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Transfer Pricing 2023

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Zambia: Law & Practice
and
Zambia: Trends & Developments

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ZAMBIA

Law and Practice

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Contents

1. Rules Governing Transfer Pricing p.5
1.1 Statutes and Regulations p.5
1.2 Current Regime and Recent Changes p.5

2. Definition of Control/Related Parties p.6
2.1 Application of Transfer Pricing Rules p.6

3. Methods and Method Selection and Application p.6
3.1 Transfer Pricing Methods p.6
3.2 Unspecified Methods p.7
3.3 Hierarchy of Methods p.7
3.4 Ranges and Statistical Measures p.7
3.5 Comparability Adjustments p.8

4. Intangibles p.8
4.1 Notable Rules p.8
4.2 Hard-to-Value Intangibles p.8
4.3 Cost Sharing/Cost Contribution Arrangements p.8

5. Affirmative Adjustments p.9
5.1 Rules on Affirmative Transfer Pricing Adjustments p.9

6. Cross-Border Information Sharing p.9
6.1 Sharing Taxpayer Information p.9

7. Advance Pricing Agreements (APAs) p.9
7.1 Programmes Allowing for Rulings Regarding Transfer Pricing p.9
7.2 Administration of Programmes p.9
7.3 Co-ordination Between the APA Process and Mutual Agreement Procedures p.9
7.4 Limits on Taxpayers/Transactions Eligible for an APA p.9
7.5 APA Application Deadlines p.9
7.6 APA User Fees p.10
7.7 Duration of APA Cover p.10
7.8 Retroactive Effect for APAs p.10

8. Penalties and Documentation p.10
8.1 Transfer Pricing Penalties and Defences p.10
8.2 Taxpayer Obligations Under the OECD Transfer Pricing Guidelines p.11

9. Alignment With OECD Transfer Pricing Guidelines p.11
9.1 Alignment and Differences p.11
9.2 Arm's Length Principle p.12
9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project p.12
9.4 Impact of BEPS 2.0 p.12
9.5 Entities Bearing the Risk of Another Entity's Operations p.12

10. Relevance of the United Nations Practical Manual on Transfer Pricing p.12
10.1 Impact of UN Practical Manual on Transfer Pricing p.12

11. Safe Harbours or Other Unique Rules p.13
11.1 Transfer Pricing Safe Harbours p.13
11.2 Rules on Savings Arising From Operating in the Jurisdiction p.13
11.3 Unique Transfer Pricing Rules or Practices p.13

12. Co-ordination With Customs Valuation p.13
12.1 Co-ordination Requirements Between Transfer Pricing and Customs Valuation p.13

13. Controversy Process p.13
13.1 Options and Requirements in Transfer Pricing Controversies p.13

14. Judicial Precedent p.14
14.1 Judicial Precedent on Transfer Pricing p.14
14.2 Significant Court Rulings p.14

15. Foreign Payment Restrictions p.16
15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions p.16
15.2 Restrictions on Outbound Payments Relating to Controlled Transactions p.16
15.3 Effects of Other Countries' Legal Restrictions p.16

16. Transparency and Confidentiality p.16
16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes p.16
16.2 Use of "Secret Comparables" p.16

17. COVID-19 p.16
17.1 Impact of COVID-19 on Transfer Pricing p.16
17.2 Government Response p.16
17.3 Progress of Audits p.17

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Mulenga Mundashi Legal Practitioners is a full-service law firm with strong capabilities and a proven track record in tax advisory and tax litigation. It operates from an office in Lusaka and has a team of five partners, ten associates, six legal assistants and seven trainee advocates.

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1. Rules Governing Transfer Pricing

1.1 Statutes and Regulations

The rules governing transfer pricing include legislation and various regulations. These are the Income Tax Act, Chapter 323 of the Laws of Zambia (the "Income Tax Act") as read with the Income Tax (Transfer Pricing) Regulations, Statutory Instrument No 20 of 2000 (the "Transfer Pricing Regulations")(collectively, the "Transfer Pricing Rules"), as amended by the following regulations:

- the Income Tax (Transfer Pricing) (Amendment) Regulations, Statutory Instrument No 24 of 2018;
- the Income Tax (Transfer Pricing) (Amendment) Regulations, Statutory Instrument No 117 of 2020;
- the Income Tax (Transfer Pricing) (Amendment) Regulations, Statutory Instrument No 107 of 2021; and
- the Income Tax (Transfer Pricing) (Amendment) Regulations, Statutory Instrument No 89 of 2022.

1.2 Current Regime and Recent Changes

Although Zambia's Transfer Pricing Rules were first introduced in 1999 under Section 97A of the Income Tax Act, and in 2000 under the Transfer Pricing Regulations, the Zambian government only began to focus on major transfer pricing reforms in 2012, when four officers from the Zambia Revenue Authority's (ZRA) Large Taxpayers Office undertook transfer pricing audits within mining and non-mining audit units. These reforms commenced when the ZRA became aware of the need for robust documentation rules to clarify taxpayer expectations and avoid unnecessary delays in the audit process.

In March 2016, the ZRA created a Transfer Pricing Unit comprising four officers with the aim of providing a direct focus on transfer pricing audit cases, which generally take a longer period of time to conclude compared with normal audits. Additionally, the ZRA had noted that without specific guidelines taxpayer compliance was difficult to enforce regarding the need to prepare a transfer pricing policy document for the relevant group. This is in view of the fact that the ZRA, in ensuring compliance, relied on the general provisions in the Income Tax Act to compel taxpay-

ers to submit transfer pricing documentation and information.

In 2017, the Zambian government joined the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and agreed to adopt the BEPS project agreement, the country-by-country reporting measures to prevent tax treaty shopping, and the minimum standards that were set out by the OECD and G20 nations in 2015. In doing so, the government aimed to increase tax revenue payments and reduce the tax burden on easy-to-pay taxes by creating an atmosphere of fairness among companies that are liable for tax, which, it was hoped, would lead to voluntary compliance.

In view of the foregoing, the government strengthened the Transfer Pricing Rules by amending the Transfer Pricing Regulations. Major changes were introduced in 2018 when these amendments introduced, inter alia, provisions relating to the arm's length principle and preparation of transfer pricing documentation. In 2021, the requirement for country-by-country reporting was introduced, and further amendments were made to the Transfer Pricing Regulations in 2022 and 2023.

The Transfer Pricing Rules recognise the application of the OECD Transfer Pricing Guidelines and the United Nations Practical Manual on Transfer Pricing for Developed Countries. However, the Transfer Pricing Rules will prevail in the case of any inconsistencies.

2. Definition of Control/Related Parties

2.1 Application of Transfer Pricing Rules

The Transfer Pricing Rules apply to controlled transactions, which are defined as transactions between associated persons. Associated persons include the following:

- parties connected directly or indirectly through shareholding, equity or partnerships;
- any joint venture owned or operated jointly with an unrelated person;
- connected persons;
- parties connected through direct or indirect management control and capital; or
- any existing arrangements, whether in writing or not, that benefit two or more entities whose conditions are deemed not to be at arm's length.

It is important to note that a party is associated with another if:

- the person participates directly or indirectly in the management, control or capital of the other; or
- the persons participate directly or indirectly in the management, control or capital of both of them.

3. Methods and Method Selection and Application

3.1 Transfer Pricing Methods

The Transfer Pricing Rules provide for the following five transfer pricing methods that taxpayers may use:

- comparable uncontrolled pricing method;
- resale pricing method;

- cost plus method;
- transactional net margin method; and
- transactional profit split method.

3.2 Unspecified Methods

A different method may be applied by a taxpayer or the Commissioner General of the ZRA, provided the Commissioner General is satisfied that:

- none of the approved methods can be reasonably applied to determine arm's length conditions for the controlled transaction; and
- such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

Where the taxpayer wishes to apply a different method, the taxpayer must state why the five transfer pricing methods listed in **3.1 Transfer Pricing Methods** were regarded as less appropriate or non-workable in the circumstances of the case, and the reasons why the selected method was regarded as the most appropriate for satisfying the arm's length principle.

The application to use a different transfer pricing method should be made in writing to the Commissioner General.

3.3 Hierarchy of Methods

The tax authorities have the discretion to select the most appropriate transfer pricing method from the methods listed in **3.1 Transfer Pricing Methods** based on the facts and circumstances of the case and reliability of data for the comparability analysis. The tax authorities will consider the following:

- the respective strengths and weaknesses of the methods in the circumstances of the case;
- the appropriateness of the approved transfer pricing method, having regard to the nature of the controlled transaction, determined through an analysis of the functions undertaken by each person in that controlled transaction and taking into account assets used and risks assumed;
- the availability of reliable information needed to apply the selected transfer pricing method or other transfer pricing methods; and
- the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments, if any, that may be required to eliminate differences between them.

The rules provide that where the comparable uncontrolled price method and the other listed transfer pricing methods can be applied with equal reliability, the tax authorities would choose the comparable uncontrolled price method. Further, where the comparable uncontrolled price method, the resale price method, the cost plus method, the transactional net margin method and the transactional profit split method can be applied with equal reliability, the tax authorities would choose either the comparable uncontrolled price method, the resale price method or the cost plus method.

3.4 Ranges and Statistical Measures

The Transfer Pricing Rules provide for the arm's length range, which is defined as a range of relevant financial indicator figures including prices, margins or profit shares produced by the application of the most appropriate transfer pricing method to a number of uncontrolled transactions, each of which is relatively equally comparable to the controlled transaction based on

comparability analysis (though in some cases not all examined comparable transactions will have a relatively equal degree of comparability).

Further, the regulations provide for the interquartile range, which is used to enhance the reliability of the analysis where the range includes a sizeable number of observations, and the taxpayer has made reasonable efforts to exclude points of lesser degree of comparability.

3.5 Comparability Adjustments

There is no express requirement for comparability adjustments. However, when picking the most appropriate transfer pricing method, the tax authorities consider the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments.

It is worth noting that the tax authorities may adjust the taxpayers' results where the results fall outside the arm's length range.

4. Intangibles

4.1 Notable Rules

Zambia's Transfer Pricing Rules define "intangible property" as including any property which is not a physical or financial asset, and is capable of being owned or controlled for use in commercial activities. This includes the following:

- patent;
- invention;
- secret formula or process;
- design;
- model;
- plan;
- trade mark;
- know-how; or
- marketing intangible.

For transactions that involve intangible property such as licences and sales, the determination of the arm's length conditions for controlled transactions between associated parties takes into account both the perspective of the transferor of the property and the perspective of the transferee. Such transactions also take into account the pricing at which a comparable independent enterprise would be willing to transfer the property and the value and usefulness of the intangible property to the transferee in its business.

In transactions involving the licensing, sale or transfer of intangible property, a person is required to consider special factors relevant to the comparability of the controlled and uncontrolled transactions, including the following:

- the expected benefits from the intangible property;
- any geographic limitations on the exercise of rights to the intangible property;
- the commercial alternatives otherwise available to the acquirer or licensee derived from the intangible property;
- the exclusive or non-exclusive character of the rights transferred; and
- whether the transferee has the right to participate in further developments of the intangible property by the transferor.

4.2 Hard-to-Value Intangibles

Zambia does not have any special rules regarding hard-to-value intangibles.

4.3 Cost Sharing/Cost Contribution Arrangements

The Transfer Pricing Rules recognise cost contribution arrangements and define them as arrangements among persons to:

- share the costs and risks of developing, producing or obtaining assets, services or rights; and
- determine the nature and extent of the interests of each participant in the results of the activity of developing, producing or obtaining the assets, services or rights.

There are no special rules that apply to these types of arrangements.

5. Affirmative Adjustments

5.1 Rules on Affirmative Transfer Pricing Adjustments

A taxpayer may make an adjustment where the conditions of an actual transaction differ from the arm's length principle requirements. The taxpayer may make the relevant adjustment in the calculation of assessable income included in the annual tax return. Generally, year-end adjustments are permitted before filing of the income tax return for the relevant financial year.

6. Cross-Border Information Sharing

6.1 Sharing Taxpayer Information

Zambia has signed 22 tax treaties which provide for exchange of information agreements.

Further, it has signed the ATAF Agreement on Mutual Assistance in Tax Matters which established exchange of information and assistance in tax collection among the contracting countries in Africa.

While Zambia has international agreements which provide for exchange of information, this is not sufficient for country-by-country (CbC) reporting purposes. Zambia has not yet implemented the Qualifying Competent Authority Agreements (QCAA) which govern the automatic exchange of CbC reports filed on an annual basis between party jurisdictions and between authorised representatives of those jurisdictions that are parties to an international agreement.

7. Advance Pricing Agreements (APAs)

7.1 Programmes Allowing for Rulings Regarding Transfer Pricing

Zambia does not have advance pricing agreements (APAs), and these are not expected in the near future given that transfer pricing audits are still in their early stages.

7.2 Administration of Programmes

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

7.3 Co-ordination Between the APA Process and Mutual Agreement Procedures

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

7.4 Limits on Taxpayers/Transactions Eligible for an APA

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

7.5 APA Application Deadlines

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

7.6 APA User Fees

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

7.7 Duration of APA Cover

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

7.8 Retroactive Effect for APAs

This is not applicable in Zambia. See **7.1 Programmes Allowing for Rulings Regarding Transfer Pricing**.

8. Penalties and Documentation

8.1 Transfer Pricing Penalties and Defences

The Transfer Pricing Rules provide that failure to maintain the required transfer pricing documentation or make transfer pricing information available to the ZRA when required to do so may render the entity liable to pay a fine not exceeding ZMW30,000 or to imprisonment for a term not exceeding 12 months, or to both.

Although the fine is capped at ZMW30,000, interest is always charged on debts owed to the ZRA and there is no cap on the interest that accrues on such debts. Interest is charged at the Bank of Zambia discount rate plus 2% per annum. The Income Tax Act also states that the Transfer Pricing Regulations may create offences which will render an entity liable to pay a fine not exceeding ZMW24 million; however, presently the Transfer Pricing Regulations do not contain penalties and provide that the penalties under the Income Tax Act are applicable.

The Transfer Pricing Rules further provide that a taxpayer is required to provide transfer pricing documentation to the ZRA within 30 days from the date of receiving the request for documentation. In addition, where the ZRA serves a taxpayer with a notice of assessment, the taxpayer may within 30 days of the date of said service object to the assessment by way of written statement addressed to the Commissioner General of the ZRA, setting out the grounds of objection. If the taxpayer is dissatisfied with the outcome of the Commissioner General's decision concerning the objection to the assessment, the taxpayer may, within 30 days of the date of being served written notice of this decision, appeal against the assessment to the Tax Appeals Tribunal (the "Tribunal").

Taxpayers must retain documents and records relating to transfer pricing for ten years from the date of the last entry in those documents and records. The documentation must contain information that verifies that the conditions in a taxpayer's controlled transactions for the relevant tax year are consistent with the arm's length principle. The documentation must reflect the following:

- the controlled transactions, including the nature, terms and price of each controlled transaction, details of property transferred or services provided, and the quantum and value of each respective transaction;
- the identity of associated persons involved and the relationship between the associated persons;
- a detailed comparability analysis of the person and associated person with respect to each documented category of controlled transaction, including the functions performed, risks, borne tangible and intangible

assets used and any changes made compared to prior years;
- details of other controlled transactions that directly or indirectly affect the pricing of the subject controlled transaction;
- records of the economic forecasts, budgets or other financial estimates prepared by the person for that person's business or separately for each division or product that may have a bearing on a controlled transaction;
- uncontrolled transactions and information on financial indicators for unrelated parties relied on in the transfer pricing analysis, including a description of the comparable search methodology, and a record of the nature, terms and conditions relating to any uncontrolled transaction with unrelated parties relied upon in the transfer pricing analysis;
- the details of any comparability adjustments performed, indicating whether they have been performed on the tested party or on the comparable uncontrolled transaction, or both;
- the transfer pricing methods considered in determining the arm's length price in relation to each transaction or class of transaction, the method selected as the most appropriate method, why that method was selected, and how that method was applied in each controlled transaction;
- which associated person is selected as the tested party, and an explanation for the choice of the tested party;
- a summary of financial information used, and the assumptions made in applying the transfer pricing methodology;
- the reasons for performing a multi-year analysis, where applicable;
- the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
- details of the adjustments, if any, made to the transfer price to align it with the arm's length price, and consequent adjustments made to the total income for tax purposes;
- the reasons for concluding that the controlled transactions were conducted on an arm's length basis, based on the application of the selected transfer pricing method;
- information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements of the taxpayer;
- summarised schedules of relevant financial data for comparables used in the analysis; and
- any other information, including information relating to the associated person that may be relevant for determination of the arm's length price.

Transfer pricing documents and records must be prepared on an annual basis.

8.2 Taxpayer Obligations Under the OECD Transfer Pricing Guidelines

Zambia has adopted a three-tiered structure or approach that taxpayers must adopt. The master file and local file reports are mandatory, while a country-by-country report must only be prepared and filed with the ZRA subject to meeting certain conditions.

9. Alignment With OECD Transfer Pricing Guidelines

9.1 Alignment and Differences

Zambia's Transfer Pricing Rules closely align with the OECD Transfer Pricing Guidelines, as they are to be construed in a manner consistent with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations as supplemented and updated from time to time.

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Where there is any inconsistency between the Transfer Pricing Rules and the OECD Guidelines, the Transfer Pricing Rules prevail to the extent of the inconsistency.

9.2 Arm's Length Principle

Zambia's Transfer Pricing Rules do not depart from the arm's length principle.

9.3 Impact of the Base Erosion and Profit Shifting (BEPS) Project

The OECD's BEPS project influenced amendments to Zambia's Transfer Pricing Rules. Zambia joined the Inclusive Framework on BEPS and in 2020 an amendment was introduced to bring about country-by-country obligations to the domestic landscape, thereby fulfilling the country-by-country reporting minimum standard and implementing it into domestic law.

It also worth noting that the BEPS-recommended transfer pricing methods have been implemented. These are as listed in **3.1 Transfer Pricing Methods**.

9.4 Impact of BEPS 2.0

Zambia has not explicitly provided a conclusive perspective on the OECD's BEPS 2.0 initiatives. However, the country continues to introduce changes to the domestic Transfer Pricing Rules to ensure they are aligned with the OECD Guidelines. Zambia's joining the Inclusive Framework on BEPS in 2017 illustrates the country's commitment to and participation in reducing multinational tax avoidance and improving cross-border tax dispute resolution.

The OECD's BEPS 2.0 initiatives involving Pillar One and Pillar Two are likely to be implemented, even though there is no definite set period for such implementation. The initiatives will likely address challenges in taxation of the digital economy in Zambia, which could lead to an increase in Zambia's revenue growth from taxation of multinational entity digital companies, and also to tax certainty.

An example of Zambia's commitment to the OECD's BEPS 2.0 initiatives is that while previously Zambia's tax legislation did not have specific rules dealing with the digital economy and digital services, as of 1 January 2023 the government has extended the turnover tax regime to service providers in the gig economy, which is a segment of the digital economy that involves individuals carrying out business through an online platform and under flexible or temporary conditions, and that includes an independent contractor or freelancer conducting business through an online platform. This exemplifies Zambia's commitment to unifying approaches on taxation of the digital economy.

For Zambia, the likely impact of the OECD's BEPS 2.0 initiatives involving Pillar One and Pillar Two in the coming years is the growth of Zambia's revenue gains.

9.5 Entities Bearing the Risk of Another Entity's Operations

The Transfer Pricing Rules do not provide for an entity to bear the risk of another entity's operations.

10. Relevance of the United Nations Practical Manual on Transfer Pricing

10.1 Impact of UN Practical Manual on Transfer Pricing

The Transfer Pricing Regulations provide that they are to be construed in a manner consistent with the UN Practical Manual on Transfer Pricing

for Developing Countries as supplemented and updated from time to time. This illustrates Zambia's consistency with the application of transfer pricing rules in accordance with the UN Practical Manual on Transfer Pricing. The Manual essentially influences the practice of transfer pricing in domestic legislation.

11. Safe Harbours or Other Unique Rules

11.1 Transfer Pricing Safe Harbours

Safe harbours are provided on the amount charged for the provision of a low value-added service between connected persons. They only apply to the mark-up applied to the cost of the services. Taxpayers will still need to establish that all other conditions of the transaction are at arm's length, including that:

- the services were actually provided;
- the services provide economic benefit to the recipient that is not incidental, duplicative or only relating to the activities of the shareholder;
- the cost of the services has been calculated using an appropriate cost base;
- the services have been allocated using appropriate allocation keys;
- the service providers have applied the cost plus method to determine the costs; and
- the mark-up on these costs is no more than 5%.

11.2 Rules on Savings Arising From Operating in the Jurisdiction

Zambia does not have specific rules governing savings that arise from operating in Zambia.

11.3 Unique Transfer Pricing Rules or Practices

There are currently no notable unique rules or practices in Zambia, as the country's Transfer Pricing Rules are highly influenced by the OECD Transfer Pricing Guidelines and are construed in a manner consistent with the Guidelines, except where there is inconsistency.

12. Co-ordination With Customs Valuation

12.1 Co-ordination Requirements Between Transfer Pricing and Customs Valuation

The Transfer Pricing Rules do not require co-ordination between transfer pricing and customs valuation; however, the ZRA has an integrated tax administration system called ASYCUDA (Automated System for Customs Data) which captures customs information and uses this as intelligence data in audits.

13. Controversy Process

13.1 Options and Requirements in Transfer Pricing Controversies

Zambia's domestic transfer pricing controversy process is as follows.

Where the ZRA issues a notice of assessment following a transfer pricing audit and a taxpayer is unhappy with this, the taxpayer can challenge the assessment within 30 days of receiving notice of it. This can be done by objecting to the results of the transfer pricing audit in the notice of assessment by way of writing to the Commissioner General of the ZRA, setting out the taxpayer's grounds of objection.

If the Commissioner General makes a determination following the taxpayer's objection, and the taxpayer is still dissatisfied with this, they have the right to appeal to the Tribunal within 30 days of receiving the Commissioner General's decision. The decision of the Tribunal will be enforced as if it were the decision of the High Court of Zambia.

It is important to note that all tax laws in Zambia, including the Transfer Pricing Rules, are based on the "pay now, argue later" rule of taxation. As such, no legislation contains any express provision that empowers the Tribunal to grant a stay of execution to prevent the ZRA from collecting dispute tax in cases where there is an appeal lodged with the Tribunal.

If either the ZRA or a taxpayer is aggrieved by the decision of the Tribunal, they have the right to appeal against the Tribunal's decision to the Supreme Court of Zambia. The Supreme Court may determine the matter or refer it back to the Tribunal for re-hearing, confirmation, reduction, increment or annulment of the assessment or decision made by the Tribunal, and may make such further or other order on appeal, as to costs or otherwise, as the Supreme Court considers necessary.

Because the Supreme Court is Zambia's final court of appeal, its decision on a particular transfer pricing dispute is final as it does not have the jurisdiction to review its judgments, or to set aside and re-open an appeal.

14. Judicial Precedent

14.1 Judicial Precedent on Transfer Pricing

Although Zambia has a well-established legal framework for pursuing transfer pricing, and the ZRA formed a dedicated Transfer Pricing Unit in March 2016, the judicial precedent on transfer pricing is not yet well developed as not many disputes on transfer pricing have been taken to the courts.

14.2 Significant Court Rulings

Mopani Copper Mines Plc v The Zambia Revenue Authority – SCZ/8/269/2016

This case is considered the landmark case on transfer pricing in Zambia. It arose from an appeal from the Tribunal in which the Tribunal held against Mopani on a complaint raised by the ZRA disputing certain tax assessments made by the ZRA. In brief, the ZRA undertook an audit on the mining industry's cost levels, and the exercise involved a tax audit on costs, revenues and transfer pricing practices. The audit was largely centred on possible transfer pricing practices between Mopani and its shareholder, Glencore International AG (GIAG), a related party that bought copper at a significantly lower price than the price at which it was sold to third parties.

The tax audit raised some concerns regarding certain related party transactions. The issue was whether the transactions between Mopani and GIAG were at arm's length, given GIAG's shareholding in Mopani. The ZRA had issued a tax assessment following conclusions that the internal pricing was not decided in line with the arm's length principle, and that one of the major reasons for the mispricing was to reduce tax liability.

Mopani argued that Section 95 of the Income Tax Act was wrongly invoked by the ZRA in the case of transfer pricing as that section can only be invoked where there is reason to believe that the main purpose of the transaction was to avoid or reduce liability with respect to tax, in which case the Commissioner General of the ZRA would direct that a particular adjustment be made. Section 95(1) of the Income Tax Act provides that:

"Where the Commissioner General has reasonable grounds to believe that the main purpose or one of the main purposes for which any transaction was effected (whether before or after the commencement of this Act) was the avoidance or reduction of liability to tax for any charge year, or that the main benefit which might have been expected to accrue from the transaction within the three years immediately following the completion thereof, was the avoidance or reduction of liability to tax, he may, if he determines it to be just and reasonable, direct that such adjustments shall be made as respects liability to tax as he considers appropriate to counteract the avoidance or reduction of liability to tax which would otherwise be effected by the transaction."

The ZRA explained the nature of the symbiotic business relationship between Mopani and GIAG and how that special relationship reflected in the sales of the copper produced by Mopani. The ZRA further stated that the audit by the ZRA revealed issues that could cause any prudent tax authority to have misgivings about the arm's length claim of the transactions between Mopani and GIAG. This, in the Supreme Court's view, rightly raised reasonable suspicion sufficient to lead the ZRA to invoke Section 95 of the Act.

The Supreme Court of Zambia held in favour of the ZRA and ordered that Mopani pay a total of ZMW240 million in taxes assessed for the 2006 to 2010 tax years. This particular case shows the applicability of the Commissioner General's discretion under Section 95 of the Income Tax Act concerning transfer pricing.

Nestlé Zambia Trading Limited v The Zambia Revenue Authority – 2018/TAT/03/DT

In this case, Nestlé Zambia Trading Limited ("Nestlé Zambia") appealed against the decision of the ZRA on an assessment resulting from a transfer pricing audit covering the period of 2010 to 2014. Nestlé Zambia argued that the ZRA wrongfully assessed when it was found liable for additional tax, as Nestlé Zambia's non-compliance with the arm's length principle had not been tested.

Nestlé Zambia also argued that the ZRA had erred in law and fact by issuing its assessment on the premise that Nestlé Zambia could not run at a loss since incorporation, when all the evidence provided to the ZRA showed the various factors which led to Nestlé Zambia's loss-making, and that the ZRA failed to objectively test the related party transactions, to which it raised transfer pricing concerns but made assumptions and estimates that were excessive and unreasonable.

Nestlé Zambia further argued that the ZRA erred in law and fact when it categorised Nestlé Zambia as a low-risk distributor when it was shown beyond doubt that Nestlé was an independent full-fledged distributor company undertaking all the sale and distribution functions as well as the typical risk incurred in performing these functions.

In turn, the ZRA argued that it carried out adequate tests on all related party transactions and the analysis of contracts and transactions

revealed that Nestlé Zambia's transactions were mainly with various related parties. The ZRA further argued that Nestlé Zambia was paying royalties to Nestlé South Africa for the exclusive use of Nestlé trade marks and patents as a distribution company in violation of the arm's length principle, and that the assessments were made under the Income Tax Act and were therefore not estimates or assumptions.

The Tribunal held in favour of Nestlé Zambia except for the argument on the categorisation of Nestlé Zambia as a low-risk distributor, and stated that it was erroneous for the ZRA to have aggregated the unrelated, discontinuous and not closely linked transactions as a means to test for arm's length. The Tribunal held that the assessment by the ZRA was wrongly arrived at because said assessment was based on inaccurate transfer pricing results emanating from the use of an inappropriate transfer pricing method and disproportionate comparables.

The case referred to the OECD Transfer Pricing Guidelines, showing their applicability in Zambia, and provided guidance with regard to similar cases involving transfer pricing audits and assessments.

15. Foreign Payment Restrictions

15.1 Restrictions on Outbound Payments Relating to Uncontrolled Transactions

Zambia's Transfer Pricing Rules do not restrict outbound payments relating to uncontrolled transactions.

15.2 Restrictions on Outbound Payments Relating to Controlled Transactions

Zambia's Transfer Pricing Rules do not restrict outbound payments relating to controlled transactions.

15.3 Effects of Other Countries' Legal Restrictions

The Transfer Pricing Rules do not provide for rules regarding the effects of other countries' legal restrictions.

16. Transparency and Confidentiality

16.1 Publication of Information on APAs or Transfer Pricing Audit Outcomes

The ZRA does not publish information on APAs or transfer pricing audit outcomes.

16.2 Use of "Secret Comparables"

The Transfer Pricing Rules do not prohibit the use of secret comparables. In fact, the ZRA has procured a database for the use of comparables.

17. COVID-19

17.1 Impact of COVID-19 on Transfer Pricing

Although the COVID-19 pandemic has had a negative impact on the Zambian economy due to factors such as loss of income and loss of business, it has not had any impact on Zambia's transfer pricing landscape.

17.2 Government Response

To mitigate the impacts of the COVID-19 pandemic, which presented a health and economic burden across the globe, the government imple-

mented a tax amnesty programme (TAP) on all penalties and interest accumulated up to 30 September 2022, which covers all tax types. The TAP commenced on 1 October 2022 and expires on 31 March 2023.

During the TAP, a waiver of penalties and interest on all tax types in Zambia would be granted upon submission or lodgement of outstanding returns and upon full settlement of the principal tax liabilities or evidence of a valid time-to-pay agreement (TPA). The TPA will provide for the payment of the principal amounts in instalments.

17.3 Progress of Audits

The COVID-19 pandemic has not stalled the progress of the ZRA's audits of taxpayers. As such, the ZRA still periodically carries out audits and reviews to determine whether transactions between related parties are at arm's length.

Trends and Developments

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Mulenga Mundashi Legal Practitioners is a full-service law firm with strong capabilities and a proven track record in tax advisory and tax litigation. It operates from an office in Lusaka and has a team of five partners, ten associates, six legal assistants and seven trainee advocates.

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Mulenga Chiteba is a partner at Mulenga Mundashi Legal Practitioners, specialising in commercial dispute resolution, corporate advisory and tax. He heads the firm's tax and regulatory compliance practice group, which covers all areas of tax and regulatory compliance including competition law and ESG. He has significant experience in income tax, VAT and customs and excise tax, and has been at the forefront of advising clients on transfer pricing matters and successfully objecting to several assessments issued by the Zambia Revenue Authority against large corporate taxpayers. Mulenga has considerable experience before the Tax Appeals Tribunal, arbitral tribunals and the superior courts in Zambia.

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Transfer Pricing in Zambia

Transfer pricing in Zambia refers to the rules, laws and practices for determining the prices of transactions between related companies or companies under common ownership. Zambia's Transfer Pricing Rules were initially introduced in 1999 under Section 97A Income Tax Act Chapter 323 of the Laws of Zambia (the "Income Tax Act"), and in 2000 under the Income Tax (Transfer Pricing) Regulations, Statutory Instrument No 20 of 2000 (the "Transfer Pricing Regulations"). However, the Zambian government only began to focus on major transfer pricing reforms in 2012, when four officers from the Zambia Revenue Authority's (ZRA) Large Taxpayers Office were identified and trained to undertake transfer pricing audits within the mining and non-mining audit units. These reforms commenced when the ZRA became aware of the need for robust documentation rules to clarify taxpayer expectations and avoid unnecessary delays in the audit process.

In March 2016, the ZRA created a Transfer Pricing Unit comprising four officers. Its purpose was to provide a direct focus on transfer pricing audit cases, which generally take a longer period of time to conclude compared to normal audits. Additionally, the ZRA had noted that without specific guidelines taxpayer compliance was difficult to enforce regarding the need to prepare a transfer pricing policy document for the relevant group. This is in view of the fact that the ZRA, in ensuring compliance, relied on the general provisions in the Income Tax Act to compel taxpayers to submit transfer pricing documentation and information.

In 2017, the Zambian government joined the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and agreed to adopt the BEPS project agreement, the country-by-country reporting measures to prevent tax treaty shopping, and the minimum standards that were set out by the OECD and G20 nations in 2015. In doing so, the government aimed to increase tax revenue payments and reduce the tax burden on easy-to-pay taxes by creating an atmosphere of fairness among companies that are liable for tax, which, it was hoped, would lead to voluntary compliance.

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In view of the foregoing, the government strengthened the Transfer Pricing Rules by amending the Transfer Pricing Regulations. Major changes were introduced in 2018 when these amendments introduced, inter alia, provisions relating to the arm's length principle and preparation of transfer pricing documentation. In 2021, the requirement for country-by-country reporting was introduced, and further amendments were made to the Transfer Pricing Regulations in 2022 and 2023.

This article addresses some of the notable changes to Zambia's Transfer Pricing Rules.

The Arm's Length Principle

Zambia's Transfer Pricing Rules broadly adopt the internationally accepted "arm's length principle" for the purposes of determining the income and associated expenditure for transactions between connected persons. This has been drafted in a manner broadly consistent with the OECD and UN Model Tax Conventions on Income and Capital, and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. However, where there is inconsistency, the domestic Transfer Pricing Rules prevail to the extent of such inconsistency.

The Transfer Pricing Rules provide for the application of the arm's length principle to controlled transactions – ie, transactions between associated parties. Zambia recognises five methods to be applied to controlled transactions:

- comparable uncontrolled price method;
- resale price method;
- cost plus method;
- transactional net margin method; and
- transactional profit split method.

The method used is dependent on what is deemed the most appropriate method based on the circumstances of the case.

However, where a taxpayer wishes to use a different method to the five methods provided by the Transfer Pricing Rules, they may apply to the Commissioner General of the ZRA for approval of such other method. The application will be approved if the Commissioner General is satisfied that:

- none of the five approved methods can be reasonably applied to determine arm's length conditions for the controlled transaction; and
- such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

The taxpayer is required to provide an explanation as to why the five transfer pricing methods were regarded as less appropriate or non-workable in the circumstances of the case, and the reasons why the selected method was regarded as the most appropriate for satisfying the arm's length principle.

Country-by-Country Reporting

In addition to joining the Inclusive Framework on BEPS in 2017, in 2020 the government sought to implement BEPS Action Point 13 on country-by-country (CbC) reporting. It should be noted that the BEPS Action Points aim to equip governments with domestic and international rules and instruments to address tax avoidance. Zambia achieved this through the amendment of the Transfer Pricing Regulations in 2020, which came into effect on 1 January 2021. This was done by introducing CbC reporting for ultimate parent entities (UPEs) of a multinational enter-

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prise (MNE) group that is tax-resident in Zambia for tax purposes with an annual consolidated group revenue exceeding ZMW4,795 billion in the immediately preceding accounting year.

As a result of the forgoing, a CbC reporting notification must be made to the ZRA by the end of the accounting year by an MNE group with respect to a tax charge year, and the CbC report must be filed within 12 months after the end of the accounting year of the MNE group in relation to the tax charge year.

As the CbC reporting requirement came into effect on 1 January 2021, the first CbC reporting fiscal year was 2021, and the first reporting year ended on 31 December 2022.

It is worth noting that the definitions of an MNE group and a UPE in the Transfer Pricing Rules closely reflect the definitions under Article 1 of the OECD Model Legislation Related to Country-by-Country Reporting. An MNE group is defined as:

- including two or more enterprises the tax residences for which are in different states, and including an enterprise that is resident for tax purposes in one state and is subject to tax with respect to the business carried out through a permanent establishment in another state; and
- not an excluded MNE group.

A UPE is defined as a constituent entity of an MNE group that meets the following conditions:

- the constituent entity directly or indirectly owns a sufficient interest in one or more of the constituent entities of the MNE group, and the constituent entity is required to prepare consolidated financial statements under accounting principles generally applied in the constituent entity's state of tax residence, or would be required if the constituent entity's equity interests were traded on a public securities exchange in the constituent entity's state of tax residence; and
- there is no other constituent entity of that MNE group that directly or indirectly owns an interest described in the preceding point in the constituent entity mentioned therein.

The foregoing is one of many examples of the commitment Zambia has shown to aligning its Transfer Pricing Rules with international standards, and to the implementation of the BEPS Action Points.

Notably, the CbC report submitted to the ZRA must contain:

- information relating to allocation of the MNE's income, taxes and business by tax jurisdiction;
- a list of all the constituent entities in the MNE group included in each aggregation per tax jurisdiction; and
- any additional information that would be considered necessary or that would facilitate the understanding of the compulsory information provided in the CbC report.

Submission of this report may be made physically to the office of the Commissioner General of the Direct Taxes Division, or electronically.

It is also important to note the Transfer Pricing Rules state that entities in Zambia which are not UPEs of the MNE group may be required to file the CbC report if they are resident in Zambia for tax purposes and meet any of the following requirements:

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- the UPE operates in a jurisdiction that does not require the filing of a CbC report;
- the jurisdiction of the UPE has an international agreement with Zambia but does not have a qualifying competent authority agreement with Zambia; and/or
- there is a systemic failure by the jurisdiction in which the UPE is tax-resident, and the Commissioner General has notified the entity of such failure.

This places an obligation on non-UPEs of the MNE to file a CbC report when they are tax-resident in Zambia and meet any of the above conditions.

However, constituent entities that are resident in Zambia are excluded from filing a CbC report where the surrogate parent entity (SPE) has already been appointed in another country by the MNE group and they meet the following conditions:

- the SPE is required to file a CbC report in its country of tax residence;
- the SPE is tax-resident in a country which has a Qualifying Competent Authority Agreement (QCAA) with Zambia at the date of filing;
- the country of tax residence for the SPE, through the competent authority, notifies the tax authorities of the systemic failure if and when it occurs;
- the constituent entity that has been appointed as the SPE notifies the jurisdiction in which it is tax-resident that it will be filing the CbC report; and
- the constituent entity tax-resident in Zambia notifies the tax authorities of the identity of the SPE and its country of residence.

The ZRA has the mandate to preserve the confidentiality of the information provided in the CbC report. The information must be protected and kept secret as though the information were obtained under Zambia's domestic legislation.

Transfer Pricing-Related Disputes

The Transfer Pricing Rules provide that where the ZRA serves a taxpayer with a notice of assessment, a taxpayer may within 30 days of the date of said service object to the assessment by way of written statement addressed to the Commissioner General of the ZRA, setting out the grounds of objection. If the taxpayer is dissatisfied with the outcome of the Commissioner General's decision concerning the objection to the assessment, the taxpayer may within 30 days of the date of being served written notice of the decision appeal against the assessment to the Tax Appeals Tribunal (the "Tribunal").

If either the ZRA or a taxpayer is aggrieved by the decision of the Tribunal, they have the right to appeal against the Tribunal's decision to the Supreme Court of Zambia. Because the Supreme Court is Zambia's final court of appeal, its decision on a particular transfer pricing dispute is final.

The jurisprudence on transfer pricing in Zambia has developed over the years following the promulgation of the Transfer Pricing Regulations. The two notable cases on transfer pricing are Nestlé Zambia Trading Limited v The Zambia Revenue Authority – 2018/TAT/03/DT and Mopani Copper Mines Plc v The Zambia Revenue Authority – SCZ/8/269/2016.

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Nestlé Zambia also argued that the ZRA had erred in law and fact by issuing its assessment on the premise that Nestlé Zambia could not run at a loss since incorporation, when all the evidence provided to the ZRA showed the various factors which led to Nestlé Zambia's loss-making, and that the ZRA failed to objectively test the related party transactions, to which it raised transfer pricing concerns but made assumptions and estimates that were excessive and unreasonable.

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The ZRA argued that it carried out adequate tests on all related party transactions and the analysis of contracts and transactions revealed that Nestlé Zambia's transactions were mainly with various related parties. The ZRA further argued that Nestlé Zambia was paying royalties to Nestlé South Africa for the exclusive use of Nestlé trade marks and patents as a distribution company in violation of the arm's length principle, and that the assessments were made under the Income Tax Act and were therefore not estimates or assumptions.

The Tribunal held in favour of Nestlé Zambia, except for the argument on the categorisation of Nestlé Zambia as a low-risk distributor, and stated that it was erroneous for the ZRA to have aggregated the unrelated, discontinuous and not closely linked transactions as a means to test for arm's length. The Tribunal held that the assessment by the ZRA was wrongly arrived at because said assessment was based on inaccurate transfer pricing results emanating from the use of an inappropriate transfer pricing method and disproportionate comparables. The case referred to the OECD Transfer Pricing Guidelines, showing their applicability in Zambia, and provided guidance with regard to similar cases involving transfer pricing audits and assessments.

This case shows that the ZRA must be satisfied that transactions being assessed are in line with the arm's length principle. Further, a transfer pricing assessment will be held erroneous if the ZRA uses inappropriate transfer pricing methods and disproportionate comparables. In other words, the ZRA must ensure that when it assesses taxpayers such assessments are in line with the arm's length principle, and that it uses the appropriate transfer pricing method.

Mopani Copper Mines Plc v The Zambia Revenue Authority – SCZ/8/269/2016

This case is considered the landmark case on transfer pricing in Zambia. It arose from an appeal from the Tribunal, in which the Tribunal held against Mopani on a complaint raised by the ZRA, disputing certain tax assessments made by the ZRA. The ZRA undertook an audit on the mining industry's cost levels, and the exercise involved a tax audit on costs, revenues and transfer pricing practices. The audit was largely centred on possible transfer pricing practices between Mopani and its shareholder, Glencore International AG (GIAG), a related party that bought copper at a significantly lower price than the price at which it was sold to third parties.

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The tax audit raised some concerns regarding certain related party transactions. The issue was whether the transactions between Mopani and GIAG were at arm's-length, given GIAG's shareholding in Mopani. The ZRA had issued a tax assessment following conclusions that the internal pricing was not decided in line with the arm's length principle, and that one of the major reasons for the mispricing was to reduce tax liability.

Mopani argued that Section 95 of the Income Tax Act was wrongly invoked by the ZRA in the case of transfer pricing, as that section can only be invoked where there is reason to believe that the main purpose of the transaction was to avoid or reduce liability with respect to tax, in which case the Commissioner General of the ZRA would direct that a particular adjustment be made. Section 95(1) of the Income Tax Act provides that:

"Where the Commissioner General has reasonable grounds to believe that the main purpose or one of the main purposes for which any transaction was effected (whether before or after the commencement of this Act) was the avoidance or reduction of liability to tax for any charge year, or that the main benefit which might have been expected to accrue from the transaction within the three years immediately following the completion thereof, was the avoidance or reduction of liability to tax, he may, if he determines it to be just and reasonable, direct that such adjustments shall be made as respects liability to tax as he considers appropriate to counteract the avoidance or reduction of liability to tax which would otherwise be effected by the transaction."

The ZRA explained the nature of the symbiotic business relationship between Mopani and GIAG and how that special relationship reflected in the sales of the copper produced by Mopani. The ZRA further stated that the audit by the ZRA revealed issues that could cause any prudent tax authority to have misgivings about the arm's length claim of the transactions between Mopani and GIAG. This, in the Supreme Court's view, rightly raised reasonable suspicion sufficient to lead the ZRA to invoke Section 95 of the Income Tax Act. The Supreme Court of Zambia held in favour of the ZRA and ordered that Mopani pay a total of ZMW240 million in taxes assessed for the 2006 to 2010 tax years.

This case shows the applicability of the Commissioner General's discretion under Section 95 of the Income Tax Act concerning transfer pricing. Further, it highlights that related parties must ensure that their transactions are in line with the arm's length principle when they are setting the price. In this case, Mopani was adjudged to have sold copper to an associated party that happened to be its shareholder at a lower price as compared to third parties, resulting in an assessment which was upheld by the court.

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