MINISTRY OF FINANCE

A DIRECTIVE TO PROVIDE RULES ON TRANSFER PRICING
Directive No. 981/2024

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January 2024

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A DIRECTIVE TO PROVIDE RULES ON TRANSFER PRICING

WHEREAS, the Federal Income Tax Proclamation provides that the distributions, apportions or allocations between the parties to the transactions that is not in an arm's length transaction; to reflect the income, gains, deductions, losses or tax credits that would have been realized in an arm's length transactions shall be made in accordance with the Directives to be issued by the Ministry of Finance;

WHEREAS, comprehensive and sufficient transfer pricing rules are needed to facilitate the proper implementation of the arm's length principle based on international best practices and guidance particularly the OECD Transfer Pricing Guidelines;

NOW, Therefore, pursuant to the power granted to the Ministry of Finance by way of Art. 79 (2) and (4) of the Federal Income Tax Proclamation, this directive is issued as follows:

PART ONE

GENERAL

1. Short Title

This directive may be cited as a "Directive to provide Rules on Transfer Pricing No. 981/2024"

2. Definitions

Unless the context otherwise requires, the following terms shall have the meaning ascribed to them hereunder:

1/ **"Comparable transactions"** shall mean transactions that are comparable in accordance with Article 5 of this Directive;

2/ **"Controlled transaction"** shall mean any transaction between related persons;

3/ **"Domestic transaction"** shall mean any transaction within Ethiopia made between taxpayers;

4/ **"Functional analysis"** shall mean an analysis of the functions undertaken by each person with respect to transactions, taking into account assets used and risk assumed

5/ **“Income Tax Proclamation”** shall mean the Federal Income tax Proclamation no 979/2016;

6/ **“International transaction”** shall mean any transaction between a taxpayer and a non-resident

7/ “**Non-resident**” shall mean a person who is not a resident in Ethiopia.

8/ **“Person"** shall mean any individual, body, government, local government or international organization as defined in Article 2(26) of the Tax Administration Proclamation No.983/2016.

9/ **“Related persons”** shall have the meaning under Article 4 of the Tax Administration Proclamation No.983/2016;

10/ **“Resident”** shall have the meaning under Article 5 of the Income Tax Proclamation

11/ **“Tax Authority”** shall mean the federal or regional tax authority

12/ **“Taxpayer”** shall have the meaning under Article 2(22) of the Federal Income Tax Proclamation

13/ **“Tested party”** shall mean the party to the controlled transaction for which the financial indicator is tested under the resale price method, cost plus method or transactional net margin method, as applicable.

14/ **“Transaction”** shall mean:

(a) The purchase and sale of goods;
(b) The purchase, sale, lease, or use of a tangible asset including capital goods;
(c) The purchase, sale, lease, or use of an intangible asset;
(d) The provision of services;
(e) The provision of finance and other financial arrangements;
(f) Any other transaction or series of transactions, dealing or arrangement written or unwritten or any kind whatsoever, directly or indirectly between Related Persons, which may affect the taxable income of the taxpayer

15/ **“Uncontrolled transaction”** shall mean any transaction between unrelated persons.

3. <u>Scope of Application</u>

This directive is applicable for the application of Article 79(2) (4) of the Federal Income Tax Proclamation which concerns the pricing of international and domestic transactions between related persons whose annual turnover is over Birr 500,000.

4. The Arm`s Length Principle

1/ Where a taxpayer engages in a transaction with a related person, the taxpayer shall determine the amount of its taxable income in a manner that is consistent with the arm`s length principle.

2/ The amount of taxable income indicated in sub-article 1 of this article shall be consistent with the arm`s length principle if the conditions of those transactions do not differ from the conditions that would have applied between unrelated persons in comparable transactions carried out under comparable circumstances.

3/ The determination of whether conditions of controlled transactions are consistent with the arm's length principle and the quantum of any adjustment made shall be made in accordance with the Articles of this Directive.

5. Comparability

1/ An uncontrolled transaction is comparable to a controlled transaction where:

a) there are no significant differences between them that would materially affect the financial indicator being examined under the appropriate transfer pricing method; or

b) where such differences exist, if a reasonably accurate comparability adjustment is made to the relevant financial indicator of the uncontrolled transaction in order to eliminate the effects of such differences on the comparison.

2/ To determine whether two or more transactions are comparable, the following factors shall be considered to the extent that they are economically relevant to the facts and circumstances of the transactions:

a) The characteristics of the property or services;
b) The functions undertaken by each person with respect to transactions, taking into account assets used and risk assumed;
c) The contractual terms and conditions of the transactions;
d) The economic and market circumstances in which the transactions take place; and
e) The business strategies pursued by the parties to the transactions.

3/ For the purposes of sub-article 1(b) of this Article comparability adjustments should be considered only if they are expected to increase the reliability of the results, taking into account:

a) the materiality of the difference for which the adjustment is being considered;
b) the quality of the data subject to adjustment;
c) the purpose of the adjustment; and

d) the reliability of the approach used to make the adjustment.

6. Transfer Pricing Methods

1/ For the purposes of this Directive, the following transfer pricing methods are 'approved transfer pricing methods':

a) **Comparable Uncontrolled Price Method** which consists of comparing the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction.

b) **Resale Price Method** which consists of comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in an uncontrolled transaction on with the resale margin that is earned in comparable uncontrolled purchase and resale transactions.

c) **Cost Plus Method** which consists of comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction.

d) **Transactional Net Margin Method** which consists of comparing the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that one party to the transaction (the tested party) achieves in a controlled transaction with the net profit margin relative to the same base achieved in one or more comparable uncontrolled transactions.

e) **Transactional Profit Split Method** which consists of allocating to each related person participating in a controlled transaction the portion of common profit (or loss) derived from such transaction that an unrelated person would expect to earn from engaging in a comparable uncontrolled transaction.

2/ When it is possible to determine an arm's length price for some of the functions performed by one or both of the related persons in connection with the transaction using one of the approved methods described in sub-articles 2 (a) to (d), the transactional profit split method shall be applied based on the common residual profit (or loss) that results once such functions are so remunerated. In allocating profit (or loss) in accordance with this paragraph, the criteria to be used to achieve an allocation consistent with the arms' length principle will depend on the facts and circumstances of the case, taking into account that the criteria (or allocation key) should be based on objective data (e.g. sales to independent parties or expenses paid to independent parties) and not data relating to controlled transactions.

3/ Notwithstanding sub-article 1 of this article, a taxpayer may use a transfer pricing method other than one of the approved methods contained in sub-article 1 of this article where it is demonstrated that none of the approved methods can be reasonably applied to determine the arm's length conditions for the controlled transactions and such other method produces a result that is consistent with the arm's length principle.

7. Selection of Transfer Pricing Method

1/ Consistency of the conditions of a controlled transaction with the arm's length principle shall be determined by applying the most appropriate transfer pricing method to the facts and circumstances of the case.

2/ The most appropriate transfer pricing method shall be selected from among the approved transfer pricing method set out in Article 6 (1) of this Directive, taking into consideration the following criteria:

a) The respective strengths and weaknesses of the approved methods;

b) The appropriateness of an approved method in view of the nature of the controlled transaction, determined in particular through an analysis of the functions undertaken by each party in relation to the controlled transaction (taking into account functions performed, assets used or contributed and risks undertaken);

c) The availability of reliable information needed to apply the selected transfer pricing method and/or methods, and

d) The degree of comparability between the controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.

3/ Where, taking account of the criteria described in sub-article 2 of this Article, the method described in sub-article 1(a) of Article 6 and one of the methods described in sub-article 1 (b) to © of Article 6 can be applied with equal reliability, the method described in sub-article 1(a) of Article 6 shall be applied. Where, taking account of the criteria described in sub-article 2 of this Article, one of the methods described in sub-article 1 (b) to (c) of Article 6 and one of the methods described in sub-article 1 (d) to © of Article 6 can be applied with equal reliability, the method described in s sub-article 1 (b) to (c) of Article 6 shall be applied.

4/ It is not necessary to apply more than one method to determine whether the conditions of a given controlled transaction are consistent with the arm's length principle.

5/ Where a taxpayer has used an approved transfer pricing method and the selection of that method is consistent with this article, the examination by the Tax Authority of whether the conditions of the taxpayer's controlled transactions are consistent with the arm's length principle shall be based on that transfer pricing method applied by the taxpayer, unless it is proven by the tax authority that the method applied by the taxpayer is not the most appropriate method.

8. <u>Selection of Tested Party</u>

The selection of the tested party, when applying a cost plus, resale price or transactional net margin method (as described in Article 6 of this Directive, should be consistent with the functional analysis of the transaction(s).

9. <u>Evaluation of Combined Controlled Transactions</u>

If a taxpayer carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or that form a continuum such that they cannot reliably be analyzed separately, those transactions may be combined to perform the comparability analysis provided in Art.5 of this Directive and apply the transfer pricing methods set out in Art.6 of this Directive.

10. <u>Arm's Length Range</u>

1/ An arm's length range is a range of relevant financial indicator figures (e.g. prices, margins or profit shares) produced by the application of the most appropriate transfer pricing method (as per Art. 7 of this Directive) to a number of uncontrolled transactions, each of which is reliable and relatively equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with Art. 5 of this Directive.

2/ A controlled transaction, or as set of transactions that are combined according to Art. 9 of this Directive, shall not be subject to an adjustment under Article 79 of the Federal Income Tax Proclamation where the relevant financial indicator derived from the controlled transaction, or set of transactions, and being tested under the appropriate transfer pricing method is within the arm's length range.

3/ Where the relevant financial indicator derived from a controlled transaction, or from a set of transactions that are combined according to Art. 9 of this Directive, falls outside the arm's length range, the Tax Authority may make an adjustment to the taxable income of the taxpayer pursuant to Article 79(1) of the Federal Income Tax Proclamation. The basis for such an adjustment shall be the median of the arm's length range, unless either the taxpayer or the tax authority demonstrates that adjustment to another point in the range is more appropriate.

4/ For the purposes of sub-article 3, the median of the arm's length range shall be the 50th percentile of the financial indicator figures derived from the comparable uncontrolled transactions forming the arm's length range. For this purpose, the 50th percentile is the lowest financial indicator figure such that at least 50 percent of the financial indicator figures are at or below the value of that figure. However, if exactly 50 percent of the results are at or below a financial indicator figure, then the 50th percentile is equal to the arithmetic mean of that figure and the next highest figure.

5/ Pursuant to Article 79(1) of the Federal Income Tax Proclamation, but subject to the application of Articles 15 and 16 of this Directive, adjustments under sub-article 3 shall only be made whereby the net effect is an increase in the taxpayer's taxable income.

11. <u>Sources of Information on Comparable Uncontrolled Transactions</u>

1/ Possible sources of information on comparable uncontrolled transactions may include:

a) internal uncontrolled transactions, which are uncontrolled transactions where one of the parties to the controlled transaction is also a party to the uncontrolled transaction

b) external uncontrolled transactions, which are uncontrolled transactions to which neither of the parties to the controlled transaction is a party.

2/ Information concerning a comparable external uncontrolled transaction may not be relied upon by the Tax Authority for the purposes of making an adjustment under Article 79 of the Federal Income Tax Proclamation if the information concerning the transaction is not available to the taxpayer.

3/ Information concerning a comparable uncontrolled transaction may not be relied upon by the taxpayer for the purposes of demonstrating the consistency of a transaction with Article 79 of the Federal Income Tax Proclamation if the information on the transaction is not made available to the Tax Authority by the taxpayer.

4/ In the absence of information on uncontrolled transactions from the same geographic market (i.e. country or region) as the controlled transaction, comparable uncontrolled transactions from other geographic markets may be accepted by the Tax Authority. A determination of whether comparables from other geographic markets are reliable has to be made on a case-by-case basis, and by reference to the extent to which they satisfy Article 5 of this Directive as well as the extent to which alternative sources of comparability data are available. Taxpayers using such comparables would be expected as far as possible to assess the expected impact of geographic differences and other factors on the price and profitability.

12. <u>Advance Pricing Arrangements</u>

1/ Without prejudice to Art. 79(2) of the Federal Income Tax Proclamation, a taxpayer may request the Tax Authority to enter into an advance pricing arrangement to determine appropriate set of criteria for the determination of the arm's length conditions for certain future controlled transactions over a fixed period of time. The commencement date of this sub-article shall be fixed by a circular of the Ministry of Finance.

2/ The taxpayer's request for an advance pricing arrangements shall be accompanied by:

a) a description of the taxpayer's activity, of its controlled transactions, and of the proposed scope and duration of the determination;

b) a proposal by the taxpayer, based on the arm`s length principle under Article 4 of this Directive shall describe the comparability factors that are regarded as significant to the circumstances of the case in accordance with Art.5, the selection of the most appropriate transfer pricing method to the circumstances of the case in accordance with Art.6 of this directive, and critical assumptions as to future events under which the determination is proposed;

c) An identification of any other country or countries the taxpayer wishes to participate in the arrangements; and

d) Any other information the Tax Authority may prescribe.

3/ The Tax Authority will consider the request of the taxpayer and make a decision whether or not to proceed with it taking account of the taxpayer's compliance with this article and of the expected benefits from an advance pricing arrangement in the circumstances of the case. The Tax Authority may reject the taxpayer's request to enter into an advance pricing arrangement where the Tax Authority has sufficient reasons to do so.

4/ The Tax Authority may agree to enter into such an arrangement alone or in consultation with the competent authorities of the country(ies) of the related person(s) identified by the taxpayer.

5/ Where the Tax Authority approves the taxpayer's proposal or changes it with the taxpayer's consent, it shall formalize the determination in an advance pricing arrangement that will provide confirmation to the taxpayer that no transfer pricing adjustment will be made under Art.4 (2) of this directive to controlled transactions that are within the scope of the arrangement as long as the taxpayer follows the terms of the arrangement.

6/ An advance pricing arrangement shall have effect with respect to the controlled transactions specified therein that are carried out subsequent to the date on which it is approved and shall be valid during the tax periods indicated in the arrangement itself, which may not extend beyond five tax periods beginning after the date on which the arrangement is approved. In addition, the parties to the

arrangement may determine that the effects of the agreement will apply to transactions during the tax period in progress at the time the request is presented, or to tax periods prior to the period in progress at the tax period in progress at the time the request is presented.

7/ Notwithstanding the preceding provisions of this article, the Tax Authority:

a) may revoke the advance pricing agreement, with retroactive effect, where it is established that there was a misrepresentation, mistake or omission that was attributable to the neglect or willful default of the taxpayer, or that the taxpayer failed to materially comply with fundamental terms and conditions of the arrangement.

b) may cancel an advance pricing arrangement for the remaining duration of the arrangement if it is established that there was a misrepresentation, mistake or omission that was not attributable to the neglect or willful default of the taxpayer, or that the taxpayer failed to materially comply with a fundamental term or condition of the arrangement, or that there was a material breach of one or more of the critical assumption, or that there was a change in tax law materially relevant to the arrangement.

8/ The Tax Authority shall insure the confidentiality of trade secrets and other sensitive information and documentation submitted to it in the course of an advance pricing arrangement proceeding.

PART TWO

APPLICATION TO SPECIFIC TRANSACTIONS

13. Services Transactions

1/ For the purpose of this Directive, ‘service’ includes, but is not limited to, any rights, benefits, privileges, or facilities that are, or to be, provided, granted, or conferred under an arrangement for or in relation to any work and assistance including financial assistance.

2/ Without prejudice to the other articles of this Directive, a service charge between related persons shall be considered consistent with the arm’s length principle where:

a) it is charged for a service that is actually rendered;

b) the service provides, or when rendered was expected to provide, the recipient with economic or commercial value to enhance its commercial position;

c) it is charged for a service that an unrelated person in comparable circumstances would have been willing to pay for if performed for it by an unrelated person or would have performed in-house for itself, and

d) its amount corresponds to that which would have been agreed between unrelated persons for comparable services in comparable circumstances.

3/ A service charge made to a person shall not be consistent with the arm’s length principle where it is made by a related person solely because of the shareholder’s ownership interest in one or more other group members, including, but not limited to, for any of the following costs incurred or activities undertaken by such a related person:

a) Costs or activities relating to the juridical structure of the parent company of the first-mentioned person, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the parent company’s supervisory board;

b) Costs or activities relating to reporting requirements of the parent company of the first –mentioned enterprise, including the consolidation of reports; and

c) Costs or activities related to raising funds for the acquisition of participation in members of the group of related person, unless those members are directly or indirectly acquired by the first-mentioned person and the acquisition of benefits or is expected to benefits that first-mentioned person.

4/ Where it is possible to identify specific services provided by a person to a related person, the determination whether the service charge is consistent with the arm's length principle shall be made for each specific service, subject to the provisions of Article 9 of this Directive.

5/ Where services are rendered by a person jointly to various related persons and it is not possible to identify specific services provided to each of them, the total service charge shall be allocated among the related persons that benefit or expect benefit from the services according to one or more reasonable allocation keys, that:

a) take into account the nature of the services, the circumstances under which they are provided;

b) reasonably approximate the benefits obtained or that were expected to be obtained by the parties for which the services are intended;

c) relate exclusively to uncontrolled, rather than controlled, are based exclusively on uncontrolled transactions; and

d) are capable of being measured in a reasonably reliable manner.

14. Transactions Involving Intangible Property

1/ For the purposes of this Directive, transactions involving intangible property shall include, but be not limited to, licenses, sales and any other transfer, arrangement concerning or provision of intangible properties such as patents, copyright, formula, process, design, model, plan, trade secret, know-how, trademark and the like.

2/ Determination of whether conditions in controlled transactions involving intangible property are consistent with the arm's length principle shall take into account the perspectives of both parties to the transaction, including, in particular, the pricing that unrelated persons, in similar circumstances, would be willing to accept.

3/ In applying the provisions of Article 5 of this Directive to a transaction involving the transfer of intangible property, consideration shall be given to any special factors relevant to the comparability of the controlled and uncontrolled transactions, including, but not limited to:

a) the expected benefits from the intangible property;

b) any geographical limitations on the exercise of rights to the intangible property;

c) the exclusive or non-exclusive character of the rights transferred; and

d) whether the transferee has the right to participate in further development of the intangible property by the transferor.

PART THREE

DOCUMENTATION

15. Transfer Pricing Documentation

1/ A taxpayer must have in place contemporaneous documentation that verifies that the conditions in its controlled transactions for the relevant tax year are consistent with the arm's length principle.

2/ Documentation which shall be maintained in accordance with sub-article 1 of this Article include:

a) an overview of the taxpayer's business operations (history, recent evolution and general overview of the relevant markets of reference) and organizational chart (details of business units/departments and organizational structure);

b) a description of the corporate organizational structure of the group that the taxpayer is a member (including details of all group members, their legal form, and their shareholding percentages) and the group's operational structure (including a general description of the role that each of the group members carries out with respect to the group's activities, as relevant to the controlled transaction(s));

c) a description of the controlled transaction(s), including analysis of the comparability factors specified in Article 5 of this Directive;

d) explanation of the selection of most appropriate transfer pricing method(s), and, where relevant, the selection of the tested party and the financial indicator;

e) comparability analysis, including: description of the process undertaken to identify comparable uncontrolled transactions; explanation of the basis for the rejection of any potential internal comparable uncontrolled transactions (where applicable); description of the comparable uncontrolled transactions;

taking into account Article 5 of this directive analysis of comparability of the controlled transaction(s) and the comparable uncontrolled transactions; and, details and explanation of any comparability adjustments made;

f) detail of any industry analysis, economic analysis, budgets or projections relied on;

g) details of any advance pricing agreements or similar arrangements in other countries that are applicable to the controlled transactions;

h) a conclusion as to consistency of the conditions of the controlled transactions with the arm's length principle, including details of any adjustment made to ensure compliance; and

i) any other information that may have a material impact on the determination of the taxpayer's compliance with the arm's length principle with respect to the controlled transactions.

3/ Documentation may be submitted in Amharic or English language.

4/ **D**ocumentation for a relevant tax year is considered to be contemporaneous where it is in place at the statutory tax return's filing date.

5/ Documentation shall be provided to the Tax Authority within 45 days of the written request being duly issued by the Tax Authority.

6/ The obligation of the taxpayer to provide this documentation is established without prejudice to the power of the Tax Authority to request additional information that in the course of audit procedures it deems necessary in order to carry out its functions.

PART FOUR

ADMINISTRATIVE PROCEDURES

16. Corresponding Adjustments for Domestic Transactions

Where an adjustment is made by the Tax Authority under article 79(1) of the Federal Income Tax Proclamation to the taxable income of a taxpayer in relation to domestic transaction, then, the Tax Authority shall make an appropriate adjustment to the taxable income of the other party to the transaction.

17. Corresponding Adjustments for International Transactions

1/ Where:

a) an adjustment to the conditions of a controlled transaction is made by a tax administration of another country;

b) this adjustment results in the taxation in that other country of an amount of profits on which the party to the controlled transaction is a taxpayer in Ethiopia and has already been charged to tax in Ethiopia; and

c) the country proposing the adjustment has a treaty with Ethiopia that reflects an intention to provide for the relief of economic double taxation;

Then, the Tax Authority, after a request is made by the taxpayer in Ethiopia, shall examine the consistency of that adjustment with the arm's length principle. If the Tax Authority concludes that the adjustment is consistent with the arm's length principle both in principle and as regards the amount, it shall make an appropriate adjustment to the amount of the tax charged to that taxpayer on those profits.

2/ A request under sub-article 1 of this Article must include the information necessary for the Tax Authority to examine the consistency of the adjustment made by the tax administration of the other country with the arm's length principle, including:

a) the name, registered address and, where applicable, trading name(s) of the related person;

b) evidence of the tax residence of the related person;

c) the year(s) in which the adjusted controlled transaction(s) took place;

d) the amount of the requested corresponding adjustment and the amounts of the adjustment made by the tax administration of the other country;

e) evidence of the adjustment made by the tax administration of the other country and the basis for the adjustment, including details of comparability analysis relied upon and the transfer pricing method applied;

f) confirmation that the related person party will not, or is unable to, pursue any further recourse under the domestic law of the other country that may result in the adjustment made by the tax administration of the other country being reduced or reversed;

g) any other information that may be relevant for examining the consistency of the adjustment with the arm’s length principle.

3/ The request must be made within the applicable time period for making a request for the case to be resolved by way of mutual agreement procedure under the applicable tax treaty.

18. Relevance of the OECD Transfer Pricing Guidelines

The Organization for Economic Cooperation and Development (OECD) “Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” are a relevant source of interpretation for this Directive, however, in case of any differences or conflicts with the Federal Income Tax Proclamation and this Directive, the Federal Income Tax Proclamation and this Directive will take precedence.

19. Administrative Penalties

A taxpayer who fails to maintain documents listed under Article 15 of this Directive or fails to submit such documents when requested by the Tax Authority shall be liable to a penalty provided under Article 102 of the Tax Administration Proclamation No. 983/2016.

20. Repealed and Inapplicable Directives

1/ The Transfer Pricing Rules Directive No 231/2021 is hereby repealed.

2/ Any directive or any provision of a directive, which is inconsistent with this directive, shall be inapplicable on matters covered under this directive.

21. Effective Date

This Directive shall be effective from the date of its registration on minisetry of justice and uploading to the website of the Ministry of Finance.

Addis Ababa
January 2024

Ahmed Shide
Minister of Finance