit deduction of interest payments to 100 percent in the year of income, plus 70 percent of the entity's total income for the year without including any interest or deducting any interest. To strengthen this scheme the 2010 Finance Act introduced a debt-to-equity ratio of 70:30, which was later amended to debt-to-equity ratio of 7:3. This is Tanzania's only safe harbor. The government managed to negotiate with extractive companies already operating in Tanzania to adopt this provision. The reform was spearheaded by parliamentarians in response to numerous instances of thin capitalization particularly in the mining sector. According to one parliamentarian, who was a member of the Presidential Mining Review Committee, in 2008 Tanzania lost a total of US $830 million in corporate income tax from three of the main gold mines due to thin capitalization. Geita Gold Mine Ltd., Acacia Mining (formerly African Barrick Gold) and Resolute Tanzania allegedly had debt-to-equity ratios of 12,597,000:1, 791:1, and 5,088:1 respectively.

Box 2. Geita Gold Mine at 12.5 million:1

Geita Gold Mine Ltd. commenced production in 2000. Initially it was a joint venture of Anglogold and Ashanti, but became fully owned by Anglogold Ashanti (AGA) after a merger in 2004. The mine produces approximately 538,000 ounces of gold per year, and is one of the largest open pit mines in Africa.

According to an Alex Stewart Gold Assayers (ASA) annual report, the company sold US $1.549 billion worth of gold from 2001-2007. Despite this, the company only paid US $144.4 million in tax during the same period, with payroll taxes amounting to 15 percent of the company's total tax contributions over the period 2000-2004. While payment of taxes has increased over time, a prominent MP (who was also a member of the Presidential Mining Review Committee in 2008) revealed that at the time of the investigation into Geita Gold Mine the mine had a debt-to-equity ratio of 12,597,000 percent. The same MP has suggested that between 2001-2007, the amount of tax revenue lost due to thin capitalization by Geita Gold Mine was enough to cover the combined 2011 budgets of both the ministries of water and energy.

According to the TMAA, the thin capitalization provision has reduced interest deduction claims from mining companies. However the TRA is aware that even with the new provision there is a need to monitor interest rates on loans from affiliates. The 2010 Finance Act requires taxpayers to demonstrate that the loan has not been given by a connected company in order to qualify for interest deductibility, however a concrete definition is lacking. The new Petroleum Act of 2015 has introduced a specific rule that interest rates on loans from affiliate companies should not exceed the lowest market rate available for such loans. This specific rule should be adopted more generally.

Thin capitalization rules have reduced interest deductions by mining companies. However there is a further risk that interest rates may not be at arm's length. This could be addressed by a limit on interest deductibility.

Mine	Company	2004	2005	2006	2007	Total
Geita Gold Mine	GGML & SMRL	6,942	7,276	12,324	12,324	38,866
Bulyanhulu Gold Mines	BGML	10,713	16,733	26,481	19,524	73,451
Tulawaka Gold Mine & Bulyanhulu Gold Mines	PML	2,786	7,125	7,199	6,762	23,872
North Mara Gold Mine	NMGML	5,586	11,504	13,046	18,027	48,163
Golden Pride Mined	RTL & MML	1,133	1,014	1,394	2,706	6,247
Industry total		**27,160**	**43,652**	**60,444**	**59,343**	**190,599**

Table 1. Interest charged to local mining companies for 2004-2007 (USD million)

Source: TMAA "Mining Industry Analysis" - Ratio Computations from audited financial statements of mining companies but figures of 2007 for GGM & BGM are estimates based on average of 3 prior years because the audit was conducted before issuance of audited accounts.

Advance pricing agreements

Section 12 of the transfer pricing regulations provides for advance pricing agreements (APAs), however they are currently not in use, despite requests from some manufacturing companies. The ITU stated that limited capacity to negotiate, and concerns that the TRA would end up losing taxes, were the primary reasons for not entering into APAs. This is a view that has been reinforced by technical advisors to the ITU. However, there may be an opportunity to embark on APAs in the future as the ITU builds further experience.

Reference pricing

In 2010 the government introduced the gross value method for calculating royalties in an attempt to overcome the asymmetry of information pertaining to deductions, discounts, and commissions on mineral sales. Previously, royalties were calculated netback and taxpayers could use that loophole for deductions as well as generous discounts to related party customers. Companies have been encouraged to use spot prices, however to the TMAA's knowledge Barrick is the only company doing this as they are listed on the London Stock Exchange. The changes to the royalty regime have had limited impact on current mining operations most of which are governed by agreements signed in the 1990s and therefore subject to stabilization. According to the TMAA, most MDAs have never been changed; the only amendment that companies have agreed to has been removing the 15 percent uplift on capital allowance.

Separate tax treatment of hedging

Currently, hedging losses are deductible from total income in Tanzania. However, the TRA is keen to change this practice, proposing to separate hedging losses and gains from the primary business unit so as to limit risk to the tax base. Although the TRA recognizes that the upside of hedging can be advantageous to government, in most cases they see hedging losses based on what they assume are non-arm's length terms of sale, but can be difficult to verify. According to a TRA official, "hedging is done outside of Tanzania, you are told by companies that they have hedged, but you lack the secondary information to verify this." Therefore, separate tax treatment of hedging would seem to be an appropriate step to safeguard the tax base. According to the TMAA, they have informally reconciled the issue of abusive hedging with companies, allowing them to do some hedging but not to the same extent as before.

Losses from hedging arrangements are deductible in Tanzania. Consequently, some companies may engage in abusive hedging to offset their chargeable income. This could be addressed by separate tax treatment of hedging.

Box 3. Resolute gold mine paid income tax once between 1997-2012

In January 2008 the Presidential Mining Review Committee mission visited Resolute Gold Mine in Nzega, Western Tanzania. The committee found that the company was selling its gold at US $530 per ounce at a time when gold prices were around US $1,200 per ounce. The company claimed that the reason for the discrepancy was that they had hedged at the lower price. Later the committee found that Resolute was engaged in a hedging arrangement with its sister company. This arrangement could have denied Tanzania up to millions of dollars in royalties and tax revenues. The mine was closed in 2012, after exporting US $3.5 billion dollars of gold since starting operation in 1997. During this time Resolute paid corporate tax only once, three years before closure.

TRANSFER PRICING ADMINISTRATIVE ARRANGEMENTS

Transfer Pricing Unit

The International Tax Unit (ITU) was set up at the LTO of the TRA in 2011. The ITU has 12 staff divided across transfer pricing and double taxation agreements (DTAs). It is expected that the ITU will grow to 20 staff soon. There were five transfer pricing specialists in the team, however due to demand for the ITU's services, an additional three transfer pricing staff have been hired. Of those currently working on transfer pricing there are two economists, two accountants, and one tax specialist. Given the significant workload of the transfer pricing team, and the less frequent nature of double taxation agreements, other ITU staff members are regularly brought in to work on specific transfer pricing cases.

The ITU currently reports to the Commissioner for Large Taxpayers, servicing only the LTO. However, there is demand for the ITU to support the entire TRA, including regional offices. While it is extremely promising that the ITU, specifically the transfer pricing team, is held in such high regard by the rest of the TRA, the ITU should approach such expansion cautiously. The regulations are new and transfer pricing expertise is under development, thus a gradual approach to expanding the scope of the ITU is required. Transfer pricing audits are time and cost intensive, consequently it is best to focus on the sectors that contribute most to tax revenue, as well as on specific taxpayers and types of transactions. The ITU runs a risk of spreading itself too thin and undermining the integrity and effectiveness of its work if it goes beyond large taxpayers.

The International Tax Unit should be cautious about responding to demand for transfer pricing audits for small and medium size taxpayers. They must focus on the sectors and taxpayers that are financially significant, otherwise they risk being spread too thin.

The transfer pricing team is currently working across a range of sectors including manufacturing, telecommunications, and tourism. There is no division of staff according to different sectors, however this may change as the unit expands. There are plans to hire an extractive sector specialist, but this was not particularly concrete at the time of interview. While further training on transfer pricing in the extractive sector is required, the ITU should avoid trying to build all the necessary sector expertise in-house. Rather it should strengthen links with the extractive industries audit team in the LTO, as well as the TMAA and PURA.

There is no independent oversight governance mechanism for the ITU. By coincidence, the ITU is responsible for preparing the annual business plan for the whole of the LTO. The ITU collects inputs from the rest of the LTO regarding taxpayers they intend to audit that financial year, as well as earmarking specific transfer pricing cases for audit. This plan is then submitted to the operations commissioner for approval. On the one hand this coincidental function enables the

ITU to be fully appraised of transfer pricing issues arising in general audits, and to develop strong links with the rest of the LTO. However, this level of responsibility for general audit selection, and the lack of oversight of transfer pricing audits, may compromise the independence of the ITU.

Internal coordination

Initially, the ITU struggled to get the rest of the LTO to coordinate. There was concern that the ITU didn't have sufficient expertise to tackle transfer pricing cases, and many in the LTO thought the issue wasn't significant enough to warrant a separate unit. Over time however, the ITU has raised awareness of the importance of transfer pricing, and staff have come to recognize that the ITU has the legal framework, skills, and the database to do the work. The ITU's specialist skills and ability to deliver results was demonstrated by recent tax adjustments. Consequently, the ITU is now experiencing demand from the rest of the TRA to address transfer pricing issues across a range of taxpayers.

The rest of the LTO is separated into three audit teams: extractive industries, services, and manufacturing. In theory, these teams should refer transfer pricing issues identified during the course of general audits to the ITU. While this is becoming more common, in previous years the ITU selected cases independently via the annual business planning process. The extractive industries audit team is separated into mining, and oil and gas, with approximately 15 staff in each team. The extractives audit team is yet to submit a transfer pricing case to the ITU. This is not because they haven't been faced with transfer pricing issues among extractives taxpayers, however; according to the team, these cases have been simple enough to be resolved internally rather than needing to be referred to the ITU. Most auditors in the extractive industries team have received some level of transfer pricing training to be able to identify and address such issues. If the extractives audit team has the capacity to deal with transfer pricing issues it makes sense that they should do so. However, it may also be the case that the extractives team prefers to address transfer pricing issues internally, so as to maintain complete oversight of extractive industry taxpayers. Given the politically sensitive nature of the extractive sector and longstanding concerns about the government's opaque dealings with companies, more checks and balances within the LTO would seem appropriate. It is also important that the new transfer pricing regulations are applied consistently, and that the ITU has the opportunity to build up its exposure to, and understanding of transfer pricing issues in the extractive industry. According to the ITU, there are plans to collaborate with the extractives audit team on at least two audits in 2016.

Inter-agency coordination

There is a proliferation of government institutions involved in auditing extractive companies in Tanzania. These include the TRA, TMAA, TPDC (now PURA) and the National Audit Office. In theory, each of these institutions has a particular mandate when it comes to audits, however in practice, there are significant coordination problems that are likely to undermine the effective application of transfer pricing regulations to the sector. Since 2012, a revenue forecasting and modelling team on mining, oil and gas, supported by the Norwegian government, has been based at the TRA. While this has been a positive initiative aimed at building capacity on forecasting, and consolidating relevant information, the initiative has nearly concluded and as yet there is no formal coordination mechanism to take its place. Rather than establishing a brand new coordination mechanism, there is no reason why the revenue team should not continue, albeit with an expanded mandate

The Revenue Forecasting and Modeling Team on Mining, Oil and Gas is coming to a close and there is need for a new inter-agency coordination mechanism to emerge. A new mechanism should focus on information sharing and coordinating audit efforts.

and membership. The primary objective of the next iteration of the revenue team should be coordination of audit efforts and information sharing, and new members must include PURA, and the Tanzania Extractive Industries Transparency Initiative (TEITI).

Mining

The numerous government institutions involved in mining audits have the potential to promote transparency and accountability, however without adequate coordination there is likely to be significant overlap thus creating inefficiencies. The TMAA's mandate is to focus on assessment of royalties, as well as technical and cost auditing. However, the IMF as well as other institutions have expressed concern that the TMAA also comments on tax issues, which potentially duplicates the role of the TRA. While the TMAA is extremely effective in recovering royalties and accelerating payment of income tax, without adequate coordination mechanisms in place revenue collection becomes fragmented.

According to one expert, "Monitoring of the mineral value chain should not be separate from the tax administration as it creates silos. If you can coordinate properly as in Norway, fine, however personality clashes prevent the TMAA from limiting itself according to its mandate and transferring information to the TRA."

All of the information currently collected by the TMAA is reported in an online database, however this is not accessible to the TRA. There are plans to build an online integrated database but there was no concrete evidence of this at the time of interview and the TMAA indicated reluctance due to confidentiality issues. One area that requires harmonization is the time period that mining companies are required to keep records for. The Mining Act requires companies to keep records on capital expenditure for the life of the mine, whereas the TRA only requires them to do so for five years. This variation has proved difficult in terms of dealing with unsupported capital expenditure with the TRA saying that the assessment is closed and it cannot revert during general audits. It is hoped that inter-agency coordination will improve following the signing of the MoU between the TMAA and the TRA.

All production information collected by the Tanzania Mineral Audit Agency is uploaded onto an online database. This database must be made available to the Tanzania Revenue Authority so that they can monitor transfer pricing risks along the mining value chain.

A future coordination challenge in the mining sector relates to the role of the National Development Corporation (NDC) regarding the major iron ore and steel project agreed with Sichaun Hongda Corporation (SHC) of China. There is a conflict of interest, as like the transfer TPDC, the NDC attempts to be both a commercial operator and regulator. Both the TMAA and TRA had little knowledge of this project when interviewed for this study, indicating an emerging coordination problem regarding assessment of royalties and income tax. It is critical that the relevant ministries and agencies are fully informed on all aspects of this project to ensure that it is subjected to normal audit requirements.

Box 4. Liganga iron ore deposit at risk of transfer mispricing

A joint venture agreement was signed between the NDC and the Sichaun Hingda Corporation (SHC) of China in 2011. The project is intended to produce steel for domestic and export sale using iron ore recovered from the Liganga deposit. From the outset, the arrangement has been shrouded in secrecy and few government officials knew about the project.

The Liganga iron ore deposit will be used to supply a steel mill also owned by SHC. This presents a significant risk of transfer mispricing, assuming that the mine and mill are subject to different tax obligations. There is a risk that the iron ore will not be priced according to the market value and that the government may not realize the maximum possible value from the iron ore, especially if the mill enjoys tax holidays.

The IMF has recommended that the ministries of finance and mines be brought up to speed on all aspects of the project, as well as involved in key decisions on project development. It is particularly important that the TRA and TMAA are also appraised of the issues so that they can monitor potential instances of transfer pricing.

Petroleum

According to petroleum companies operating in Tanzania, there is virtually no coordination between the TPDC and the TRA. Companies have tried to encourage both agencies to combine audit efforts in order to limit duplication, but this has been unsuccessful. The coordination problem extends to the interpretation of tax law as was recently illustrated at a workshop convened by companies aimed at bringing together the TPDC and TRA to discuss tax issues affecting the petroleum sector. According to a company representative: "it was clear that there was a huge divide in terms of basic concepts, what taxes companies should pay, and general interpretation of the law."

The customs clearance process is one area where coordination challenges have been particularly costly. Petroleum companies are required to apply to the TRA for customs clearance, but before this is granted the TRA need approval from the TPDC on the items being brought into the country. According to a company representative, "if you are on a drilling campaign and you need something tomorrow you need it tomorrow as it costs a fortune to keep a ship out at sea." While it is reasonable to expect both the TPDC and TRA to play a role in approving customs clearance, it is critical that these agencies collaborate effectively and efficiently in order to prevent costly delays for companies.

The TPDC has significantly more independence than the TMAA. Until recently, the TPDC was required to return only 50 percent of production sharing revenues and royalties collected to the TRA. There is no MoU between the TPDC and the TRA, although there are tentative plans to develop one. The TRA expressed significant frustration at the difficulties of obtaining information from the TPDC, with the TPDC claiming that secrecy provisions prevent them from sharing information.

Coordination in the petroleum sector is more problematic with requests for information from the Tanzania Petroleum Development Corporation often being refused on the grounds of 'secrecy'.

It is hoped that the new Oil and Gas Revenue Management Act will resolve coordination challenges in terms of revenue collection and audit responsibilities. According to Section 6 of the act, oil and gas revenues derived from taxes and levies are to be assessed and collected by the TRA, with the government-owned national oil company responsible for non-tax oil and gas revenues. The new upstream regulator PURA is charged with auditing cost recovery on exploration, development, production, and sale of oil and gas to determine the government's profit share and royalty. It will be important to monitor the transfer of responsibilities from the TPDC to PURA; some TPDC officials claim that as license holder, the TPDC will continue to be responsible for cost audits. While the TPDC may provide inputs to PURA by virtue of their board presence, audit responsibilities must shift to the new regulator to avoid conflicts of interest. Finally, the new Oil and Gas Advisory Bureau, a high-level body intended to advise the cabinet on petroleum matters, may also function to improve coordination at the political level. However, it is unlikely that the Bureau will go into detail on audit roles and responsibilities.

TRANSFER PRICING ACCOUNTABILITY MECHANISMS

Civil society

Civil society organizations are active and informed contributors to the debate on extractive industry taxation in Tanzania. A number of reports have been written by civil society that demonstrate real awareness and understanding of tax avoidance issues pertaining to the sector. Notable contributions include "The One Billion Dollar Question," commissioned by the Interfaith Standing Committee on Economic Justice, and "A Golden Opportunity," financed by Christian Aid and Norwegian Church Aid. Both reports highlight numerous instances of alleged tax avoidance by mining companies. These reports, as well as other similar contributions are generally well received by parliament and by the Ministry of Finance, however civil society claim that they have a poor relationship with the Ministry of Mines where they are seen as "troublemakers and anti-mining."

Transfer pricing is a new topic for civil society organisations. To better engage with the issue civil society groups require access to real-time information on transfer pricing so that they can begin to conduct their own analysis.

Civil society groups admit that transfer pricing is a new area for them and they are still developing capacity on the topic. They understand how transfer pricing works, however they struggle to access the real-time information needed to undertake their own analysis. According to Policy Forum, if civil society groups could access real-time information on transfer pricing they might become more engaged, as was the case regarding tax exemptions. Policy Forum and others are working to build the capacity of journalists to investigate and document transfer pricing issues, however it has been difficult to get journalists to write on tax issues as it is considered a "hard topic to sell." Political intervention is also a challenge for the media with a civil society representative revealing examples of journalists being required to get personal approval from the newspaper owner before any mining stories go to print.

Tanzania Extractive Industry Transparency Initiative (TEITI)

Tanzania was declared EITI compliant in 2012. TEITI is considered a positive intervention: "Now extractive companies know that there is a body to scrutinize payments whereas before nobody was really questioning." The reports are good quality and provide a detailed overview of tax and non-tax payments, and the presence of a multi-stakeholder committee means that companies must crosscheck what they have paid, and what they owe.

However, the overwhelming view of TEITI was that it lacks teeth, rarely going beyond identifying financial discrepancies in order to achieve real accountability or policy change. A prominent member of parliament asked: "When the auditor general's report comes out it goes to parliament, then there is a press conference. But the TEITI report, who has it?"

Development partners in Tanzania suggest that TEITI is disproportionately weighted towards financial reconciliation, failing to make itself "policy-relevant." According to a representative, "The emphasis on reconciliation is less relevant for

Tanzania as there is no problem of huge revenues disappearing so this as an end in itself is unsatisfactory. There is a need to expand TEITI's focus and develop a higher threshold for what is relevant. Without a broader focus people in the government may think, why is TEITI managing a government function, this is the work of the Ministry of Finance, the TRA, but TEITI is doing their job."

While it is important for the government to have some degree of ownership of the TEITI process, it seems that TEITI may have become too closely linked, preventing the initiative from functioning in its civil society capacity. When asked how TEITI produces reconciliation reports without access to mining development agreements (MDAs) or PSAs, the response was that such information was unnecessary as the agreements simply follow the law. This suggests a lack of understanding of the political economy of the extractive industry and TEITI's role in demanding accountability.

Tanzania is one of the 12 countries that was involved in the EITI beneficial ownership pilot. As a result, TEITI will now be asking for information on beneficial ownership from companies in the fifth and sixth reconciliation reports. Furthermore, the Ministry of Energy and Minerals is working together with TEITI to establish an open registry for disclosing names of individuals who own mineral rights for non-public traded companies. TEITI is of the view that beneficial ownership information will be useful, however they are concerned that they may struggle to get the "true picture." Requiring companies to disclose who their shareholders are will not necessarily lead TEITI to the owners, they need to go "behind the curtains" to know who actually owns the company.

Parliament

Parliament is credited with playing a significant role in recent policy reforms to strengthen revenue collection in the extractive industry, namely the introduction of thin capitalization provisions and capital gains tax. However, members of parliament who are informed and vocal on tax issues are limited in number. The majority fail to provide sufficient oversight either due to lack of expertise and understanding, or the presence of vested interests. Some members of civil society suggest that parliamentarians have limited knowledge on transfer pricing issues, including the Parliamentary Committee on Extractive Industries who, despite active engagement on tax holidays, environmental degradation, and benefits to host communities, know very little about specific types of tax avoidance. Parliamentarians have been offered the opportunity to participate in numerous workshops on taxation of extractive industries, yet a lack of staff limit parliamentarians ability to thoroughly analyze legislation and apply what they have learnt to decision-making processes.

Although some members of parliament are knowledgeable and vocal about tax avoidance in the extractive industry, political interference and personal gain continue to undermine effective oversight. Civil society claim that of the parliamentarians who have been active on mining issues, some have gradually become quiet over the years, suggesting that "making noise" ultimately leads to joining the circle of vested interests. According to one civil society representative, "Political interference and the opportunity for personal gain whips them back into line."

Some members of parliament have been vocal about tax avoidance in the extractive industry. But for the most part "political interference and the opportunity for person gain whips them back into line."

TRANSFER PRICING KNOWLEDGE AND SKILLS

Transfer pricing expertise

Since establishing the ITU in 2011, the TRA's transfer pricing-related manpower and technical expertise has improved considerably. The ITU has 12 staff, the majority of which have been trained as transfer pricing specialists. It is not just the ITU that have been trained on transfer pricing, other officials from the LTO have also been sent abroad to undertake short courses on transfer pricing, as well as being trained at the Institute for Tax Administration in Dar es Salaam.

The ITU's understanding of transfer pricing is evident in the number of audits recently undertaken, five of which have concluded with tax adjustments valued at TZS232 billion. According to a senior official at the TRA, the ITU has surpassed its revenue target in the first year of the transfer pricing regulations being in force. In part, this success demonstrates the skill and understanding of ITU officials, however it is important that such targets do not compromise the technical nature of the work, or lead to reckless application of the regulations. Various external technical advisors to the ITU have however endorsed the findings of the audits concluded so far, despite the fact that the relevant taxpayers are contesting them.

Understanding the extractive industry value chain

International Tax Unit

The ITU have yet to undertake transfer pricing audits of extractive companies. According to the ITU, this is because they have insufficient expertise and understanding of the sector, and require specialist transfer pricing training before commencing audits. The ITU has attended numerous trainings on transfer pricing, including a specific course on extractives convened by the International Bureau of Fiscal Documentation. In late 2015 a delegation from the TRA, including representatives from the ITU, travelled to Australia for training on taxation of extractive industries at the University of Sydney. Following this, the ITU has begun four transfer audits in the extractive sector. While it is very reasonable that the ITU wanted to build capacity in this sector before commencing audits, they not express the same concern in relation to other prior sectors such as manufacturing, telecommunications, and tourism. Arguably this reluctance stemmed from the fact that the extractives audit team in the LTO was yet to collaborate with the ITU, suggesting that the sector was closed to newcomers.

Extractive industries audit team

On the other hand, the extractives audit team has received significant capacity building such that the previous skill deficit in the sector has improved considerably. The team was established in 2008 and since then all staff have received some level of training on minerals taxation, specialized auditing, as well as transfer pricing. While some staff have rotated to other divisions within the LTO, in general, the team has remained the same and it has been possible to build specialized skills. The primary source of capacity building has been the Norwegian Tax Administration (NTA). According to the assistant manager of the extractive audit team: "The most useful trainings have been those that have focused on building an understanding of the industry. We know our tax law, and we know how to apply it, the issue is understanding what is normal industry practice and what is abusive."

"The most useful trainings have been those that have focused on building an understanding of the industry. We know our tax law, and we know how to apply it, the issue is understanding what is normal industry practice and what is abusive."

The technical expertise and understanding of the TRA has undoubtedly grown in recent years, however there are some government institutions, as well as civil society, who are less confident about the TRA's ability to effectively monitor extractive companies. Civil society is of the view that general tax audits of extractive companies are weak due to the TRA's limited exposure to the sector. According to one representative, "The experienced auditors at the TRA are few in number, expertise at the TRA is small. Look at how many court cases we have lost in the extractive sector because the cases were not well framed." Here the representative was referring to the Assistant Manager of the extractives audit team who has lengthy experience in the sector. Another civil society group suggested that secrecy of contracts is also a challenge for the TRA: "While some officials may have the contracts many do not in which case they do not know what to argue about." A TRA official also acknowledged that implementation of transfer pricing rules in the extractive sector may be difficult due to significant variation between extractive company agreements and the relevant legislated fiscal regime.

Former international advisors to the TRA have suggested that the ongoing development of extractive industry expertise may be used as an excuse to avoid investigating taxpayers, particularly in relation to expenditure that is considered "too technical." One such advisor cited an example of the TRA's uncertainty about whether an excavation tool fell into the category of mining equipment and therefore what depreciation treatment was required. The TRA tried to resolve their uncertainty internally, instead of requesting that the taxpayer prove the deductions. Questions in relation to taxation of the extractive sector often require a level of industry expertise, yet this doesn't preclude the TRA from asking basic questions. According to the same advisor: "the basic questions are as true for special tools as they are for paper and staples."

Further development of extractive industry expertise amongst tax officials is vital. But we must be wary of this being used as an excuse to avoid investigating taxpayers.

TRANSFER PRICING INFORMATION

Risk assessment and selection of transfer pricing cases

The ITU has developed a generic risk assessment framework for selecting taxpayers for transfer pricing audit. The most valuable aspect of this risk matrix is the profitability ratios, comparing gross profit to turnover, management fees, marketing fees, and interest rates. This is an area where it would be particularly helpful to develop industry-specific guidance on acceptable ratios given that they are likely to vary. For example, the mining sector is more capital intensive than financial services or information technology, so it requires significant upfront investment, reducing return on investment particularly in the short-term. While the current generic risk factors outlined by the ITU are sensible and predictable there is a need for detailed guidance on identifying and evaluating transfer pricing risks in the extractive sector, as well as other relevant sectors. Weighting of risk factors may also be necessary over time as the workload of the ITU increases and there becomes a need to be more selective when choosing taxpayers and transactions for audit.

As mentioned in the previous section on coordination, coincidentally the ITU is responsible for preparing the annual business plan for the LTO. One of the reasons for this is because of the ITU's perceived independence. Often general audit teams might be seen as having a particular bias towards certain taxpayers. The advantage of the arrangement is that the ITU has the opportunity to screen recommended general audit cases for transfer pricing issues. This way, transfer pricing issues are referred to the ITU, in addition to which the unit identifies its own cases based on the risk matrix. So far, the ITU has been referred cases from the manufacturing and services audit teams, however it has not yet received cases from the extractives audit team. According to the extractives team, transfer pricing issues they have encountered so far have been simple enough to resolve without the support of the ITU.

Box 5. Extractives audit team adjusts sale price of rare gemstone

In 2011, the extractives audit team at the TRA noticed that the price at which a local mining company was selling rare gemstones to its parent company was very low compared to the on-sale price to other unrelated customers. Finding an appropriate comparable sale price was difficult given that the gemstone is found only in Tanzania and the particular company in question was one of only a few companies mining it. According to one tax official: "it was as if they got the stone free of charge in Tanzania." The TRA adjusted the sale price and applied it to sales from two years prior. While the adjustment meant that the TRA collected additional income tax, the company had been in operation since 2004, and the TRA was unable to adjust the sale price before 2009. This meant that significant revenue may have been forgone during this period.

The extractive industries audit team is yet to submit a transfer pricing case to the International Tax Unit. They may have some transfer pricing expertise however generally cases should be handed over so that the regulations can be applied consistently.

While the extractive industries audit team have received some basic capacity building training on transfer pricing, the ITU is the primary repository for such knowledge and expertise and it receives regular training from various international partners. It is critical that any transfer pricing issues are referred to the ITU so that they can be dealt with in a comprehensive and consistent fashion. To overcome this challenge the Head of the LTO must issue a directive to the effect that any transfer pricing issues identified during the course of a general audit must be referred to the ITU.

Access to appropriate transfer pricing comparables

The ITU is in its second year of using Orbis, a popular comparables database provided by Bureau van Djik (BVD). The TRA finances the Orbis subscription at a cost of €45,000 per year, and it has recently renewed the subscription for a second year. The database is regarded as a worthwhile investment given the additional tax collected by the ITU so far. The ITU is aware that at some point they may need to contextualize the comparables provided by the database, however so far no adjustments have been made to account for geographical or market differences. Given that the ITU has not yet undertaken transfer pricing audits of extractive companies it is unclear how applicable the Orbis database will be to this sector.

Cost deductions by mining companies have been a long-running issue for Tanzania. In 2010, the TMAA audited 12 mining companies, raising many queries relating to over-claimed capital allowances, unsupported capital and operating expenditure. These queries were valued at US $705.8 million, with US $251.1 million remaining unresolved. This is not a new problem. ASA allegedly reported four companies that over-declared their losses by US $502 million in 2006. The alleged discrepancies are summarized below.

Over-claimed capital allowance	179.3
Unsupported capital and operating expenditure	141.2
Disallowable items	53.8
Wrongly claimed and premature capital deduction	44.5

Table 2. Audit queries communicated by TMAA to companies for their response in 2010 (US$ million).

Source: TMAA, Annual Report 2010, p.36.

Regardless of whether the allegations are accurate, it is clear that cost deductions are a major issue for the government. Despite the scale of the challenge, all the relevant government institutions (TRA, TMAA, TPDC/PURA) lack access to robust comparables for deductible expenditure. This is particularly problematic in the petroleum sector where Tanzania's status as a "frontier basin" is being used to justify high costs, and the TPDC, TRA, and the auditor general lack the comparable data to challenge these claims.

Box 6. Exploration company drags feet on drilling to artificially inflate costs

According to TPDC: "verifying drilling rig rental fees can be extremely difficult given the cost variation. We use the internet to evaluate the cost but the difference can be between US $300,000 per day and US $600,000, and Tanzania's status as a "frontier basin" makes it easy for companies to record the maximum rental price." In addition to challenges of cost variation, companies often charge the full market price for "new" equipment that is actually second hand and transferred from related parties.

One particular case that the TPDC has investigated relates to a petroleum exploration company that owns their own drilling rig. Instead of taking 30 days to drill (the standard duration) they often use their own rig for 60 days. The company says that technical problems cause delays in drilling, however the TPDC suspects it is a way of increasing costs: at anywhere between US $300,000 and US $600,000 per day, every extra day charged has a considerable impact on chargeable income over the long-term.

The TPDC suspected that transfer mispricing was going on because the related subcontractor rented the rig to other non-related exploration companies in Tanzania. These non-related companies did not experience similar technical delays in drilling and, in general, hired the rig for the standard 30 days. The TPDC discussed the issue with the exploration company in question and, "then he becomes more careful because he knows that you know." To prevent further transfer mispricing, TPDC officials are stationed on the drilling rig, a standard practice for all rigs, and if the extra days are a result of non-technical problems the TPDC will be alerted.

Box 7. International sale of LNG at risk of transfer mispricing

Both the TPDC and the IMF recognize the potential risk of mistransfer pricing regarding the sale of liquified natural gas (LNG) once production begins in 2020. This risk is heightened by the lack of independent LNG price benchmarks. Consequently, the IMF has advised that the government retain the right of approval over all major LNG sales contracts, and that regular external expert advice may be required when it comes to monitoring the sale of LNG between related parties. This was echoed by the TPDC. An official stated that, "the mitigation strategy is to make sure that the government is part of the discussion and understands the market price of different countries."

The IMF also stressed that the government should establish a mechanism for approval of any volumes sold via short-term spot sales to avoid delays in project decision-making. Although the risk of transfer mispricing requires careful monitoring, it is hoped that as long as there are multiple (experienced) upstream joint venture (JV) partners who are not also co-investors in the LNG buyer, the risk of any abusive transfer pricing in LNG sales contracts will remain low, as the JV partners will police each other.

Access to information

Since the establishment of the TMAA in 2009, access to information from mining companies has improved considerably. However, the TRA remains concerned that tax returns continue to have significant discrepancies as well as missing data. According to the TRA, "it seems as if returns are not filled in by knowledgeable people, and that record keeping is unreliable." The lack of timely cooperation from companies often results in the TRA issuing an assessment without having received the required information, and as a result, the taxpayer ends up taking the government to court. This is costly for the government in terms of deferred tax, as well as the allocation of time and resources it takes to pursue an issue via the courts. The TRA stressed that such delays are particularly challenging for transfer pricing audits where it can take even more time to gather the necessary information. Consequently, the time limit on issuing an assessment has been extended from three to five years.

In addition to the information received from companies, the TMAA independently monitors the mines. An auditor is stationed at each and every gold room to collect data and enter it in the TMAA database. The TMAA also has its own laboratory to verify the quality of mineral exports. If they find that companies have under-declared they can uplift the value according to their laboratory results. According to the TMAA, their results are usually within the same range as those reported by the companies.

Tanzania is one of the few African countries to have its own mineral laboratory to verify the quality of mineral exports. This is critical to monitoring potential under-valuation of related party sales.

Despite both the TMAA and TPDC's considerable information from extractive companies, the institutions seem reluctant to share this with the TRA in a coordinated and regular manner. The TMAA submits audited company financial reports to the TRA on an annual basis, however the frequently updated online database is not automatically accessible to the TRA. According to a TRA official: "the TMAA and TPDC don't like to give information to us, they say it's confidential, confidential to who, we are the government." The same official claimed that: "these institutions continue to treat the industry as underground."

There are plans to build an integrated database for oil, gas, and mining information that would be accessible to all the relevant stakeholders. However, this plan was far from concrete at the time of interview, and given the general reluctance demonstrated by the TMAA and TPDC to share information it seems unlikely to happen soon. The TPDC is particularly secretive about the sector. For example, the

TPDC was requested to release the PSAs to the Parliamentary Committee on Public Accounts in late 2014, however the TPDC board director refused on the basis that the agreements were secret. This was despite the fact that the companies had no concerns about making the agreements public. The director was arrested and held only for a matter of hours before being released. It may be that these agreements will be made public according to the 2015 TEITI law, but this is yet to take effect.

Is the TRA actually requesting the information it needs?

Former international advisors to the ITU have questioned how effectively the TRA utilizes the information it already has, and whether it is actively requesting information to verify expenditure by mining companies. According to former advisors, the TRA would allege that a mining company was engaging in transfer mispricing, and when asked why, the response was: "they are clearly taking gold out of the ground and not making a profit." These assumptions were formed despite the fact that the TRA had not requested relevant documentation from companies for cost deductions.

The onus is on taxpayers to justify cost deductions, and the Tanzania Revenue Authority should enforce existing documentation requirements accordingly.

Moreover, TRA officials often fail to specify the particular information they require from taxpayers when starting an audit, suggesting a lack of preparation and risk analysis. Before starting an audit tax officials must write down what they know, what the risks are, and meet with the TMAA to confirm their assumptions, before requesting specific information to be available for audit. The alternative is that the TRA gets swamped with boxes of information that the taxpayer decides to provide, and they start building a position based on what they were provided with. Yet it is often the information not provided that is critical. One of the most significant tax adjustments in the mining sector came as a result of the TRA asking for information, the company's response being: "good you asked for information because we looked into it and these costs shouldn't have been included." A request for documents solved this file. What is required is a change of attitude among tax officials that they are allowed to ask questions of taxpayers.

Information from other jurisdictions

The ITU is yet to obtain access to information from other tax jurisdictions. Despite Tanzania having nine DTAs, with many more countries lining up to agree new DTAs, these have been unhelpful in terms of exchange of information with the relevant tax administrations. The setbacks experienced in accessing information are partly the TRA's fault due to a failure to channel requests through the proper competent authority. This has since been rectified, however DTAs are still viewed as a largely ineffective means of accessing information. Instead, Tanzania has recently joined the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in the hope that this will be a more successful mechanism for the exchange of information.

TRANSFER PRICING DOCUMENTATION REQUIREMENTS

The transfer pricing regulations do not include specific documentation requirements, rather Sections 80, 139 and 40 of the Income Tax Act apply. These provisions require taxpayers to keep information and documents necessary to explain a tax return. The transfer pricing guidelines produced by the ITU provide further detail on the application of these provisions. This guidance is in accordance with the United Nations Manual on Transfer Pricing. In addition to keeping the aforementioned information on hand for the TRA, taxpayers are required to disclose any related party transactions via their annual tax return.

Since the regulations came into force in 2014, the ITU has requested transfer pricing documentation from 44 large taxpayers. While there has been good compliance from taxpayers, the ITU has identified gaps in the transfer pricing documentation provided. Consequently, the ITU is preparing to sensitize taxpayers on documentation requirements, including drafting a more comprehensive note on transfer pricing documentation that was due to be finalized by the end of 2015.

TRANSFER PRICING DISPUTE RESOLUTION MECHANISMS

Four transfer pricing cases are currently being disputed by taxpayers. When a taxpayer disputes the findings of the TRA they have the right to first lodge an objection at the TRA, and if it cannot be settled internally it is referred to the Board of Appeals, and then to the Tax Tribunal if still under dispute. The Tax Tribunal has the same authority as the High Court. If still not resolved the case will go to the Court of Appeal. The four cases currently under review are still at the level of the Board of Appeals, and, according to the technical advisors to the ITU, the TRA is in a strong position to win all four cases. As long as transfer pricing disputes remain at the level of the board or tribunal the process is not overly costly for the government. However, the ITU must monitor the time spent on these cases with a view to improving the TRA's capacity to resolve transfer pricing issues internally, via negotiations with taxpayers.

TRANSFER PRICING TECHNICAL ASSISTANCE

The ITU has received significant technical support and capacity building since its inception in 2011. From the outset, international advisors were hired to assist the ITU with specific questions on transfer pricing files. The U.S. government has also provided considerable support, seconding a U.S. Treasury official to the ITU three to four times a year for the last two years. On those visits the US official is embedded within the ITU, working through practical cases with the team. The ITU is also set to receive new technical assistance from the U.K. Department for International Development (DFID) to build an information exchange desk. Significant assistance was received from the NTA during the development of the transfer pricing regulations, as well as ongoing support to the revenue modelling group.

According to the International Taxation Unit: "the most useful assistance is in the form of experienced transfer pricing specialists who have done it themselves, confronted problems, and developed pragmatic approaches."

Unsurprisingly, the ITU prefers practical support from technical partners. According to the unit: "the most useful assistance is in the form of experienced transfer pricing specialists who have done it themselves, confronted problems, and developed pragmatic approaches." While the value of this type of support is clear, the TRA is a crowded space in terms of technical assistance, and according to one development partner: "the TRA is good at asking for support, but less good at bringing the support together."

GOVERNMENT LEADERSHIP

The extractive industry in Tanzania has a negative reputation amongst citizens and public officials alike. In particular, there is a perception that the benefits of the mining sector have failed to materialize due to bad deals and poor management. When the mines were state owned there was limited mineral development. Privatization came at a time of low gold prices, so the government offered generous fiscal terms to investors. Following privatization, six large gold mines started production, and while they continue to make a significant contribution to the balance of payments, revenue has never really materialized substantially. Consequently, mining is regarded as having lined the investors' pockets while citizens failed to benefit.

This view of the mining industry has been substantiated by numerous reports from civil society and parliament. Generous tax incentives provided to companies were required to attract investment, but were also the result of high levels of corruption. According to one civil society activist: "The preferential tax treatment of mining companies is due to vested interests, people in power influence policies to favour companies. It is clear that political heavyweights provide protection to companies."It is difficult to refute these allegations when mining and petroleum agreements are not yet public, making monitoring by civil society and the media virtually impossible. Rather than attempting to dispel concerns about corruption, the government's recent negotiations with a handful of new extractive industry investors have continued to be opaque.

Despite their growing awareness of the problem of tax avoidance, government ministries and agencies responsible for regulating the extractive sector regularly interfere with the implementation of anti-tax avoidance rules. According to a prominent member of parliament: "Issues of tax avoidance receive zero prioritization at the top." The TRA echoed this, with one official revealing: "You are a government official at a particular level, you know that tax hasn't been paid on seven to eight containers being imported into Tanzania, and you get a letter from State House telling you not to do anything, what do you do?"

Corruption in the extractive sector undermines the technical competence of government officials charged with regulating the industry. According to a civil society activist: "The TRA has skilled staff, capable of doing the work, but they are incapacitated by the system." While the TRA does not seem to have been implicated in the recent Tegeta escrow account scandal, this incident reinforced concerns people might have had about the debilitating effect of corruption on the work of government officials. Transfer pricing may have been prioritized in words, however civil society is less sure that the regulations will be robustly applied.

"The TRA has skilled staff, capable of doing the work, but they are incapacitated by the system."

CONCLUSION

The government of Tanzania has made considerable progress towards establishing a robust transfer pricing regime. Since the introduction of transfer pricing regulations in 2014, the ITU has completed five transfer pricing audits amounting to TZS232 billion in tax adjustments. Consequently, the ITU is in high demand not just from the LTO but the rest of the TRA to investigate transfer pricing issues in relation to a range of taxpayers. While the extractive industry regulatory agencies, the TMAA and TPDC, have not yet received training on transfer pricing, their regular cost audits of extractive companies create a strong foundation for future assessment of transfer pricing risks regarding cost deductions.

Despite having strong fundamentals, the ITU has been slow to begin transfer pricing audits of mining and petroleum companies. This is due to three key issues: weak internal and inter-agency coordination, limited extractive industry expertise, and difficulties obtaining relevant comparable data. In relation to the first and second issues, the extractive industry audit team has been reluctant to refer a transfer pricing issue to the ITU for investigation, and, to a lesser extent the ITU has lacked the technical expertise to pursue extractive companies independently. Cooperation between the TRA and the TMAA is growing, however the same cannot be said for the TPDC, and we are yet to see how PURA shapes up. Consequently, the exchange of extractive industry information and expertise remains ad hoc and disorganized, preventing the ITU from systematically assessing transfer pricing risks throughout the extractive industry value chain. Unlike most other countries in this study, Tanzania is actively monitoring cost deductions by extractive companies, a major source of potential transfer mispricing. The TMAA and TPDC are aware of potential over-claims regarding related party payments, but they lack the appropriate comparable data to conclusively challenge companies. This is particularly pronounced in Tanzania's nascent offshore gas industry.

The mining industry in Tanzania has failed to deliver on its promises to transform the economy and develop the country. This is largely due to generous tax incentives and weak governance structures, often reinforced by political corruption. However, the discovery of offshore gas offers a second chance. To capitalise on this opportunity, Tanzania must first get its house in order by ensuring that there are strong anti-tax avoidance measures in place, supported by the appropriate skills, information, and administrative arrangements. Finally, there can be no place for inter-agency clashes, and political discretion in the implementation of transfer pricing rules in the extractive sector. A whole-of-government approach is required if Tanzania is to combat transfer mispricing, and ensure that the extractive industry finally begins to drive the country's transformation.

RECOMMENDATIONS

Transfer pricing legal framework

1 The Ministry of Finance should amend the transfer pricing regulations to clearly state whether taxpayers are to follow OECD or UN guidance. Currently, the regulations refer taxpayers to both the UN and OECD guidelines to help interpret certain terms and concepts. This may create confusion for the taxpayer and the TRA where UN and OECD guidelines disagree. The Ministry of Finance should select the most appropriate standard to assist with interpretation of the regulations, preferably the UN guidelines as they are considered to be more practical for developing countries, and clarify the regulations accordingly.

2 The Ministry of Finance should introduce separate tax treatment of hedging to limit the risk of this practice being used as a tax shield to offset income. Reference pricing may limit the impact of abusive hedging on royalty payments, however hedging losses may still diminish the profit of the main business unit, thereby reducing taxable income. Separate tax treatment will still allow extractive companies to engage in legitimate hedging, but protect the tax base from abusive hedging. Notwithstanding these reforms, it is important that the TRA, TMAA and PURA continue to review hedging agreements so as to ensure that the sale price is at arm's length.

3 With support from international partners, the Ministry of Finance should make use of advance pricing agreements as provided for in the transfer pricing regulations. APAs could be hugely advantageous for Tanzania: reducing the monitoring burden for the TRA, ensuring efficient allocation of limited audit capacity, and enabling greater insight into the workings of taxpayers, particularly their transfer pricing methods. The TRA is hesitant to enter into APAs having only recently started working on transfer pricing. However, if properly negotiated with support from technical experts, APAs provide an opportunity for the TRA to develop their expertise in transfer pricing and gain access to valuable information.

4 The Ministry of Finance should introduce the earnings-stripping rule that limits interest deductibility as a function of earnings. This will strengthen application of the debt-to-equity ratio in the Income Tax Act. A limit on interest rates has been included in the new Petroleum Act and should be made to apply to the mining sector as well, either through an amendment to the Income Tax Act, or the Mining Act of 2010. In addition, to ensure more complete information about borrowing, financing plans should be made part of mining plan approval.

Transfer pricing administrative arrangements

5 The TRA should limit transfer pricing audits and enquiries to high-income taxpayers and high value transactions, at least while the ITU is still building manpower and expertise. That the ITU's services are in demand from other divisions within the TRA is extremely promising. However, at least in the short term, while expertise and credibility is being established and the resources to conduct transfer pricing audits are constrained, the ITU should limit itself to high impact interventions within the LTO.

6 The government of Tanzania should improve cooperation between the TMAA and the TRA, and the TPDC/PURA and the TRA by enacting the following measures:

- A formal coordination mechanism to replace the current revenue forecasting model team on mining, oil and gas. This mechanism should include non-tax revenue streams so as to strengthen cooperation between the TRA and industry regulators.
- Require a strong working relationship between the TRA and PURA from the outset. The new Oil and Gas Advisory Bureau, while primarily a think-tank, should be given an informal oversight role regarding coordination of audit responsibilities in the petroleum sector.

7 Civil society should monitor the transfer of audit responsibilities from TPDC to the new upstream regulator PURA to ensure that the TPDC's conflict of interest is finally resolved. While the new Oil and Gas Revenue Management Act clearly outlines the division of audit responsibilities, there may be some resistance from the TPDC in transferring audit responsibilities to PURA. Consequently, civil society should monitor implementation of the act to ensure that the new organizational structure is implemented and that the TRA obtains full cooperation from PURA.

8 The National Development Corporation should inform the Ministry of Finance, the Ministry of Energy and Minerals, and through them the TRA and TMAA, of all aspects of the Liganga iron ore project. Both the TRA and TMAA have virtually no knowledge of the project due to it having been negotiated, and now regulated, by the NDC. This is problematic for many reasons including the risk of transfer mispricing given that the iron ore is to be sold between related parties within Tanzania for the purpose of producing steel for sale domestically and internationally. It is important that all aspects of the project are properly scrutinized by the TMAA and TRA to ensure that the government obtains the maximum benefit from the iron ore.

9 The head of the LTO should issue a directive that any transfer pricing issues identified during the course of a general audit by the extractive industries audit team should be referred to the ITU. While the extractive industries audit team have received some basic training on transfer pricing, the ITU is the primary repository for such knowledge and expertise, receiving regular top up training from various international partners. It is critical that any transfer pricing issues are referred to the ITU so that they can be dealt with thoroughly and consistently.

Transfer pricing information

10 The Ministry of Finance, in collaboration with the Ministry of Energy and Mineral Development should develop an online information-sharing platform where all information concerning exploration, development, and production of mineral and petroleum resources is made automatically available to the TRA. This will improve transfer pricing risk analysis and case selection.

11 The ITU, in collaboration with the extractive industry audit team, should develop a transfer pricing risk matrix specific to the extractive sector. This will strengthen monitoring and evaluation of potential transfer pricing risks along the extractive industry value chain, and improve selection of cases for audit. This should include initial analysis of the cost structures of all large-scale extractive companies operating in Tanzania. Using this information, the generic transfer pricing indicators that the ITU have already developed can be adapted to the extractive industry, enabling more informed risk profiling and analysis. This should also help to clarify what transfer pricing documentation is required so that the taxpayer can be prepared and delays avoided.

Transfer pricing knowledge and skills

12 The government of Tanzania, with support from international partners, should ensure that the TMAA and PURA receive training on transfer pricing so that they are able to flag transfer pricing risks regarding non-tax revenue, and cost deductions. Price referencing has reduced the risk of under invoicing of sales, however there are still major risks in terms of expenditure. It is critical that the TMAA and PURA receive transfer pricing capacity building so that they can combine transfer pricing knowledge with industry expertise to effectively monitor the sector.

13 The government of Tanzania, with support from international partners, should ensure that the ITU receives specialized training on transfer pricing as it relates to the extractive sector, as well as further capacity building on taxation of extractive industries generally. This is necessary to equip the ITU with both the expertise and confidence to conduct transfer pricing audits in the extractive industry.

Research for this case study took place in August 2015.

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APPENDIX 2: ABBREVIATIONS AND ACRONYMS

APA	advance pricing agreement
AGA	Anglogold Ashanti
ASA	Alex Stewart Gold Assayers
BVD	Bureau Van Djik
DTA	double taxation agreement
EARATC	East African Revenue Authorities Technical Committee
GoT	Government of Tanzania
ITA	Income Tax Act
ITU	International Tax Unit
JV	joint venture
LNG	liquefied natural gas
LTO	Large Taxpayers Office
MDA	mining development agreement
MNE	multinational enterprise
MoU	memorandum of understanding
NDC	National Development Corporation
NTA	Norwegian Tax Administration
OECD	Organization for Economic Cooperation and Development
PSA	production sharing agreement
PURA	Petroleum Upstream Regulatory Authority
PWYP	Publish What You Pay
SSA	sub-Saharan Africa
SHC	Sichaun Hongda Corporation
TEITI	Tanzania Extractive Industries Transparency Initiative
TMAA	Tanzania Minerals Audit Agency
TPDC	Tanzania Petroleum Development Company
TRA	Tanzania Revenue Authority
UN	United Nations
TZS	Tanzanian shillings
VAT	value added tax