



Transfer Pricing considerations for intra-group services



Multinational enterprises (“MNEs”) often employ intra-group services as a means of enhancing efficiency and realising cost savings by centralising services delivery to group entities. These are often offered by multiple group entities, a head office, or a Shared Service Centre designated by the group.

Frequently, these intra-group services transactions involve the provision of managerial, administrative, marketing, legal, accounting, information technology, human resource, and other corporate services. Intra-group shared support services provide commercial and economic advantages to the group such as cost optimisation, standardisation, control, elimination of effort duplication, and the ability for group entities to focus on their core operations, all of which are essential components considered in a transfer pricing analysis.

The transfer price of intra-group services must be determined in accordance with the arm’s-length principle. When determining whether intra-group services comply with transfer pricing rules and regulations, the arm’s-length nature of the services arrangement must be carefully evaluated, and there are a number of factors to take into account.

The ZRA prioritises the evaluation of transfer pricing arrangements of services when conducting transfer pricing audits. When undertaking transfer pricing audits for intra-group services transactions, the ZRA scrutinises the cost bases, the allocation basis of costs, the nature of services, the markup applied,

and whether the recipient of the services obtained a commercial or economic advantage.

In the sections that follow, we will discuss the most important transfer pricing considerations that Zambian taxpayers should be aware of with respect to intra-group services.

Have the services actually been rendered?

In accordance with the general deduction principle, which states that a tax deduction is only allowable if the expenditure was incurred wholly and exclusively for business purposes, the ZRA’s primary focus will be to determine whether intra-group services were rendered before assessing the appropriateness of the transfer price. The taxpayer will be expected to provide evidence to the ZRA that the services were actually rendered. It is also essential that the taxpayer provides proof to the ZRA that the service provider had the capacity and capability to render the services in question.

Was the service necessary?

The TP Regulations dictate that an intra-group service has to provide a respective group member with economic or commercial value to enhance or maintain its business position. The service in question should pass what is referred to as the “Benefit Test”.

Would an independent third party, acting rationally, be willing to pay to receive the same service or would they have performed the activity in-house instead? Does

this service provide an identified need for the local entity? If not, such intra-group services are not normally deemed to be provided at arm’s length.

The “Benefit Test” will be passed when the given service provides economic value for the recipient, enhancing or maintaining its commercial position.

To pass the test, the taxpayer may be required to provide the ZRA with a comprehensive chart describing the services provided, the nature of the services received, the extent of the taxpayer’s commercial and economic benefits from the services received, and other supporting documentation such as budgets, technical specifications of services rendered, personnel deployed to deliver the services, emails, reports, and other evidence including correspondence between the taxpayer and the service provider.

What constituted the cost base?

In many instances, a group member may provide a service to several members of the group or to all members of the group. This can result in some members of the group receiving and paying for a service that they may not necessarily have requested or required.

There are three categories of services that should not be recharged to local entities. These include:

- Shareholder Services: Services performed by a group member (usually the parent company



or an intermediate holding company) solely because of its ownership interest in one or more group entities, for example, for group financial reporting purposes. Such costs should be borne by the parent company and may not be considered for tax deductions.

- Duplicate services: Intra-group services provided which are already self-performed within the local recipient entity itself or outsourced to an independent party would be considered as duplicative services. Duplicate services may not be considered for tax deductions, but a transfer pricing analysis must evaluate the specifics of each service.
- Incidental benefits: Incidental benefits that arise when the local entity benefits from a service that a group member provided for other group members. The local entity benefited as a result of belonging to the larger MNE group and would not ordinarily be willing to pay a third party for the same service and may not be considered for tax deductions.

In order for the service provision to be considered to be in line with the arm's length principle, it is important that the costs included in the calculation of the cost base are attributable to the provision of the intra-group service from which the recipient actually derived a commercial or economic benefit.

In certain cases, the costs associated with the provision of a service can be easily recognised and allocated to the appropriate service recipient. The Direct Charge Method is used when associated parties are charged for particular services received.

Where the Direct Charge Method is not appropriate, taxpayers can use the Indirect Charge Method. This method is used when services

are rendered which benefits many members of the MNE group. When using the Indirect Charge Method, taxpayers must apply suitable allocation keys to ensure that the costs are allocated to the relevant service beneficiaries. According to paragraph 7.25 of the OECD TP Guidelines, an allocation key should be based on a reasonable measure of service utilisation and should be simple to verify.

Was the markup percentage at arm's length?

In certain cases, transfer pricing rules may require intragroup service providers to include a profit element or markup on the costs of providing services, in order to ensure that the remuneration is at arm's length. To establish the appropriate transfer price for an intra-group service, it is crucial to conduct an analysis of the service to accurately classify the nature of services provided. Services can be classified as routine or non-routine for transfer pricing purposes.

Non-routine services are services which:

- Require specialised skills;
- Are core competencies of the business;
- Are profit-earning activities; and
- Contribute to economically significant activities.

Examples of non-routine services include research and development, technical support, marketing and sales, procurement, manufacturing and production, financial services among others.

In transfer pricing, it is customary to verify the arm's length nature of non-routine services by performing a benchmarking study. This entails gathering information pertaining to comparable third-party entities engaged in provision of similar services as the transacting parties for transfer pricing purposes. Access to the required data is not always publicly available, and taxpayers may need to rely on commercial databases to conduct benchmarking studies.

Routine services or 'low value adding services' ("LVAS") are services which:

- Are of a supportive nature;
- Are not part of the core business of the MNE Group;
- Do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles; and
- Do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk for the provider.



Specifically, the local TP Regulations define a LVAS as a service that:

- Is not provided by any member of the group to unrelated customers;
- Does not use or create valuable intangible property; and
- Does not involve the assumption, control or creation of significant risks.

Examples of LVAS include legal, human resource, administrative, IT,

finance and audit, processing and management of accounts.

The TP Regulations provide a simplified transfer pricing approach for LVAS, permitting the service provider to determine arm's-length intra-group service charges. This approach involves implementing a cost-plus method with a five percent markup. Under this approach, the profit margin applied on costs is not required to be supported by a benchmarking study.

Documentary Evidence

It is essential for taxpayers to maintain records substantiating the arm's length nature of services they received. In the event of an audit, the ZRA will rely on such evidence to prove that the paid-for services were in fact received and necessary. We provide a summary of the types of records the local entity ought to maintain below.

Fact to be substantiated	Documentation/ evidence required
Substance Test	<ul style="list-style-type: none"> • Service level agreements. • Reports of work done by service provider, e.g., work done sheet with the staff member's name, job title, description of detailed services performed, estimate of time spent executing the task and summary of a service delivery report issued. • Minutes and presentations from meetings held in the performance of the intercompany services, telephone logs and email correspondences.
Benefits Test	<ul style="list-style-type: none"> • Nature of the service provided, i.e., financial, scientific, commercial, etc. • Description of the expected benefits of each category of services. • Impact of the service on the improvement of the local entity's business. • Description of the potential advantage (cost savings, competitive advantage, etc.) to the local entity's business. • Transfer Pricing Local File.
Duplication	<ul style="list-style-type: none"> • Detailed curriculum vitae and job descriptions of all employees performing the intercompany services to show competency and the level of skill of the employees. • Transfer Pricing Local File.
Cost Base and Allocation	<ul style="list-style-type: none"> • Identification of cost base. • Description of the selected allocation keys and the reasons justifying their use. • Identification of the markup. • Benchmarking study to support the markup applied. • Calculation showing the cost base, application of allocation key and markup. • Invoices for the payment of services.
Use of the Safe Harbor	<ul style="list-style-type: none"> • A description of the categories of LVAS. • Contracts or agreements for the provision of LVAS.

Conclusion

During the majority of transfer pricing audits, the ZRA carefully evaluates intra-group service transactions critically. There are various factors that either support or do not support the arm's-length

nature of intra-group services as outlined in this article. The burden of proving that commercial and economic benefits were obtained lies with the taxpayer. It is therefore advisable for MNEs to maintain comprehensive documentation that outlines the services provided, their

purpose and benefits, and provides evidence of the costs associated with them as doing so can be beneficial in defending oneself during assessment proceedings and potential legal disputes down the line.

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