

## ZAMBIA REVENUE AUTHORITY



### Presentation at UN/ATAF workshop on TP Comparability Analysis - Madagascar

14<sup>th</sup> to 17<sup>th</sup> November 2016

## TRANSFER PRICING LEGISLATION IN ZAMBIA

- Income Tax Act Section 97A requires that transactions entered into between controlled parties follow arm's length conditions.
- ZRA is empowered under the Act to make adjustments to controlled transactions that are not done at an arm's length.
- Reported income of any taxpayer engaging in commercial or financial transactions with related parties can be revised so that it is computed on the arm's length basis

## TP GUIDELINES

- Zambia currently doesn't have Transfer pricing guidelines in place however the Income Tax Act Section 97C(6) was amended in 2013 to empower the Minister of Finance to Issue a statutory Instrument on TP documentation & Information.
- Draft guidelines have been formulated in line with OECD/UN guidelines.
- Draft guidelines being reviewed by the Ministry of Finance with a view to issue them before the end of 2016.

## TP EXPERIENCE AND PRACTICE IN ZAMBIA

- Prior to March 2016 ZRA didn't have a specific Transfer pricing unit dealing with transfer pricing Audits.
- Four officers from the large taxpayer office were identified in 2012 and trained to undertake transfer pricing Audits identified within the mining and non mining audit units.
- 6 to audits done from 2012 to 2015
- 3 are under objection and 3 in court

## CREATION OF TP UNIT /TP DOCUMENTATION

- A transfer pricing unit comprising four officers was created in 2016 to focus on transfer pricing and Permanent Establishment issues.
- Approach gives a direct focus on transfer pricing audit cases which generally take a longer period of time to conclude compared with the normal audits.
- Without specific guidelines Taxpayer's compliance is difficult to enforce on the need to prepare transfer pricing policy document for the group.
- ZRA is relying on Section 58 and other Sections to compel taxpayers to submit the transfer pricing documentation and information.

## COMMON TP ISSUES

- Common transfer pricing issues that arise during audits are ;
- Sales of goods
- Purchase of Goods
- Management and consultancy services
- Interest on loans
- Royalties on use of patents and trade marks

## TP RELATED PAYMENTS TO NON ATAF COUNTRIES

- Switzerland
- Isle of Man
- Bahamas
- Bermuda
- Neitherland
- Cayman Island
- Dubai
- Canada
- USA
- Australia

## TP METHODS AND ACES TO COMPARABLE

- The Transactional Net Margin Method- TNMM and Cost Plus Methods are the methods commonly used by most taxpayers
- "6TH METHOD" Income Tax act provides that sale of base metals directly or indirectly between related or associated parties, the applicable price is the LME price or average metal bulletin price.
- ZRA is using TP catalyst/CUFT/ORBIS provided by Bureau Van Dijk.
- Challenge to obtain comparable companies from africa as most companies are not on the Database.

## FUTURE OF TP AND APA'S

- Zambia to work with corroborating partners such (UN,ATAF, OECD) to ensure that officers in the Transfer pricing unit develop adequate skills and capacity to conduct more complex TP audits.
- TP legislation will be strengthened once TP guidelines are issued by the Minister of Finance.
- Zambia to sign more information exchange agreements
- Advance pricing Agreements(APA) are not expected soon as the transfer pricing audits are still in the infancy stages.

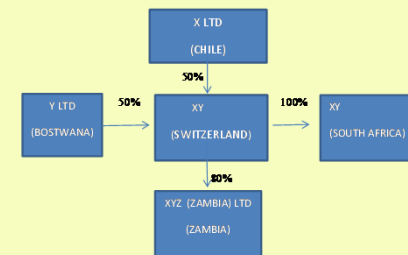
## Case study company background

- XYZ mining is a highly automated mine based on the Copper belt of Zambia
- XY(Switzerland) is a joint venture company owned equally by Two mining conglomerates X and Y who are resident in Chile and Botswana respectively.
- X and Y have 80% controlling interest in XYZ whilst the other 20% is owned by the government of Zambia through a parastatal called Z. The Audit was conducted in 2015 and covered a period of 2 years.
- XY Man Co is a management services company owned by XY

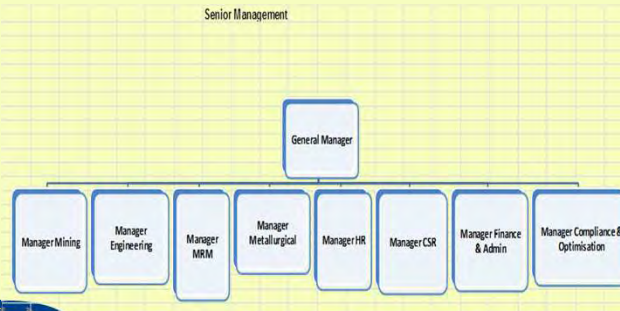
## MANAGEMENT SERVICE AGREEMENT

- XYZ limited entered into a management consultancy agreement with its shareholders X limited, Y and Z. The trio were appointed as consultants to undertake consultancy services
- It was also agreed that management consultancy services would be provided by a related party called XY management company (XY man co) resident in the republic of South Africa.
- The consultancy fee payable was agreed as 2.5% of the total costs of XYZ for each quarter during the financial year.
- The Consultancy fees were paid to all shareholders in the proportions of the current shareholding in the company.
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## GROUP STRUCTURE



## LOCAL STRUCTURE



## TYPE OF MANAGEMENT SERVICES

- **Type of services provided by XY man co**
- Technical advice
- Labour relations
- Finance, administration and human resources
- Procurement
- Investment of XYZ's funds
- Insurance
- Media Relations
- Preparation and implementation of the work plan and budget
- Management of the development of the mining area
- Operations management
- Management of the evaluation of the mining area
- Liaison with national, provincial and local regulatory, government and other authorities in Zambia
- Building and maintenance of local community and other stakeholders relationships
- Local vendor supplier lists and how to liaise with them
- Contractual relationships
- Facilitating shared services between the mine and neighboring mines

## AUDIT FINDING

- Audit findings revealed that XYZ mines did not request for any consultancy services during the audit period.
- No meeting was held to decide which services should be provided during the audit period.
- No records pertaining to management services rendered to XYZ were provided to the Audit team.
- It was observed that the services that were claimed to have been provided were duplicate services as XYZ has highly qualified personal performing similar functions and services as claimed by XY man co.

## AUDIT FINDINGS

- It was also observed that all the shareholders were paid the Management fees regardless of who provided the services among the shareholders. This arrangement was designed to benefit all the shareholders.
- There was no justification for the shareholders to Charge management fees based on the total costs for XYZ Mining limited. The management fee should have been charged based on cost plus a markup.
- Based on the facts above we proposed to dis allow the management fees paid to the shareholders.
- Management Fees Disallowed **2013: USD\$ 2,898,918**  
**2014: USD\$ 2,800,191**

## INTEREST ON LOANS

- During the period 2011 to 2015, XYZ mining obtained short term loan amounting to USD456 million
- The loan was unsecured
- The Interest was payable at 12 months Libor + 5%
- Interest Charged was 2013 : USD\$ 10,554,876  
2014: USD\$ 14,997,914

## INTEREST BENCH MARKING

- The TP catalyst was used to determine the arm's length price in the absence of the Taxpayers justification that 5% interest charged plus libor was arm's length price.
- 20 companies who obtained loans from unrelated companies under similar terms and conditions as XYZ Mining companies. Comparable uncontrolled price(CUP) method was selected as the most appropriate method because there were transactions among unrelated third parties , which meet the comparability requirements under this method to provide a reliable measure of arm's length results.

## ARM'S LENGTH

- Benchmarking analysis results showed the distribution of arm's length lending margins as below
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- Maximum - 3.25%
- Median - 1.5 %
- Lower - 1.11%
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- ZRA adjusted the lending margin from 5% to 3.25% to reflect the arm's length price interest rate.

## INTEREST DISALLOWED

	2013	2014
	USD000	USD000
Interest expensed	19,896,650	26,060,724
Adjusted interest @libor + 3.25%	12,335,923	16,087,337
Interest disallowed	7,560,727	9,973,387
Exchange rate	5.42	6.31
Total in ZMW	40,979,141	62,932,072

## OBJECTION

- **MANAGEMENT FEE**
- XYZ objected to the adjustment and submitted transfer policy document justifying the charge of the management fee.
- That TNMM was selected as the most appropriate method to determine a range of the arm's length mark ups earned by independent comparable rendering similar services to those of XY Man Co over the costs incurred in providing the services.
- The tested party was XY man co, it was submitted that the choice of the tested party was because XY man co had least complex transactions and that it was easy to get comparable companies providing management services.

## ARM'S LENGTH INTEREST

- The company stated that the results of the comparability analysis for margin earned by 25 independent companies indicated that the inter-quartile range for 2013, was 3.02% to 13.68%, median 6.95% and 2014 inter-quartile range was 3.69% to 13.2% median 6.45%

## INTEREST

- In order to assess the risk profile of XYZ , the company used moody's Risk calculator plus
- The company relied on moody's implied ratings in order to determine the spread charged by the market for similar risk profiles.
- The credit rating was then used to determine the spread charged by market taking account of the maturity date of each loan.

## ARM'S LENGTH INTEREST

- The company used moody's Market Implied Rating for a 4 year and 5 year loan maturity period to create a range of the arm's length spread for each loan agreement.
- The arm's length spread was found to be between 5.11% to 9.22%
- Consequently based on the Benchmarking study it was found that an interest rate of Libor plus 5% charged by the related parties falls below the arm's length range.

**Thank You**

