

GOVERNMENT OF ZAMBIA

STATUTORY INSTRUMENT NO. 24 OF 2018

The Income Tax Act
(Laws, Volume 25 Cap. 453)

**The Income Tax (Transfer Pricing) (Amendment)
Regulations, 2018**

IN EXERCISE IN EXERCISE of the powers contained in sections 97C and 97D of the Income Tax Act, the following Regulations are made:

1. These Regulations may be cited as the Income Tax (Transfer Pricing) (Amendment) Regulations, 2018, and shall be read as one with the Income Tax (Transfer Pricing) Regulations, 2000, in these Regulations referred to as the principal Regulations.

Title and
commencement

S.I. No. 20
of 2000

2. Regulation 2 of the principal Regulations is amended by the insertion—

Amendment
of regulation
2

(a) in the appropriate places of the following definitions:

“ appropriate allocation method ” means a method that allocates total group cost among members of a group in a way that is proportional to the benefits or expected benefits to each member of the group;

“ arm’s length conditions ” has the meaning assigned to the term in the Act;

“ associated person ” has the meaning assigned to the word under section 97C of the Act;

Cap. 467

“ Commissioner-General ” has the meaning assigned to the word in the Zambia Revenue Authority Act;

“comparable transactions” means transactions that are comparable in accordance with regulation 11;

“comparable uncontrolled price method” means the 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;

“comparability factors” means factors specified in regulation 11;

“controlled transaction” is a transaction between associated persons;

“cost contributions arrangement” means an arrangement among persons to—

(a) share the costs and risks of developing, producing or obtaining assets, services or rights; and

(b) 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;

“cost plus method” means the 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;

“financial indicator” means in relation to the—

(a) comparable uncontrolled price method, the price;

(b) cost plus method, the mark up on costs;

(c) resale price method, the resale margin;

(d) transaction net margin method, the net profit margin; and

(e) transactional profit split method, the division of the operating profit and loss;

“information” includes a document and electronic information;

“low value added service” means a service that -

(a) is not provided by any member of the group to unrelated customers;

(b) does not use or create valuable intangible property; and

(c) does not involve the assumption, control or creation of significant risks;

“multi-national enterprise” means a business entity that is part of a multi-national enterprise group;

“multi-national enterprise group” means a group of associated business entities established in two or more countries;

“resale price method” means the 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 with the resale margin that is earned in comparable uncontrolled purchase and resale transactions;

“total group costs” means the direct and indirect costs incurred by connected persons in providing the service to members of the group of companies to which a Zambia taxpayer belongs;

“transactional net margin method” means the method which consists of comparing the net profit margin relative to an appropriate base which includes costs, sales, assets that a person achieves in a controlled transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions;

“transactional profit split method” means the method which consists of allocating to each associated person participating in a controlled transaction the portion of common profit (or loss) derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction; and

“uncontrolled transaction” is transaction between independent persons.

Insertion of
new
Regulations
10, 11, 12,
13, 14, 15,
16, 17, 18,
19, 20, 21,
22 and 23

3. The principal Regulations are amended by the insertion of the following new regulations immediately after Regulation 9:

Determination
of arms
length
principle

10. The Commissioner-General shall cause the determination of whether the conditions of a controlled transaction are consistent with the arm's length principle specified in section 97A (2) of the Act and the quantum of any adjustment made under section 97A (3) of the Act, in accordance with the provisions of these Regulations.

Comparability

11. (1) An uncontrolled transaction is comparable to a controlled transaction within the meaning of section 97A (2) of the Act when—

- (a) there are no significant differences between that uncontrolled transaction and a controlled transaction that could materially affect the financial indicator being examined under the appropriate transfer pricing method; or
- (b) such differences exist, if a reasonably accurate adjustment is made to the relevant financial indicator of the controlled transaction in order to eliminate the effects of those differences on the comparison.

(2) The Commissioner-General, in causing to be determined whether two or more transactions are comparable, shall consider the following factors to the extent that they are economically relevant to the facts and circumstances of the transactions:

- (a) the characteristics of the property or services transferred or supplied;
- (b) the functions undertaken by each person with respect to the transactions while taking into account assets used and risks assumed;
- (c) the contractual terms of the transactions;
- (d) the economic circumstances in which the transactions take place; and
- (e) the business strategies pursued by the person and associated person in relation to those transactions.

12. (1) The Commissioner-General shall cause to be determined the arm's length remuneration of a controlled transaction by applying the most appropriate transfer pricing method to the circumstances of the case.

Transfer
pricing
methods

(2) The Commissioner-General shall cause to be selected the most appropriate transfer pricing method from among the approved transfer pricing methods set out in subregulation (3), taking into consideration the—

- (a) respective strengths and weaknesses of the methods in the circumstance of the case;
- (b) 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;
- (c) availability of reliable information needed to apply the selected transfer pricing method or other transfer pricing methods; and
- (d) 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.

(3) For the purposes of subregulation (1), the following transfer pricing methods may be used:

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) transactional net margin method; or
- (e) transactional profit split method.

(4) When it is possible to determine an arm's length remuneration for some of the functions performed by the associated persons in connection with the transaction using one of the approved methods described in sub-regulations (3)(a)(b)(c) or (d), the transactional profit split method shall be applied based on the common residual profit that results once such functions are so remunerated.

(5) The Commissioner-General shall, cause the determination where, taking account of the criteria described in subregulation (1), the comparable uncontrolled price method under subregulation (3) *(b)*, *(c)*, *(d)* or *(e)* can be applied with equal reliability, of arm's length conditions to be made using the comparable uncontrolled price method.

(6) The Commissioner-General shall, where, taking account of the criteria described in subregulation (2), the methods under sub-regulations (3)*(a)*, *(b)* or *(c)* and the methods under sub-regulation (3)*(d)* and *(e)* can be applied with equal reliability, cause the determination of arm's length conditions to be made using any of the methods under subregulation (3)*(a)*, *(b)* or *(c)*.

13. (1) A person may choose only one method to determine the arm's length remuneration for a given controlled transaction.

(2) A person may apply a transfer pricing method other than the methods under regulation 12 (3) where that person can establish that—

(a) none of the methods can be reasonably applied to determine arm's length conditions for the controlled transaction; and

(b) such other method yields a result consistent with that which would be achieved by independent persons engaging in comparable uncontrolled transactions under comparable circumstances.

(3) A person may apply in writing to the Commissioner-General for use of a method other than those under regulation 12 (3), and where the Commissioner-General is satisfied, the Commissioner-General shall grant approval.

(4) The Commissioner-General's examination of whether the conditions of a person's controlled transactions are consistent with the arm's length principle shall be based on the transfer pricing method applied by that person where that person has used a transfer pricing method which satisfies the provisions of this Regulation, to establish the remuneration of a controlled transaction.

(5) The application of the Comparable Uncontrolled Price method shall in relation to transactions involving the acquisition of new or used assets by persons from connected persons not resident in Zambia, require—

- (a) the invoice payment for the acquisition of the asset of;
- (b) proof of when the asset was purchased from an independent third party; and
- (c) delivery notice.

(6) The Commissioner-General shall in the case of a used asset, require the subsequent application of the decline in value already amortised since the asset was purchased, as allowed under accounting principles generally accepted in Zambia.

(7) Despite subregulations (5) and (6), a technical appraisal may be performed by a third-party expert not employed by the company providing details of the characteristics, scope and other conditions considered in the appraisal, for the purposes of this Regulation—

- (a) where an asset is sold in a different state from the one in which it was purchased, excepting ordinary wear and tear;
- (b) where there is no third-party invoice; or
- (c) in the case of an asset built or assembled using a number of components with several invoices.

14. (1) A person shall when applying a cost plus, resale price or transactional net margin method provided under regulation 12(3), select a party, referred to as the “tested party”, to the transaction in respect of which a financial indicator, markup on costs, gross margin, or net profit indicator, is tested under the most appropriate transfer pricing method under the circumstances.

Selection of
tested party

(2) A person shall select the tested party in a manner consistent with the functional analysis of the transaction.

(3) A tested party is the party in respect of which—

- (a) a transfer pricing method may be applied in the most reliable manner;
- (b) the most reliable comparables can be found; and
- (c) has the less complex functions.

(4) The Commissioner-General shall, require the financial information on the tested party in addition to the information under sub-regulation 14, irrespective of whether the tested party is a domestic or foreign entity where the most appropriate transfer pricing method in the circumstances of the case, is determined following the provisions of subregulation 6 is a onesided method.

(5) A person shall where the most appropriate method is a cost plus, resale price or transactional net margin method and the tested party is the foreign entity, require sufficient information to be able to reliably apply the selected method to the foreign tested party and to enable a review by the Commissioner-General of the application of the method to the foreign tested party.

Evaluation
of person's
combined
controlled
transactions

15. If a person carries out, under the same or similar circumstances, two or more controlled transactions that are economically closely linked to one another or form a continuum that cannot reliably be analysed separately, those transactions may be combined to—

(a) perform the comparability analysis provided under regulation 11; and

(b) apply the transfer pricing methods provided in regulation 12.

Arm's
length range

16. (1) For the purposes of these Regulations, an arm's length range is a range of relevant financial indicator figures including prices, margins or profit shares produced by the application of the most appropriate transfer pricing method as provided under regulation 12, to a number of uncontrolled transactions, each of which is relatively equally comparable to the controlled transaction based on a comparability analysis conducted in accordance with regulation 11, except that in some cases, not all comparable transactions examined will have a relatively equal degree of comparability.

(2) A controlled transaction, or a set of transactions that are combined under regulation 15, shall not be subject to an adjustment under section 97A of the Act 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 it is possible to determine that an uncontrolled transaction has a lesser degree of comparability than another, those transactions shall be eliminated.

(4) Where every effort has been made to exclude points that have a lesser degree of comparability, and what is arrived at is a range of figures for which it is considered, given the process used for selecting comparables and limitations in information available on comparables, that some comparability defects remain that cannot be identified or quantified, those transactions shall not be adjusted.

(5) In the cases referred to in subregulation (4), where the range includes a sizeable number of observations, a person shall use the interquartile range to enhance the reliability of the analysis.

(6) The Commissioner-General shall, where the relevant financial indicator derived from a controlled transaction, or from a set of controlled transactions that are combined under regulation 13, falls outside the arm's length range, adjust the indicator pursuant to section 97A(3), and that adjustment shall be to a point in the arm's length range that best reflects the circumstances of the case.

(7) Despite subregulation (6), the Commissioner-General may, in the absence of persuasive evidence for the selection of a particular point in the range, select the midpoint

in the range.

17. (1) A service charge between associated persons shall be considered consistent with the arm's length principle where—

Services
between
associated
persons

- (a) it is charged for a service that is actually rendered;
- (b) the service provided or rendered was expected to provide the recipient of the service with economic or commercial value to enhance the recipient's commercial position;
- (c) it is charged for a service that an independent person in comparable circumstances would have been willing to pay for if performed for it by an independent person, or would have performed inhouse for itself; and
- (d) the amount of the charge corresponds to that which would have been agreed between independent persons for comparable services in comparable circumstances.

(2) A service charge made to a person shall not be consistent with the arm's length principle where it is made by an associated person solely because of the shareholder's ownership interest in one or more other group members, including for any of the following costs incurred or activities undertaken by that associated person:

- (a) costs or activities relating to the juridical structure of the parent company of that 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 that person, including the consolidation of reports; and
- (c) costs or activities related to raising funds for the acquisition of participations, unless those participations are directly or indirectly acquired by that person and the acquisition benefits or is expected to benefit that firstmentioned person.

(3) Subject to the provisions of regulation 15, a person shall, where it is possible to identify specific services provided by that person to an associated person, determine whether the service charge is consistent with the arm's length principle for each specific service.

(4) Where a service is rendered by a person to various associated persons jointly and it is not possible to identify a specific service provided to each of them, the total service charge shall be allocated among the associated persons that benefit or expect to benefit from the services in accordance with a reasonable allocation criteria under these Regulations.

(5) For the purpose of subregulation (4), allocation criteria shall be viewed as reasonable where they are based on a variable or variables that—

- (a) take into account the nature of the services, the circumstances under which they are provided and the benefits obtained or that were expected to be obtained by the persons for which the services are intended;

- (b) relate exclusively to uncontrolled transactions;
and
- (c) are capable of being measured in a reasonably reliable manner.

(6) An amount charged for the provision of a low value added service between connected persons shall be considered as arm's length if —

- (a) the amount is based on an allocation to each person that receives a low value added service of the total group costs of providing the services;
- (b) the allocation of these costs is based on an appropriate allocation method;
- (c) the cost plus method is applied to these costs;
and
- (d) the mark-up on these costs is five percent.

18. (1) The determination of arm's length conditions for controlled transactions involving licenses, sales or other transfers of intangible property between associated persons shall take into account both the perspective of the transferor of the property and the perspective of the transferee, including 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.

Transactions
involving
intangible
property

(2) A person shall, in applying the provisions of regulation 11 to a transaction involving the license, sale or other transfer of intangible property, consider any special factors relevant to the comparability of the controlled and uncontrolled transactions, including—

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

(3) For the purposes of this regulation:

“intangible property” includes any property which is not a physical or a financial asset, and is capable of being owned or controlled for use in commercial activities and includes patent, invention, secret formula or process, design, model, plan, trademarks, knowhow, or marketing intangibles.

Corresponding
adjustments

19. (1) The CommissionerGeneral shall, after a request is made by a person, examine the consistency of an adjustment with the arm’s length principle of section 97A(2) of the Act, consulting as necessary with the competent authority of the other country where—

- (a) an adjustment to the conditions of transactions between any person and an associated person is made or proposed by a tax administration in a country other than Zambia;
- (b) the adjustment results in the taxation in that other country of an amount of profits on which the person has already been charged tax in Zambia; and
- (c) the country making or proposing the adjustment has a tax treaty with Zambia that reflects an intention to provide for the relief of economic double taxation.

(2) The CommissionerGeneral shall, if the adjustment proposed or made by the other country is consistent with the arm’s length principle both in principle and as regards the amount, make a corresponding adjustment to the amount of the tax charged in Zambia to that person on those profits, in order to eliminate the economic double taxation that would result from the inclusion of the same profits in the taxable income of both the person and the associated person.

(3) For purposes of this regulation:

“economic double taxation ” means the taxation of the same income twice in the hands of two different taxpayers.

Consistency
with
organisation
for
economic
cooperation
and
development

20. (1) These Regulations shall be construed in a manner consistent with—

- (a) the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations as supplemented and updated from time to time; and
- (b) the United Nations (UN) Practical Manual on Transfer Pricing for Developing Countries as supplemented and updated from time to time.

(2) Where there is any inconsistency between the Act, these Regulations and the OECD Guidelines or the UN manual referred to in this regulation, the Act and these Regulations shall prevail to the extent of the inconsistency.

21. (1) A person participating in a controlled transaction shall prepare on an annual basis and 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.

Provision of
documentation
on
controlled
transaction

(2) This Regulation does not apply to a person whose annual turnover is below twenty million Kwacha in any charge year.

(3) The threshold referred to in sub-regulation (2) shall not apply to a multi-national enterprise.

(4) The contemporaneous documentation referred to in subregulation (1) shall include records and documents that describe—

- (a) the controlled transaction, including the nature, terms and price of each controlled transaction, details of property transferred or services provided and the quantum and the value of each respective transaction;
- (b) the identity of associated persons involved in each controlled transaction and the relationship with the associated person;
- (c) 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;
- (d) the details of other controlled transactions that directly or indirectly affect the pricing of the subject controlled transaction;
- (e) a record of the economic forecasts, budgets or other financial estimates prepared by the person for that person's business as a whole, or separately for each division or product that may have a bearing on a controlled transaction;

- (f)* uncontrolled transactions and information on financial indicators for unrelated parties relied on in the transfer pricing analysis, including a description of the comparables search methodology, a record of the nature, terms and conditions relating to any uncontrolled transaction with unrelated parties relied upon in the transfer pricing analysis;
- (g)* the details of any comparability adjustments performed indicating whether they have been performed on the tested party on the comparable uncontrolled transaction or both;
- (h)* 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;
- (i)* which associated person is selected as the tested party and an explanation for the choice of the tested party;
- (j)* a summary of financial information used and the assumptions made in applying the transfer pricing methodology;
- (k)* the reasons for performing a multiyear analysis, where applicable;
- (l)* the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
- (m)* details of the adjustments, if any, made to the transfer price to align it with arm's length price and consequent adjustment made to the total income for tax purposes;
- (n)* 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;
- (o)* 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;

- (p) summarised schedules of relevant financial data for comparables used in the analysis; and
- (q) any other information including information relating to the associated person that may be relevant for determination of the arm's length price.

(5) The records and documents referred to in subregulation (3) shall be provided to the CommissionerGeneral upon request.

(6) For the purposes of this regulation:

“contemporaneous documentation” means documentation which is generated when a person is developing or implementing a controlled transaction.

22. (1) A person who engages in a controlled transaction shall maintain information in respect of the transaction, the associated person and the transfer pricing method used.

Maintenance
of
information

(2) The information maintained under sub-regulation (1) shall include—

- (a) a description of the management structure of the local entity to which local management reports are sent and the geographical location of senior executives;
- (b) a profile of the multi-national group which the person is a part of and the name, address, legal status and country of tax residence of each of the persons comprised in the group with which controlled transactions have been made and the details pertaining to the ownership of the companies;
- (c) a detailed description of the business of the person, the industry in which that person operates and the business of associated persons with whom that person has controlled transactions; and
- (d) a statement on whether the person has been involved in or affected by business restructuring or intangible transfers in the current or immediate past year and explanation of aspects of the transactions affecting that person.

(3) The information kept under sub-regulation (2) shall be prepared by the due date of the annual return submission, but shall not be submitted with that return.

(4) The information maintained under sub-regulation (1) shall include —

(a) a chart illustrating the multi national enterprise's legal and ownership structure and the geographical location of operating entities comprising that enterprise;

(b) general written description of the multi national enterprise's business including—

(i) important drivers of business profit;

(ii) the supply chain for the group's five largest product or service offerings by turnover and any other products or services accounting for more than five percent of group turnover;

(iii) important service arrangements between members of the multi national enterprise group, other than research and development services, including a description of the capabilities of the principal locations providing important services, and the transfer pricing policies for allocating services costs and determining prices to be paid for intragroup services;

(iv) the main geographic markets for the group's products and services that are referred to in regulation 6(2)(b);

(v) a brief functional analysis of the principal contributions to value creation by individual entities within the group, including key functions performed, important risks assumed and important assets used; and

(vi) important business restructuring transactions, acquisitions and divestitures that occur during a financial year;

- (c) a general description of the multi national enterprise group's overall strategy for the development, ownership and exploitation of intangibles, including the location of principal research and development facilities and location of research and development management;
- (d) a list of intangibles or groups of intangibles of the multi national enterprise group that are important for transfer pricing purposes and which entities legally own them;
- (e) a list of important agreements among identified associated persons related to intangibles, including cost contribution arrangements, principal research service agreements and licence agreements;
- (f) a general description of the group's transfer pricing policies related to research and development and intangibles;
- (g) a general description of any important transfers of interests in intangibles among associated persons during the fiscal year concerned, including the entities, countries, and compensation involved;
- (h) a general description of how the group is financed, including important financing arrangements with unrelated lenders;
- (i) the identification of any members of the group that provide a central financing function for the group, including the country under which laws the entity is organised and the place of effective management of such entities;
- (j) a general description of the multi national entity group's general transfer pricing policies related to financing arrangements between associated enterprises;
- (k) the group's annual consolidated financial statement for the financial year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes; and
- (l) a list and brief description of the group's existing unilateral advance pricing agreements and other tax rulings relating to the allocation of income among countries.

Request for
information

23. (1) The Commissioner-General may, by notice in writing, request a person to submit the information kept for purposes of these Regulations.

(2) A person shall, within thirty days from the date of issue of the notice referred to in sub-regulation (1), provide the information to the Commissioner General.

(3) Where a document required for purposes of these Regulations is not in English, the person required to submit it shall, at the person's own expense, produce a translation in English, prepared and certified by a translator before a Notary Public.

(4) A person who fails to furnish any information to the Commissioner-General upon receipt of a notice under sub-regulation (1), commits an offence and is liable, upon conviction, to the penalties specified in the Act.

(5) The obligation of a taxpayer to provide documentation is without prejudice to the power of the Commissioner-General to request additional information that in the course of audit procedures the Commissioner-General considers necessary to carry out the Commissioner-General's functions.

LUSAKA

28th March, 2018

[MFB./101/11/45]

M. D. MWANAKATWE,
Minister of Finance