

SOUTH AFRICA

LEGISLATION	
Existence of Transfer Pricing Laws/Guidelines	<p>South African transfer pricing is governed by Section 31 of the Income Tax Act No.58 of 1962 (ITA).</p> <p>Section 31 (2) of the ITA empowers the Commissioner of the South African Revenue Service (SARS) to adjust a consideration for goods and services to reflect an arm's length price for the purpose of computing the South African taxable income of a taxpayer.</p> <p>Goods and services (including direct and indirect financial services) are defined in Section 31 (1) of the ITA while Section 31 (3) of the ITA deals specifically with the issue of thin capitalisation.</p> <p>Section 31 is discretionary in this sense that although it can place some comfort on the fact that the tax authorities should apply due care and reasonableness in raising a transfer pricing adjustment, the taxpayer bears the burden of proof to rebut such adjustment.</p> <p>The SARS issues practice notes that provide guidance on its interpretation and application of the ITA. Practice Note 2 deals with the interaction between thin capitalisation rules and transfer pricing rules. It relates to the provision of financial assistance given by a non-resident related investor to a South African resident. It addresses levels of excessive loan debt funding under the thin capitalisation rules as well as excessive interest rates under the transfer pricing rules. Its application field is limited to inbound financial funding and does not cover outbound financial funding.</p> <p>The comprehensive Practice Note 7 gives guidance on implementing transfer pricing rules and documentation requirements. Though South Africa is not an OECD member but has observer status, it generally follows the OECD Transfer Pricing Guidelines.</p>
Transfer Pricing Scrutiny	<p>Transfer Pricing scrutiny is applicable to all entities Furthermore, South African companies having related companies in low tax jurisdictions risk increased investigation. Such investigation is often two pronged testing residency together with transfer pricing, The SARS' investigations also focuses on intellectual property.</p> <p>The SARS investigates mainly on the transactional level. The SARS approaches tax on an annual basis and transfer pricing adjustments are viewed on a year by year basis irrespective of the longer term picture. The SARS does not favour transfer pricing adjustments carried through by the taxpayer as it often interprets such adjustments as a profit stripping mechanism. As such any transfer pricing adjustment by an offshore holding company functions as a trigger to a query or audit by the SARS. The SARS furthermore takes the view that the taxpayer cannot use hindsight and that year-end adjustments are made based on hindsight.</p>

<p>Definition of Related Party</p>	<p>Section 31 of the ITA refers to the notion of connected person for the application of the transfer pricing regulations and rules.</p> <p>A group of companies means two or more companies in which the controlling group company directly or indirectly holds shares in at least one other company (the controlled group company), to the extent that:</p> <ul style="list-style-type: none"> • at least 70 per cent of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and • the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company. <p>A connected person with regard to a company is any other company which would be part of the same group of companies as that company if the above threshold of 'at least 70 per cent' is replaced by 'more than 50 per cent'.</p> <p>An offshore company that individually or jointly with any connected person in relation to itself, directly or indirectly holds at least 20 per cent of a company's share capital or voting rights is also considered to a connected person to such company.</p> <p>The South African related party definition is broader than the definition applied in most OECD member countries.</p>
<p>Transfer Pricing Penalties</p>	<p>In case of additional income taxes due pursuant to a transfer pricing adjustment, interest is, on basis of Section 89 of the ITA, due on the amount of underpaid income taxes.</p> <p>Penalties of up to 200 per cent of the underpaid taxes may be due (Section 76 of the ITA).</p> <p>Furthermore, under Section 63C of the ITA, an adjusted amount can, in certain circumstances, be qualified as a dividend subject to withholding tax (replacing the previously applicable secondary tax on companies of 10 per cent).</p>
<p>Advance Pricing Agreement (APA)</p>	<p>There is presently no formal procedure in place by which a taxpayer can obtain an APA with regard to a transfer pricing issue. There may be limited opportunity to obtain a private ruling from the SARS on transfer pricing practices, but as yet this is largely untested.</p>
<p>DOCUMENTATION AND DISCLOSURE REQUIREMENTS</p>	
<p>Tax Return Disclosures</p>	<p>Each corporate taxpayer is required to submit an annual income tax return (IT14) principally twelve months after its financial year end.</p> <p>Under Section 74A of the ITA, the taxpayer is required to furnish SARS with any information they may require to administer the ITA.</p>

	<p>In respect of transfer pricing , SARS issues separately a transfer pricing questionnaire which must be completed by the taxpayer relating the last submitted income tax return (IT14)</p> <p>Please see Appendix (I) at the end of this document.</p>
Level of Documentation	<p>The ITA does not contain any explicit transfer pricing documentation requirement.</p> <p>Practice Note 7, which is heavily based on the OECD Transfer Pricing Guidelines, contains the SARS' approach to transfer pricing documentation.</p> <p>The transfer pricing documentation should adequately reflect the current transfer pricing policies being implemented and be up to date. Erroneous, out of date or incorrect documentation could be qualified as incomplete disclosure resulting in the non-application of the statute of limitations to the years in which such disclosure was made.</p> <p>The taxpayer has the burden of proof that its transfer prices comply with the arm's length principle. The best way to meet this requirement is to develop a transfer pricing policy, to determine the arm's length amount and to voluntarily produce documentation to evidence the analysis undertaken. The SARS expects the transfer pricing documentation to be in accordance with prudent business management principles, i.e. the principles governing the process of evaluating a business decision of a similar level of complexity and importance.</p>
Record keeping	<p>There are no specific transfer pricing regulations or rules dealing with record keeping. The general tax rules to record keeping consequently apply. In case the transfer pricing documentation is deemed to be incorrectly or incompletely disclosed, the statute of limitations does not apply and the records with regard to the years concerned must in consequence be kept until the issue is finally settled</p>
Language for documentation	<p>Transfer pricing documentation should be drafted in either English or Afrikaans. The Commissioner can ask that documentation drafted in another language be translated to either English or Afrikaans at the expense of the taxpayer.</p>
Small and medium sized enterprises (SMEs)	<p>There are no specific rules for small and medium sized enterprises.</p>
Deadline to Prepare Documentation	<p>Transfer pricing documentation must be contemporaneous and regularly updated. Where previously the SARS accepted the update on a three year basis or in the case of change in operations, it expects an annual documentation update.</p>
Deadline to Submit Documentation	<p>The SARS exercises in practice its authority, based on Sections 74A of the ITA, to require a taxpayer to submit his transfer pricing policy and documentation with the corporate income tax return (which is, in principle, due twelve months after the financial year end). In practice, the SARS may furthermore require that detailed transfer pricing information be supplied within a prescribed time period from the date of request</p>

STATUTE OF LIMITATIONS

The standard statute of limitations is three years from the date of the original assessment notice. No statute of limitations applies in case of fraud, misinterpretation or inaccurate or incomplete disclosure of material facts.

TRANSFER PRICING METHODS

The OECD Transfer Pricing Guidelines are the basis for defining an acceptable transfer pricing methodology: the CUP method, the resale price method, the cost plus method, the profit split method and the transactional net margin method are accepted. The SARS prefers transaction-based methods over profit-based methods. The transactional net margin method is most commonly applied by taxpayers and accepted provided that evidence can be given that reliable data to apply the transaction based methods are insufficiently available.

COMPARABLES

Information on South African public companies is only readily available in the form of published financial accounts. More detailed information on public companies and information on private companies is generally not publicly available. South African comparables are consequently not easily available. The SARS accepts the use of foreign financial databases but may require that adjustments to the data are carried through for use in the South African market. It is the understanding of practitioners that the SARS uses Amadeus One Million to conduct comparable studies relying heavily on European companies for comparability. Tax practitioners have further experienced limited evidence that SARS relies on secret comparable information it has access to. Although such information can never be used in court, it emphasises the need for the taxpayer to develop a robust benchmarking to rebut the proposed adjustments based on such secret information.

Thursday, October 29, 2009

APPENDIX (I)

**TRANSFER PRICING QUESTIONNAIRE:
FOREIGN-OWNED COMPANIES**



TRANSFER PRICING QUESTIONNAIRE: FOREIGN-OWNED COMPANIES

1. *Please complete the following questions based on the latest completed IT14 tax return for the latest year submitted. In responding to the questions you may provide separate written comments if you wish to give clarification on any issue or identify assumptions made. All values should be stated in South African Rands.*

- a. Name of Company
- b. Company registration number
- c. Company tax reference number
- d. Company VAT reference number
- e. Registered address of company
- f. Name, telephone number and email address of the public officer
- g. Name and contact details of the tax advisors

h. Name and country of incorporation of holding company and ultimate holding company (if different)

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i. Tax residence of holding company and ultimate holding company (if different)

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2. Please provide the principle activities of the South African company.

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3. Please provide details of the principal activities of the ultimate parent company and its consolidated group.

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4. The following information is required for the purpose of calculating various accounting ratios for comparison purposes. The intention is to compare the performance of the South African company with that of the consolidated

group of the ultimate parent company. If your company is performing below consolidated group levels you may wish to provide an explanatory note.

	<i>South African Company</i>	<i>Consolidated Group</i>
	<i>(R) Value</i>	
<i>Total Assets</i>		
<i>Operating Assets</i>		

<i>Current Liabilities</i>		
<i>Turnover</i>		
<i>Gross profit</i>		
<i>Total expenses</i>		
<i>Operating expenses</i>		
<i>Operating profit</i>		

5. The following information is required to understand the nature and quantum of international related party transactions.

	<i>Supplied by international related parties (R) value</i>	<i>Supplied to international related parties (R) value</i>
Goods		
<i>Raw materials</i>		
<i>Processed or finished goods</i>		
<i>Other (specify)</i>		
<i>Rents, royalties, license fees or franchise fees</i>		
<i>Intangible property transferred</i>		
Services		
<i>Management and administration</i>		
<i>Technical</i>		
<i>Research and development</i>		
<i>Commissions</i>		
Financial		
<i>Interest</i>		
<i>Insurance</i>		
<i>Other (specify)</i>		
Other		
<i>Reimbursement of expenses</i>		
<i>Cost sharing / cost contribution arrangements</i>		
<i>Employment costs for expatriate employees</i>		
<i>Other (specify)</i>		

Total Value of international related party transactions

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6. The South African Revenue Service recognises the transfer pricing methods endorsed by the Organisation for Economic Development and Cooperation (OECD) in its Guidelines on Transfer Pricing for Multinational Enterprises and Tax Administrations (1995), the OECD Guidelines. These methods are outlined in Practice Note 7 issued on 6 August 1999. Please identify the transaction value from the transactions identified above against each of the methods used to set or test the appropriateness of the pricing policy adopted. If more than one method was used please provide information to support this and allocate the value against the primary method used. Please note that the total value of transactions should equal the total from the above table.

<i>Methods</i>	<i>Supplied by international related parties (R) Vale</i>	<i>Supplied to international related parties. (R) value</i>
<i>Comparable Uncontrolled price (CUP)</i>		
<i>Resale Price Method (RP)</i>		
<i>Cost Plus Method (CP)</i>		
<i>Transactional Net Margin Method (TNMM)</i>		
<i>Transactional Profit Split Method (TPSM)</i>		
<i>Other method (specify)</i>		
<i>Not tested</i>		
Total Value of transactions		

7. Has the company provided any goods or services (Including the provision of financial assistance) to an international related party for no consideration?

If Yes please check the box and provide details

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8. *Have any of the transactions listed in (5) above occurred with an international related party resident in a tax haven?*

If Yes please check the box and provide details

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9. *Has the company prepared transfer pricing supporting documentation for the transactions listed at point (5) above.*

If Yes please check the box and provide an approximate percentage of the value of transactions for which documentation has been prepared.

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10. *Please provide details of the representative from the company completing the questionnaire for future reference, should we wish to contact you further.*

Name
Position
