



Challenges and Implications of Applying the Zimbabwean Domestic Transfer Pricing Rules: An SME Perspective

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Abstract

Purpose: Transfer pricing has largely been viewed in the context of cross-border transactions of multinational enterprises. Zimbabwe recently revised its transfer pricing rules to include domestic transactions. This study sought to explore the challenges and implications of transfer pricing legislation for SMEs.

Methodology: A qualitative inquiry is applied with the use of in-depth interviews and a questionnaire survey. Thematic analysis was used to analyse both interview and questionnaire data.

Findings: The findings revealed that the paradox of observing fairness as a canon of taxation by equally taxing domestic and cross-border transactions has both economic and social implications for the Zimbabwean economy. It was evident that SMEs find themselves unduly burdened with compliance costs, capacity limitations as well as knowledge constraints in complying with the rules.

Originality or Value: The implications of transfer pricing rules on SMEs have not been explored in the Zimbabwean context. The study explores a critical sector that has often been neglected in the transfer pricing discourse. It recommends that the government revisit the applicability of domestic transfer pricing legislation to SMEs.

Introduction

For years, Zimbabwe has faced an economic meltdown characterised by industry closures, low production levels, a high unemployment rate, and acute shortages of basic commodities as well as a negative balance of payment (Mabenge, Ngorora-Madzimure & Makanyeza 2020; Gukurume (2018). This gave rise to the burgeoning of SMEs as a survival strategy for the majority of citizens (Gukurume, 2018). While in some countries entering the SMEs sector is a choice or done out of passion, in the Zimbabwean context, SMEs were created out of necessity because citizens were out of employment or needed to supplement income (Mutalemwa, 2015; Baporikar, Nambira & Gomxos, 2016). This sector has become the engine of the economy constituting more than 90% of the economy's GDP, employing more than 75% of the population, and constituting more than 70% of the Zimbabwe Revenue Authority (ZIMRA) database (Wadesango, Denford & Sitcha, 2019). SMEs are described as the roadmap to industrialisation and are hailed for the pivotal role that they play in the sustainable economic development of every nation, especially in Africa (Sibanda, Hove-Sibanda, & Shava 2018; Muriithi 2017). Their significance to the Zimbabwean economy is stressed by Mabenge et al (2020), with Bell and Mawadza (2017) describing the country as increasingly an 'SME economy'.

Since major industries had closed, the increase in SMEs was welcomed and supported by the government as a revival of the collapsed economy. The support includes the formation of the Small and Medium Enterprises Development Corporation (SMEDCO) and a ministry specifically targeted at promoting this vital sector (Mabenge et al 2020). The government also introduced tax heads such as the presumptive tax to capture this sector into the tax net to boost its tax revenue (Utaumire, Mashiri & Mazhindu, 2013). Furthermore, Zimbabwe recently promulgated transfer pricing (TP) laws that do not only apply to cross-border transactions but rather extend to domestic transactions. This situation is unique in the sense that the requirements to comply with transfer pricing laws and regulations include the SMEs which are now the backbone of the country, yet the world over transfer pricing rules are targeted at cross-border transactions only. Transfer pricing is defined as the setting of prices for controlled transactions between associated enterprises to minimise their tax liability (Mashiri, 2018).

This happened at a time when there have been reports that SMEs in Zimbabwe are experiencing stunted growth and dying at infancy stages with many failing to make it to the large corporate status because of tax-related issues (Majoni, Matunhu & Chaderopa, 2016). Research on the effects of taxation on the growth and survival of SMEs in Zimbabwe remains paltry yet it is believed that 80% of SMEs in the developing countries cease to exist before their 5th anniversary (Ocheni & Gemade, 2015). Rahman et al (2015) defined SME survival as the number of years in operation, availability of future goals, and diversity of product range, while growth refers to an increase in the size of the organisation for example a positive change in turnover or number of employees (Hanifzadeh et al, 2018).

While there is substantial literature to support the existence of SMEs, their survival has been marred by globalisation (Mabenge et al 2020; Mutalemwa, 2015) and incompatible tax policies (Njanike, 2019; Bomani, et al, 2015). Tax compliance costs have been described as the major obstacle to the growth and survival of SMEs (Dejan et al, 2019; Ameyaw et al, 2016). Solilova et al (2019) and Solilova et al (2017) emphasised that compliance costs particularly associated with transfer pricing impair the performance of SMEs. The purpose of this study is to explore the implications of the decision by the Zimbabwean government to apply transfer pricing rules to domestic transactions which include SMEs. This study focuses on SMEs, a sector that has often been neglected in transfer pricing literature, as evidenced by numerous studies (Lohse and Riedel, 2013; Ekstrom et al, 2014; Davies et al, 2014; Cristea & Nguyen, 2014; Sebele-Mpofu, Mashiri and Schwarts (2021) whose focus has been on the MNEs' cross-border transactions. These studies have documented transfer pricing implications for MNEs and did not consider the influence of transfer pricing regulations on the growth and survival of SMEs. There is a lack of scholarly evidence of the implications of TP regulations to SMEs' survival and growth and executing this study would enlighten policymakers on the implications of domestic TP laws, and provoke thinking towards strategies that would promote the growth of the SMEs sector and resuscitate the long-drained economy leading to socio-economic progress. The study became necessary given that tax policies usually favour larger corporates than SMEs (Okolo et al, 2016; OECD, 2017). It also adds to the paucity of literature on SMEs transfer pricing compliance and especially in Zimbabwe where this vital sector has been overlooked. The study further makes a vital contribution to the literature on domestic transfer pricing regulation, studies on transfer pricing legislation normally focus on multinational activities.

Literature and context

Taxation has remained a fundamental source of revenue for governments especially in developing economies. In Zimbabwe, the government has restructured its tax system to align with international standards. One reform is the adoption of the Arm's Length Principle (ALP) in the transfer pricing legislation and regulations of 2012 as amended in 2016 and 2019 introducing contemporaneous documentation. The complications of the provisions require domestic businesses including small to medium enterprises (SMEs) involved in transactions with an associated person to apply transfer prices consistent with the ALP and prove their consistency. The application of domestic transfer pricing to domestic transactions did not follow international best practices (Sachin, 2017; PWC, 2017) and placed extra burdens on the SMEs.

Literature has identified SMEs as business entities and significant drivers of economic growth, yet their survival and growth prospects are threatened by a myriad of challenges, especially in developing countries. Buyl and Roggeman (2019) demonstrate that the debate on the tax implications for SMEs compared to large

entities is relevant nowadays. Joshi et al (2014) explain that the taxation of SMEs may ultimately hamper growth which can be far more costly than the revenue anticipated. Buyl and Roggeman (2019) found that in Belgium SMEs are always disadvantaged with a higher tax burden compared to domestic firms and MNEs with an average of 1.6 and 4.8 percentage points higher. Ahmad, Muhammad, and Farooq (2017) found that approximately 50% of SMEs fail to maintain their survival in the first 5-10 years of operation. Cheong et al (2020) also found the tax structures in Malaysia hinder SMEs growth, and encouraged the creation of regulatory frameworks that stimulate SME growth. Huong and Cuong (2018) found friendly tax policies and government support for SMEs positively correlated to tax compliance in Vietnam. In South Africa, complex tax laws and subsequent paperwork have been described as major obstacles to SME development (Nieuwenhuzen, 2019; Fiseha and Oyelana, 2015). In Zimbabwe, the government has been castigated for unfairly imposing tax laws on taxpayers without proper consultations with all the concerned economic actors thereby causing tax non-compliance by SMEs (Kurauone et al, 2020).

In an attempt to explore the implications of tax laws such as transfer pricing to SMEs, the Neo-Classical theory of taxation by Laffer Arthur became adept. There are however two sides to the same coin in the theory position. On the one hand, the theory specifies that a high tax burden on SMEs will hinder economic activities, and restrain investment policies of corporations which will eventually lead to a downfall of SMEs hence economic depression. According to the Laffer curve (2004), higher tax rates discourage individuals and SMEs from growing and discourage entrepreneurs to invest. Implying that the efforts by the Zimbabwean government to indigenise (or promote entrepreneurship) may be jeopardised by counterproductive tax policies. Inconsiderate tax policies provide an unfair competitive advantage to larger firms. Laffer (2004) further states that governments should remove obstacles to free market competition. The theory envisaged tax policies where taxes are minimal with exemptions granted to businesses like SMEs. The question is whether SMEs can comply with the transfer pricing requirements such as the hiring of tax experts, preparing TP documentation, etc.

On the other hand, the theory also argues that high taxes lead to reduced government revenues. Reduced government revenue impacts SMEs profitability and survival. Government revenues stimulate the economy resulting in increased spending and demand for products and services of SMEs. Once government revenues are reduced, demand for SMEs products also falls. The Laffer curve (2004) highlighted that high tax rates lead to tax revenue reduction hence the shrinking of tax bases. The theory stated that as tax rates increase, revenue collected from taxes falls. This is so because high tax rates caused a reduction in economic activities. Laffer (2004) also mentioned that as the government keeps increasing the tax rates, it is less worthwhile for the individual or SMEs to work more or invest as they will get less

disposable income or equity. This implies that higher tax rates are correlated to less economic effort and output.

The theory ignores that being tax compliant can help SMEs grow and eventually turn into larger corporations. For SMEs to contract with government parastatals in Zimbabwe, they are required to produce a tax clearance certificate first. It can therefore be argued that being tax compliant in Zimbabwe can help SMEs participate in large tenders and contracts that can greatly increase their profits and sustainability. Tax contributions by SMEs, which form a greater part of the Zimbabwean economy, contribute to economic growth. Given that the theory supports higher tax obligations caused by domestic transfer pricing could have both positive and negative impacts on SMEs development means there is more scope for research in this area.

The Zimbabwean SME Act (2011) describes SMEs as business organizations with an asset value of from USD10,000 to USD2 million, employing 2 to 20 people, and having an annual turnover that ranges from USD30,000 to USD5 million. ZIMRA currently defines SMEs by segmenting its clientele into large, medium, and small clients with the medium having an annual turnover of USD1-5m, $USD20000 \leq \text{PAYE/VAT/income Tax} < USD50000$ per month, while small enterprises are those that either fall below these thresholds or are new entrants. SMEs constitute more than 70% of the ZIMRA database of registered taxpayers (Chanakira & Masunda, 2019) but contribute only 20% (Financial Tribune, 2018). Notwithstanding their contribution to the tax base, they have become the main source of survival in the country with businesses transcending municipal borders mandating compliance to transfer pricing rules despite their survival struggles. Zvarivadza (2018) described the government's tax regimes and regulatory frameworks as constraints to the growth and development of SMEs. Nyoni and Bonga (2018) reported that SMEs die prematurely or remain in a state of perpetual infancy owing to some crippling policies.

TP regulations increase compliance costs (Saunders-Scott, 2013) worsened by its domestication with higher cost implications for small businesses (Solilova et al, 2017). These costs involve time and expertise that SMEs lack with the consequent financial burden (Smulders et al, 2017; Nyamwanza et al, 2014). TP compliance cost makes SMEs victims of stronger tax obligations that are disproportionate to their sizes (Solilova et al, 2019; World Bank Group, 2019). TP rules introduce further complexities of comparable data benchmarking (Ezenagu, 2019) that SMEs are not configured to accommodate (Bowman, 2017). Literature has proposed several ways to address the related TP rule challenges for SMEs; the commodity rule method (Solilova & Nerudova, 2015), and safe harbours (Solilova et al, 2019). This argument is supported by Jousten (2007) who argues against preferential tax regimes for SMEs arguing that while SMEs incur tax compliance costs the tax authorities equally incur substantial costs in implementing the tax laws and that such provisions would perpetuate inequality. These unresolved debates spur this study at a time when

Muriithi (2017) and Maunganidze (2016) acknowledge that African governments give little support to SMEs thereby neglecting a vital economic driver.

Materials and methods

This study followed the interpretive philosophy as the researchers sought to unpack the implications of domestic TP on SMEs. A qualitative approach was preferred for its strengths in interpretation, and focus on practices and meanings (Brinkmann & Kvale, 2015) of domestic TP in the context of SMEs, see Table 1.

Table 1: Analysis of respondents

| Participant | Questionnaire distributed | Questionnaire collected | Interview scheduled | Interview conducted | Response rate |
|-----------------------------|----------------------------------|--------------------------------|----------------------------|----------------------------|----------------------|
| SMEs | 100 | 74 | - | - | 74% |
| ZIMRA | - | - | 10 | 7 | 70% |
| Tax consultants (TC) | - | - | 15 | 7 | 47% |

Source: Primary data collected by the Authors.

The data was collected from ZIMRA officers and TCs and SMEs. The study was scheduled for 15 interviewees out of which data was collected from 10 ZIMRA officers serving in the domestic taxes (Small Claims Office and Medium Claims Office) at the ZIMRA headquarters. The large claims office was excluded as this fell outside the scope of this study.

The idea was to have a balanced view of the implications of domestic TP on SMEs from all the stakeholders involved. The inclusion of SMEs as central participants to the objects of the study, ZIMRA as the enforcer of the TP laws, and advisor to policymakers and tax consultants (TCs) as intermediaries between the SMEs and ZIMRA allowed for an informed and in-depth analysis of the implications of recently enacted domestic TP laws on SMEs. Deductive thematic analysis unravelled their distilled experiences and their interactions with the TP legislation.

The TCs that had clients that met the definition of SMEs according to the ZIMRA's new definition were the ones that were purposefully consulted. The sampling was two-layered, first, we first identified tax consultants that were indexed with the Institute of Certified Tax Accountants (ICTA) and inquired about the size of the clients within their portfolio. Those that were confirmed to meet the SME criteria (registered with ZIMRA and meet the SME definition as provided in table 1) within their portfolio are the ones we scheduled interview appointments with. Eventually, 15 interviews were scheduled with 7 interviews conducted representing a 47% interview rate.

The small sample size for the interviews was not a concern as the study relied on Creswell (2014) who opines that small samples of between 3 and 10 are adequate. Provided the targeted respondents have sufficient knowledge and competencies relevant to the research. For this reason, participants were selected based on their relevance to the realisation of the study objectives and the knowledge they possess on the subject matter.

Convenience sampling was applied to identify respondents from SMEs and open-ended questionnaires (Appendix 1) were distributed to the targeted sample of 100 SMEs within the Harare metropolitan province. To qualify as a participant, the SMEs had to have related enterprises (subsidiaries, partners, or joint ventures) in Harare or other parts of Zimbabwe. The majority of the participants were obtained from Kaguvi Street and Mbare where most of the SMEs are designated. As stated in Table 2 above, 74 questionnaires were considered based on tax registration, denoting a response rate of 74%.

The research employed both questionnaires and interviews (Appendix 2) to allow one source of data to compensate for the weaknesses of the other data collection methods and benefit from the enhanced depth and breadth of findings that come with triangulation (Denzin & Lincoln, 2011). The instruments were pilot tested to check for correctness and validity (the ability to measure what it is intended to measure). A data-driven (inductive thematic analysis) was conducted to allow themes to emerge directly from the data as suggested by Fereday and Muir-Cochrane, (2006) and remain within the confines of the research objectives. To test the proposition that domestic transfer pricing affects SMEs in Zimbabwe, the data obtained from the interviews and questionnaires were analysed as informed by the research objective and the theoretical positions of the study (Hosseini, 2015).

Sebele-Mpofu (2020) alludes to the importance of saturation as a fundamental element of qualitative research. Accordingly, while analysing data through ATLAS.ti, saturation was considered from two dimensions; the point where no additional codes and themes were emerging (thematic saturation) and also where further interviewing and data analysis could not yield additional knowledge (data saturation).

Ethical considerations included written permission from ZIMRA to undertake the study. The individual participants' consent was also sought, participation was entirely voluntarily and their personally identifiable data was anonymised. Member checks were conducted with the ZIMRA heads of department and TCs to check for trustworthiness and credibility of the results as advised by Reilly (2013) and results were collectively reported.

Results

To analyse the data, interviewees were assigned identification codes and individual numbers for protection of identity and analysis purposes. For example, ZIMRA1 represented the ZIMRA tax official, TC2 was a tax consultant and SME3 was an SME accountant/bookkeeper or owner in that order. The results were presented in a thematic form as guided by the themes that emerged from data analysis and the research proposition. We find it important to provide the profile of domestic TP in Zimbabwe to aid the understanding of its complication on SMEs. Therefore, the analysis was presented under five themes. Theme 1 focused on the rationale of domestic TP in Zimbabwe (4.1); theme 2, the compliance rate for domestic TP in Zimbabwe (4.2); theme 3, challenges hindering SME TP compliance (4.3); theme 4, ZIMRA implementation capacity (4.4) and theme 5 domestic TP implications on SMEs (4.5).

Due to the uniqueness of this study, data was prepared based on three perspectives; tax registration, TP knowledge and the lived experiences of the participants which Polkinghorne (2005) deems crucial for deep analysis. A minimum of four (4) years of experience was vital for the TCs and ZIMRA officials since the TP legislation came into effect in 2016 while tax registration was a pre-requisite for SMEs to participate in the survey. This cleaning was done before the analysis to enhance the veracity of the data gathered. Of the 100 questionnaires distributed, 74 were the ones who were registered for tax, and so the remaining 26 were discarded since they did not qualify for this inquiry. Of the 74 only 11 (15%) knew about TP (with some acknowledging that they have only heard about TP rules and never applied the rules while a small number had applied them, and the rest 85% (63/74) were not familiar with the transfer pricing phenomenon. Therefore, a further 63 completed questionnaires were discarded to enhance the veracity of the data as shown in table 2.

Table 2: Data cleaning

| Participant | Questionnaires collected | Questionnaires discarded | Questionnaires analysed |
|-------------|--------------------------|--------------------------|-------------------------|
| SMEs | 74 | 63 | 11 |

And of the targeted 15 TCs, only 7 had dealt with TP cases. The small proportion of TCs that deal with domestic TP within SMEs could be an indication of the magnitude of such transactions as well as the compliance rate of SMEs and probably the fact that SMEs do have not enough resources to hire the services of TCs. Four (4) interviewees from the Medium Claims Office (MCO) and three (3) from the Small Claims Office (SCO) were interviewed from ZIMRA. All the TCs and ZIMRA officers that participated in the study had a minimum of 4 years of working experience.

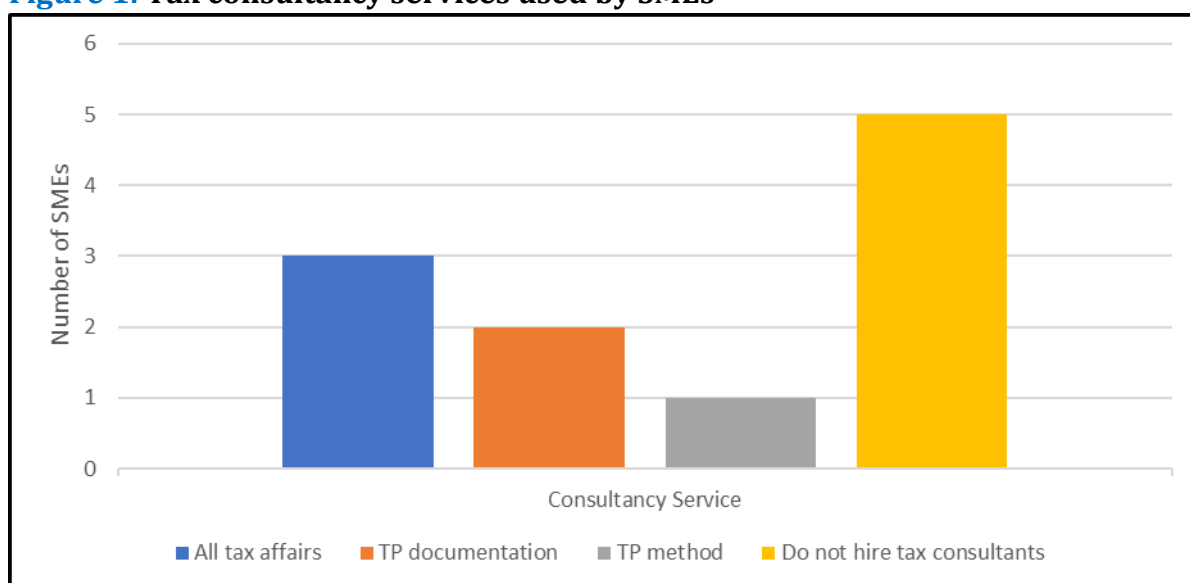
The rationale for domestic TP

The majority of the indigenous companies qualify as SMEs, but it was evident from the questionnaires that the majority of the SMEs barely knew about the TP rules in Zimbabwe. Zimbabwean TP legislation does not distinguish between cross-border or domestic transactions, hence the requirement for every taxpayer to comply with the TP regulations for transactions even within the borders of Zimbabwe. Compared to other tax jurisdictions, ZIMRA can legally apply transfer pricing adjustments to domestic transactions. Tax consultants (TC1-6) expressed concern over the application of transfer pricing rules to domestic transactions which is not the case with OECD. They alluded to the assumption that transfer pricing rules target foreign enterprises but noted that most of their clients are those that do in-country transfer pricing, Tax consultants question the reason for the rules to apply to domestic transactions, emphasising that no significant differences exist since the tax rate is the same, and the conditions are the same.

SMEs use of tax professionals

From the questionnaires, the following responses emerged. About 55% (6/11) SMEs indicated that they make use of tax professionals, while the rest 5/11 (45%) lamented the costs associated with such services. Of the 6 SMEs, 3/11 use consultancy services for all their tax affairs regardless of whether its transfer pricing issues and 2/11 SMEs hire tax consultancy for purposes of preparing TP documentation, while only 9% (1/11) use the service solely for determining the appropriate TP method as shown in figure 1.

Figure 1: Tax consultancy services used by SMEs



Source: ATLAS.ti results

While TCs derive most of their business from large companies, a substantial part of their TP tax advice is related to domestic transactions than cross-border transactions. This was attributed to the country's investment climate which is dominated by indigenous firms since not so many foreign investors are interested in setting up business in Zimbabwe because of the country's macro-economic environment. When further probed, TC2 added that *"in as much as tax-related issues could hinder Foreign Direct Investment (FDI), Zimbabwe's situation is more intricate because of its macro-economic factors since its taxes are not far from what others are charging."*

Both ZIMRA and TCs agreed that the Zimbabwe legislation specifically requires that where there are related party transactions regardless of whether they are cross-border or domestic transactions. When asked whether TP arises between branches of the same company, it was revealed that TP arises as long as a trading company is registered as a separate legal entity and has transactions with related parties for instance subsidiary to subsidiary or subsidiary to holding company. Taxmatrix (2016) acknowledges that transfer pricing manipulation is very possible within the same country as two associated enterprises can make arrangements to lower their overall tax burden.

Knowledge about domestic TP requirements

Data revealed SMEs are oblivious of what exactly is expected of them, as they did not have much to say concerning the modus operandi of the Zimbabwean TP legislation and regulation, except that they knew that they are expected to comply. About 71% of TCs expressed concern over the application of transfer pricing rules to domestic transactions yet the OECD does not cover such. Some of the sentiments passed are; *"OECD does not talk of domestic guidelines but our legislation talks about domestic transactions so we need a guideline e.g. on the thresholds who are supposed to comply with the rules, we would rather have our own guideline which guides on domestic transactions like maybe not everyone should apply TP rules in domestic transactions."* (TC7). TC5 said, *"Yes ... maybe suffice to say in Zimbabwe transfer pricing applies to domestic transactions as much as it applies to international transactions. Where there are two related parties, they are all operating from Zimbabwe, they must have transfer pricing documentation. In the absence, just like what happens with multinationals, the Commissioner may make adjustments for both entities."*

As a follow-up question, the interviewees were asked to comment on what domestic TP meant for Zimbabwe since the other countries. One of the TCs said, *"I think the domestic is more worrisome because there are so many group entities, some large, some very small, and the regulations have no safe harbours, everyone is subject to transfer pricing no matter the size."* And TC4 said *"The problem with our legislation now is it also covers domestic transactions. So the majority of taxpayers that we see are those with domestic transfer pricing. Those that do in-country transfer pricing, those that*

deal amongst themselves, and so forth." The TCs generally acknowledged the requirement by the Zimbabwean legislation to apply TP to domestic transactions. Safe harbours as advocated for by Solilova (2019).

Interestingly, some of the ZIMRA officers professed ignorance of what domestic TP meant, *"According to this legislation ...it is specific to say this transfer pricing shall not be applicable for companies within the border it's specific in law..."* (ZIMRA7). *"Hmmm, I thought they don't apply depending on what exactly like euh...but in this case, their expense becomes this one's income, and then we are still saying that they... Well if it's done in a way of error... maybe that's what I can come to think of but generally, these are for multinationals...but here and there, maybe there might be specific peculiar cases that are unique* (ZIMRA 4).

ZIMRA3 said, *" ... there is an element of TP in sec 98, but am not clear on what is required and sec 98B spells out that"*. The ZIMRA officers who are expected to enforce the TP legislation are not yet conversant with the prescriptions of the law. Their ignorance connotes that enforcement is weak or close to none. This was analogous to Shongwe (2019) and Mashiri (2018) who highlighted that TP enforcement in developing countries is weak and ineffective. Though ZIMRA confessed that it is still preoccupied with large clients (those companies with related parties and that contribute 60-80% of the total taxes), it acknowledged that revenue from SMEs is equally important though it is relatively low compared to those of large companies. They argued that there are local companies with no cross-border transactions, and so the domestic TP is justified and important to bring every company into the tax net.

The extent of compliance by SMEs

The next question was asked about the level of compliance with TP laws among SMEs. It was evident that the complexity of the tax system and burdensome compliance costs heighten non-compliance with tax obligations. SMEs were not comfortable in answering this question, probably because of its sensitivity, and so most simply reported that they are trying their best. ZIMRA acknowledged that there is high non-compliance as companies are budgeting for expenses not incurred as required under section 15 (2a) of the Income Tax Act. Companies are not having consistency in the application of TP methods which is a requirement by the Zimbabwean legislation, and a justification for change demanded under IFRSs. The companies apply a method that is favourable to them in particular instances and change when they feel that the same method disadvantages them, but fail to justify the reason for the change. This presents the rationality tendencies of taxpayers which was explained by Mashiri (2018). The TCs who interact with SMEs more indicated that TP is relatively new and there is no basis for coming up with pricing structures such as services that require a cost-plus method, the SMEs don't understand and most of them use a certain percentage of revenue which is not permissible at law.

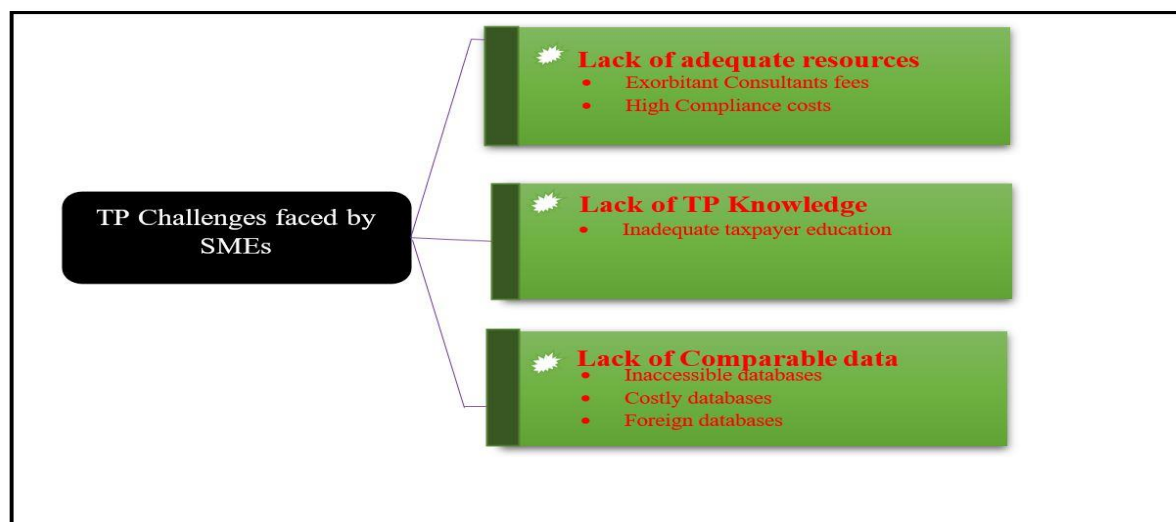
Justification of domestic TP on SMEs

One of the interviewees (ZIMRA1) bemoaned going after SMEs and argued that even after aggregation of their receipt, their contribution to tax revenue is minimal and therefore more costly than beneficial. This was echoed by Oguttu (2006) who noted that the revenue leakages through transactions between related enterprises resident within the same country are minimal. The interviewee (ZIMRA 1) said that for those SMEs whose transactions are centralised at the head office, there is barely TP to talk about as most of the transactions will largely be mere movement of stock between the dependent branches. This means transfer pricing issues emerge more when the entities are separately registered and operate independent of the head office and where there are related (subsidiaries, partners, joint ventures, etc).

Challenges hindering compliance with TP laws

Figure 2 presents TP challenges faced by SMEs. This, in a bid to understand the implications of domestic TP on SMEs, was considered important given their low level of compliance with TP laws.

Figure 2: TP Compliance Challenges faced by SMEs



Source: ATLAS.ti results

There was a general consensus among the respondents (SMEs, TCs and ZIMRA) that domestic TP is fraught with challenges, particularly for SMEs. They cited (i) lack of TP knowledge, (ii) paucity of comparable data and (iii) inadequate resources as the major challenges that hinder SMEs from fully complying with the TP laws. All the SMEs lamented their inclusion in the TP legislation arguing that it should be targeted at the MNCs as their income is paltry to finance the onerous compliance costs. Directly quoting SME9's additional information; *"At a time when my business is starting to flourish, ZIMRA brings up these additional tax obligations, what do they*

want me to do, close shop, huh?" All the SMEs vented their frustrations over the costs of complying with the TP legislation. SME8 indicated that the tax obligations were a huge obstacle for SMEs to grow into large corporations, a development that is very critical for Zimbabwe's industrial sector which is in a sorry state. The survey for SMEs also asked the SMEs to estimate the costs they incur in trying to comply with TP regulations regarding issues such as determining the TP method, preparing relevant documents, and hiring tax consultants. Most of them indicated that they were unable to estimate the costs as they needed to factor in time, transport costs, and other attendant costs. The inability to accurately estimate costs spent on tax-related issues by SMEs is also confirmed by Solilova and Nerudova (2018). However, only those that hire the consultancy services (6/11) could estimate their consultancy fees. The annual consultancy fees for the three SMEs that hire tax consultants for all tax matters ranged between USD5 800- USD6 300, while those that hire TCs for purposes of transfer pricing had compliance costs ranging between USD9 000- 10 800. These costs are quite significant to SMEs.

ZIMRA alluded to a lack of requisite knowledge and limited resources as the main challenges faced by SMEs and TCs added the issue of difficulties in accessing the information on similar transactions. When asked to elaborate on the resources that are in short supply, they mentioned recruitment of less qualified personnel and limited resources to hire the services of tax professionals. This was also buttressed by the TCs when they said SMEs could not afford the cost of tax consultants' services. They lamented about how exorbitant the tax consultancy fees were, making their services inaccessible to many and leaving them at the mercy of ZIMRA. The TCs said that the large companies hire them more than the SMEs mainly because of the costs involved since their charges are exorbitant. TC2 iterated that, *"...SMEs cannot pay us, they can't afford us"*. When probed further, TC2 explained that the reason for low subscription from SMEs was also attributed to the large companies being the ones that are more worried and concerned about tax issues than the SMEs. Further commenting that *"SMEs have a catch me if you can attitude"* explains why they are reluctant to hire the services of tax consultants. Among the SMEs which indicated that they never approached tax professionals, were some who stressed that they were chased away by the steep prices, while a few of them use unregistered tax consultants. This finding is consistent with Rita and Onyeukwu (2019) who believe that SMEs rely on tax practitioners for their tax affairs and Baporikar, et al (2016) who stress that SMEs do not afford to hire professionals. The lack of capacity to seek professional tax advice is compounded by scant taxpayer education from ZIMRA. A concern that received mixed views from the respondents, with SMEs and TCs conceding that ZIMRA is not providing adequate tax education while ZIMRA insists that it is doing this religiously.

Another important point that was raised is the issue of comparable data. TC2 elaborated that comparable data relating to leasing transactions are easily accessible from the real estate companies, while financial transactions are also easily attainable since they are regulated by the Reserve Bank of Zimbabwe (RBZ) but accessing data for the rest of the transactions is a daunting task. This is the information that is

required to enable the SMEs to apply some of the TP methods such as Comparable Uncontrolled Price (CUP) as prescribed within the Zimbabwean TP legislation. This limitation adds additional costs to the already burdensome compliance costs such as producing TP documentation.

All the SMEs complained that the preparation of TP documentation is cumbersome and laborious. Similarly, the TCs concurred that the requirements for SMEs to comply with transfer pricing legislation and regulations are “taxing” on their part, especially in terms of the preparation of TP documentation. The TCs also hinted that the SMEs are questioning why they should be incurring such costs yet the cost in one group member is revenue in the other. For example, in the case of a holding company that performs management services to the provider, the charge will be a cost to the recipient while the same is revenue to the provider of the service, and as a group, the transfer pricing requirements disadvantage the group when they consolidate. TCS also advocate for the elimination of TP compliance costs for SMEs as they agree that the TP-related costs are unnecessarily high for SMEs. One of the TCs (TC2) iterated that they wrote a paper to ZIMRA proposing that they set thresholds for those who should prepare TP documentation. This is consistent with the UN (2017) recommendation of thresholds for documentation requirements and is meant to relieve very small firms from high compliance costs. Literature generally concedes that increased TP regulation is positively correlated with significant compliance costs for SMEs (Solilova et al 2019; Solilova et al, 2017; Saunders-Scott, 2013).

One of the TCs (TC2) also pointed out that they have a screening mechanism whereby they decline offering certain potential clients based on the size of the entity. This implies that even some of the small companies that may be willing to comply with the TP rules may not be able to access the tax advice, and given the complexity of the TP laws and regulations, the SMEs would not be able to apply the legislation correctly. When asked if their pricing model is segmented to cater to small entities, the tax consultant replied that their pricing is depended on the volume of transactions, the complexity of the transactions, and the method to be applied in economic analysis or functional analysis. He gave an example that *“where you are to apply the CUP method, the information is easily available and where the benchmarking will be done using comparable data from foreign databases, we would need to consult the licensed agents and then transfer the cost to the client....definitely cost for the functional analysis for 10 transactions will not be the same for two transactions”*.

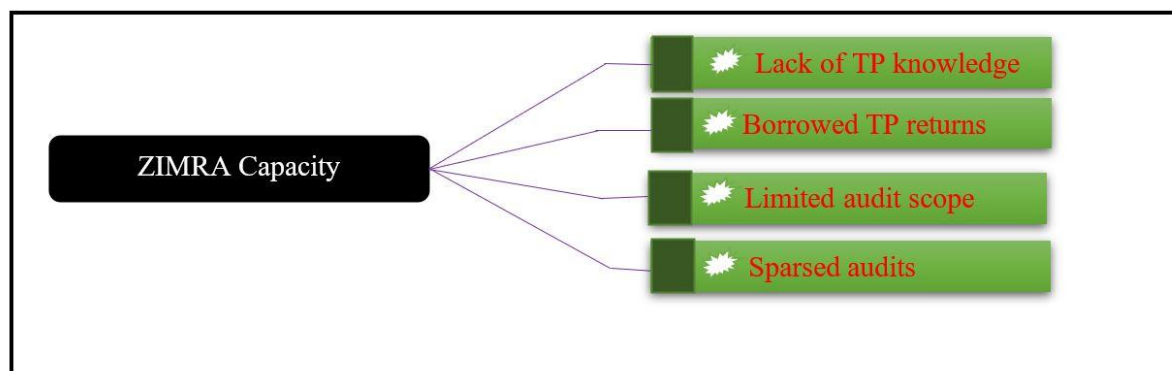
This generally confirms the inflated costs of compliance for the SMEs sector. Also evident from the analysis is that when applying for example the Transaction Net Margin Method (TNMM) and where one wants to come up with interquartile ranges the data is not easy to find. This may be the reason why Solilova and Nerudova (2015a) advocate for the 6th method – the commodity rule method for SMEs in targeted sectors. TCs allude to the challenges in accessing comparable data culminating in consulting foreign databases such as Orbis and VanDijk. They stressed that the limitation of this is that the results are generated from foreign companies

from countries such as Italy and Spain whose macro-economic fundamentals are parallel to those of African countries.

ZIMRA implementation capacity

Figure 3 indicates ZIMRA'S capacity to implement the TP laws of the country. It was imperative to assess the ability of ZIMRA (as the enforcer of TP laws) to implement the TP laws and ensure compliance at all levels as antecedent literature concurred on the limited capacity of revenue authorities in developing countries to implement TP rules (Kabala & Ndulo, 2018; Mashiri, 2018; Oguttu, 2016). The question here received diverging views, ZIMRA attempted to downplay its incapacity, but TCs and SMEs confirm this given their experiences with the revenue authority. The identified capacity weaknesses are presented in Figure 3.

Figure 3: ZIMRA Capacity weaknesses in enforcing TP rules



Source: ATLAS.ti results

It was evident that while ZIMRA claims to have done enough to educate taxpayers the TCs believe there is still room for more. ZIMRA 1 indicated that they provide awareness through tax education seminars and the taxman's corner forum published regularly in Zimbabwe's popular newspapers, but generally, SMEs do not read nor utilise that information to their advantage. TCs indicated that there is still a lot that ZIMRA requires to do to make taxpayers appreciate TP legislation. *"ZIMRA is not doing enough, they should have done several seminars now, but the last they did was last year (2019)"*, echoed TC4. Nonetheless, they shared the TP practice notes with the taxpayers which is commendable (TC4).

Another challenge for SMEs is the TP return (ITF 12C (2) which they are required to complete and should capture all related party transactions (income and expenditure). The *"SMEs are not yet familiar with it and we charge them for doing it for them"* (TC2). SMEs echoed the same that completing the TP return is a quandary for them.

These implementation challenges are compounded by ZIMRA's limited knowledge of the subject. This was stressed by the TCs that some ZIMRA professed ignorance of some fundamental issues of the TP legislation. Most of the TCs (TC2, 4, 5, 6) pointed out that, *"TP legislation is still a fairly new phenomenon, and ZIMRA is still learning about this legislation. The legislation is OECD borrowed, and ZIMRA has introduced the ITF 12C (2) TP return which they just borrowed from Australian Tax Authority (ATO) yet Zimbabwe requires a customised form."* Incompatible opinion, Oguttu (2016) stressed that the OECD fails to capture the specific needs of African developing states, and therefore nations should not just take up prescriptions of international laws, but rather exercise their sovereignty. Durst (2015) also asserts that international solutions will not solve developing countries' problems. Mashiri (2018) further stressed the need for African states to address their TP problems at a domestic level to capture the country-specific needs arguing that the unique economic and political structures of these states demand special redress. This is important as the Zimbabwean government is between a rock and a hard place regarding tightening their TP rules and creating a "pro-business environment" to meet their economic needs (Hasseldine et al, 2012).

When asked whether ZIMRA was being aggressive in enforcing TP rules, the majority of the TCs agreed that *ZIMRA is still learning about this legislation. TC2 said...in auditing, they single out one item currently, which is management fees currently"*. When probed further the TCs revealed that this is because ZIMRA is still learning, and seem not to be conversant with the other transactions. Similar to most developing countries where TP audits are handicapped by a lack of audit skills and limited capacity by the tax authorities (Shongwe, 2019; Mashiri, Dzomira & Dzingirai, 2021; McNaire et al 2010). One of the TCs (TC5) believed that ZIMRA TP audits are centred on management services because they are revenue-driven, and ZIMRA seems to have found a weakness in most of the taxpayers, making management fees a possible niche for reaping significant revenue. *"This is so because in practice most related parties apply a percentage of turnover for the management services, and this general practice is a violation of the TP legislation"*, he added. This finding is consistent with Sebele-Mpofu et al (2021a) who found management services as the major TP strategy manipulated by taxpayers. ZIMRA admitted that they have not been very aggressive with TP audits especially concerning SMEs as they are still trying to get the sense of TP with focussed attention on the large clients. This shows that ZIMRA is trying to be cautious though limited in capacity.

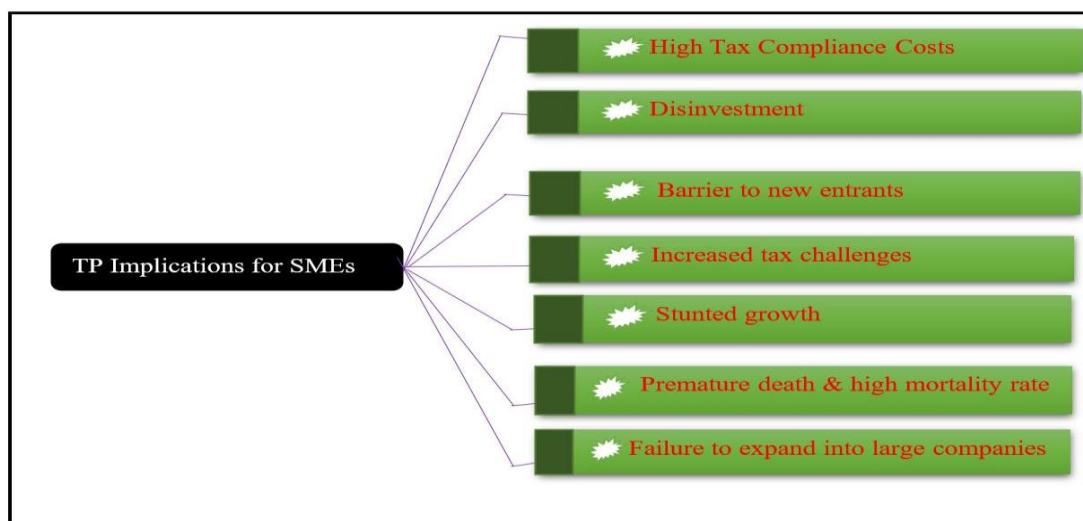
One of the TCs, said *"Like I said before they have limited capacity, I for one have left ZIMRA then I would cite for you an example on the 13th of October I was making a presentation in the presence of ZIMRA officials when I had finished the guy who is now responsible for TP we are having differences, he said, "when you said domestic transactions are subjected to TP rules my Act does not say that", and he was using a bill and not an Act so we are talking about someone who is supposed to be championing this, a ZIMRA guy who is supposed to be enforcing this they know the theory part and they can't apply it because to sit and say this should be the structure of the documentation they can't, even myself when I left ZIMRA I just knew the theory but now*

I can prepare documentation.” All this was pointing toward, poor implementation of TP legislation and regulations, thus the study can conclude that ZIMRA is not adequately capacitated to implement TP rules nor handle in-country TP. This is consistent with Kabala and Ndulo (2018) that most African tax authorities are inexperienced and cannot enforce TP rules as their mastery of TP issues is rudimentary. Sebele-Mpofu, Mashiri, and Korera (2021) specifically call on Zimbabwe to formulate clear TP regulations and invest in the capacitation of ZIMRA.

Domestic TP implications on SMEs

The implication of domestic TP appeared to be huge for SMEs in the country. Through deductive thematic analysis, the implications that emerged are summarised in the network in Figure 4.

Figure 4: TP Regulation Compliance implications for SMEs



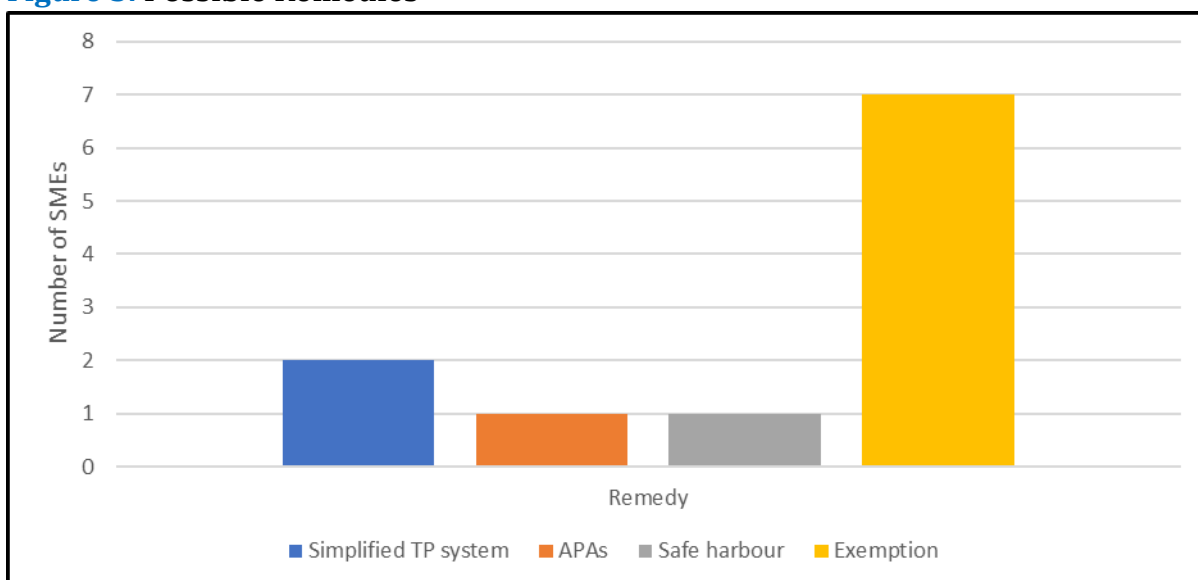
Source: ATLAS.ti results

It was evident that there are quite several implications for the SMEs which may not be favourable not only to the SMEs but to the entire economy as a whole. The implications were derived from the themes that emerged from the analysis as shown in figure 4. There was an outcry on inflated tax compliance costs for SMEs by both the SMEs and TCs. This is consistent with Solilova (2019) who alludes to the burdening of TP obligations on SMEs. The data also revealed the possible disinvestment of SMEs as a result of these exorbitant compliance costs. All the SMEs vented their frustration over how the TP obligations stand as an obstacle to their growth, denying prospective SMEs from entering the market as well as limiting the chances for the existing SMEs to migrate to large corporates. One of the SMEs (SME11), said, *“Most of the promising and vibrant SMEs that I knew went into bankruptcy and closed shop (between 2017 & 2019) most likely because of excessive tax obligations”*, and now he fears that his business would also fall into the same predicament. This suggests an uncondusive investment climate in Zimbabwe, a country where the SME sectors are

expected to be the backbone of the economy. The majority of the TCs echoed that the additional tax obligations lead to a decimated SMEs sector, and did not approve of this resolution arguing that it overburdens the local business enterprises. TC2 emphasized that *“the SMEs are too small for the complex TP regulations, and would require a favourable tax regime”*. This is consistent with Solilova (2019) who believes in preferential tax regimes for SMEs (safe harbour). There is also a wealth of literature confirming a negative correlation between a poor tax system and SMEs (Agu and Aruomah, 2019; Miller, 2018; Santhariah et al, 2018; Majoni et al, 2016; Ocheni and Gemade, 2015; Abrie and Doussy, 2006). Generally, the implications of domestic TP seem to defy the canons of taxation, and the rationale for in-country TP and fail to reap the expected benefits. Yet the growth and survival of SMEs are positively correlated with high economic activity which should translate to more tax revenue collections. The implications of domestic TP in Zimbabwe are a theoretical and contextual contribution to the body of knowledge as such a study has never been conducted in this context.

Lastly, the survey asked respondents to make suggest possible measures to remedy the situation. There were mixed views regarding the specific tools to be applied, however, the consensus was for SMEs to be either exempted from complying with TP rules or be granted a simplified TP system. This is large because all the respondents felt that the TP rules are not SME-friendly and will most likely thwart the indigenisation and entrepreneurship efforts by the government. Figure 5 below summarises the responses.

Figure 5: Possible Remedies



Source: ATLAS.ti results

Majority 64% (7/11) of the SMEs preferred that they be exempted from TP rules, while 18% suggested a simplified TP regime that has smaller penalties and no TP

documentation requirements. Only 9% suggested that Advance Pricing Agreements (APAs) be introduced so that SMEs can have a predetermined price with ZIMRA that will alleviate the chances of disputes with ZIMRA. A further 9% proposed a safe harbour regime which has preferential requirements for SMEs whose turnover falls within certain thresholds. The TC interviewees concurred with the minority SMEs who prefer a safe harbour arguing that it is widely practised in OECD-compliant countries. Zimbabwe's rules are largely aligned with OECD rules, and Ezenagu (2019) echoes that safe harbours for small taxpayers are common in OECD countries. ZIMRA interviewees were aligned with the notion that SMEs should be exempted from TP rules as going after them is more costly than beneficial.

Discussion

Because of Zimbabwe's challenging investment climate, the country faced an exodus of multinational companies and failed to attract FDI which led to the burgeoning of SMEs. SMEs are the major employers of labour and suppliers of the basic commodities that are in short supply in the country, and thus a critical sector of the Zimbabwean economy. This makes their growth and survival a major area of concern. SMEs generally are already hard-pressed with a plethora of challenges multiple taxes, high tax compliance costs, inadequate finances and limited access to some of the privileges that are available to large companies such as economies of scale. These challenges are amplified by the TP obligations. The rationality of Zimbabwe saddling SMEs with compliance costs against limited administrative capacities is exploitative. Ordinarily, the aspect of paying taxes should be just and fair (canons of a good tax system) (Tapera & Majachani, 2017). Although it may be driven by the country's hunger to protect its shrunken tax base and foster economic growth, this measure has caused disinvestment by these local firms yet the country is failing to attract adequate foreign investment. Consistent with the narrative, the neo-classical theory discourages high tax burdens that lead to disinvestment, lower economic activity and eventual economic depression. This study is the first of its kind and provides distinct insights to policymakers and positively influences their decisions towards supporting SMEs in Zimbabwe.

It was observed that indeed the TP legislation affects SMEs in a number of ways, as many SMEs lamented the additional tax obligations imposed by the TP rules given that in Zimbabwe SMEs are already subject to multiple taxes such as VAT, presumptive tax, income tax, import duties etc. This is the conundrum that is bedevilling the most promising SMEs. While it was ideal for Zimbabwe to domesticate its TP legislation, seeking equality without equity is superficial. The impact of domestic TP is meditated through attributes such as size, financial capacity, and compliance costs, all hinging on the survival and growth of SMEs. The imposition of complex TP rules yet SMEs are already overwhelmed by common challenges such as financial illiteracy and lack of tax knowledge is problematic.

The rules have also been accused of being unfairly applied to domestic transactions and the data revealed that domestic transactions pose a transfer pricing risk to the national tax base. Tax consultants were most vocal regarding the non-selective application of domestic transfer pricing arguing that it burdens the SMEs and defeats the efforts of the government to foster investment in the country. Such a situation is synonymous with the cobra effect and would be unhealthy for an economy which is grappling with a myriad of economic challenges such as high unemployment rates and negative balance of payments.

The unique economic, political and social systems in Zimbabwe expose the government to unique challenges which require creative and practical solutions. Solutions to base erosion and profit shifting cannot be universal, and the evidence shows that most proposed solutions emanate from developed economies which carry different economic, political, and social structures compared to African states, and as such have domesticated TP rules that address domestic problems as done by Zimbabwe is highly commendable, though there is room to improve the rules. The findings have suggested that Zimbabwe's distinct TP rules pose high compliance costs for domestic firms while international guidelines are silent about it. The TCs indicated that the preparation of TP documentation is burdensome to the customer particularly SMEs because they would then need to consult tax consultants at a fee. TC2 highlighted that more often than not comparable information will be unavailable because the entities are too small. TCs expressed their desire that there be set thresholds for those who should comply just like they did for VAT. This may then exonerate very small entities from complying with the transfer pricing documentation requirements.

Whereas ZIMRA believes that the revenue from SMEs domestic transactions may be minimal, TCs acknowledge that the magnitude of revenue from domestic TP is greater than that of cross-border transactions. Even though the risks associated with transfer pricing are postulated to be high in cross-border transactions, the revenue from SMEs counts and should be harnessed. However, ZIMRA needs to be capacitated as the tax authority for it to effectively discharge its mandate. Although Zimbabwe largely borrowed the OECD TP guidelines, international standards are not universal and so a country's unique situation should be addressed at a domestic level. Transfer pricing is a global issue, and its practice is not uniform for all countries because of the heterogeneity of economic environments, controversies, and complexities surrounding the transfer pricing concept as alluded to by Cazacu (2017:19). Overall, Zimbabwe should seek to strike a balance between widening its tax base and disinvestment of SMEs which has negative ramifications on the entire economy.

Conclusion and Recommendations

This study explored the implication for SMEs of domestic transfer pricing in Zimbabwe. To better address the study proposition, issues around compliance and implementation capacity among others were x-rayed. The interpretive philosophy within the qualitative approach was the preferred analysis for the proposition that domestic TP has a negative impact on SMEs. Interviews and an open-ended survey questionnaire were employed to collect data from TCs, ZIMRA officers, and SMEs. Key findings revealed hitherto that there's low knowledge of TP among SMEs resulting in low compliance levels with those complying finding it overly costly. Hence the burden of tax compliance costs meant disinvestment, the barrier to new entrants, stunted growth preventing expansion, and ultimately the early demise of most of the SMEs which dampens the efforts by Zimbabwe to indigenise the economy. Evidence aligned with the proposition that domestic TP has a negative impact on SMEs in Zimbabwe. Hence the conclusion is that domesticating TP in Zimbabwe has far-reaching consequences for SMEs. The results have serious implications for policymakers on tax and SME developments.

Notwithstanding, the intense debate on whether SMEs should be awarded preferential tax regimes, this study highly recommends Zimbabwe policymakers consider its eccentric needs and distinguish SMEs from the large companies in terms of TP rules just as they are distinguished in terms of their definition. The study also recommends that Zimbabwe come up with thresholds for the preparation of transfer pricing documentation for domestic transactions which is practised by countries such as South Africa, and thresholds for the domestic companies that should comply with the transfer pricing provisions. Such a regime is best known as a safe harbour, whereby the SMEs will have specific provisions that are meant to relieve them from the general rules. Improved regulation of domestic SMEs promotes SME growth and survival which translates to economic growth and enhanced national competitiveness. While it is consistent with principles of taxation to ensure that every taxpayer pays his fair share of tax, the consequences of domestic TP on SMEs cannot be overlooked. The requirements are not only burdensome to the SMEs but to the tax authority as well since the revenue collected may not be proportionate with the related enforcement costs such as TP audits. Asking SMEs to determine accurately the arm's length price when the costs associated with that exceed the revenue anticipated will not make economic sense. Sebele-Mpofu, Mashiri, and Warima (2022) describe TP as a thorny area that cannot be ignored especially in the context of legislative and administrative capacities.

Even though auditing is based on estimations and sampling, ZIMRA should broaden the scope of their TP audits, and then restrict it to management services. Whilst it is not always appropriate to invent your own wheel, ZIMRA's TP returns should be tailor-made to suit the Zimbabwean tax needs. Another intriguing finding was not

only the rudimentary TP knowledge of SMEs but of ZIMRA officers as well, implying weak enforcement and possible revenue leakages. The study recommends tax education (TP) for both the taxman (ZIMRA) and the taxpayer (SMEs).

TCs are also encouraged to revise their pricing models and segment their market, taking into consideration the size of other taxpayers such as SMEs.

This study only employed a qualitative approach hence it could suffer from the inherent limitations of qualitative inquiries, and therefore future studies could employ quantitative or mixed methods. The magnitude of the contribution of SMEs to tax revenue has received mixed views, therefore, future studies can attempt to quantify this contribution and the impact of domestic TP on revenue flows in Zimbabwe.

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Appendix 1

SMEs Questionnaire

1. Do you know about transfer pricing rules in Zimbabwe?
.....

...

2. What is your view given that the rules extend to domestic transactions?
.....

3. Indicate the purpose for which you hire the services of tax professionals

| | |
|------------------|--|
| All tax affairs | |
| TP documentation | |
| TP methods | |
| Do not hire | |

4. Is transfer pricing abuse possible among companies within the same country?
.....

If so explain how.....

5. Comment on what domestic transfer pricing means for Zimbabwean local firms.
.....

Do you think the extension of transfer pricing rules to domestic firms including SMEs is justified?
.....

How are you complying with the transfer pricing rules?
.....

What challenges are you facing in trying to comply with the pricing regulation rules?
.....

6. Have you received any training from ZIMRA on how to comply with the transfer pricing rules?
.....

7. Has ZIMRA aggressively enforcing the transfer pricing rules?
.....

8. How have the new transfer pricing rules affected you as an entity?
.....
.....

9. What are your suggestions to improve transfer pricing in Zimbabwe?
.....
.....

Appendix 2

ZIMRA/ TC Interview Guide

1. Do you know about transfer pricing rules in Zimbabwe?
2. What is your view given that the rules extend to domestic transactions?
3. Have you ever rendered tax consultants services pertaining transfer pricing to SMEs?
4. Is TP abuse possible among companies within the same country?
5. What is your view regarding the domestic transfer pricing rules in Zimbabwe?
6. Do you think the extension of TP rules to domestic firms including SMEs is justified?
7. What challenges are faced by local firms in complying with the TP rules?
8. Has ZIMRA rendered any training services to local firms on how to comply with the transfer pricing rules?
9. In your view, does ZIMRA have sufficient capacity to enforce the new TP rules?
10. How have the new TP rules affected local firms, especially SMEs?
11. What are your suggestions to improve TP regulation in Zimbabwe?