Analysis of Factors Leading to the Rejection of Transfer Pricing Policies of Multinational Companies in Morocco: The Case of Alpha Company

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Abstract

Transfer pricing has been of interest to many countries for decades, as it is considered an efficient way to transfer profits. As an international economic actor, Morocco takes on this challenge by regularly auditing the transfer pricing policies of multinationals operating within its borders. The objective of this article is to analyze and explore the factors that led to the rejection of the transfer pricing policy of the company ALPHA, based in Morocco. Following an interpretivist epistemological paradigm and employing inductive reasoning, we conducted a purely exploratory study. Through non-directive interviews, we identified four factors likely to explain this rejection: the company's internal practices, the completeness of the documentation provided to the tax authorities, the prevailing transfer pricing legislation, and finally, the tax audit methodology followed. It was found that the latter two factors played a significant role in the rejection of the transfer pricing policy.

Keywords: transfer pricing policy; tax audit; profit transfer;

Résumé

Les prix de transfert suscitent l'intérêt de plusieurs États depuis des décennies, étant considérés comme un moyen efficace de transfert de bénéfices. En tant qu'acteur économique international, le Maroc relève ce défi en effectuant des vérifications régulières des politiques de prix de transfert des multinationales implantées sur son territoire. L'objectif de cet article est d'analyser et d'explorer les facteurs ayant conduit au rejet de la politique de prix de transfert de l'entreprise ALPHA, basée au Maroc. En suivant un paradigme épistémologique interprétativiste et un raisonnement inductif, nous avons mené une étude purement exploratoire. À travers des entretiens non directifs, nous avons pu identifier quatre facteurs susceptibles d'expliquer ce rejet : les pratiques internes de l'entreprise, l'exhaustivité de la documentation fournie à l'administration fiscale, la législation en vigueur en matière de prix de transfert, et

enfin, la méthodologie de vérification fiscale suivie. Il s'est avéré que ces deux derniers facteurs ont joué un rôle significatif dans le rejet de la politique de prix de transfert.

Mots-clés : Politique de prix de transfert ; vérification fiscale ; transfert de bénéfices ;

INTRODUCTION

Global trade has increased by 7.8 times since 1980, primarily due to globalization, technological advancements, trade liberalization, and the rise of global supply chains. This exceptional growth has enabled businesses, especially multinational corporations, to expand their operations internationally. However, this expansion has raised crucial questions regarding international taxation, particularly concerning transfer pricing. These prices, defined by the OECD as the rates at which a company transfers tangible goods, intangible assets, or provides services to associated enterprises, enable profits to be shifted from companies located in high-tax countries to other affiliates established in more advantageous tax jurisdictions. To counter such transfers, governments, through their tax administrations, seek to ensure that cross-border transactions of companies within their territories reflect arm's length prices, corresponding to the prices charged between independent enterprises under similar circumstances. With this in mind, these tax authorities carry out regular controls to prevent profit manipulation. Morocco is also committed to this approach, in accordance with Article 213 of the General Tax Code, which gives the Moroccan tax authorities the power to reject transfer pricing policies and rectify the tax base of multinationals in the event of a profit transfer being discovered. 2 In this context, it is essential to understand the factors that may lead to the rejection of transfer pricing policies of multinational corporations established in Morocco. This article focuses on exploring the reasons behind the rejection of the transfer pricing policy of company ALPHA, based in Morocco, during the last tax audit conducted in 2021. From this issue arises the following research question:

- What are the factors that led to the rejection of company ALPHA's transfer pricing policy?

In order to facilitate the answer to this problem and identify the factors that contributed to the rejection of ALPHA's transfer pricing policy, it is crucial to formulate the following questions:

- What factors may lead to the rejection of company ALPHA's transfer pricing policy?
- How did each factor contribute to the rejection of company ALPHA's transfer pricing policy, and why did some factors not result in its rejection?

In order to answer these questions, we will begin by presenting a literature review of works on transfer pricing issues. We will then describe and justify the research methodology we followed to arrive at the results we will discuss in the following section. Finally, we will set out the recommendations formulated at the end of this work, as well as suggestions for future research.

1. LITERATURE REVIEW

Transfer pricing is a crucial element in the tax management of multinational companies, as it determines the allocation of profits between different corporate entities, often located in separate tax jurisdictions. This literature review aims to explore existing research on transfer pricing, focusing on several key aspects. It examines studies on tax avoidance, factors contributing to non-compliance and ineffective tax audits of multinational enterprises, and the importance of providing appropriate documentation in this area.

A transfer price is the amount charged by one division, called the transferring division, to another division, called the receiving division, within the same organization. This transaction generates income for the selling division and constitutes a cost for the buying division (TERZIOGLU & INGLIS, 2011). In the same vein, (ARNOLD & MCINTYRE, 2002) assert that the transfer price is the price set by the taxpayer when selling, buying or sharing resources with affiliated companies. (MATEI & PÎRVU, 2011) point out that transfer pricing is determined within the decisionmaking structures of transnational corporations, thus playing several roles, including reducing corporate tax payments and facilitating the transfer of income from countries imposing restrictions or prohibitions on profit repatriation.

In this context, several authors have examined transfer pricing as an effective means of profit transfer. A study by (OVERESCH, 2006) on a sample of German multinationals revealed a significantly negative impact of the tax rate on intra-firm sales, highlighting the use of transfer pricing to shift profits. Furthermore, (CHOI, FURUSAWA, & ISHIKAWA, 2020) point out that transfer pricing aims to minimize taxes by shifting profits to the most advantageous tax jurisdictions. Similarly, (VICARD, 2015) estimates that profit shifting via transfer pricing reduced the tax base of French companies by 8 billion USD in 2008, while (WEICHENRIEDER, 2009) demonstrates that multinational companies tend to shift profits to their subsidiaries in Germany when tax rates in their home country are higher than in Germany. In South Africa, (WIER, 2020) observes that multinational companies manipulate transfer prices to shift taxable profits to low-tax countries.

These studies highlight the tendency of companies to minimize their tax liabilities by manipulating their internal transfer pricing practices. However, according to (KLASSEN, LISOWSKY, & MESCALL, 2017), many companies prioritize tax compliance. Indeed, multinationals seek to justify their transfer pricing policies by providing tax authorities with comprehensive documentation. This documentation is useful for both tax authorities and entities, as highlighted by (MARCUTA, POPESCU, & MARCUTA, 2021). The importance of such documentation has been corroborated by the research of (LOHSE & RIEDEL, 2013), which demonstrated that profit-shifting activities by multinationals are significantly reduced when countries introduce or strengthen transfer pricing documentation requirements. Their results suggest that transfer pricing legislation can reduce revenue shifting behavior by more than 50%. Furthermore, (KOROL, NYKYFORUK, PELEKH, BARABASH, & ROMASHKO,

2022) have justified the role of transfer pricing documentation quality in the context of globalization and regional tax burden optimization.

However, it is important to point out that the complexity of legislation can present a challenge to this practice and its purpose. A study carried out by (COX & EGER III, 2006) on the fuel taxation system revealed that the complexity of the tax system can deter taxpayers from complying with their tax obligations, even if they have no intention of evading tax. On the other hand, (HOFFMAN, 1961) highlighted that gaps in tax jurisdictions reflect the complexity of the law, opening the door to different interpretations. Furthermore, research by (RICHARDSON, 2006), based on an analysis of 45 countries, has shown that complexity is the main factor contributing to tax evasion and non-compliance. Moreover, according to (KABALA & NDULO, 2018), in many African countries, transfer pricing legislative frameworks are often incomplete or ill-defined. This complicates the application of the law by taxpayers.

On the other hand, the complexity and lack of clarity of the legislative framework have been identified among the factors affecting the effectiveness of transfer pricing audits and dispute resolution in developing countries (SEBELE-MPOFU, MASHIRI, & KORERA, 2021). Indeed, Tax auditing of multinational enterprises is not straightforward and requires careful considerations, including a clear understanding of the company's organization, including its commercial and economic reality as well as the functions essential to generate profits (SHONGWE, 2019). In this respect, a clear legislative framework is paramount to properly conduct these audits, especially since, the absence of explicit formal transfer pricing rules allows companies to use these mechanisms to manipulate transfer prices in order to avoid paying taxes (BEEBEEJAUN, 2019).

The research examined in this review highlights the crucial importance of transfer pricing in today's economic landscape, where companies seek to manipulate transfer prices to maximize profits. They also highlight the challenges faced by companies in this area, notably the complexity of tax legislation and the lack of an appropriate legislative framework in certain countries, which can hamper tax compliance and consequently lead to the rejection of transfer pricing policies. With this in mind, the aim of this article is to explore the factors contributing to the rejection of transfer pricing policies by multinationals in Morocco, focusing on the specific case of ALPHA.

2. RESEARCH METHODOLOGY

The most appropriate epistemological perspective for our study is interpretivism, and this choice is motivated by several fundamental considerations. Firstly, the literature review revealed a lack of theories or studies on transfer pricing, particularly regarding the factors leading to the rejection of transfer pricing policies, in the specific context of Morocco. Secondly, the ontological assumption of this paradigm (the relativism of constructed realities) (GUBA & LINCOLN, 1994) is suited to the situation of the multinational under study, 4 operating in a specific context. Therefore, our study is specific to this particular context and cannot be generalized. Thirdly, the subject-object interaction, as stated by this paradigm, implies a more active and subjective role of the researcher in the study compared to the positivist researcher, who deliberately detaches from the research question (DAVID, 1999). In an interpretivist perspective, a double subjectivity is envisaged, involving both the researcher and the actors concerned.

By adopting an interpretivist epistemological perspective, we have consciously chosen an exploratory research approach, in the literary sense of the term. Our main objective is to demystify the factors that may explain the rejection of company ALPHA's transfer pricing policy. Our literature research did not reveal specific theories on this subject. Consequently, we decided to carry out an in-depth exploratory study focusing on a concrete case of transfer pricing policy rejection. The purpose of this approach is to identify the truly determinant factors and gain a thorough understanding of their contribution to the rejection. This approach aims to fill the theoretical gap in this area, hence the choice of an inductive approach, starting with on-the ground exploration of factors that may explain the rejection of transfer pricing policies and then formulating contextual theories based on the results we will obtain. The objective of this research is therefore to contribute to enriching existing knowledge regarding the understanding of factors influencing the rejection of transfer pricing policies in Morocco.

In this framework, we employed several qualitative methods. Firstly, an in-depth analysis of internal documents, Moroccan laws, and international standards was conducted to identify possible causes of rejection and gain a thorough understanding of these elements. Next, three non-directive interviews were conducted: the first with the chief accountant responsible for company ALPHA's transfer pricing policy. This interview aimed to understand how the company determines its transfer pricing policy, verification procedures, its scope, and other relevant aspects. The second interview, conducted with two tax auditors, aimed to uncover the actual factors leading to the rejection of the transfer pricing policy while identifying areas for improvement. Finally, an in-depth case study was undertaken to examine in detail the operations, processes, and decisions related to the transfer pricing policy within the company. This study allowed us to gain a thorough understanding of the contribution of each identified factor in the rejection of ALPHA's transfer pricing policy.

It is important to note that this article does not claim to be exhaustive. Indeed, our study focused on the case of a single company and a single tax audit. Other cases and audits could lead to different results, hence the importance of further exploratory studies involving several 5 Moroccan companies. This would make it possible to identify more general trends concerning the factors driving the rejection of transfer pricing policies in the Moroccan context.

Results and Discussion:

In our search for factors explaining the rejection of ALPHA's transfer pricing policy, we relied on non-directive interviews. By analyzing them, we were able to identify four main factors. The first is related to ALPHA's internal transfer practices. The second concerns the completeness of documentation. The third factor pertains to Moroccan transfer pricing legislation, and the last factor is associated with the tax audit approach followed.

It is important to note that, to increase the credibility of our study, we considered using NVIVO software. However, our interviewees did not give their consent to be recorded, which prevented us from transcribing their words in full. We therefore wrote a synthesis of what we understood, which could imply a certain subjectivity in the results.

- **Factor 1: ALPHA's internal transfer pricing practices**

A company's internal transfer pricing practices can significantly influence the acceptance or rejection of its policy. Failure to adhere to transfer pricing principles aligned with international standards and Moroccan legislation may result in rejection. In an effort to comply with the arm's length principle, the company sought to align its practices with OECD guidelines, as the General Tax Code lacks explicit provisions for this principle. To develop its transfer pricing policy, the company carried out a functional analysis, accompanied by an analysis of the characteristics of the goods or services transferred, ALPHA's economic circumstances and the market in which it operates, and an analysis of the economic strategies pursued. These analyses should have encompassed all parties involved in controlled transactions (OCDE, 2022). Cela aurait permis de délimiter avec succès ces transactions et de choisir la partie testée pour laquelle des comparables auraient été recherchés en vue de comparer les transactions contrôlées. Ce processus aurait également permis d'identifier les facteurs de comparabilité servant de base à la sélection des comparables. Such comprehensive analyses would have facilitated delineation of transactions and identification of comparables for testing, thereby establishing a basis for selecting appropriate comparables. However, non-compliance with these elements adversely affected subsequent steps, notably in selecting the suitable method for determining transfer prices, and particularly in comparability analysis, which lost relevance without clearly defined criteria for involved parties. Consequently, issues persist in ALPHA's transfer pricing practices, potentially providing grounds for the rejection of its policy during a tax audit, especially if the General Tax Code had adopted OECD guidelines or explicitly referenced them in legislation.

- **Factor 2: Completeness of documentation**

The documentation of transfer pricing plays a crucial role in justifying a company's transfer pricing policies. If the documentation provided by ALPHA was incomplete, lacking in detail, or did not meet legal requirements, the Moroccan tax authorities could legitimately reject the transfer pricing policy (Article 185-IV) of (Direction générale des Impôts, 2023). This documentation mainly includes a local file and a master file, the specific contents of which have not yet been defined by the Moroccan tax administration. However, it has been indicated that the implementing decree stipulates that these files will align with international standards, particularly those of the OECD. Consequently, the company based its documentation on these principles. Upon review of all the documentation provided by ALPHA to the tax authorities, it is confirmed that ALPHA has supplied all the elements required by the OECD, as outlined in its guide titled 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.' This compliance applies to both the master file and the local file. Consequently, the completeness of the documentation provided was not a reason for rejection in the case of company ALPHA during the tax audit.

- **Factor 3: Current transfer pricing legislation**

The absence of clear directives in transfer pricing legislation can complicate the determination of a compliant transfer price. These legislative gaps can unintentionally lead to tax compliance errors, thus resulting in the rejection of transfer pricing policies. It is undeniable that Morocco has placed great importance on transfer pricing regulation in the country, particularly in recent years. On one hand, Article 210 and Article 213 I-II of the General Tax Code (Direction générale des Impôts, 2023) provide for the tax authorities' powers to rectify the tax base in the event of profit shifting being detected. On the other hand, Articles 214-I and 154 specify the procedures for communication and exchange of information between tax authorities. These texts also define taxpayers' rights and the deadlines for tax audits when the tax authorities request information from countries that are signatories to tax treaties. Another category of articles concerns advance pricing agreements (Article 234 bis - Article 234 ter). They describe the procedure for concluding such agreements, specifying the parties involved and their respective obligations. Finally, a fourth category of articles deals with transfer pricing documentation in Morocco (Article 214-III - Article 219). These texts address the content of the documentation, the persons concerned, and the procedures for submitting these documents.

To assess the existence of legislative gaps, we relied on the OECD transfer pricing principles, recognized by many experts as an effective framework for ensuring compliance with the arm's length principle and for effectively controlling transfer pricing. With reference to the article by (MOUMEN, KASSI, & MENZHI, 2022), especially the section on divergences and convergences between Moroccan transfer pricing legislation and OECD practices, a series of divergences were listed. Firstly, the OECD provides detailed guidelines regarding transfer pricing methods, required analyses, and factors to consider. Conversely, Moroccan legislation does not provide such a comprehensive framework to guide companies in applying transfer pricing rules. Secondly, international practices systematically outline the required steps for conducting comparability studies and implementing the arm's length principle. However, Moroccan legislation lacks specific guidelines on this matter, creating uncertainty as to how companies should conduct these comparisons to comply with the regulations. Thirdly, the OECD report details the correction and adjustment mechanisms that need to be put in place to ensure a reliable and fair comparison. For example, it mentions working capital adjustments. The Moroccan system, on the other hand, does not provide adjustment mechanisms or remedies to enhance the reliability of comparability studies. Finally, unlike international standards, the General Tax Code (CGI) does not offer alternative solutions for assessing compliance with the arm's length principle in the absence of comparable transactions in the open market.

One of the responses proposed by the Moroccan tax authorities to fill the gaps in current transfer pricing legislation is to enter into advance pricing agreements. These agreements represent a preventive measure against transfer pricing-related tax audits. ALPHA could have chosen this option to avoid any rejection of its transfer pricing policy. Nevertheless, ALPHA did not opt for this option for several reasons mentioned in the article by (HARICI, 2020). Firstly, there is a lack of clear guarantees. Taxpayers expected comprehensive guarantees and protection throughout the procedure and after the advance pricing agreement. Additionally, the legislation does not provide for a certification process conducted by a member of the institute of Chartered Accountants when the advance agreement is concluded. This would have strengthened taxpayers' confidence while guaranteeing the rights of the tax authorities. Finally, there is a systematic resort to tax audits. The only way to ensure the rights of the administration is to carry out a tax audit. This method raises doubts about the effectiveness and credibility of the advance pricing agreement procedure.

Overall, it is undeniable that Moroccan legislation has gaps in transfer pricing regulation. These shortcomings have a negative impact on taxpayers who, faced with ambiguous legislation, must determine a transfer price in accordance with the arm's length principle. Therefore, it is legitimate to consider that these legislative gaps may constitute grounds for the rejection of ALPHA's transfer pricing policy.

- **Factor 4: Tax audit methodology**

A final factor that could explain the rejection of ALPHA's transfer pricing policy during the tax audit is the methodology adopted by the auditor to determine whether or not there has been a transfer of profits.

Table1: Calculation of indirectly transferred profits

Total costs (a)
Operating income (b)
Margin rate according to the Transactional Net Margin Method (TNMM) declared (b)/(a)
Arm's length margin rate (c)
Recalculated operating result (d)= (a)*(c)
Proportion of group purchases/total purchases (e)
Insufficiency to reintegrate (f)= (d-b)*(e)

Source: prepared by the authors

To begin his assessment, the auditor calculated the total margin generated by all of ALPHA's transactions, whether they occurred in Morocco or abroad, involving independent or affiliated companies within the same group. Subsequently, he outlined the total margin (c) that the company should, according to his analysis, theoretically achieve in the context of its activities, although the bases of this calculation were not specified. Using this margin, he recalculated the operating result (d) of the company by multiplying the total costs (a) incurred by ALPHA by the new margin rate. The auditor then carried out an analysis to determine the proportion of internal activity among the company's overall activities. This analysis was used to assess the portion of the result associated with intra-group transactions, which may involve profit transfers through transfer pricing manipulations. To perform this calculation, he simply multiplied the proportion of intra-group activity relative to the company's overall activities by (d-b). The resulting amount represents the indirectly transferred profits that need to be taxed.

The problem with this method of calculating indirectly transferred profits lies in the calculation of the total margin generated by all ALPHA transactions, whether they took place in Morocco or abroad, involving independent and affiliated companies within the same group. In reality, according to OECD guidelines, applying the arm's length principle transaction by transaction is imperative to get as close as possible to the fair market value. This approach requires a meticulous analysis of each transaction, taking into account its specific characteristics. It involves detailed examination of prices, costs, margins, functions, assets, and risks associated with each operation. The auditor's method could have been valid if the comparable companies were 100% identical to company ALPHA, but this is practically impossible due to the many variables at play, such as significant differences in activities, functions, suppliers, risks, and products, etc.

Conclusion

After thoroughly analyzing each factor influencing the rejection of ALPHA's transfer pricing policy, it appears that both the current legislation and the adopted tax audit methodology play a significant role. Regarding ALPHA's internal transfer pricing practices, although anomalies were observed compared to OECD guidelines, it is relevant to emphasize that strict adherence to these guidelines does not necessarily guarantee policy approval. However, adhering to these OECD guidelines can certainly assist the company in justifying its transfer pricing policy to the tax authorities. As a result of this analysis, recommendations have been made to enhance compliance and transparency, both on the company side and the tax administration side. For the company, it is advisable to carry out an exhaustive analysis of all related parties involved in controlled transactions, in line with OECD guidelines. Regular transfer pricing audits, conducted by independent experts, are also recommended to maintain policy compliance with current rules. Considering the conclusion of an advance agreement on transfer pricing could help anticipate disputes and clarify the evaluation criteria used by the tax administration. In addition, if ALPHA is convinced that it complies with international standards, it could consider appealing to the relevant commissions to present its arguments. Regarding the tax administration, legislative reforms are necessary to clearly define fundamental principles, evaluation methods, and comparability criteria, with reference to OECD guidelines. Increasing the duration of tax audits to allow for thorough investigations and diversifying the profile of auditors by recruiting specialists in different fields would also be beneficial. It is also crucial to improve advance pricing agreements by enhancing taxpayer guarantees and protection, introducing certification mechanisms, and ensuring increased transparency. Lastly, providing detailed explanations of transfer pricing tax calculation methods to taxpayers would be essential for promoting tax transparency. 10 These recommendations aim to ensure better compliance of transfer pricing policies with international standards, enhance transparency and promote effective collaboration between companies and tax authorities. In this context, the General Tax Directorate published a transfer pricing control guide in December 2023 (Direction générale des Impôts, 2023). The purpose of this guide is to facilitate the control of transfer prices as part of an accounting audit. It provides a detailed overview of the practical approach adopted by the Moroccan tax authorities in this area. The first part provides an overview of current transfer pricing legislation, to the benefit of both taxpayers and auditors. The second part of the guide describes the phases and actions required to carry out an effective transfer pricing audit. It also presents in detail a set of previously unspecified guidelines, such as the approach to determining the arm's length principle, the methodology of comparability analysis, and transfer pricing methods, among others. The clarifications provided by this guide complement existing legislation and correct the shortcomings identified in the second and third factors. A complementary study could be envisaged to determine whether these factors remain relevant with the application of this guide, and whether new factors could emerge.

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