ZAMBIA REVENUE AUTHORITY VS NESTLE ZAMBIA TRADING LIMITED (2025): LIMITATIONS OF THE SOURCE PRINCIPLE AMID FUNCTIONAL CHAEACTERISATION OF GROUP ENTITIES IN ZAMBIA

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DEDICATION

This work is dedicated to people that have significantly been a part of this journey, my Mum Emily, and the one person who makes my world a better place, Thandiwe Banda.

This is for you!

ACKNOWLEDGMENTS

Firstly, I want to thank God for being with me through out this academic journey, it has not been an easy one but you have been my strength.

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Special thanks to my family for the support, love and prayers. Dad, Mum, you my story would be incomplete without. Forever grateful. And to my loving siblings, you guys are amazing

ABSTRACT

This research discusses the limitations of the source principle of taxation in its current form and to what extent it guides the recharacterisation of group entities, while maintaining its normative role. The source principle forms the foundation of taxation in Zambia and aims to define what income is from a Zambian source. The research is motivated by the fact that the source principle has not been exhaustively defined under Section 14(1) of the Income Tax Act, to address issues of recharacterisation of group entities. While Section 18 of the Act has attempted to extend the source principle beyond the Zambian borders by deeming certain categories of income as Zambian sourced, challenges are particularly evident under transfer pricing arrangements that go beyond the scope covered. This has led to uncertainty and unpredictability in the manner in which transfer pricing assessments may be carried out. Consequently, it undermines equity and neutrality. This knowledge gap, which this paper aims to cover, is the lack of an exhaustive definition of the source principle to shape the recharacterisation of group entities under transfer pricing arrangements. This study uses statutory law, case law, international instruments such as the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines and the United Nations Practical Manual on Transfer Pricing and secondary data to carry out the research. Overall, the research found that the source principle does not fully shape recharacterisation of group entities during transfer pricing assessments due to its limited scope. As a result, there is no consistent manner in which income under transfer pricing arrangements can be attributed to Zambia because it is shaped by the circumstances of the case. This has negative implications on the principles of certainty, equity and neutrality, resulting in injustice on the part of the taxpayer, and consequently altering the taxpayer's behaviour. Therefore, the study recommends that the law be amended to ensure certainty and predictability, which will eventually encourage equity and neutrality. Additionally, the courts must harmonise the source principle and recharacterisation of group entities through statutory interpretation. Aside from the doctrinal aspect, there is a need for capacity building on the part of the tax administration to equip tax officers with the necessary tools to enforce tax laws effectively.

LIST OF ABBREVIATIONS

ALP	Arm's Length Principle
BEPS	Arm's Length Principle
CJ	Chief Justice
FAR	Functions, Assets and Risks
G20	Group of 20
LRD	Low risk distributor
MNC	Multinational Enterprises
MNE	Multi-National Enterprises
NZL	Nestle Zambia Limited
OECD	Organisation for European Economic Cooperation
TNMM	Transactional Net Margin Method
UN	United Nations
ZRA	Zambia Revenue Authority

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Mohammad Hussein v ZRA (1999).

Mopani Copper Mines Plc v Zambia Revenue Authority (Supreme Court Appeal No 24/2017).

Partington v Attorney-General (1869) LR 4 HL 100.

Scottish Provident Institution v Allan 6 F 1028.

Sony Ericsson Mobile Communications India (P) Ltd v CIT III and Ors, High Court of Delhi (2015).

Tariff Reinsurances Ltd v Commissioner of Taxes (Vic) (1938) 59 CLR 194.

Transvaal Associated Hide and Skin Merchants v Collector of Income Tax 1967 (29) SATC 97 (BCA).

Vestey v Inland Revenue Commissioners STC 10.

Zambia Revenue Authority v Nestle Zambia Trading Ltd (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025).

CHAPTER ONE

GENERAL INTRODUCTION

1.1 INTRODUCTION

Section 14(1)(a) of the Income Tax Act[1] constitutes the cornerstone of income taxation, charging tax on income that is received by a person, from a source within or deemed to be within Zambia.[1] This provision establishes the source principle as the jurisdictional basis for taxation. Although not expressly defined, it can be inferred from the provision that the term source refers to the origin or cause from which income derives. However, common law jurisprudence also supplies interpretive guidance to appreciate the principle. In this regard, in the case of **Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd,**[2] the courts established that the source of income simply refers to profit-earning activities. In a similar vein, the court in the case of **Tariff Reinsurances Ltd v Commissioner of Taxes**[3] was of the opinion that, in the simplest form, the source of income can be understood as income-producing operations. Therefore the narrow framing of Section 14(1)(a)[4] makes it vulnerable to abuse by the Zambia Revenue Authority (ZRA), specifically in matters of transfer pricing assessments, where the ZRA can recharacterise multinational affiliates as local operations. This vulnerability of the source principle was exposed in the case of **Zambia Revenue Authority v Nestle Zambia Trading Ltd,**[5] where ZRA reclassified Nestle as a limited-risk distributor (LRD), and increased the tax margin by imputing K56.6 million affiliate profits as Zambian-sourced. Consequently, placing the burden of proof on Nestle Zambia Limited (NZL)pursuant to Section 106 of the Income Tax Act, so that they can disprove the assessment and show what the correct one ought to be.

The doctrinal tension arises between Section 14(1)(a)[6] and Section 97A[7] With respect to situating transfer pricing adjustments within the source principle context. With

[1] The Income Tax Act, Chapter 323 of the laws of Zambia
[2] Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd 1946 AD 441, 456 (Watermeyer CJ)
[3] Tariff Reinsurances Ltd v Commissioner of Taxes (Vic) HCA 21, 206 (Latham CJ)
[4] The Income Tax Act, Chapter 323 of the laws of Zambia
[5] Zambia Revenue Authority v Nestle Zambia Trading Ltd Appeal No 03/2021 ZMSC 20 (Supreme Court, 20 August 2025)
[6] The Income Tax Act, Chapter 323 of the laws of Zambia
[7] Ibid.

absent statutory limits on source, the ZRA may deem recharacterised income as locally sourced, complicating cross-border interpretation. Multinationals face retrospective assessments, thereby disrupting legitimate planning, while procedural asymmetry undermines taxation's foundational principles of predictability, uniformity, and fairness.[8]

This study will assess the source principle under Section 14(1)(a)[9] , and its applicability to transfer pricing adjustments. Its significance lies in equipping Zambian courts with analytical frameworks to resolve tensions between Sections 14(1)(a) and 97A,[10] while advancing jurisprudence on source-based taxation amid global transfer pricing complexities.

1.2 BACKGROUND

Taxation is one of the most essential means through which Zambia raises revenue to finance public expenditure and ultimately provides public goods. However, being a source-based tax system, tax liability is primarily attached to income that is received from a source within Zambia.[11] This principle has long underpinned the Zambian income tax regime. As earlier highlighted, Section 14(1)(a) of the Income Tax Act provides the legal basis for source-based taxation. However, due to a lack of an exhaustive definition of the source, Zambian courts have historically relied on common law reasoning to interpret the source principle. In this regard, common law courts such as those in the cases of **Tariff Reinsurances Ltd v Commissioner of Taxes**[12] and **Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd**[13] *inter alia,* have time and again visited the source principle and have established a slight understanding of the source of income. Additionally, in the case of **CIR v Black**[14] The approach taken was to determine the source of income by identifying the main or dominant cause behind the earning of income, rather than considering minor or incidental factors. This reasoning was later affirmed in **Transvaal Associated**

[8] Zambia Revenue Authority v Nestle Zambia Trading Ltd Appeal No 03/2021 ZMSC 20 (Supreme Court, 20 August 2025)
[9] The Income Tax Act, Chapter 323 of the laws of Zambia
[10] Ibid.
[11] Ibid
[12] Tariff Reinsurances Ltd v Commissioner of Taxes (Vic) HCA 21, Latham CJ (at 206)
[13] Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd 1946 AD 441, 456
[14] CIR v Black 1957 (3) ALL SA 388 (AD).

Hide and Skin Merchants,[15] where Schreiner JA explained that the court must look for a cause with a higher level of importance or essentiality, Meyerowitz also supports this view, noting that secondary or incidental causes can be disregarded unless the dominant cause cannot be determined.

However, while common law courts have contributed to understanding the source principle, the challenges in its application are reflected when income is spread across multiple jurisdictions, a common practice associated with tax planning methodologies such as transfer pricing, thereby leaving the question as to where the real source of income arises.[16]

The growth of international trade and the increasing desire for tax planning have led to a wide usage of transfer pricing methodologies among group entities and have unleashed significant pressure on traditional source-based taxation. However, to regulate the transfer pricing regime, Zambia has adopted transfer pricing rules and Regulations from the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines.[17] and the United Nations Practical Manual on Transfer Pricing.[18] These international standards have shaped the transfer pricing regime in Zambia and have been domesticated under the Income Tax (Transfer Pricing) Regulations, 2000, being the principle Regulation, as amended by SI No. 24 of 2018[19]

These Regulations empower the Zambia Revenue Authority to review related-party transactions and adjust them to reflect arm's length conditions. In practice, this means that the source principle assumes the responsibility to shape functional characterisation, comparability analysis, and other transfer pricing tools that can reshape the tax treatment of group entities.[20]

This dissertation is therefore situated within the broader debate on whether Zambia's source principle remains adequate in an era of sophisticated multinational business models. The central concern is that the current legal framework does not clearly state the boundaries of "source" when transfer pricing adjustments are made, which may

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[15] Transvaal Associated Hide and Skin Merchants v The Collector of Income Tax, Botswana 1967 (29) SATC 97 (BCA).
[16] Ibid.
[17] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 (OECD Publishing 2022).
[18] United Nations, Practical Manual on Transfer Pricing for Developing Countries (UN 2013).
[19] Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018
[20] Ibid.

create uncertainty for taxpayers, while increasing administrative discretion for the revenue authority.

1.3 STATEMENT OF THE PROBLEM

Section 14(1)(a) of the Income Tax Act[21] establishes the source principle as the basis for taxing income arising in Zambia. Yet the Act fails to comprehensively define source, leaving its interpretation to ZRA and the courts. This statutory silence creates uncertainty, allowing ZRA to exercise broad discretion to deem income as Zambian-sourced. The vulnerability of the source principle was exposed in **Zambia Revenue Authority v Nestle Zambia Trading Ltd**,[22] where ZRA reclassified Nestle as a Limited Risk Distributor and increased the tax margin. While the affiliate profits were attributed locally, it remained unclear how much was truly sourced in Zambia. Therefore, without statutory limits, Section 106[23] enables aggressive assessments that compromise predictability, uniformity, and fairness. This paper asks whether the source principle can withstand recharacterisation pressures in transfer pricing, and explores reforms to ensure certainty, equity, and neutrality in Zambia's tax regime.

1.4 OBJECTIVES OF THE STUDY

The objectives of the study are:

1. To discuss some of the theoretical justification and the common law definition of the Source principle.
2. To discuss the constraints of the source principle in the case of Zambia Revenue Authority v Nestle Zambia Limited (2025).
3. To discuss some of the negative implications of functional characterisation of group entities on the principles of certainty, equity, and neutrality in Zambia's source-based taxation.
4. To discuss the challenges in harmonising the source principle and functional characterisation of group entities.

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[21] The Income Tax Act (Chapter 323 of the laws of Zambia)
[22] Zambia Revenue Authority v Nestle Zambia Trading Ltd (Appeal No 03/2021
[23] The Income Tax Act (Chapter 323 of the laws of Zambia)

1.5 RESEARCH QUESTIONS

The following are the research questions:

1. What are some of the theoretical justifications and the common law definition of the source principle under Section?
5. What are the constraints of the source principle in the case of Zambia Revenue Authority v Nestle Zambia Limited (2025)?
2. What are some of the negative implications of functional characterisation of group entities on the principles of certainty, equity, and neutrality in Zambia's source-based regime?
3. What are the challenges in harmonising the source principle and functional characterisation of group entities?

1.6 SIGNIFICANCE OF THE STUDY

This study is significant because it examines the limitations of the source principle in transfer pricing contexts. It highlights how the narrow drafting of the source principle negatively impacts doctrines of certainty, neutrality and equity. This is starkly evident in the Nestle case, in which the ruling demonstrates how administrative discretion can expand the source of income beyond the geographical test.

Furthermore, the study contributes by proposing specific legislative amendments to Section 14(1)(a) to establish a clear source determination criterion, equipping policymakers and tax administrators with doctrinal clarity. The study also contributes to the scarce scholarly work addressing the interaction of the source principle and recharacterisation of group entities operating in Zambia.

1.7 SCOPE OF THE STUDY

The scope of this study is confined to Zambia's statutory framework for source- based taxation, with particular emphasis on Section 14(1)(a) of the Income Tax Act. It examines the adequacy of the source principle and highlights its limitations with respect to its narrow drafting, which omits the definition of the term source in a manner that shapes transfer pricing assessments. The study further highlights how the limitations of the source principle enabled ZRA's recharacterisation in the Nestle

Zambia Trading Ltd (2025) case. Put simply, the study focuses specifically on the doctrinal and practical tensions between Section 14(1)(a) and Section 97A in transfer pricing contexts. Its ultimate aim is to propose legislative amendments that establish clear source determination criteria aligned with taxation law principles of certainty, equity, and neutrality.

1.8 LIMITATIONS

The main limitation of this study is the scarcity of domestic jurisprudence and academic literature directly addressing the definition of the source principle under Section 14(1)(a) in transfer pricing contexts. While the Nestle Zambia Trading Ltd (2025) case provides a critical precedent, the limited number of rulings addressing the limitations of the source principle constrains legal analysis. In addition, the absence of statutory commentary or detailed administrative guidance on how the source principle should be determined restricts the depth of interpretation. The study therefore relies primarily on statutory analysis, judicial reasoning in the Nestle case, and doctrinal principles of taxation law, recognising that reforms must be tailored to Zambia's unique legal and economic context.

1.9 RESEARCH METHODOLOGY

This study adopts a qualitative doctrinal approach, focusing on Section 14(1)(a) of the Income Tax Act and its inferred definition of the source principle as origin. It analyses Zambian tax legislation, statutory interpretation, and administrative practice, with particular emphasis on the interaction between Section 14(1)(a) and Section 97A recharacterisation powers. Central to the methodology is the examination of the Nestle Zambia Trading Ltd (2025) case, supported by secondary sources such as legislation, case law, and government publications, alongside secondary materials including academic journals and policy reports. The aim is to assess the adequacy of Section 14(1)(a), evaluate the Nestle ruling's impact on certainty, equity, and neutrality, and propose legislative reforms tailored to Zambia's legal and economic context.

1.10 LITERATURE REVIEW

Eric P Ketchemin[24] laboured to establish some of the theoretical justifications for source-based taxation. The author stated that source-based taxation is based on the existence of a link between a particular jurisdiction and the economic activity from which the income is derived. Put differently, source-based taxation rests on the assumption that in an instance where the state produces wealth for a taxpayer by virtue of using natural resources, the same state is entitled to a share of the wealth generated by the taxpayer. The author further stated that in the case of a non-resident taxpayer, such a taxpayer derives benefit from the ability to compete with residents to use and enjoy the income-earning opportunities, resources and infrastructure that have been afforded. The author concluded that the preceding discussion is consistent with the benefit theory, which simply posits that the state from which the income is earned is entitled to impose tax on nonresidents so as to reconcile for the costs which they have imposed on the public.

This paper aligns with the author's findings and exemplifies the practical aspects of the benefit theory in the Zambian context. However, even though such is the case, this paper emphasises the need for the state to establish clear laws linking transfer pricing Regulation to the source principle owing to the fact that Zambia is a source-based regime. This act promotes clarity for taxpayers and certainty of the law.

James Roche[25] attempted to define what really constitutes the term 'source' in Taxation. The author acknowledged that there is no universal test, understanding or definition of the source principle, as different jurisdictions apply various standards to define the source. The author found that, in general terms, the source refers to the origin of income. However, this determination is not universally applied but must be determined on a case-by-case basis. Additionally, the author found that the source test

[24] Eric P Ketchemin, A Comparative Analysis of the Concept of Fiscal Jurisdiction in Income Tax Law (unpublished Doctor of Laws thesis, University of Cape Town, 2002) 9.
[25] James Roche, An Evaluation of the Adequacy of the Existing Framework for Source-Based Taxation in South Africa as Applied to the New Business Models Proliferated by the Digitalisation of the Economy (LLM thesis, University of Cape Town 2021) https://open.uct.ac.za/server/api/core/bitstreams/a735a717-bc8b-4eb1-9869-30dc8e5588e9/content accessed 13 May 2026.

is a two-step inquiry. Firstly, the court must establish the originating cause of the income, and secondly, the court must determine the location of that originating cause.
Furthermore, the author highlighted that the difficulty in determining the source of income is compounded by unclear and contradictory guidelines in the law and the courts, consequently making it difficult for them to apply to specific facts.
The author additionally addressed challenges of determining the source from multiple jurisdictions. The author found that when income has multiple contributing factors across jurisdictions, the courts determine the dominant, main, substantial, or real and basic cause of income accrual. In this regard, Courts reject apportionment absent statutory guidance, seeking a single dominant source.

This paper agrees with the author's finding that the source can be defined as the originating cause of income. It also emphasises the need for statutory clarity to ensure certainty. Statutory clarity also lessens the tension that comes with contradictory theories, such as the need for a geographical link and the dominant test in an instance of income stemming from multiple jurisdictions.

Ftouhi and Ghardallou[26] Conceptualise tax planning as the strategic structuring of personal or corporate affairs to minimise tax liabilities. At the international level, this practice develops into cross-border tax planning, where companies exploit differences in national tax laws, often through subsidiaries, to reduce global exposure. Advances in digital technology have facilitated this process, enabling executives to operate across jurisdictions and leverage multiple legal systems. Tax havens, in turn, benefit by offering favourable regimes designed to attract multinational firms and their offshore earnings.

This paper concurs with *Ftouhi and Ghardallou* and establishes that transfer pricing represents sophisticated international tax planning, enabling multinationals to allocate profits across jurisdictions. The paper goes on to expose some challenges of such tax planning strategies, for instance, **Zambia Revenue Authority v Nestle Zambia Trading Ltd** exposes the doctrinal weakness of the counter-strategy. In this regard, ZRA's reliance on Section 97A recharacterisation overrides contractual planning in

[26] Khaoula Ftouhi and Wafa Ghardallou,'International Tax Planning Techniques: A Review of the Literature' (2020).

the absence of precise source limits under Section 14(1)(a). The case illustrates how source jurisdictions can aggressively reclaim profits that the authors have assumed are securely sheltered. Extending their taxpayer-focused perspective, this paper highlights the vulnerabilities of tax administration when statutory definitions of the source principle remain unclear, and the sophistication of tax planning becomes irrelevant against judicially sanctioned profit reallocation.

Kouroub, and Oubdi[27] have observed that the majority of taxpayers, including individuals and corporations, engage in tax planning behaviour so as to reduce their taxable income. To achieve this goal, the taxpayer may engage in either illegal or legal tax planning practices. The author attempts to define tax planning by stating that tax planning involves undertaking certain actions and decisions, which may or may not be fiscally aggressive, with the aim of controlling the tax burden more effectively. The authors further attempt to situate tax planning along related concepts, which include tax avoidance, tax management and tax optimisation. According to the authors, the distinction between tax evasion and avoidance is often blurred since both involve exploring loopholes or weak enforcement to gain undue advantage or escape obligations. The key differentiators are the intentional element and the material element. The authors state that a breach of tax law is not automatically fraudulent unless bad faith is proven, in which case genuine error may be excused. However, merely exploring legal gaps, even without violation, can deepen tax inequality. In simple terms, the authors highlight that evasion is illegal, while avoidance is legal but opportunistic. The authors point out further ambiguities between tax optimisation and avoidance, and stated that optimisation involves using established rules to reduce liability, while avoidance involves relying on artificial schemes which are often linked to tax havens and transfer pricing.

This paper agrees with *Kouroub, and Oubdi*, who have laboured to establish that tax planning is a common practice among both individuals and corporations who seek to reduce their tax burden while optimising their income. While this is the case, this paper further argues that while transfer pricing fits the description of legitimate

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[27] S Kouroub and L Oubdi, 'Tax Planning: Theory and Modelling' (2022) 1(6) *Journal of Applied Business, Taxation and Economics Research* 594.

practice and has a legal framework formed around it under Zambian law, it must be regulated in a neutral, predictable and fair manner. One of the ways this may be achieved is by effectively aligning the legal framework to the source principle of taxation.

Mwape, Mwange and Hamalengwa[28] have noted that the global expansion of transfer pricing Regulation reflects international efforts to counteract the challenges of base erosion and profit shifting (BEPS) by multinational enterprises. At the core of this regulatory framework lies the Arm's Length Principle (ALP), which requires that transactions between related parties must be conducted under conditions that are comparable to those between independent entities. Although the ALP enjoys broad endorsement within both the OECD and UN tax models, its incorporation into domestic legal systems has been influenced by institutional capacities of various jurisdictions, their legislative design, and economic priorities.
The authors further state that ALP provides a normative framework for regulating intragroup Opricing; their application must be attuned to domestic realities. The authors have established that comparative jurisprudence has effectively shown that the successful enforcement of ALP-based transfer pricing rules depends on legislative clarity, administrative capacity and political commitment. Additionally, the authors have also emphasised the need for a well-structured legal framework to administer transfer pricing effectively. They established that while legislative clarity is a move in the right direction, such legislation must be flexible because inflexibility may amplify base erosion vulnerability. The authors have also emphasised the need for Zambia to draw lessons from comparative models, which may be both cautionary and aspirational. Aside from drawing lessons from comparative models, the authors also highlight the need for a pragmatic domestication and enforcement of global norms to serve national developmental objectives. The bright side of such domestication is that it will enhance Zambia's ability to mitigate tax avoidance and attract foreign direct investment.

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[28] Victor Mwape, Austin Mwange and Munyonzwe Hamalengwa, 'Comparative Jurisprudence on the Application of the Arm's Length Principle: A Global Survey of Transfer Pricing Regulation and its Implications for Zambia' (2025) 6(3) *African Journal of Commercial Studies* 19

This paper agrees with the authors' emphasis on the domestication of global norms relating to ARP and ensuring that their applications align with domestic realities. This paper adds that such domestication must also reflect a linkage with the source principle of taxation so as to effectively enhance certainty and counter the arbitrary application of ALP.

Michael Pressman[29] discusses the ability to pay principle and states that although the majority of tax literature states that the tax burden must be shared equally according to the ability to pay, the actual meaning is far from consensus. The author unpacks the actual meaning of the ability to pay by stating that the principle has two main goals. Firstly, it supports the egalitarian idea, which states that taxes should be distributed according to people's capacity. This view promotes fairness by distributing the tax burden in ways that reflect the taxpayers' capacity to contribute. However, the second goal is that it also upholds the utilitarian ideas that the end goal of tax design should be maximisation of welfare and efficiency. This goal seems to take a different approach, rather than supporting the overall social welfare by allocating taxes in a way that reduces hardship for the taxpayers. Further, to establish the meaning of equity, the author leans more on the utilitarian approach to determine the tax burden according to utility. The author concludes by stating that the utilitarian view embraces both utilitarian and egalitarian ideas while preserving the fact that taxpayers with a higher ability to pay should pay more.

This paper agrees with the author's findings that equity should be interpreted in a way that considers the taxpayers' welfare while imposing a higher tax burden on taxpayers who have a higher income. This paper situates this finding in the context of transfer pricing, highlighting that an unclear source principle is exposed to manipulation, thereby threatening the taxpayers' welfare.

Jason Furman[30] has commented on the principle of neutrality by stating that the main purpose of the tax system is to raise revenue that is required for government spending. However, such revenue ought to be raised without distorting the taxpayers' decisions

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[29] Michael Pressman, 'The Ability to Pay in Tax Law: Clarifying the Concept's Egalitarian and Utilitarian Justifications and the Interactions Between the Two' (2018) 21 NYU *Journal of Legislation and Public Policy*

[30] Jason Furman, 'The Concept of Neutrality in Tax Policy' (2008)

that would be influenced by taxation. The author further adds that the lack of neutrality in the tax system causes individuals and firms to devote more effort to reforming the substance of their activities in order to reduce the tax burden. Therefore, taxes ought to increase with consideration of the taxpayers' well-being. The author highlights another consequence by stating that a lack of neutrality can also lead to a reduction in labour supply due to leisure.

This paper agrees with the author's findings that a lack of neutrality distorts tax behaviour and may lead to a reduction of labour supply due to leisure. This paper goes further by situating these findings under transfer pricing, demonstrating the effects of uncertainty. The paper establishes that uncertainty breeds abuse, which eventually may lead to a tax system that lacks neutrality.

1.11 ETHICAL ISSUES

This research is conducted in full compliance with academic integrity requirements. All references are properly cited, and originality is maintained in accordance with university standards. Since the study primarily engages with publicly available legal frameworks and general economic policy issues, no significant ethical concerns are expected to arise. However, should the research encounter sensitive or non-public information, strict confidentiality will be observed. Any data that could potentially affect individuals or institutions will be handled with care to prevent adverse consequences, ensuring that privacy and professional responsibility are upheld throughout the study.

1.12 CHAPTER OUTLINE

Chapter One has introduced the study and has laid the foundation by presenting the background to Zambia's source-based taxation framework under Section 14(1)(a) of the Income Tax Act. It sets out the statement of the problem, the objectives of the study, the research questions, and the significance of the research. The chapter also reviews the literature and establishes the theoretical and conceptual framework that guides the study.

Chapter Two will discuss the common law and statutory boundaries of the source principle under Section 14(1)(a) of The Income Tax Act, establish its historical foundation and discuss the judicial interpretation of the principle.

Chapter Three will demonstrate the constraints of the source principle as highlighted in the case of Zambia Revenue Authority v Nestle Zambia Limited, and concludes with the findings.

Chapter Four will discuss some of the ways in which functional recharacterisation negatively impacts the principles of certainty, neutrality and equity in Zambia's source-based legal framework

Chapter Five will draw the general summary of the study and recommendations for consideration

1.13 CONCLUSION

This chapter has introduced the issue of limitations of the source principle in the context of functional characterisation of group entities in Zambia, taking the case of Zambia Revenue Authority as the case study. The chapter gives the background, highlighting the difficulties in defining the source principle and has highlighted the legal issue as the statement of the problem. The chapter has also highlighted the significance of the study, the literature review, limitations, the scope of study, ethical considerations, research objectives and questions. This emphasises the legal gap which the study will address. The following chapters will discuss the definition of source from a common law perspective, statutory scope and judicial interpretation, the implications of functional characterisation in Zambia and their implication on the principle of certainty, equity and neutrality, and finally a general summary of the study as well as recommendations for further research.

CHAPTER TWO

THEORETICAL JUSTIFICATIONS AND JUDICIAL INTERPRETATION OF THE SOURCE PRINCIPLE UNDER Section 14(1)(a)

2.1 INTRODUCTION

The Zambian Taxation framework is anchored on the source principle, which sets the tone for the administration of taxes in the jurisdiction. The source principle is fundamental and entails that tax liability is tied to the source of income.[31] Although loosely defined, the principle presents multiple facets that require a more detailed definition or clearly outlined components that are applicable in various scenarios.

From a broader perspective, the principle covers both national and international taxation; what remains outstanding is that it is territorial in nature.[32] This territoriality demands that both national and international taxation must be determined by first establishing a nexus between the income and the geographical location from which the income in question was acquired. Put differently, the big question is whether or not the taxable income in question is attributable to the taxing jurisdiction.[33]

Furthermore, it is worth noting that the requirement for territoriality also includes transfer pricing assessments, which form part of the functions of ZRA pursuant to Section 97(A) of the Income Tax Act.[34] and was effectively exemplified in the case of **Zambia Revenue Authority vs Nestle Zambia Limited**.[35] In this context, re-characterisation of entities aims to link income to the Zambian source so as to determine how much of the income is taxable within the Zambian Jurisdiction.

Having demonstrated the pertinence of the source principle, what is left for discussion under this Chapter is the theoretical justifications of source taxation and the process by which the source of income can be determined. This includes the source tests that have been applied under common law as well as the Zambian courts, in transfer pricing disputes such as the Nestle case. The chapter begins by discussing some of the

[31] Income Tax Act, Cap 323 s 14(1)(a) (Zambia).
[32] Michael Pressman, '"The Ability to Pay" in Tax Law: Clarifying the Concept's Egalitarian and Utilitarian Justifications and the Interactions Between the Two' (2018) 21 N.Y.U. J. Legis. & Pub. Pol'y 141 https://www.nyujlpp.org/wp-content/uploads/2018/06/Legis-21-1-Article-Pressman-AbilitytoPay.pdf accessed 8 June 2026.
[33] Ibid.
[34] Income Tax Act (Chapter 323 of the laws of Zambia).
[35] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025)

theoretical justifications for source taxation, thereafter establishes the legal framework of the source principle in Zambia, and then proceeds with discussing how courts at common law have interpreted and applied the source principle. Lastly, the chapter will discuss the source taxation under transfer pricing, and a conclusion will be drawn at the end.

2.2 THEORETICAL JUSTIFICATIONS OF THE SOURCE PRINCIPLE

According to the case of **Kergeulen Sealing and Whaling Co Ltd v CIR**[36]The justification for a source-based taxation system is premised on the understanding that the state which provides wealth for a taxpayer through its natural resources or the activities of its inhabitants is entitled to a share of the wealth that is generated from their use. However, the source principle can be understood through the lens of various justifications, some of which are as follows.

2.3 THE BENEFIT THEORY

This theory begins with an understanding that the community is placed in a position to provide individuals with economic conditions which are required for their development. This idea reflects a concept of mutual benefit or a relationship whereby the individuals return a portion of their economic progress to the community. Put differently, the theory asserts that people should be called upon to pay taxes according to the benefits which they derive from services that are provided by the state. Implicitly, the state has a duty to provide facilities to people within its jurisdiction, who also have a duty to contribute to the cost or value of the facilities, in proportion to the benefits which they receive from the use of the provided facilities.[37]

2.4 THE SOCIAL CONTRACT THEORY

The social contract theory regards taxation as arising from an agreement or contract between the state and the people within its boundaries, where the people have to pay for the use of the state's protection, goods and services provided by the state, while the

[36] *Kergeulen Sealing and Whaling Co Ltd v CIR* 1939 (10) SATC 363 (AD) at 380.
[37] L von Stein, Lehrbuch der Finanzwissenschaft (5th ed, Erster Theil and Zweiter Theil, Erste Abtheilung, Leipzig 1885).

state has to maintain its part of the contract.[38] Therefore, when citizens and other residents within the definition of the law voluntarily engage in economic activities like acquiring property and earning income, they implicitly consent to paying taxes to the government in order to support its projects. The basis of this theory is that people who are living in society and are benefiting from its protection automatically agree to contribute financially so as to sustain government functions.[39]

Additionally, different scholars have added different dimensions to the theory. According to Thomas Hobbes, taxes are viewed as the price of security, where citizens have to pay taxes in exchange for protection from the state. John Locke added that taxes also function as the price for protecting property rights and individual liberty. Furthermore, David Hume linked the social contract theory to the benefit theory and argued that tax payments are simply a contribution to a society on which one depends to survive. Jean-Jacques Rousseau expanded the theory further by stating that taxes should not only enable government protection but also protect equal freedoms and ensure citizens' subsistence by providing welfare and an equitable tax system, such as progressive taxation based on ability to pay.[40]

2.5 THE ECONOMIC ALLEGIANCE THEORY

The economic allegiance theory forms the foundational basis for international taxation. The theory opposed residence-based taxation because it was deemed unfair and lacked a connection between the residence of the taxpayer and the benefits provided by the state. The theory also rules out double taxation and acknowledges the sovereignty of states.[41] Overall, the theory argues that while both residence and source may legitimately claim taxation, the source state would have a higher share of the tax burden because of the services provided by the source state.[42] Therefore, where a person owns a business or receives income arising from another state, the source state must be entitled to a larger share of the tax burden compared to the residence state.[43]

[38] J Frecknall-Hughes and JLM Gribnau, 'The Influence of Social Contract Theory on Taxation' in RF van Brederode (ed), *Political Philosophy and Taxation: A History from the Enlightenment to the Present* (Springer, 2022) 51–101 https://doi.org/10.1007/978-981-19-1092-0_2 accessed 5 June 2026.
[39] Ibid.
[40] Ibid.
[41] G von Schanz, 'Zur Frage der Steuerpflicht' (1892) 9 Finanzarchiv 1, 4.
[42] Ibid.
[43] Ibid.

In general terms, the theory is concerned with the understanding that the income of a particular taxpayer should be divided among states according to the economic interests of the taxpayer in each state.

2.6 THE VALUE CREATION PRINCIPLE

The notion of value creation emerged in 2013, following the Group of 20's (G20) initiation of the Base Erosion and Profit Shifting (BEPS) project,[44] which aimed at addressing tax avoidance and evasion, particularly by Multinational Enterprises (MNCs). The main idea is that profits must be taxed in the jurisdictions where the underlying economic activities occur and where value is created. The value creation is also embedded in BEPS Action 1, which addresses the digital economy, and Actions 8 to 10 focused on transfer pricing.[45]

Additionally, the value-creation principle operates in two dimensions, namely the negative function and the positive function. On one hand, the negative function is more prominent in practice and underpins anti-avoidance and base-protection measures addressed under Actions 2 to 4 and 6 to 10, ensuring that profits cannot be allocated to jurisdictions where economic activity did not originate.[46]On the other hand, the positive function is mostly visible in Action 1, which supports the development of new rules for allocating taxing rights in the digital era.[47]

2.7 ETHICAL OR RETRIBUTIVE THEORY

This theory links taxation to ethics as it is perceived to border around morality in the sense that a decision to charge tax and who should be taxed borders around moral values like fairness and justice.[48] The theory embodies two dominant ethical frameworks, the first one being the ability to pay principle. This principle aims to distribute the tax burden according to the taxpayers' economic capacity so as to reduce

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[44] OECD (2013), Action Plan on Base Erosion and Profit Shifting (OECD Publishing) http://dx.doi.org/10.1787/9789264202719-en accessed 3 June 2026.
[45] OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Reports (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris) http://dx.doi.org/10.1787/9789264241244-en accessed 3 June 2026.
[46] Ibid.
[47] Ibid.
[48] Michael Pressman, 'The Ability to Pay in Tax Law: Clarifying the Concept's Egalitarian and Utilitarian Justifications and the Interactions Between the Two' (2018) 21 N.Y.U. J. Legis. & Pub. Pol'y 141 https://www.nyujlpp.org/wp-content/uploads/2018/06/Legis-21-1-Article-Pressman-AbilitytoPay.pdf accessed 6 June 2026.

inequality in the overall well-being of taxpayers. The second framework is the benefit principle, which requires taxpayers to pay tax based on the benefits they enjoy and are provided by the state.[49]

2.8 LEGAL FRAMEWORK OF THE SOURCE PRINCIPLE

The legal framework guiding source-based taxation in Zambia is provided for under Section 14(1)(a) of the Income Tax Act, which provides that tax shall be charged on income that is received by a person from a source within or deemed to be within Zambia according to Section 18 of the Income Tax Act. According to Section 2 of the Income Tax Act, a person subject to taxation includes a corporate entity, which, according to the case of **BP Zambia Plc v Interland Motors Ltd.**[50] **It** is a metaphysical entity with only legal but no physical existence. The primary focus for Section 14(1)(a) is the source of income, which has to be from within Zambia, whether or not the person is resident in Zambia.

Additionally, Section 14(1)(a) is reinforced by Section 18, which provides for income that may be deemed to have arisen from a source within the Republic. Section 18(a) captures income generated from sale agreements made in Zambia, irrespective of where goods are delivered, while Section 18(b) extends to remuneration from a business, employment or an office held in Zambia, irrespective of whether the payment is made outside Zambia.
Furthermore, Section 18(1)(e) and (f)[51] deems interests and royalties as arising from a source within Zambia if they are earned from income generation or carrying on a business in Zambia, or when paid from funds that are derived from within Zambia. This provision is important for Multi-National Enterprises MNEs because it ensures that intragroup financing and intellectual property payments that are flowing from operations carried out in Zambia are taxed in Zambia. Finally, Section 18(2)[52] deems income arising partly in Zambia and partly outside Zambia as income arising from a source within Zambia.

[49] Ibid.
[50] BP Zambia Plc v Interland Motors Ltd: SCZ Judgment No. 5/2001
[51] Income Tax Act (Cap 323 of the laws of Zambia)
[52] Ibid.

Overall, the statutory language under Section 14(a)[53] reflects a deliberate reliance on a territorial nexus, which entails that Zambia's tax system is fundamentally origin-based. In this regard, the jurisdiction to tax is exercised where income is deemed to arise, regardless of where the taxpayer resides or where contractual arrangements allocate profits.[54] This approach reflects a traditional conception of sovereignty, essentially that the state taxes what is generated within its borders.

2.9 JUDICIAL INTERPRETATION OF THE SOURCES PRINCIPLE

The judicial role in Zambia's tax jurisprudence has been pivotal in shaping the boundaries of the source principle under Section 14(1)(a) of the Income Tax Act.[55] As the courts retain the interpretive function, they have time and again been guided by common law to carry out their function. In some cases, especially those involving transfer pricing, they were faced with the task of distinguishing between contractual allocation of income and the geographical allocation, and had to apply the economic substance tests to override formal arrangements. This reliance on judicial discretion indirectly shapes the behaviour of taxpayers like MNCs who may anticipate aggressive assessments and litigation risks.

The development of jurisprudence around the source principle can be traced back to the case of **Scottish Provident Institution vs Allan**,[56] where the court laid the foundation for the principle that income could be taxed by reference to its territorial origin, even in the absence of a statutory definition.[57]
Additionally, in the case of **Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd,**[58] The court seized the opportunity to determine the source of interest payments that were made by a South African Company on a debt that was owed to Lever Brothers, which was a non-resident. In this case, Watermeyer CJ authoritatively stated that it is almost impossible to create a definition source that is sufficient enough to be implemented as a universal test to determine the source of income. Watermeyer stated that under the Income Tax Acts and similar statutes considered by the court and the judicial committee, a number of decisions have examined what is meant by the

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[53] Ibid.
[54] Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd. 1946 (14) SATC 1 (AD).
[55] Income Tax Act (Cap 323 of the laws of Zambia)
[56] *Scottish Provident Institution v Allan* [1903] 6 F 1028
[57] Harris, *International Tax Law* (Cambridge University Press 2010)
[58] Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd. 1946 (14) SATC 1 (AD).

term "source." From those authorities, one should conclude that the source of receipt classified as income is not the particular quarter or place from which they are paid, but rather the originating cause that gives rise to their being received as income. That originating cause is the work performed by the taxpayer to earn the income, the quid pro quo he provides, which is given in return for receiving it. The taxpayer's work may consist of conducting a business, undertaking an enterprise, or engaging in some activity, and it may involve personal exertion, whether intellectual or physical, or it may consist of the deployment of capital, either by using capital to produce income or by permitting others to use it.
Additionally, in jurisdictions like Australia, the source of income was initially determined based on the contractual test. For instance, in the case of **Tariff Reinsurances Ltd v Commissioner of Taxes**[59] The court established that income from reinsurance contracts was sourced at the place where the contract was made, not where payments were received, even if remitted locally.

However, in the case of **Federal Commissioner of Taxation v United Aircraft Corporation,**[60] Australian courts refined the contractual test by introducing practical multi-factor tests in instances where contract situs alone would be inconclusive or misleading. The court's refinement built on the **Tariff Reinsurances** case by treating contracts as a starting point rather than being the absolute determinant for income sourcing. Latham CJ emphasised that what is important is what the taxpayer did to earn the income, and where it was earned. This position prioritises the location of value-creating activities such as *inter alia,* manufacture, testing and sales, over formal contract situs, especially in complex cases where duties are to be performed across different jurisdictions. This approach overrides rigid contractual labels when economic reality, such as local operations generating royalties, demands it, evolving the source principle toward practical, multi-factor analysis akin to modern OECD transfer pricing's FAR framework.

Furthermore, the origin or location of business activities test emphasises the geographical site of profit-earning operations. For instance, in **CIR v. Hang Seng Bank Ltd**,[61] The Privy Council stressed that the source of trading profits was the

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[59] Tariff Reinsurances Ltd v Commissioner of Taxes (Vic) HCA 21; (1938) 59 CLR 194
[60] Federal Commissioner of Taxation v United Aircraft Corporation (1943) 68 CLR 525
[61] CIR v. Hang Seng Bank Ltd [1991] AC 306

place where profit- making activities were carried out, not merely where contracts were signed.

In Zambia, the courts have followed the reasoning of Watermeyer CJ in **Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd,**[62] by subjecting the definition of source to a geographical test. In notable cases such as the Nestle case, ZRA laboured to show that characterising Nestle as a low-risk distributor was justified, as a bigger portion of income was taxable in Zambia because it was attributable to the Zambian source. The courts upheld ZRA's position, which aimed to prevent artificial profit-shifting through what was determined as non-arm's-length inter-company transactions. This emphasised the substance over form, as a determinant of the source of income. Nestle Zambia's role as a limited-risk distributor involved critical local functions such as inventory management, customer relationships, and market execution. This directly drove sales revenue, even if contracts nominally shifted risks to the Swiss parent company.

Another pivotal Zambian case illuminating the judicial interpretation of the source principle is **Mopani Copper Mines PLC v Zambia Revenue Authority**.[63] Triggered by ZRA's 2009 audit, the dispute centred on Mopani's systematic undervaluation of copper sales to its Swiss affiliate, Glencore International AG (GIAG), effectively shifting substantial profits offshore in violation of arm's-length standards. The Supreme Court decisively upheld ZRA's adjustments, affirming that the full economic value of copper extracted and processed in Zambia constituted income sourced within the jurisdiction, thereby reinforcing territorial taxing rights.

It is therefore established that Section 14(1)(a)[64] bolstered by the deeming provisions of Section 18(1)(b),[65] attributes business profits to Zambia, where the trade is carried on locally. In the Mopani case, the court rejected Mopani's artificial pricing mechanisms, which locked in artificially low sales values through internal hedging arrangements that netted out gains as derivative losses. These tactics distorted the actual taxable income, as the source principle demands that income should be

[62] Commissioner for Inland Revenue v Lever Brothers & Unilever Ltd. 1946 (14) SATC 1 (AD).
[63] Mopani Copper Mines PLC v Zambia Revenue Authority (Supreme Court Appeal No. 24/2017)
[64] Income Tax Act (Cap 323 of the laws of Zambia)
[65] Ibid.

connected to the particular economic activity that generated it and not the location of the related party.

2.10 THE SOURCE PRINCIPLE AND TRANSFER PRICING

In Zambian jurisprudence, the source principle under Section 14(1)(a) intersects transfer pricing through the arm's length mandate under Sections 97A and ZRA's assessment powers under Section 106, which ensures that substantive economic value created locally is not eroded by intra-group pricing.[66] On the premise, it can be concluded that under transfer pricing, the starting point is an understanding that income that has been generated within Zambia should be taxed in Zambia, with the exception of only that income that is transferable overseas, bordering on the arms' length requirement under Section 97A of the Income Tax Act.[67]

Additionally, courts interpret source as tied to business activities and functional contributions (FAR analysis), subordinating form, such as contractual allocations, to substance, such as full market value, which accrues where extraction, sales, or distribution occurs. Additionally, taxpayers bear the burden of providing documentation in order to prove arm's-length pricing. If they fail to do so, ZRA is empowered to recharacterise the entity. Furthermore, aggregation rules ensure that integrated transactions are treated holistically.[68]

2.11 CONCLUSION

This chapter has shown that Section 14(1)(a) of the Income Tax Act establishes the legal basis for source-based taxation while leaving out the actual statutory definition or test that can be used to determine whether or not income is from a source in Zambia. The source principle has since been interpreted by case law, administrative practice, and transfer pricing doctrine. By tracing the theoretical justification for source taxation, examining the statutory framework, and analysing cases such as **ZRA v Nestle Zambia** and **Mopani Copper Mines v ZRA** *inter alia*, it became clear that both the courts and the Zambia Revenue Authority increasingly rely on

[66] Income Tax Act (Chapter 323 of the laws of Zambia)
[67] Ibid.
[68] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025)

economic-substance and FAR-based analysis. In practice, this means that the source principle is located where value-creating activities occur, rather than where contracts are drafted or labels applied. While this approach has strengthened protection of the domestic tax base, it also exposes how fragile the tax system currently is, in the sense that crucial jurisdictional questions are resolved through broad interpretation instead of precise statutory rules. In the case of transfer pricing, it is clear that the legal framework still lacks accurate integration of the source principle to ensure certainty with regard to exactly how much the taxpayer has to pay in Zambia and how much can be transferred offshore. Ensuring certainty would therefore ensure neutrality of the tax system.

CHAPTER THREE

CONSTRAINTS OF THE SOURCE PRINCIPLE IN ZRA V NESTLE ZAMBIA LIMITED (2025)

3.1 INTRODUCTION

The Supreme Court judgement in the case of **Zambia Revenue Authority v Nestle Zambia Limited**[69] has been regarded as a landmark and historic decision in international transfer pricing jurisprudence. It highlights the administrative authority of ZRA to make substantial transfer pricing adjustments and validates the use of aggregated analysis and foreign comparables. Additionally, it affirms the use of the FAR analysis in characterising entities and finally confirms that the burden of proof lies on the taxpayer.

Furthermore, chapter two has defined the source of income as the geographical location where income-generating activities take place, and leans on the substance over form test, especially in transfer pricing matters. Under transfer pricing, the process of determining how much income is from a Zambian source, separating such income from that which can be legally transferred out of Zambia, is heavily influenced by the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines.[70] The OECD guidelines are supplemented by the United Nations Practical Manual on Transfer Pricing.[71] These standards have shaped the Zambian transfer pricing law under Section 97A of the Income Tax Act and Statutory Instrument No 24 of 2018[72] which provides for the transfer pricing Regulations.

In the Nestle case, the process of attributing income to Zambia as a source involved classifying Nestle Zambia as a low-risk distributor (LRD), relying on Western European comparables, and applying the Transactional Net Margin Method (TNMM).[73] Yet these steps do not reflect a transparent source of income narrative as

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[69] Zambia Revenue Authority v Nestle Zambia Limited Appeal No. 03/2021, Order dated 20 August 2025

[70] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 (OECD Publishing 2022).

[71] United Nations, Practical Manual on Transfer Pricing for Developing Countries (UN 2013).

[72] Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018

[73] Zambia Revenue Authority v Nestle Zambia Limited, Appeal No. 03/2021, Order dated 20 August

defined. This process undermines the predictability and fairness of source-based taxation in Zambia, especially under transfer pricing.[74]

3.2 ROLE OF THE OECD TRANSFER PRICING GUIDELINES FOR MNEs AND TAX ADMINISTRATORS

The role of the OECD Transfer Pricing Guidelines for MNEs and Tax Administrators is to provide guidance on the application of the ALP, which requires that the price of goods and services between related parties is consistent with the prices that would be charged between unrelated parties who are operating in similar circumstances. The main objective of the ALP is to prevent taxpayers from shifting their profits to low-tax jurisdictions by manipulating transfer prices. In this regard, the OECD transfer pricing guidelines also provide guidance on how to apply other transfer pricing methodologies, how to carry out *inter alia* assessments, the choice of comparables, issues related to the characterisation of group entities, and other related matters. Aside from issuing guidelines, it also makes recommendations on ways in which the guidelines can be improved in various jurisdictions.[75]

3.3 ROLE OF THE UNITED NATIONS PRACTICE MANUAL ON TRANSFER PRICING FOR DEVELOPING COUNTRIES

The role of the United Nations (UN) Practical Manual on TP for Developing Countries guide (UN Manual) is to help developing countries understand and use transfer pricing Regulations. It describes the manner in which the ALP works in transfer pricing by setting fair and unbiased prices for related party dealings. Tax administrators across the world can therefore use the UN Manual to easily put transfer pricing guidelines into practice. Further, the UN Manual retains most of the OECD guidelines and helps tax administrators to make better decisions.[76]

Additionally, this manual aims to strike a balance between reducing international tax abuse and promoting fair practices that encourage foreign investment. In this vein, it

[74] OECD. (2017). Tax Certainty: IMF/OECD Report for the G20 Finance Ministers.

[75] Victor Mwape, Austin Mwange and Munyonzwe Hamalengwa, 'Reconciling Global Norms and Local Realities: An Assessment of Zambia's Legislative and Institutional Framework on Transfer Pricing Regulation' (2025) 6(2) *African Journal of Commercial Studies* 204 https://doi.org/10.59413/ajocs/v6.i2.20 accessed 26 June 2026.

[76] Ibid.

prohibits state auditors from relying on secret comparable data unless taxpayers are able to provide their own supporting evidence.[77]

3.4 LEGAL BASIS OF TRANSFER PRICING IN ZAMBIA

3.4.1 THE INCOME TAX ACT

Zambia's transfer pricing framework is established under Section 97(A-D) of the Income Tax Act.[78] Section 97A(1) established the arm's length principle to regulate controlled transactions between related parties. Additionally, Section 97A(2) establishes three elements that must exist in order for Section 97A (1) to apply. According to the provision, the taxpayer must transact with an associated entity, the actual conditions must differ from arm's length conditions, and finally, there must be a reduction in the income of the Zambian taxpayer.[79]

This framework is complemented by the Income Tax (Transfer Pricing) Regulations, 2000, being the principle Regulation, as amended by SI No. 24 of 2018[80] (hereinafter referred to as the Regulations)[81] aligning the transfer pricing framework with OECD BEPS Actions 8-10.

3.4.2 THE INCOME TAX (TRANSFER PRICING Regulations) (AMENDMENTS) REGULATIONS 2018

These transfer pricing Regulations incorporate various OECD standards[82] Recommended in respect of the BEPS Actions 8 to 10, which include the preparation of transfer pricing documentation as well as rules governing the application of the arm's length principle.[83] In this regard, Regulation 10 empowers the Commissioner General with the authority to determine whether conditions of a controlled transaction

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[77] Ibid.
[78] Income Tax Act (Chapter 323 of the laws of Zambia)
[79] Ibid.
[80] Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018
[81] Income Tax (Transfer Pricing) (Amendment) Regulations, SI No. 24 of 2018
[82] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Publishing 2022)
, ch. I.
[83] TPA Global, Zambia Transfer Pricing Country Summary Report 2018 (2018) https://www.tpa-global.com/wp-content/uploads/2020/05/180626-zambia-transfer-pricing-country-summary-report-2018.pdf accessed 23 June 2026.

align with the arm's length principle under Section 97A(2). Additionally, Regulation 11 explains when an uncontrolled transaction is comparable and also sets out the comparability factors that may be put into consideration when assessing the arm's length pricing.[84]

Another important provision is Regulation 12, which provides for the determination of the arm's length remuneration by applying the most appropriate transfer pricing method under Regulation 12(3) while taking into consideration the factors set out under Regulation 12(2).[85]

Finally, Regulation 20 provides for the manner in which the Regulations are to be interpreted. The Regulation provides that the Regulations should be interpreted consistently with the OECD guidelines and the UN Manual on transfer pricing. However, in the event of conflict between the Regulations and the OECD guidelines and the UN Manual, the Regulations must prevail.[86]

3.4.3 PRACTICE NOTES

Aside from the Regulations, Section 97A is also complemented by ZRA practice notes, which offer interpretive guidance of tax law. In this regard, one of the notable practice notes on transfer pricing is Practice Note No. 2 of 2018[87] (hereinafter referred to as the practice note) which summarises the interpretation of Section 97A of the Income Tax Act. It offers guidance on applying the arm's length principle to controlled transactions, the transfer pricing methods that may be used and the documentation rules that ought to be followed when dealing with controlled transactions in the business environment.

Just like the transfer pricing law in the Income Tax Act and the Regulations, the practice note also reflects both Article 9 of the OECD Model Tax Convention on Income and Capital and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The transfer pricing rules have been adopted to

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[84] Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018
[85] Ibid.
[86] Ibid.
[87] Zambia Revenue Authority, Practice Note, No. 2 of 2018

regulate controlled transactions to ensure that both income and expenses of related parties are at arm's length.[88]

However, the practice note together with the relevant legislation and Regulation enshrined under Zambian law prevails over the OECD Transfer Pricing Guidelines or the UN Practical Manual, in the event of inconsistency between this Practice Note and the OECD Transfer Pricing Guide or the UN Manual.[89]

Additionally, it is worth noting that the practice note offers administrative guidelines and does not intend to replace the provisions of the Act in any way and the Transfer Pricing Regulations of 2000. Therefore, where there is an inconsistency between the Practice Note and the Act and the Transfer Pricing Regulations of 2000, the Act and the Transfer Pricing Regulations prevail over the Practice Note to the extent of the inconsistency.[90]

3.4.4 CASE LAW

Case law is another important component of the transfer pricing legal framework, as it is an opportunity to tap into the interpretive minds of the courts on issues before them. For instance, in the case of **Zambia Revenue Authority v Nestle Zambia Limited**[91] One of the principles that became dominant was the substance over form, which asserts that actual conduct of the parties prevails over contractual arrangements. This is consistent with the United States case of **Lucas v Earl**[92] In which the court established that a taxpayer may not avoid taxation by entering into contractual arrangements to divert such income.

Similarly, the courts have built on this substance preference to establish the source of income. In the case of **Frank Lyon Co. v United States**,[93] The United States Supreme Court case held that a transaction which has a real business purpose and possesses a genuine economic effect should be respected even if it has tax advantages, provided that it is not a sham. The case of **Pacific Management Group, BSC**

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[88] Ibid.
[89] Ibid.
[90] Ibid.
[91] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025).
[92] Lucas v Earl 281. U.S. 111, 115 (1930)
[93] Frank Lyon Co. v United States, 435 U.S. 561 (1978)

Leasing Inc., Tax Matters Partner and others v Commissioner of Internal Revenue[94] also relied on this principle by testing whether the transaction had genuine non-tax business substance, rather than treating formal structure as automatically controlling. Finally, the case of **Cooper v Commissioner**[95] builds on the substance over form logic in a more modern appellate setting. The case reinforces that courts should examine the real economic arrangement rather than rely only on labels or formal documentation. The cases highlighted are evidence that case law carries high significance in transfer pricing arrangements, where the courts get the opportunity to interpret complex transfer pricing arrangements to shape the legal framework.

3.5 FAR ANALYSIS AND LIMITATIONS OF THE GEOGRAPHIC NARRATIVE OF THE SOURCE PRINCIPLE

Functional analysis (FAR analysis) is a component of the comparability test under Regulation 11(2) of the Regulations[96], which determines where economic value is actually created. While the source principle remains the basis of taxation in Zambia, complex cross-border structures leading to transfer pricing have exposed major difficulties in accurately applying the source principle. As a result, the law has involved embracing OECD guidelines and the UN Manual, thereby importing the FAR analysis to shape the legal framework, at the cost of deviating from what has been defined as the source.

In a source-based system like Zambia's, FAR analysis is particularly important because the source principle is not always easy to identify in multinational structures. As shown in **the Nestle case**,[97] an entity may be registered in Zambia, sign contracts and even distribute or sell goods in Zambia and yet some of the profits are situated elsewhere because the real profit drivers are not in Zambia. The FAR analysis resolves this problem by examining who exactly performs the income-generating functions, who controls or avails the assets and who assumes the associated risks. Put differently, the analysis mainly distinguishes entities that perform routine activities

94 Pacific Management Group, BSC Leasing Inc., Tax Matters Partner, et Al Petitioners v Commissioner of Internal Revenue August, 2018
95 Cooper v Commission, 877 F. 3D 1086, 1091 (9th Cir. 2017)
96 Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018
97 Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018

from those that actually control strategic decisions, own key intangibles, or bear significant commercial risks.[98]

Furthermore, while the FAR analysis is an important component of tax assessments in transfer pricing, it is at this point that the attribution of income to a Zambian source begins to divert from the geographic narrative of the source principle. The analysis not only exposes an entity's profitability but also redefines the source from geographic location to economic characterisation within the multinational group. Under the geographic definition, only income generated within Zambia or that is deemed so under Section 18 of the Income Tax Act is considered to be Zambian sourced. This position was highlighted by the Zambian courts in the case of **Mohammad Hussein v ZRA**[99] where it was held that income imported into Zambia for purposes of investment was taxable because it was not income generated in Zambia. However, under the FAR analysis, the determinant of how much income is attributable to a source in Zambia is shifted to identifying who performs the functions, who owns the intangibles and who bears the risks so as to characterise the related parties.[100]

The effect of FAR analysis is evident in the Nestle case, where Nestle Zambia was characterised as a low-risk distributor (LRD) even though the income-generating activities were carried out in Zambia. This was because the strategic functions, such as marketing, know-how and the assumed risks, were centralised in Nestle South Africa while intangibles were situated offshore. As a result, only a low risk distributor margin was attributed to Zambia, while the rest was attributable to South Africa, not based on the geographic test but rather based on the economic role they played.[101]

3.6 THE LRD CLASSIFICATION

The LRD classification is a transfer pricing concept derived from the n OECD that is not expressly defined in the Zambian Income Tax Act or transfer pricing Regulations, but has been applied in Zambian practice through functional analysis and judicial

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[98] Mariana I Muzychuk and Olena V Fomina, 'Functions, Assets and Risk Analysis in the Preparation of Transfer Pricing Documentation' (2021) 9(5) Universal Journal of Accounting and Finance 935.
[99] Mohammad Hussein v ZRA (1999) RAT.
[100]Mariana I Muzychuk and Olena V Fomina, 'Functions, Assets and Risk Analysis in the Preparation of Transfer Pricing Documentation' (2021) 9(5) Universal Journal of Accounting and Finance 935.
[101] Mariana I Muzychuk and Olena V Fomina, 'Functions, Assets and Risk Analysis in the Preparation of Transfer Pricing Documentation' (2021) 9(5) Universal Journal of Accounting and Finance 935.

treatment in the Nestlé case.[102] This classification was a critical aspect of the Nestle case as it formed the basis for applying comparables to determine the amount of income that could be treated as Zambian sourced.

An LRD may be defined as a related party entity existing within a multinational group that essentially performs distribution functions. This function is sometimes carried out under contractual arrangements which allocate risks to the foreign principal company, as it was in the Nestle case. However, courts are more interested in investigating the actual substance of the activities carried out, relying on contractual allocations.[103]

Consequently, the LRD earns a modest income due to its narrow functional profile and not a full return that may be available to a fully fledged distributor bearing the risks independently. Income of an LRD, like in the Nestle case, is often determined using the Transactional Net Margin Method (TNMM) provided for under Regulation 12 (3)(d) of the Regulations, which entitles them to a routine risk adjustment return and excludes residual profits.[104]

While the LRD framework is not fully reflected under Zambian law, it is governed by the arm's length standard under Article 9 of the OECD model tax convention. This requires that the terms of controlled transactions reflect what independent parties would agree on, taking into consideration the functions performed, the assets used and the risks assumed.[105]

The LRD framework gives evidence of how insufficient the definition of the source of income is. While the courts have embraced the substance over form test to link income to the geographic location where it is generated, this test is insufficient and ambiguous in multinational structures. Under the traditional geographic definition, facts of the Nestle case show that NZL sold products within the Zambian borders, meeting the criteria set out in Sections 14 and 18 of the Income Tax Act, such that all the income generated as profits (net income) within Zambian geographical boundaries

[102] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022* (OECD Publishing 2022)

[103] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025).

[104] Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018

[105] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022* (OECD Publishing 2022)

would be deemed as Zambian sourced, while other expenses would be treated as capital imported to carry out the business. This approach is consisted with the holding in the case of **Mohammad Hussein v Zambia Revenue Authority**[106] where the court held that money that is brought into Zambia for purposes of investment was not earned income within the meaning of the Income Tax Act and therefore was not taxable.

However, according to the LRD classification, not all income is Zambian sourced despite having been generated within Zambia. But instead, Zambian sourced income is determined based on the results of the FAR analysis which classifies the NZL and partly sets the tone for taxation because the other determinant is the choice of the suitable comparable, which also has its own weaknesses for instance, the taxable income may either be adjusted upwards or downwards purely based on the type of comparable that is used, leading to an unpredictable outcome.[107] This situation leaves questions as to what the source of income really is. On one hand, relying on the common law definition and the substance over form principle entails that NZL's sales occurred in Zambia, making the income Zambian sourced; on the other hand, the LRD classification points to the economic role of the entity to set the basis of determining how much income is Zambian sourced despite having been generated in Zambia. This means that in transfer pricing matters, Zambian-sourced income is not calculated from Zambian economic activity but rather from economic characterisation within the multinational structure.[108]

Furthermore, the Zambian law does not provide for detailed classifications of distribution entities and a well-developed legal framework to guide both the taxpayer and the tax authority, but instead, it is anchored on international standards such as the OECD.[109] As a result, certain questions remain unanswered as to what constitutes entrepreneurial risk, who bears the risk versus who manages it. Lack of clear statutory guidance gives room to abusive application of the law.

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[106] Mohammad Hussein v Zambia Revenue Authority - 2001/RAT/36
[107] Victor Mwape, Austin Mwange and Munyonzwe Hamalengwa, 'Reconciling Global Norms and Local Realities: An Assessment of Zambia's Legislative and Institutional Framework on Transfer Pricing Regulation' (2025) 6(2) *African Journal of Commercial Studies* 204 https://doi.org/10.59413/ajocs/v6.i2.20 accessed 26 June 2026.
[108] Ibid.
[109] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025).

3.7 COMPARABILITY ANALYSIS AND THE ARM 'S-LENGTH PRINCIPLE

Comparability analysis refers to the process of identifying and assessing uncontrolled transactions or independent companies that may serve as benchmarks for controlled entities or transactions that are under examination. This analysis is an important component of transfer pricing because it provides the basis on which to select the most appropriate transfer pricing method and determine the arm's length principle. Additionally, this analysis establishes whether the terms and economic conditions of controlled transactions are consistent with those between unrelated parties operating under similar circumstances. Put simply, it is a tool used to determine if transactions between related parties are at arm’s length.[110]

Under Zambian law, comparability factors are provided for under Regulation 11 of the Regulations, which state that an uncontrolled transaction is comparable to a controlled transaction within the meaning of Section 97A(2) of the Income Tax Act when there are no significant differences between controlled and uncontrolled transactions that would materially affect the financial indicator that is being examined. And secondly, if reasonably accurate adjustments are made to eliminate the effects of the differences on comparison, in circumstances where such differences existed.[111]

In the Nestle case, ZRA selected comparables drawn from Western European distributors to assess NZL due to the unavailability of suitable Zambian or African comparables. The case exposes the uncertainty of the source principle in the sense that even in the absence of local comparables, income can still be treated as Zambian sourced using non-Zambian standards not within the Zambian geographical boundaries. At the same time, the case shows that income may be generated from economic activities in Zambia, but treated as non-Zambian sourced.[112]

In the context of the geographical test used to determine Zambian-sourced income, it may be argued that one of the most suitable comparables may be those that are within the Zambian geographical boundaries. In such a case, a prominent limitation of

[110] Mariana I Muzychuk and Olena V Fomina, ‘Functions, Assets and Risk Analysis in the Preparation of Transfer Pricing Documentation’ (2021) 9(5) Universal Journal of Accounting and Finance 935.
[111] Zambia Revenue Authority, Income Tax (Transfer Pricing) Regulations, SI No. 24 of 2018
[112] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025).

Section 14 would be that the law is not wide enough to dictate how Zambian-sourced income may be determined in the absence of publicly available data on comparable Zambian distributors. Therefore, by accepting the western comparables, the court in the Nestle case acknowledged that in certain circumstances, the geographical test cannot function without modification.

3.8 AGGREGATION OF RELATED PARTY DEALINGS

The Court departed from the Tribunal's restrictive stance on aggregation. Referring to Chapter III of the OECD Guidelines, it clarified that although transaction-by-transaction analysis is the default, aggregation is permissible where transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. The court followed the decisions of the **Deputy Commissioner of Income Tax v Adcock Ingram Limited**[113] and **Sony Ericsson Mobile Communications India (P) Ltd v CIT III and Others**[114] where the Indian courts held that transactions need not be identical to qualify as closely linked. Dealings such as raw-material supply, technical services, royalty payments, and finished goods sales may be aggregated when they arise from a single commercial arrangement and collectively define the taxpayer's economic return. The decisive factor is essentially whether the transactions emanate from a common source and operate together to generate profit.

Therefore, by endorsing this wider understanding, the Supreme Court signalled that aggregation should no longer be treated as an exceptional measure but as a legitimate benchmarking technique whenever transactions are commercially intertwined and reflect a unified value-creation process.[115]

This development carries significant implications for Zambia's source-based taxation regime, as it reinforces the source principle by consolidating all generated income, for instance, management fees and product purchases, to test profitability on a consolidated basis. However, this is just the starting point of applying the appropriate transfer pricing method, which would potentially import foreign comparables, as was the case in ZRA v Nestle. This raises questions as to the scope of the source principle.

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[113] Deputy Commissioner of Income Tax v Adcock Ingram Limited A.No 1039 & 1078/Bang/2015

[114] Sony Ericsson Mobile Communications India (P) Ltd v CIT III and Ors., High Court of Delhi (India) (2015

[115] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025)

3.9 CONCLUSION

Overall, this chapter has discussed the legal framework of transfer pricing and some of the procedures that were applied in the case of Zambia Revenue Authority v Nestle Zambia. Additionally, these procedures have been discussed in the context of the source principle under Sections 14 and 18 of the Income Tax Act, highlighting the gaps with regard to the definition of the source principle in the context of transfer pricing. This chapter has found that while the source principle has been defined by various common law courts, by employing the geographical test and stating that the source of income is the geographical location where income-generating activities took place, this only forms the starting point of determining how much income is Zambian-sourced. This has been supported by the the substance over form consideration, which is closely tied to the geographic test but does not entail finality. This chapter, therefore, exposes the vulnerability of the source principle as it has not been clearly or exhaustively defined and can be manipulated to fit different narratives.

CHAPTER FOUR

NEGATIVE IMPLICATIONS OF FUNCTIONAL CHARACTERISATION IN THE CONTEXT OF EQUITY, NEUTRALITY AND CERTAINTY OF SOURCE - BASED TAXATION.

4.1 INTRODUCTION

The recharacterisation of group entities is justified by the OECD, which states that transfer prices should reflect arm's length conditions. As a result, ZRA takes the opportunity to exercise its assessment powers to determine the arm's length conditions of an entity's controlled transactions. This chapter discusses some of the implications that come with the recharacterisation of NZL as an LRD, consequently imposing a higher tax margin based on non-Zambia factors. This has a negative effect on principles of certainty, equity and neutrality.

As highlighted in the preceding chapters, the transfer pricing framework is heavily influenced by the international standards, such as OECD guidelines[116] and the UN Manual on transfer pricing[117] to frame the arm's length regime in Zambia. While this is the case, the source principle under Sections 14 and 18 of the Income Tax Act remains foundational for Zambian Taxation.

Additionally, the case of **Zambia Revenue Authority v Nestle Zambia Limited[118]** It is a classic illustration of the pressures placed on Zambia's source principle under transfer pricing assessments. It highlights how recharacterisation of NZL as an LRD can displace the common law definition of the source principle, leaving it to administrative discretion and judicial interpretation based on foreign guidance.

This chapter will discuss the implications of recharacterizing NZL and subsequently imposing a higher tax margin. The discussion will focus on three normative principles of taxation: certainty, equity, and neutrality. Certainty concerns the predictability of tax rules and outcomes, while equity relates to the fair distribution of tax burdens and finally, neutrality, which requires that taxation does not distort business or investment decisions. The analysis will show that while recharacterisation aligns Zambia with

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[116] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 (OECD Publishing 2022)
[117] United Nations, Practical Manual on Transfer Pricing for Developing Countries (UN 2013).
[118] Zambia Revenue Authority v Nestle Zambia Limited (Supreme Court of Zambia, Appeal No 03/2021, 20 August 2025)

international practice, it simultaneously undermines the principles of equity, neutrality and certainty, revealing the limitations of the source principle in Zambia's transfer pricing regime.

4.2 CONSTITUTIONAL FOUNDATION OF TAXATION

Before examining the principles of certainty, equity and neutrality, it is essential to establish that in Zambia, these principles have been elevated from mere policy guidelines to supreme constitutional mandates. Part XVI of the Constitution[119] establishes the basis for public finance, placing binding limits on the state's taxation power and creating enforceable rights for taxpayers. In this regard, Article 199[120] provides that tax shall not be charged on taxpayers unless as prescribed. Put differently, the provisions state that tax will only be charged in the prescribed manner. This provision forms the fecundation of tax law in Zambia. Under the Income Tax Act, the charge of tax is provided for under Section 14 of the Income Tax Act, which also establishes the source principle of taxation.[121]

4.3 ADAM SMITH'S CANONS OF TAXATION

In his influential work, The Wealth of Nations (1776),[122] Adam Smith outlined four fundamental principles of taxation, which are equity, certainty, convenience, and efficiency (or economy). These enduring principles remain central to modern tax systems, providing a strong framework for evaluating the fairness and effectiveness of tax laws. This context paves the way for a deeper analysis of how these canons influence current tax policy and the statutory framework in Zambia. Additionally, the canons also serve as a standard against which Section 14(1) and (18) of the Income Tax Act.[123] establishes the foundation of Zambia's corporate income tax regime. Put differently, the canons of taxation require that the source principle must be certain as to its wider scope and extent of application, it must promote the equitable distribution of the tax burden among taxpayers, and it must promote convenience and efficiency with respect to the collection of taxes.

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[119] The Constitution of Zambia (Amendment) Act No. 2 of 2016
[120] Ibid.
[121] Income Tax Act (Chapter 323 of the laws of Zambia)
[122] Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations (first published 1776, Edwin Cannan edn, University of Chicago Press 1976) Book V, ch II, pt II.
[123] Income Tax Act (Chapter 323 of the laws of Zambia)

Furthermore, the source principle is not merely technical, as it embodies constitutional principles as the foundation of taxation. Therefore, taxation without a territorial nexus undermines the rule of law by imposing obligations that lack a rational connection to the state's interests.

4.4 THE PRINCIPLE OF CERTAINTY

The canon of certainty entails that tax rules should be clear and predictable, so that taxpayers know exactly how much tax they owe, when and how to pay it, and whom to pay.[124] However, certainty is undermined because the arm's length principle does not provide a clear and stable basis for determining the correct tax outcome in many cross-border transactions. According to the OECD, transfer pricing often involves transactions that are not found between independent parties, which makes the search for comparable data difficult. In this regard, the ALP does not provide a clear and stable basis for determining the correct tax outcome in many cross-border transactions.[125]

Additionally, certainty protects against arbitrary state power by ensuring that the tax system is predictable in terms of the tax obligations due to the taxpayer. This safeguards the taxpayers' constitutional rights. Certainty under this study is segmented into three categories: legal certainty, outcome certainty, and procedural certainty. Legal certainty requires clear and accessible rules for taxpayers to understand their obligations in advance. Outcome certainty ensures that taxpayers can reasonably predict the consequences of their transactions. Procedural certainty guarantees that the processes of assessment, appeal, and remedy are transparent and consistent.[126]

Furthermore, it is worth noting that the foundation of tax certainty lies in the rule of law. Obligations must be fixed in advance, not to be determined retrospectively, and taxpayers must have a legitimate expectation that rules will be applied consistently. Arbitrary taxation without a clear legal basis undermines this protection, violating the principle that no taxation should occur without clear law.[127] This principle was

[124] OECD. (2017). Tax Certainty: IMF/OECD Report for the G20 Finance Ministers.
[125] OECD, Transfer Pricing' available at: https://www.oecd.org/en/topics/sub-issues/transfer-pricing.html accessed on 27th June 2026
[126] EL Gharad Souhail and Aarab Karim, 'Legal Certainty and the Effectiveness of Taxpayer Safeguards in Tax Audits: An Exploratory Qualitative Study in Morocco' (2026) 3(34) African Scientific Journal ISSN 2658-9311.
[127] Task Force, Wuzhen Action Plan (2019–2021) Final Report: Following Rule of Law and Raising Tax Certainty (2019).

affirmed in the case of **Partington v Attorney-General**[128] which concerned statutory interpretation. In this case, Lord Cairns established a foundational principle by stating that in an event where there is ambiguity in the statute, the statute must be construed strictly in favour of the taxpayer. Similarly, in the case of **Vestey v Inland Revenue Commissioners**[129] Lord Wilberforce stated that a citizen should not be taxed unless he is clearly designated by the taxing Act as a taxpayer, with a clearly defined tax liability.

Certainty, however, is not absolute. It exists in tension with other values in tax law. Strict certainty may limit flexibility, yet tax systems must adapt to complex multinational structures and evolving economic arrangements. Certainty may also conflict with equity, as rigid rules can produce unfair outcomes, while discretionary relief reduces predictability. Finally, certainty can clash with revenue adequacy, since discretion is often needed to counter aggressive tax planning. The challenge is balancing these competing demands without eroding certainty altogether.[130]

Under transfer pricing, the Nestle case highlights the uncertainty that lies in the source principle of taxation, as it leaves questions as to the true definition and extent of application of the principle. This is also particularly evidenced by functional characterisation, which intensifies uncertainty across multiple stages. Before transactions occur, taxpayers cannot plan effectively because they do not know how their operations will be classified.[131] During compliance, they may face high costs of preparing documentation that may later be rejected. After filing, liability remains open-ended, as the ZRA may reassess characterisation after some time, as was the case with Nestle. Additionally, remedies may also be uncertain, due to the fact that courts may defer to administrative discretion, leaving taxpayers unsure whether challenges will succeed.[132]

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128 Partington v Attorney-General (1869 LR 4 HL 100)
129 Vestey v Inland Revenue Commissioners [1980] STC 10 at 18.
130 Diego Sánchez de la Cruz, 'Legal Certainty in Taxation: A Comparative Ranking of Tax Systems in Europe' (EPICENTER, 4 March 2026) https://www.epicenternetwork.eu/briefings/legal-certainty-in-taxation-a-comparative-ranking-of-tax-systems-in-europe accessed 11 May 2026.
131 Organisation for Economic Co-operation and Development, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 (OECD Publishing 2022) https://doi.org/10.1787/0e655865-en accessed 11 May 2026.
132 Diego Sánchez de la Cruz, 'Legal Certainty in Taxation: A Comparative Ranking of Tax Systems in Europe' (EPICENTER, 4 March 2026) https://www.epicenternetwork.eu/briefings/legal-certainty-in-taxation-a-comparative-ranking-of-tax-systems-in-europe accessed 11 May 2026.

Furthermore, comparability adds another layer of unpredictability, as identifying appropriate benchmarks for Zambian entities is often unclear. The Nestle Zambia case illustrates these problems, with the Court affirming ZRA's discretion without clarifying how functional analysis interacts with the source principle.[133] According to Mwape, Mwange and Hamalengwa, related enterprises often engage in transactions that do not exist between independent enterprises, which makes comparability difficult and leaves both tax authorities and taxpayers without reliable data.[134] Additionally, the ALP assumes that comparable prices in markets exist, yet in reality, they are dominated by integrated multinational structures rather than truly independent firms. For instance, independent arrangements between a manufacturer and distributor are not realistic comparators for multinational groups, because comparable prices may not exist where the market is structurally integrated.[135]

Overall, the current underdeveloped form of the source principle breeds uncertainty because, under transfer pricing, the geographical test alone is not enough to determine the source of income, because the arm's length principle demands different requirements which are more centred on the economic roles of the parties to the controlled transactions. For instance, functional analysis plays a major role in characterising entities before selecting the appropriate transfer pricing method. As was the situation in the Nestle case, the appropriate transfer pricing method, depending on the circumstances, may require importing foreign comparables to ascertain whether or not the controlled transactions were at arm's length. This entails that income that is generated within Zambia may be determined as such using standards that are not within the jurisdiction.

4.5 THE PRINCIPLE OF EQUITY

Equity is a fundamental canon of taxation, which requires fairness in the distribution of the tax burden. This canon is enshrined under Article 198(b)(i) of the

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[133]Ibid.

[134] Victor Mwape, Austin Mwange and Munyonzwe Hamalengwa, 'Reconciling Global Norms and Local Realities: An Assessment of Zambia's Legislative and Institutional Framework on Transfer Pricing Regulation' (2025) 6(2) *African Journal of Commercial Studies* 204 https://doi.org/10.59413/ajocs/v6.i2.20 accessed 26 June 2026.

[134] Ibid.

[135] Victor Mwape, Austin Mwange and Munyonzwe Hamalengwa, 'Reconciling Global Norms and Local Realities: An Assessment of Zambia's Legislative and Institutional Framework on Transfer Pricing Regulation' (2025) 6(2) *African Journal of Commercial Studies* 204 https://doi.org/10.59413/ajocs/v6.i2.20 accessed 26 June 2026.

Constitution[136] and entails that taxpayers in similar circumstances should be treated in a similar manner, while those in different circumstances should bear the tax burden in proportion to their ability to pay. This reflects the ability to pa principle and may also be referred to as distributive justice. Under transfer pricing, the principle of certainty is weakened where recharacterisation depends on uncertain and selective comparables rather than objective legal standards.

4.6 HORIZONTAL EQUITY

Horizontal equity demands that taxpayers who are within the same or similar tax brackets should be subjected to the same tax obligation, thereby treated equally. However, having a narrow source definition, horizontal equity may be difficult to actualise in transfer pricing arrangements. This is due to the fact that its broad construction leaves room to manipulation, as it does not exhaustively dictate how transfer arrangements should be treated as Zambian sourced.[137]

In practice, two taxpayers with identical operations may be treated differently depending on how their functions are described. One may be labelled a limited risk distributor with a modest margin, while another is deemed a full-fledged distributor with a higher imputed return. The Income Tax Act provides no guidance on which level of abstraction is correct, leaving outcomes dependent on administrative interpretation. This inconsistency violates horizontal equity, as taxpayers with the same economic reality face different liabilities.[138]

The problem is worsened by differences in resources. Large multinational companies like Nestle may afford to hire transfer pricing experts, legal teams, and pursue lengthy litigation, while smaller taxpayers may be financially constrained to compete at the same level. This means bigger firms often negotiate favourable settlements, whereas smaller ones are forced to accept the full assessment. Furthermore, fairness may also be undermined by timing differences in the sense that taxpayers assessed in different years may face different economic conditions and sets of comparables. Therefore, although their operations may be identical, the outcomes vary due to the differences in the timing of the assessment.[139]

[136] The Constitution of Zambia (Amendment) Act No. 2 of 2016
[137] Income Tax Act (Chapter 323 of the laws of Zambia)
[138] Ibid.
[139] Ibid.

4.7 VERTICLE EQUITY

Vertical equity requires that taxpayers in different economic positions should bear proportionately different burdens.[140] However, this form of equity is equally compromised. Notably, transfer pricing disputes are rarely about the price itself but rather focus more on whether ZRA has captured the economic substance of controlled transactions. As established in previous chapters, transfer pricing analysis often focuses on functional analysis to ascertain if the generated profits align with the economic generation activities that occurred.[141] Therefore, where the analysis is applied rigidly, there could be chances that the income may be understated even though the entity benefited from the Zambian market, labour and institutional environment. In such a setting, the equity concern is whether the tax burden has been allocated with consideration of the real economic contribution.[142]

Additionally, while transfer pricing is anchored on the arm's length rule, enforcement is often constrained by administrative capacity, the availability of comparable data and other implementation challenges that may arise. Such constraints raise equity concerns because, where tax authorities fail to consistently evaluate complex related party transactions, then discretion may be applied unevenly. Vertical equity, therefore, relies not only on legal principles and rules but also on coherent administration.[143]

4.8 THE PRINCIPLE OF NEUTRALITY

Generally, tax neutrality entails that taxation should not influence business decisions.[144] It is concerned with ensuring economic efficiency and creating an environment where markets allocate resources without distortion. In the context of transfer pricing, transfer pricing rules should strike a balance between minimal

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[140] Martin David and Timothy Smeeding (eds), Horizontal Equity, Uncertainty, and Economic Well-Being (University of Chicago Press, 1985) http://www.nber.org/books/davi85-1 ISBN 0-226-13726-0.
[141] Raffaele Petruzzi and Argyro Myzithra, 'Substance in Transfer Pricing in a Post-BEPS World and Beyond…' (2020) *International Transfer Pricing Journal.*
[142]Ibid.
[143] Mwape, V, Mwange, A and Hamalengwa, M, 'Reconciling Global Norms and Local Realities: An Assessment of Zambia's Legislative and Institutional Framework on Transfer Pricing Regulation' (2025) 6(2) *African Journal of Commercial Studies* 204.
[144] Jason Furman, 'The Concept of Neutrality in Tax Policy' (15 April 2008) https://www.brookings.edu/wp-content/uploads/2016/06/0415_tax-_neutrality_furman-1.pdf accessed 11 May 2026.

interference with cross-border transactions and the prevention of profit shifting.[145] Therefore, transfer pricing rules must be structured in a way that they do not encourage taxpayers to choose one structure over the other purely for tax purposes. The inherent weaknesses of the source principle in the current form exacerbate these neutrality concerns because uncertainty and unpredictability may lead to unjust outcomes for the taxpayer in instances of assessments. As a result, the taxpayer may be encouraged to manipulate tax structures so as to obtain a tax advantage, or may be discouraged from taking part in legitimate business arrangements due to compliance costs or the risk of arbitrary adjustments.[146]

Furthermore, neutrality may be understood from different dimensions, which include the following. Tax treatment should not depend on legal form, type of activity, investment location, financing method, or decisions about entering or exiting markets. Overall, taxes should not create a deadweight loss, distort choices, or undermine equality of treatment.[147]

4.9 INVESTMENT NEUTRALITY

Functional characterisation undermines investment neutrality because of uncertainty. This is because firms may use certainty as the deciding factor whether or not to invest, when the real deciding factor should have been the economic efficiency of investing in the jurisdiction. Multinational enterprises may avoid establishing subsidiaries in Zambia, not because of logistical or market disadvantages, but because of uncertainty in how their operations may be treated. This discourages foreign direct investment (FDI) and deprives Zambia of economic opportunities.[148]

Related to FDI, firms may also avoid making Zambia the centre of their business arrangements that would make commercial sense for Zambia. Instead, such

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[145] E Soares, Ricardo de Moraes et al, 'The Neutrality Principle and the Economic Efficiency of Tax Policy: An Exploratory Study of the Legal-Economic Approach' (2023) *Revista de Gestão e Secretariado.*

[146] Ibid.

[147] Stephen E Shay, 'An Overview of Transfer Pricing in Extractive Industries' in Thomas Baunsgaard and Michael Keen (eds), *International Taxation and the Extractive Industries* (IMF 2016).

[148] Jason Furman, 'The Concept of Neutrality in Tax Policy' (15 April 2008) https://www.brookings.edu/wp-content/uploads/2016/06/0415_tax-_neutrality_furman-1.pdf accessed 11 May 2026.

arrangements may be situated elsewhere to avoid the risk of adverse characterisation. This results in lost jobs and economic activity that Zambia would otherwise attract.[149] Additionally, integrated business models may also be discouraged, whereby firms may avoid combining product sales with services or royalties because such arrangements create uncertainty about aggregation and characterisation. Instead, they may adopt simpler but less efficient structures, consequently reducing the overall economic efficiency without increasing Zambia's revenue.

4.10 IMPLICATIONS OF STATUTORY SILENCE ON THE SOURCE PRINCIPLE

The absence of a statutory criterion for determining source under Section 14(1)(a) has serious implications for Zambia’s tax system. Certainty and neutrality are basic principles of taxation, yet they are weakened by the narrow construction of the source principle under transfer pricing.[150] As established above, certainty requires taxpayers to know, with reasonable accuracy, when tax liability arises, when to pay and how to pay, while neutrality requires taxation not to distort economic behaviour. However, where tax law fails to clarify the linkage between the geographical test and the arm’s length rule, taxpayers cannot easily predict the outcome of the investment structures.[151] As a result, the law becomes less stable, compliance costs increase, and disputes become more common.[152]

Additionally, taxpayer confidence and compliance are affected by this statutory silence.[153] Where tax liability depends on discretionary interpretation rather than clear legislative rules, taxpayers may begin to view the system as arbitrary or unfair. Such perception weakens voluntary compliance, even though voluntary compliance is one of the foundations of effective tax administration.[154] As a result, compliance issues may extend to issues of aversion, evasion, avoidance, or mitigation, so as to legally or illegally reduce the tax burden.

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[149] Ibid.
[150] A Smith, An Inquiry into the Nature and Causes of the Wealth of Nations (1776) Vol 2
[151] OECD. (2017). Tax Certainty: IMF/OECD Report for the G20 Finance Ministers.
[152] Bird, R. M., & Zolt, E. M. (2005). Redistribution via taxation: The limited role of the personal income tax in developing countries. UCLA Law Review, 52(6), 1627–1695.
[153] Ibid
[154] Ibid.

Moreover, investment disputes are more likely to be resolved through litigation rather than through clear statutory guidance, thereby increasing the administrative and financial burden on both taxpayers and the revenue authority. In that sense, statutory silence replaces cooperation with dispute resolution through the courts.[155]

Furthermore, the implications of statutory silence are not only doctrinal but also practical. The absence of statutory guidance increases the administrative burden on the ZRA, since the authority must develop interpretive criteria through practice notes, rulings, and audit practice.[156] This reliance on administrative instruments creates inconsistency, because practice notes may change over time or may be applied unevenly across different taxpayers and industries. [157]In addition, administrative guidance does not carry the same authority as legislation, which means taxpayers may challenge it before the courts. The result is a cycle of uncertainty, litigation, and administrative adjustment that weakens the stability of Zambia's tax system. Statutory silence therefore, has cascading effects such that it undermines certainty, equity, neutrality, taxpayer confidence, compliance, and fiscal sovereignty at the same time.[158]

The interaction between Section 14(1)(a) and Section 97A of the Income Tax Act illustrates this inadequacy even more clearly.[159] Section 97A empowers the ZRA to adjust transactions between related parties so that they reflect arm's-length pricing.[160] However, without a wider application of the source principle in transfer pricing contexts, the ZRA's discretion in recharacterising transactions becomes much broader.[161] Section 97A may allow the ZRA to adjust the payment if it is considered excessive, but the absence of statutory criteria for the source principle means that the initial determination of liability depends largely on administrative interpretation. This dual regime creates uncertainty because taxpayers cannot know in advance whether

[155] M Mbeki, 'Resolving Workplace Conflicts through Litigation: Evidence, Analysis and Implications' (2016) ResearchGate accessed 6 May 2026.
[156] Zambia Revenue Authority, Practice Note No 2 of 2018.
[157] Ibid
[158] OECD, Tax Administration 2023
[159] Income Tax Act (Chapter 323 of the laws of Zamba), ss 14(1)(a) and 97A.
[160] Income Tax Act, s 97A.
[161] Income Tax Act, Ch 323, s 14(1)(a)

their transactions will be taxed under Section 14(1)(a) or adjusted under Section 97A.[162]

The risks of discretionary recharacterisation are therefore substantial.[163] In the absence of statutory guidance, the ZRA may recharacterise transactions in ways that affect neutrality and certainty. For instance, intra-group service fees may be treated as having a source in Zambia even where the substantive services were performed abroad.[164] Likewise, marketing intangibles developed by a Zambian subsidiary may be recharacterised as having their source in Zambia, thereby exposing them to taxation despite the contractual structure adopted by the parties. Such discretion creates the risk of arbitrary assessments, which in turn weakens taxpayer confidence and increases the likelihood of litigation. The doctrinal weakness of treating the source of income mainly as the origin, therefore, produces practical risks for the tax taxpayers.[165]

This problem becomes especially visible in transfer pricing disputes, like in the Nestle case, where the court was faced with an issue to determine how much income was Zambian-sourced. In this case, the ZRA sought to recharacterise payments made by Nestle Zambia to its foreign affiliates, arguing that the income had a source in Zambia despite contractual arrangements suggesting otherwise. The court was therefore indirectly required to interpret Section 14(1)(a) without detailed statutory guidance and ultimately affirmed the ZRA's discretion to recharacterise NZL and impute a higher tax margin. The case shows how statutory silence on source undermines certainty and neutrality. It also demonstrates that, in the absence of legislative clarity, the meaning of source is shaped largely by administrative and judicial interpretation rather than by express statutory direction.

4.11 CONCLUSION

The chapter has shown that the interaction between the source principle and transfer pricing rules creates serious tension with the canons of certainty, equity and neutrality.

[162] Mulenga Chiteba, Constance Namatai Mwango and Bwalya Milunga Mulenga, Transfer Pricing 2025: Zambia Law and Practice (Chambers Global Practice Guides, 2025) accessed 6 May 2026.
[163] OECD, Tax Administration 2023: Comparative Information on OECD and other Advanced and Emerging Economies (OECD 2023), ch. 1
[164] Ibid.
[165] Addis Tax Initiative, 'Zambia sets important precedent in transfer pricing enforcement' (2025)

The chapter has established the Constitutional basis for taxation and proceeded with the discussion. The chapter has also established that functional characterisation, though intended to secure arm's length compliance, has destabilised taxation due to uncertainty. Certainty requires that taxpayers are aware of their legal obligations to pay tax, how much they need to pay and where it has to be paid. This uncertainty is a result of the fact that the transfer pricing framework only treats the source principle as the starting point of imputing tax on group entities. The diversion from the geographical test highlights the extent to which the source principle needs development so as to effectively align with transfer pricing rules.

The chapter has also demonstrated that equity is affected at both horizontal and vertical levels. Horizontal equity is undermined where taxpayers with similar economic activities are classified differently depending on how their functions are described or how their transactions are benchmarked. Additionally, vertical equity is strained in instances where the allocation of taxable profits does not clearly reflect the real economic contribution of the enterprise, or where the enforcement capacity and access to comparability data lead to uneven outcomes.

Finally, the chapter has established that neutrality is compromised when transfer pricing assessments influence the commercial behaviour of taxpayers. Therefore, uncertainty surrounding functional characterisation, comparability and source attribution may discourage investment flow in the country.

CHAPTER FIVE

CONCLUSION, SUMMARY AND RECOMMENDATIONS

5.1 INTRODUCTION

This study was prompted by concerns regarding the scope of the source principle and how it forms the basis of transfer pricing assessments in Zambia. This chapter brings the discussion to a close by summarising the findings from each preceding chapter.

The first research question in this paper focused on discussing the definition of the source principle by common law courts, and how the Zambian courts have applied it, particularly under transfer pricing assessments. The second question then discussed the constraint of the source principle under functional characterisation of group entities in Zambia. The third question focused on the implications of functional characterisation, particularly in the context of the principles of certainty, equity and neutrality in Zambia. Finally, the last question focused on highlighting the challenges in harmonising the source principle and functional characterisation of group entities.

5.2 FINDINGS

This paper has found that the Zambian tax is justified by the need for a state to benefit from the opportunities that are offered to the taxpayer by the state to generate income. In this regard, this paper has found that taxpayers assume the obligation to pay the tax due to them so as to contribute to national development. This forms the foundation of the source principle, which also shapes the entire tax system in Zambia.

Additionally, the paper has also found that the source principle should be framed around economic allegiance, where the bulk of the tax burden must be borne in the jurisdiction. While this theory favours Zambia, this paper has found that the source principle has not developed widely enough to meet these aspirations.

Furthermore, the paper has also found that the source of income refers to the geographical location where income-generating activities take place. This definition goes beyond contractual arrangements and looks into the actual economic activity that generates income.

Furthermore, this paper has found that while the source of income has been attached to the geographical test by common law courts, it has developed widely enough to effectively shape transfer pricing rules. Uncertainty as to the real meaning of the source principle is exposed by the recharacterisation of group entities, which alters the tax burden of the taxpayer. The issue with such characterisation lies in the manner in which the taxable amount is arrived at, such that it may involve the use of foreign standards to decide whether or not income is Zambian sourced.

This paper has found that uncertainty of the source principle has a huge negative impact on certainty, equity and neutrality of the tax system. Additionally, it has been found that the constitution is the foundation on which tax principles have been developed. Among the canons, the constitution emphasises the equitable distribution of the tax burden. However, this constitutional requirement is negatively affected by the uncertainty of how Zambian-sourced income can be defined, especially under transfer pricing arrangements. This uncertainty exposes the source principle to manipulation to fit different narratives, as there is no predictability.

Further, the unpredictability of the source principle also leads to erosion of neutrality. Taxpayers are often either encouraged to rearrange their tax affairs and evade taxation or avoid investing in complex structures, with a preference for simpler ones.

5.3 SUMMARY OF FINDINGS

The study has found that tax law confers the obligation to pay tax on taxpayers so that they contribute to the state for the benefits they obtain from the state. Additionally, while the source principle forms the basis of Zambian taxation, it has not been exhaustively defined. However, common law courts have attempted to define it by attaching the geographical test. According to common law, the source of income refers to the geographical location where income-generating activities took place.

Under transfer pricing, the source principle is treated as the starting point of tax assessments, but it does not dictate how much income is Zambian-sourced. In this context, functional characterisation may characterise an entity based on the FAR analysis and cause the use of transfer pricing methods that may require the use of foreign comparables, leaving the major question as to what the source of income really is.

Furthermore, this paper has found that the source principle, in its current form, breeds uncertainty because its legal boundaries are unclear. Such uncertainty exposes the source principle to abuse by tax authorities, as it may be manipulated to fit different narratives.

Additionally, the unclear construction of the source principle does not safeguard the principle of equity because equity is currently dependent on administrative discretion and not established legal principles. Consequently, the distribution of the tax burden is determined by functional characterisation, which may subsequently adjust the tax burden higher or lower.

The study has also found that uncertainty in the source principle also undermines tax neutrality because it bears the potential of altering the behaviour of taxpayers who may be motivated to avoid taxation and choose simpler structures as opposed to complex ones.

5.4 RECOMMENDATIONS

The research has established that the law on the source principle, which defines income that has been generated in Zambia, is inadequate and underdeveloped, especially with regard to transfer pricing arrangements, leading to recharacterisation of entities to establish where income has been generated. As such, it has become apparent that the law needs reform and a clearer interpretation. Therefore, there is a need for statutory amendment to reflect a wider scope of the source principle.

The source principle should be defined in a sufficiently elastic manner to respond to involving commercial realities while preserving its normative role of taxing income from the Zambian source.

Furthermore, international standards must be domesticated in a manner that fits the domestic source narrative to ensure certainty and predictability.

In the current form of the source principle, clarity can be gained to a greater extent through judicial interpretation. The courts must recognise the difficulties of applying the source principle in certain transfer pricing arrangements to ascertain where the real source of income lies. Therefore, the courts must establish a clear link between the source of income and the arm's length principle to shape the tone of the whole transfer pricing framework.

Finally, there is a need to strengthen institutional capacity in transfer pricing administration, which may include training, data access and technical expertise in order to enforce tax laws effectively.

5.5 FINAL CONCLUSION

Conclusively, it is evident that the current research topic continues to attract the interest of researchers because Zambia has very few scholarly works on the subject and very few court decisions. Therefore, more scholarly work on the subject will greatly benefit tax experts and researchers in Zambia.

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