

Building capacity to prevent profit shifting by large companies in **Zambia**

From forming a transfer pricing unit to success in a landmark Supreme Court victory





Context

Zambia, a large and landlocked country in the centre of southern Africa, is the continent's second-largest copper producer.¹ Copper is also Zambia's most important export, accounting for 70% of export earnings.² Zambia is rich in other natural resources too, such as coal, cobalt, emeralds, hydropower, lead, gold, silver, uranium, and zinc.³

After a decade of impressive economic growth in 2004-14 averaging 7.4% per year⁴, Zambia's growth weakened in recent years reaching an estimated 2% in 2019, down from 4% in 2018.⁵ Growth is projected to decline at least by 4% in 2020 due to the COVID-19 crisis before climbing back 2.5% in 2021. Business activity in many key sectors driving growth including tourism, mining, manufacturing, construction, and wholesale and retail trade is projected to slow down.⁶ Heavy reliance on non-concessional external borrowing to finance large-scale infrastructure projects has resulted in large fiscal deficits since 2014⁷, which are expected to widen further due to higher public spending and lower revenues while the country tackles the COVID-19 crisis.⁸

Collecting revenues from the sale of copper and other minerals is of paramount importance to Zambia. Enhancing domestic resource mobilisation (DRM) will be all the more essential for Zambia in a post-COVID-19 environment.

This case study illustrates how the Zambia Revenue Authority (ZRA), the African Tax Administration Forum (ATAF), the OECD, the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), as well as other international partners such as the Intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development (IGF), have successfully worked together to build transfer pricing audit capacity in Zambia. African countries often report that transfer pricing represents one of the highest risks to their tax base with millions of US dollars of tax at stake. International assistance on tax matters

should encompass institutional, organisational and individual issues in order to make a difference.⁹ New transfer pricing legislation will have little or no impact if an administrative structure for enforcing them does not exist. Similarly, the effectiveness of such rules will be severely impaired if auditors responsible for enforcing them lack the requisite skills. Therefore, capacity building needs to encompass a full spectrum of issues including: policy development; legislation and guidance; administrative structure and governance; risk assessment and practical auditing skills.¹⁰

Zambia has been benefitting from a long-term ATAF/OECD/World Bank Group (WBG) technical assistance programme on transfer pricing and other base erosion and profit shifting (BEPS) related issues since 2013, and joined the OECD/G20 Inclusive Framework on BEPS – an international collaboration of over 135 jurisdictions working together to end tax avoidance – in December 2017. The technical support includes a Tax Inspectors Without Borders (TIWB) programme and a 'deep-dive' programme in the mining sector. TIWB is a joint initiative of the OECD and the United Nations Development Programme (UNDP) for improving tax audit capacities through a practical hands-on approach and was delivered in Zambia with ATAF. The deep-dive programme in the mining sector is delivered in Zambia through a partnership of ATAF, IGF and the OECD. It provides sector-specific guidance on BEPS challenges and capacity building support, including training, legal and policy advisory services, as well as hands-on tax audit assistance. Zambia has also received technical assistance on exchange of information (EOI) for tax purposes since 2018.



Box 1: Impact of the long-term technical assistance programme on transfer pricing and other BEPS related issues

- On advice from the technical assistance programme and as recommended by the Mbeki High Level Panel on Illicit Financial Flows from Africa*, the ZRA formed a Transfer Pricing Unit in March 2016. Setting up the unit has enabled the unit members to build expertise in this highly specialised area of tax.
- In 2018 and 2019, Zambia successfully implemented an extensive programme of international tax reform, introducing or amending rules relating to transfer pricing and other BEPS related issues. This included:
 - New transfer pricing and transfer pricing documentation regulations (in accordance with BEPS Actions 8-10)
 - New interest limitation legislation (in accordance with BEPS Action 4)
 - New transfer pricing Practice Note setting out how the ZRA will implement its transfer pricing regulations
 - Revised transfer pricing legislation relating to the pricing of copper and other metals for computing taxable income.

These changes have strengthened the ZRA's legal powers to address transfer pricing non-compliance, and provided greater tax certainty to both the ZRA and Zambian businesses.



- ZRA has achieved significant results on their transfer pricing audit work since 2015.

This includes:

- **USD 133 million of assessed tax**
- **USD 111 million of collected tax.****
- In May 2020, ZRA won a landmark transfer pricing case against Mopani Copper Mining plc (MCM) in the Supreme Court. The Court ordered MCM to pay additional tax of **240 million Kwacha (USD 13 million).*****

* United Nations Economic Commission for Africa, *Illicit financial flows: report of the High Level Panel on illicit financial flows from Africa*, 2015. <https://repository.uneca.org/handle/10855/22695>

** The difference in assessed and collected tax is due to a lag between the time additional tax is assessed and when the tax due on those assessments is collected from taxpayers.

*** Mopani Copper Mines Plc Vs Zambia Revenue Authority Appeal No 24 of 2017. <http://www.judiciaryzambia.com/wp-content/uploads/2020/05/App-024-2017-Mopani-Copper-Mines-Plc-Vs-Zambia-Revenue-Authority-20th-May-2020-Mambilima-Cj-Malila-And-Mutuna-JJS.pdf>.





How transfer pricing audit capacity has been built in Zambia

Long-term technical assistance on transfer pricing and other BEPS related issues

In 2013, at the request of the ZRA, the OECD, in partnership with the WBG, commenced a long-term technical assistance programme to build an efficient and effective transfer pricing regime in Zambia. This technical assistance complemented the assistance being provided by the Norwegian Tax Administration, which included the provision of a data base for ZRA to support transfer pricing.

ATAF joined the OECD/WBG partnership in 2016. The programme focussed on building the audit skills of the ZRA officials and on improving the Zambian legislative framework for transfer pricing and other BEPS related issues which had gaps that Multinational Enterprises (MNEs) could exploit to minimise their tax liability. Over the period 2014-17, the technical assistance team delivered one-week long training workshops three times a year to build the knowledge of ZRA auditors on transfer pricing concepts and to provide advice on the ZRA's transfer pricing audits. The audits were anonymised to ensure taxpayer confidentiality.

During this period, remote assistance was also provided to support the ZRA in its review of Zambian transfer pricing and other BEPS related rules, and recommendations were made for changes to legislation, as well as the accompanying regulations and supporting practice notes. Subsequently in 2018-19, Zambia successfully implemented international tax reforms to strengthen its transfer pricing framework (see Box 1). These changes have closed gaps in the law to counter tax avoidance and provided greater tax certainty. Gaining the political support of the Ministry of Finance and the Ministry of Justice was key to achieving these legislative changes. In particular, the technical assistance team worked together with the

ZRA, including meeting with the Minister of Finance in 2018, to bring attention at a political level to the gaps in Zambia's legislation and the resulting exposure to BEPS. The team also discussed the potential technical solutions and the need for political support to enact those solutions.

Support was also provided to the ZRA in publishing a Transfer Pricing Practice Note to provide greater certainty for taxpayers on how the ZRA would implement the new transfer pricing regulations.

After Zambia joined the OECD/G20 Inclusive Framework on BEPS at the end of 2017, assistance in 2018 focused on helping the country to start implementing the BEPS minimum standards.¹¹ In March 2018, a joint ATAF/OECD team visited Lusaka to meet with the Minister of Finance and senior officials from the Ministry of Finance, Ministry of Justice and ZRA to discuss a roadmap for the implementation of BEPS measures in Zambia.

“The Mopani case shows how long transfer pricing cases can take to resolve but more importantly it sends a message that African Tax Authorities are now able to take on and deal with complex transfer pricing transactions. The Mopani case has been long and complex but the capacity building support from ATAF, the OECD and other partners helped our audit and legal teams in confidently and competently dealing with the case, leading to additional revenue for the Government.”

Ignatius Mvula, Assistant Director – Mining Audit Unit, Zambia Revenue Authority.



Box 2: The Mopani case – a landmark transfer pricing case

A high priority during the period of technical assistance was one of the first large transfer pricing cases the ZRA were dealing with, resulting in a dispute with Mopani Copper Mines Plc (MCM). It related to the pricing of copper sold by MCM to its shareholder company Glencore International AG (GIAG) located in Switzerland. Utilising the advice and training received through the long-term technical assistance programme, the ZRA built its case contending that MCM had under-priced copper sold to GIAG, thus reducing its taxable income and hence its tax liability. The ZRA argued that the prices of copper sold to GIAG were significantly lower than those of similar sales to third parties.

In December 2016, the Zambian Tax Appeals Tribunal upheld the tax assessments raised by the ZRA. MCM appealed to the Supreme Court, who in its ruling of 20 May 2020 also found in favour of the ZRA, and ordered Mopani pay a total of **240 million kwacha (USD 13 million) in assessed taxes** within 30 days.* This landmark victory for the ZRA brought to an end a long running dispute and built confidence in the ZRA that they have the capacity to resolve complex transfer pricing cases and are able to raise additional revenue for the country.



* Mopani Copper Mines Plc Vs Zambia Revenue Authority Appeal No 24 of 2017.

Assistance on tax transparency and exchange of information

Also in 2018, ATAF and the Global Forum, collaborating to strengthen African countries' capacities in the fight against tax evasion, commenced a technical assistance programme on Exchange of Information (EOI) in Zambia. The objective was to create awareness on EOI mechanisms and help Zambia put in place a suitable organisational structure and business processes to use EOI on request with countries with which it has an EOI agreement, as well as expanding its network of EOI partners over the longer term to cover a wide range of jurisdictions.

The programme started with a one-week training course on EOI for tax auditors, investigators and other ZRA officials. Another week was spent on identifying areas of improvement and developing an action plan. The technical assistance team discussed with the ZRA the current organisation of the EOI function and the legislative framework compared to the international standard, identifying gaps and ways for Zambia to improve in accordance with their context and priorities. One of the challenges was the lack of awareness on EOI

and how it can assist the ZRA in auditing cross-border transactions. Global efforts to tackle tax evasion through enhanced transparency and the potential benefits and opportunities for Zambia were raised. This resulted in greater awareness of the central role of EOI in tackling tax evasion and consequently, the leadership of the ZRA took steps to establish an EOI function within the organisation.

In 2020, in response to a request from the ZRA for assistance in making EOI a support function for tax audits, ATAF and the Global Forum have started a two-year programme, currently delivered remotely, aimed at addressing the following needs:

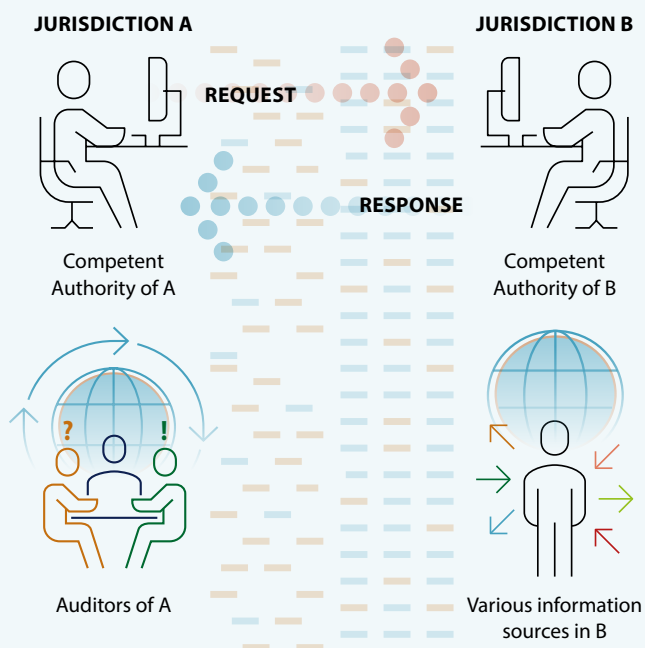
- **Building an effective EOI unit**, allowing Zambia to send EOI requests abroad and benefit from EOI in the fight against tax evasion;
- **Improving the domestic legal framework on tax transparency**, including through joining the Global Forum, allowing Zambia to fully meet the international standard and build trusting EOI relationships with its treaty partners;

Box 3: Opportunity to raise more revenue through exchange of information

Zambia's exposure to cross-border tax abuse is not limited to tax avoidance that results from transfer pricing and other BEPS related issues. It also includes tax evasion by taxpayers using foreign territories and legal systems to hide their income and assets by manipulating cross-border transactions. EOI allows tax administrations to send and obtain useful information from foreign tax administrations automatically, spontaneously or upon request, and is therefore an important tool in

detecting and addressing cross-border tax avoidance and evasion. The African Union Commission encourages African Union members to join the Global Forum Africa Initiative and make tax transparency a priority in their DRM efforts.*

Exchange of information on request



WHAT INFORMATION?

"Foreseeably relevant" for the administration or enforcement of the domestic tax laws of other tax jurisdiction or for carrying out the provisions of a relevant tax agreement, e.g. ownership information (legal and beneficial), accounting records and bank information.

Zambia has 22 tax treaties in force, which include EOI provisions. It has also signed the ATAF Agreement on Mutual Assistance in Tax Matters, which establishes EOI and assistance in tax collection among the contracting countries in Africa. However, Zambia has not yet sent any requests for information to a foreign partner, despite having had several cross-border audit cases, including transfer pricing cases. The significant results obtained by Zambia in tackling cross-border tax avoidance through transfer pricing and other BEPS related abuse can be accelerated as Zambia begins to build capacity to exchange information for tax purposes with other tax administrations worldwide. In particular, joining the Convention on Mutual Administrative Assistance in Tax Matters would provide Zambia with an EOI network with more than 140 participating jurisdictions.

Tax avoidance and tax evasion are the two main threats to international tax systems and should be addressed together. For example, EOI can help establish that a transaction apparently carried out between two related enterprises is not a controlled transaction because in fact one of the enterprises does not exist. EOI can also play a key role in conducting the functional analysis to accurately determine the role of each of the related parties in a controlled transaction.

There is a huge opportunity to be seized by Zambia in further strengthening cross-border audits and investigations and raising more revenue through EOI.

* Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency in Africa 2020: Africa Initiative Progress Report 2019*.

- **Raising awareness and delivering training on EOI**, allowing ZRA to understand the technicalities of EOI requests and mechanisms and build their skills in utilising EOI as a powerful tool in their day-to-day work; and
- **Broadening the network of EOI relationships**, allowing Zambia to request and obtain much-needed information from jurisdictions with which its taxpayers carry out transactions affecting Zambia's tax base.

Extended support through new programmes and partnerships.

As of 2018, the support provided to Zambia has also been broadened to include new programmes, such as TIWB, and the deep-dive programme in the mining

sector carried out through a new partnership between ATAF, IGF and the OECD. The one-year TIWB programme, delivered in partnership with ATAF, focused on general audit issues relating to the mining sector and was supported by the South African Revenue Service (SARS). The assistance helped the ZRA collect **additional tax amounting to USD 11 million**.

The deep-dive programme is assisting the ZRA over the next two to three years on their transfer pricing audits in the mining sector, as well as on improving legislation relating to the sector. The programme is also supporting the development of internal policies on mining related issues such as manganese pricing, royalty apportionment and commodity price hedging. The programme is delivered in close partnership with the Ministry of Mines and Mineral Development.

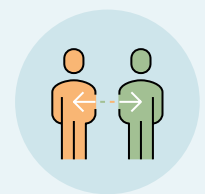


Lessons learned from the long-term technical assistance

- The formation of the ZRA Transfer Pricing Unit has helped to ensure that highly focused and bespoke technical assistance tailored to the specific needs of Zambia could be provided effectively and efficiently by the programme. The unit has started to help the ZRA to identify key transfer pricing risks and focus their scarce transfer pricing resources on these issues.
- The Mopani judgement shows the impact that such focused transfer pricing audit work can have in developing countries, even where resources in the tax administration are limited. The impact will be far broader than the amount of tax collected in the case as it sends a clear message to taxpayers that the tax administration can and will address non-arm's length transfer pricing. This should improve voluntary compliance and increase the confidence of the ZRA transfer pricing team in addressing such issues.
- The judgment also highlights the need to recognise that transfer pricing audits may take a significant length of time to resolve due to their fact-intensive nature. However, if tax administrations are properly resourced so they can pursue these difficult cases for as long as necessary, the audit work can lead to very significant results.
- It is vital to obtain political support for legislative changes at the earliest stage possible.
- A culture of EOI is critical to enhance cross-border tax investigations, including transfer pricing audit work.
- Technical assistance for low capacity countries is required over many years, if not decades, to achieve sustainable results in addressing tax avoidance and tax evasion.

Box 4: Strong partnerships with regional and sectoral approaches have been the keys to success

- Since 2013: OECD and WBG – *long-term technical assistance programme on transfer pricing and BEPS*. OECD and WBG provide transfer pricing experts.
- 2016: ATAF joined the partnership. All three organisations provide transfer pricing experts, with ATAF bringing knowledge of the specific challenges in Africa.
- 2018: ATAF and the Global Forum raised awareness and provided support on EOI leading to a two-year dedicated programme launched in 2020.
- 2019: ATAF, OECD, SARS and WBG – *support on transfer pricing audits through a TIWB programme*. ATAF, OECD and WBG provide transfer pricing experts with ATAF bringing knowledge of the specific challenges in Africa, and SARS expertise in general audit matters in the mining sector.
- 2019: ATAF, IGF and OECD – *deep-dive support on transfer pricing audits in the mining sector*. ATAF and the OECD providing advanced transfer pricing expertise and IGF providing mining industry expertise. Close partnership on the ground with the Ministry of Mines and Mineral Development.



Top photo: ATAF/OECD and IGF deliver training on transfer pricing in the mining sector. Lusaka, 2018.

Endnotes

1. World Bank, The World Bank in Zambia, 2019. <https://www.worldbank.org/en/country/zambia/overview>.
2. African Development Bank, African Economic Outlook 2020, Supplement Amid COVID-19. https://www.afdb.org/sites/default/files/documents/publications/afdb20-04_aeo_supplement_full_report_for_web_0705.pdf#page=60
3. The International Institute for Sustainable Development, BEPS in Mining Case Study: Boosting Zambia's revenues from the sale of manganese and copper, 2020. <https://www.igfmining.org/beps/resources/beps-mining-case-study-zambia/>
4. World Bank, The World Bank in Zambia, 2019.
5. African Development Bank, African Economic Outlook 2020. <https://www.afdb.org/en/countries-southern-africa-zambia/zambia-economic-outlook>
6. African Development Bank, African Economic Outlook 2020, Supplement Amid COVID-19.
7. African Development Bank, African Economic Outlook 2020.
8. African Development Bank, African Economic Outlook 2020, Supplement Amid COVID-19.
9. OECD, Supporting the Development of More Effective Tax Systems: A report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank, 2011. www.oecd.org/ctp/48993634.pdf
10. OECD, Part 2 of a Report to G20 Development Working Group on the impact of BEPS in low income countries, 2014. <http://www.oecd.org/g20/topics/international-taxation/part-2-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf>
11. As outcomes of the OECD/G20 BEPS project, four mandatory minimum standards were agreed to tackle issues in the following areas where no action by some countries or jurisdictions would have created negative spill overs on others: harmful tax practices (BEPS action 5), tax treaty abuse (BEPS action 6), Country-by-Country Reporting for the activities of MNEs (BEPS action 13), and dispute resolution (BEPS action 14).



For more information:



TaxandDevelopment@oecd.org



ATAF: www.ataftax.org

Global Forum: <https://oe.cd/tax-transparency>

OECD: <https://oe.cd/tax-global>

Zambia Revenue Authority: www.zra.org.zm



[@ATAFtax](https://twitter.com/ATAFtax) [@OECDtax](https://twitter.com/OECDtax) [#tax4dev](https://twitter.com/tax4dev)

Disclaimer

This document, as well as any data and any map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

© OECD 2020

The use of this work, whether digital or print, is governed by the Terms and Conditions to be found at www.oecd.org/termsandconditions.