

Name of Country: South Africa Date of profile: April 2009

| No. | Item | Reference to and wherever possible text of the provisions; Wherever needed and possible, a translation into one of the OECD official languages would be welcome |
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| 1 | Reference to the Arm's Length Principle | <p>Income Tax Act, 1962 (Act 58 of 1962)</p> <p>31. Determination of taxable income of certain persons in respect of international transactions</p> <p>1) For the purposes of this section—</p> <p>“goods” includes any corporeal movable thing, fixed property and any real right in any such thing or fixed property;</p> <p>“international agreement” <i>[deleted by the Revenue Laws Amendment Act, 2007 (Act No. 35 of 2007)]</i></p> <p>“services” includes anything done or to be done, including, without limiting the generality of the foregoing--</p> <p>a) the granting, assignment, cession or surrender of any right, benefit or privilege;</p> <p>b) the making available of any facility or advantage;</p> <p>c) the granting of financial assistance, including a loan, advance or debt, and the provision of any security or guarantee;</p> <p>d) the performance of any work;</p> <p>e) an agreement of insurance; or</p> <p>f) the conferring of rights to or the use of incorporeal property.</p> <p>1A) For the purposes of subsection (2), where any supply of goods or services has been effected in respect of any intellectual property as contemplated in the definition of "intellectual property" in section 23I(1) or knowledge, “connected person” shall mean a connected person as defined in section 1, provided that the expression 'and no shareholder holds the majority voting rights of such company' in paragraph (d)(v) of that definition must be disregarded.</p> <p>2) Where any supply of goods or services has been effected—</p> <p>a) between—</p> <p>i)</p> <p>aa) a resident; and</p> <p>bb) any other person who is not a resident;</p> <p>ii)</p> <p>aa) a person who is not a resident; and</p> <p>bb) a permanent establishment in the Republic of any other person who is not a resident; or</p> <p>iii)</p> <p>aa) a person who is a resident; and</p> |

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| | | <p style="padding-left: 40px;">bb) a permanent establishment outside the Republic of any other person who is a resident;</p> <p>b) between those persons who are connected persons in relation to one another; and</p> <p>c) at a price which is either—</p> <p style="padding-left: 40px;">i) less than the price which such goods or services might have been expected to fetch if the parties to the transaction had been independent persons dealing at arm's length (such price being the arm's length price); or</p> <p style="padding-left: 40px;">ii) greater than the arm's length price,</p> <p>the Commissioner may, for the purposes of this Act in relation to either the acquiror or supplier, in the determination of the taxable income of either the acquiror or supplier, adjust the consideration in respect of the transaction to reflect an arm's length price for the goods or services.</p> <p>3)</p> <p>a) Where any person who is not a resident (hereinafter referred to as the investor) has granted financial assistance contemplated in paragraph (c) of the definition of "services" in subsection (1), whether directly or indirectly, to---</p> <p style="padding-left: 40px;">i) any connected person in relation to the investor who is a resident; or</p> <p style="padding-left: 40px;">ii) any other person (in whom he has a direct or indirect interest) other than a natural person, which is a resident (hereinafter referred to as the recipient) and, by virtue of such interest, is entitled to participate in not less than 25 per cent of the dividends, profits or capital of the recipient, or is entitled, directly or indirectly, to exercise not less than 25 per cent of the votes of the recipient,</p> <p>and the Commissioner is, having regard to the circumstances of the case, of the opinion that the value of the aggregate of all such financial assistance is excessive in relation to the fixed capital (being share capital, share premium, accumulated profits, whether of a capital nature or not, or any other permanent owners' capital, other than permanent capital in the form of financial assistance as so contemplated) of such connected person or recipient, any interest, finance charge or other consideration payable for or in relation to or in respect of the financial assistance shall, to the extent to which it relates to the amount which is excessive as contemplated in this paragraph, be disallowed as a deduction for the purposes of this Act.</p> <p>b) For the purposes of paragraph (a), financial assistance granted indirectly shall be deemed to include any financial assistance granted by any third person who is not a connected person in relation to the investor, a connected person contemplated in paragraph (a) or the recipient, where such financial assistance has been granted by arrangement, directly or indirectly, with the investor and on the strength of any financial assistance granted, directly or indirectly, by the investor or any connected person in relation to the investor, to such third person.</p> |
| 2 | Reference to the OECD Transfer Pricing Guidelines (if any) | <p>SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7 DATE: 6 AUGUST 1999</p> <p>Makes a number of cross references to the OECD Guidelines.</p> |

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| | | <p>e.g. States at paragraph 3.2:</p> <p><i>Status of the OECD Guidelines</i></p> <p>Because of the international importance of the OECD Guidelines, this Practice Note is based on, <i>inter alia</i>, those guidelines...</p> <p>The OECD Guidelines should be followed in the absence of specific guidance in terms of this Practice Note, the provisions of section 31 or the tax treaties entered into by South Africa.</p> |
| 3 | Definition of related parties | <p>“connected person” means—</p> <hr/> <ul style="list-style-type: none"> a) in relation to a natural person- <ul style="list-style-type: none"> i) any relative; and ii) any trust of which such natural person or such relative is a beneficiary; b) in relation to a trust- <ul style="list-style-type: none"> i) any beneficiary of such trust; and ii) any connected person in relation to such beneficiary; bA) in relation to a connected person in relation to a trust (other than a collective investment scheme in property shares managed or carried on by any company registered as a manager under section 42 of the Collective Investment Schemes Control Act, 2002, for purposes of Part V of that Act), includes any other person who is a connected person in relation to such trust; c) in relation to a member of any partnership- <ul style="list-style-type: none"> i) any other member; and ii) any connected person in relation to any member of such partnership; d) in relation to a company- <ul style="list-style-type: none"> i) any other company that would be part of the same group of companies as that company if the expression ‘at least 70 per cent’ in paragraphs (a) and (b) of the definition of ‘group of companies’ in this section were replaced by the expression ‘more than 50 per cent’; ii) <i>[deleted by Revenue Laws Amendment Act No. 20 of 2006]</i> ; iii) <i>[deleted by Revenue Laws Amendment Act No. 20 of 2006]</i> ; iv) any person, other than a company as defined in section 1 of the Companies Act, 1973 (Act No 61 of 1973), who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20 per cent of the company's equity share capital, or voting rights; v) any other company if at least 20 per cent of the equity share capital of such company is held by such other company, and no shareholder holds the majority voting rights of such company; vA) any other company if such other company is managed or controlled by- <ul style="list-style-type: none"> aa) any person who or which is a connected person in relation to such company; or bb) any person who or which is a connected person in relation to |

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| | | <p>a person contemplated in item (aa); and</p> <p>vi) where such company is a close corporation-</p> <p>aa) any member;</p> <p>bb) any relative of such member or any trust which is a connected person in relation to such member; and</p> <p>cc) any other close corporation or company which is a connected person in relation to-</p> <p>i) any member contemplated in item (aa); or</p> <p>ii) the relative or trust contemplated in item (bb); and</p> <p>e) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person;</p> |
| 4 | Transfer pricing methods | <p>SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7 DATE: 6 AUGUST 1999</p> <p>States at paragraph 9:</p> <p><i>Acceptable Methods for Determining an Arm's Length Price</i></p> <p><i>Introduction</i></p> <p>Neither Section 31 nor the tax treaties entered into by South Africa prescribe any particular methodology for the purpose of ascertaining an arm's length consideration.</p> <p>The most appropriate method in a given case will depend on the facts and circumstances of the case and the extent and reliability of data on which to base a comparability analysis. It should always be the intention to select the method that produces the highest degree of comparability...</p> <p>As a general rule, the most reliable method will be the one that requires fewer and more reliable adjustments to be made. Taxpayers will not be required to undertake an intricate analysis of all the methodologies, but should have a sound basis for using the selected methodology. This could entail providing reasons why secondary methods are not appropriate...</p> <p><i>The principle methods referred to in the OECD Guidelines</i></p> <p>Several transfer pricing methods have been developed in international practice for determining and appraising a taxpayer's transfer prices. These methods are based on measuring a multinational's pricing strategies against a benchmark of the pricing behaviour of independent entities in uncontrolled transactions.</p> <p>The standard transfer pricing methods recognised by the OECD Guidelines, are:</p> <ol style="list-style-type: none"> a. the comparable uncontrolled price method (CUP method); b. the resale price method (RP method); c. the cost plus method (CP method); d. the transactional net margin method (TNMM); and e. the profit split method. |
| 5 | Transfer pricing documentation requirements | <p>SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7</p> |

DATE: 6 AUGUST 1999

States at paragraph 10.1:

The Act

Sections 74, 74A, 74B, 74C, 74D and 75 of the Act deal comprehensively with the information and documents of the taxpayer and the access of SARS to such information and documents, as well as the supporting documentation required when submitting returns. These provisions are also applicable to transfer pricing investigations. In addition, section 69 of the Act also enables the Commissioner to require any person to furnish the information he may require...

States at paragraph 10.2:

The need for documentation

Although there is no explicit statutory requirement to prepare and maintain transfer pricing documentation, it is in the taxpayer's best interest to document how transfer prices have been determined, since adequate documentation is the best way to demonstrate that transfer prices are consistent with the arm's length principle, as required by section 31...

States at paragraph 10.3:

Documentation guidelines

The documentation guidelines set out below broadly follow Chapter V of the OECD Guidelines. According to paragraph 5.4 of the OECD Guidelines, the taxpayer's process of considering whether transfer pricing is appropriate for tax purposes should be determined in accordance with the same prudent business management principles that would govern the process of evaluating a business decision of a similar level of complexity and importance. The Commissioner would expect taxpayers to have created, referred to and retained documentation in accordance with this principle...

As a general rule the Commissioner considers that taxpayers should contemporaneously document the process they have followed and their analysis in determining transfer prices, in their efforts to comply with the arm's length principle. This should include some justification of why those transfer prices are considered to be consistent with the arm's length principle...

The Commissioner will rely as much as possible on documentation that should be created in the ordinary course of business and of setting a transfer price. This documentation will generally address the following:

- a. identification of transactions in terms of international agreements entered into with connected persons and the extent of any other commercial or financial relations with connected persons which fall within the scope of Section 31;
- b. copies of the international agreements entered into with connected persons;
- c. a description of the nature and terms (including prices) of all the relevant transactions (including a series of transactions and any relevant off-setting transactions);
- d. the method that has been used to arrive at the nature and terms of the relevant transactions (including the functional analysis undertaken and an appraisal of potential comparables);
- e. the reasons why the choice of method was considered to be the most

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| | | <p>appropriate to the relevant transactions and to the particular circumstances;</p> <ul style="list-style-type: none"> f. an explanation of the process used to select and apply the method used to establish the transfer prices and why it is considered to provide a result that is consistent with the arm's length principle; g. information relied on in arriving at the arm's length terms such as commercial agreements with third parties, financial information, budgets, forecasts etc. h. details of any special circumstances that have influenced the price set by the taxpayer... <p>Taxpayers may be asked to provide the Commissioner with relevant documentation created when the international agreement was contemplated and at the time when the agreement was entered into. Where there is inadequate contemporaneous documentation of arm's length international dealings, between connected parties, it will clearly be more difficult for companies to convince the Commissioner that the dealings took place on an arm's length basis.</p> <p>Taxpayers under investigation would be expected to provide relevant documents, explanatory material and other information to which the company has access or could reasonably be expected to have access. The nature of the documentation likely to be sought includes relevant pricing policies, product profitabilities, relevant market information (such as sales forecasts and market characteristics), the profit contributions of each party and an analysis of the functions, assets, skills and the degree and nature of the risks involved for the various parties...</p> <p>In addition there is an annex to the Practice Note which sets out a step process for compiling documentation.</p> |
| 6 | <p>Specific transfer pricing audit procedures and / or specific transfer pricing penalties.</p> | <p>SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7 DATE: 6 AUGUST 1999</p> <p>States at paragraph 12:</p> <p><i>The Commissioner's Approach to Transfer Pricing Reviews, Audits and Investigations</i></p> <p>Depending on the facts applicable to each individual case, the Commissioner intends to follow the general guidelines set out in this Practice Note...</p> <p><i>The Commissioner's access to and use of information</i></p> <p>There are various sources from which the Commissioner can obtain information. The first is from the taxpayer, by way of enquiries into its transfer pricing practices. Alternatively, information may be sought from sources external to the taxpayer, such as:</p> <ul style="list-style-type: none"> a. other taxpayers within the same or similar industry; b. financial databases, publicly available industry information, the Internet, etc. This includes information on comparable foreign entities; c. other jurisdictions (through the exchange of information provisions contained in tax treaties). <p><i>Use of publicly undisclosed information</i></p> <p>In the context of a review of a taxpayer's voluntary compliance with the transfer pricing rules, the Commissioner's primary source for obtaining information will be from the taxpayer itself. However, it should be remembered that the Commissioner, when applying any method, may have more information available than a taxpayer has, or can</p> |

through its own efforts have reasonable access to. The Commissioner does not intend as a matter of course to use publicly undisclosed information in an attempt to substitute an alternative measure of the arm's length amount. There are procedural problems in using such information, such as the likelihood that such information could not be provided to taxpayers whose transfer prices are under review or as evidence in court due to the secrecy provisions of the Act.

Nevertheless, the Commissioner does not rule out the possibility that publicly undisclosed information will be used in administering the transfer pricing rules.

Requesting information from foreign connected persons

Where a non-resident parent dictates the transfer price adopted by its South African subsidiary, the parties may not be considered to be dealing at arm's length. Where the subsidiary has limited or no documentation to demonstrate that its transfer prices comply with the arm's length principle, it may be necessary to have recourse to documentation held by non-resident connected persons, if the taxpayer's transfer prices are to be reviewed.

The Commissioner acknowledges that taxpayers may face difficulties obtaining information from foreign connected persons. Such difficulties would not be encountered if taxpayers were required to produce only their own documents. However, due to the relationship between the parties the Commissioner considers it reasonable to expect taxpayers to obtain such information where necessary...

Transactions with entities in low tax jurisdictions

Taxpayers should be aware that the Commissioner may pay closer attention to a transaction involving an entity resident in a country with lower tax rates than South Africa. The perception exists that transactions involving low tax jurisdictions are often motivated by tax, rather than strictly commercial, reasons.

States at paragraph 13:

Interest and Penalties

The penalty, additional tax and offence provisions applicable in the event of default or omission in the completion of the tax return or evasion of taxation are contained in sections 75, 76, and 104 of the Act and will also apply to default, evasion or omission relating to transfer pricing. The Act does not impose specific penalties in respect of non-arm's length pricing practices.

Sections 89*bis* and 89*quat* of the Act provides for interest on the underpayment of tax and will also apply if the underpayment of tax results from non-compliance with section 31 of the Act.

States at paragraph 14:

Secondary Tax on Companies (STC)

Section 64C of the Act provides that certain amounts distributed to a recipient by a company are deemed to be a dividend declared by the company. Section 64C(3)(e) deems any amount adjusted or disallowed in terms of section 31 to have been distributed to a recipient by the company. The adjustment will therefore be subject to STC.

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| 7 | Relevant regulations on Advance Pricing Arrangements | South Africa does not offer an APA program at present. |
| 8 | Link to relevant Government Internet sites | http://www.sars.gov.za/ |
| 9 | Other relevant information | |