

Transfer Pricing Country Profile
(to be posted on the OECD Internet site www.oecd.org/ctp/tp/countryprofiles)

Name of Country: South Africa Date of profile: 22 January 2013

1. Reference to the Arm's Length Principle

South Africa has recently amended section 31 of the Income Tax Act 58 of 1962. Section 31, as it reads below, is effective from 1 April 2012 and applicable in respect of years of assessment commencing on or after that date.

“31 Tax payable in respect of international transactions to be based on arm's length principle

31. (1) For the purposes of this section –

“affected transactions” means any transaction, operation, scheme, agreement or understanding where –

- (a) That transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected between or for the benefit of either or both-*
 - (i)(aa) a person that is a resident; and*
 - (bb) any other person that is not a resident*
 - (ii)(aa) a person that is not a resident; and*
 - (bb) any other person that is not a resident that has a permanent establishment in the Republic to which the transaction, operation, scheme, agreement or understanding relates;*
 - (iii)(aa) a person that is a resident; and*
 - (bb) any other person that is a resident that has a permanent establishment outside the Republic to which the transaction, operation, scheme, agreement or understanding relates;*
 - (iv)(aa) a person that is not a resident; and*
 - (bb) any other person that is a controlled foreign company in relation to the resident,*

And those persons are connected persons in relation to one another;

- (b) Any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length;*

‘financial assistance’ includes the provision of any—

- (a) loan, advance or debt; or*
- (b) security or guarantee.*

(2) Where—

(a) any transaction, operation, scheme, agreement or understanding constitutes an affected transactions; and

(b) any term or condition of that transaction, operation, scheme, agreement or understanding—

(i) is a term or condition contemplated in paragraph (b) of the definition of “affected transaction” and

; and

(ii) results or will result in any tax benefit being derived by a person that is a party to that transaction, operation, scheme, agreement or understanding,

the taxable income or tax payable by any person contemplated in paragraph (b)(ii) that derives tax benefit contemplated in that paragraph must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm’s length.

(3) To the extent that there is a difference between -

(a) any amount that is, after taking subsection (2) into account, applied in the calculation of the taxable income of any resident that is a party to an affected transaction; and

(b) any amount that would, but for subsection (2), have been applied in the calculation of the taxable income of the resident contemplated in paragraph (a),

the amount of that difference must, for purposes of subsection (2), be deemed to be a loan that constitutes an affected transaction.

(4) For the purposes of subsection (2), where any transaction, operation, scheme, agreement or understanding has been directly or indirectly entered into or effected as contemplated in that subsection in respect of—

(a) the granting of any financial assistance; or

(b) intellectual property as contemplated in the definition of ‘intellectual property’ in section 23I(1) or knowledge,

connected person *means a connected person as defined in section 1:*

Provided that the expression ‘and no shareholder holds the majority voting rights in the company’ in paragraph (d)(v) of that definition must be disregarded.

(5) Where any transaction, operation, scheme, agreement or understanding has been entered into between a headquarter company and—

(a) any other person that is not a resident and that transaction, operation, scheme, agreement or understanding is in respect of the granting of financial assistance by that other person to that headquarter company, this section does not apply to so much of that financial assistance that is directly applied as financial assistance to any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights; or

(b) any foreign company in which the headquarter company directly or indirectly (whether alone or together with any other company forming part of the same group of companies as that headquarter company) holds at least 10 per cent of the equity shares and voting rights and that

transaction, operation, scheme, agreement or understanding comprises the granting of financial assistance by that headquarter company to that foreign company, this section does not apply to that financial assistance.’.

2. Reference to the OECD Transfer Pricing Guidelines (if any)

The SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7, DATED: 6 AUGUST 1999 (“Practice Note 7”) makes a number of cross references to the OECD Guidelines. For example Practice Note 7 states at paragraph 3.2:

“Status of the OECD Guidelines

Because of the international importance of the OECD Guidelines, this Practice Note is based on, inter alia, those guidelines...

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.”

With the introduction of the amended section 31 a new Interpretation Note is currently being drafted by the South African Revenue Service (“SARS”) which will replace Practice Note 7.

In the National Treasury Explanatory memorandum it is stated that South Africa will continue to follow the OECD Transfer Pricing Guidelines closely both with respect to transfer pricing in general and the power to recharacterise transactions in the application of the transfer pricing rules.

3. Definition of related parties

The connected person definition is contained in section 1 of the Income Tax Act no 58 of 1962.

“connected person” means—

- (a) *in relation to a natural person—*
 - (i) *any relative; and*
 - (ii) *any trust (other than a portfolio of a collective investment scheme in securities) of which such natural person or such relative is a beneficiary;*
- (b) *in relation to a trust (other than a portfolio of a collective investment scheme in securities)—*
 - (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 and other than a portfolio of a collective investment*

scheme in securities), includes any other person who is a connected person in relation to such trust;

- (c) *in relation to a member of any partnership—*
 - (i) *any other member; and*
 - (ii) *any connected person in relation to any member of such partnership;*
- (d) *in relation to a company—*
 - (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 of the equity shares of or voting rights in”;*
 - (ii) *.....*
 - (iii) *.....*
 - (iv) *any person, other than a company as defined in section 1 of the Companies Act, 2008 (Act No. 71 of 2008), who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20 per cent of—*
 - (aa) *the equity shares in the company; or*
 - (bb) *the voting rights in the company;*
 - (v) *any other company if at least 20 per cent of the equity shares of or voting rights in the company are held by that other company, and no shareholder holds the majority voting rights in the company;*
 - (vA) *any other company if such other company is managed or controlled by—*
 - (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 a person contemplated in item (aa); and*
 - (vi) *where such company is a close corporation—*
 - (aa) *any member;*
 - (bb) *any relative of such member or any trust (other than a portfolio of a collective investment scheme in securities) which is a connected person in relation to such member; and*
 - (cc) *any other close corporation or company which is a connected person in relation to—*
 - (i) *any member contemplated in item (aa); or*
 - (ii) *the relative or trust contemplated in item (bb); and*
- (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;*

Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme in securities”

4. Transfer pricing methods

The South African Revenue Service Practice Note No 7, dated 6 August 1999, states at paragraph 9:

“Acceptable Methods for Determining an Arm's Length Price

Introduction

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.

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...

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...

The principle methods referred to in the OECD Guidelines

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.

The standard transfer pricing methods recognised by the OECD Guidelines, are:

- 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.*

The hierarchy of methods

Section 31 does not impose a hierarchy for the transfer pricing methods. However there is in effect a hierarchy, in that certain methods may provide a more reliable result than others, depending on the quality of available data and the taxpayer's circumstances...The most reliable method will be the one that requires fewer and more reliable adjustments....

With the introduction of the amended section 31 a new Interpretation Note is currently being drafted by the South African Revenue Service (“SARS”) which will replace Practice Note 7.”

5. Transfer pricing documentation requirements

There is no explicit statutory requirement for taxpayers to prepare and maintain transfer pricing documentation.

THE TAX ADMINISTRATION ACT NO 28 OF 2011

Chapter 4 Part B of the Tax Administration Act no 28 of 2011 enables SARS to request relevant material that it requires to administer the provision of the Income Tax Act (including section 31).

THE SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7, DATED: 6 AUGUST 1999 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 appropriate to the relevant transactions and to the particular circumstances;*

- 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...*

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.

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..."

In addition there is an annex to the Practice Note which sets out a step process for compiling documentation.

With the introduction of the amended section 31 a new Interpretation Note is currently being drafted by the South African Revenue Service ("SARS") which will replace Practice Note 7.

6. Specific transfer pricing audit procedures and / or specific transfer pricing penalties

SPECIFIC TRANSFER PRICING AUDIT PROCEDURES

SOUTH AFRICAN REVENUE SERVICE PRACTICE NOTE: NO 7, DATED: 6 AUGUST 1999 states at paragraph 12:

"The Commissioner's Approach to Transfer Pricing Reviews, Audits and Investigations

Depending on the facts applicable to each individual case, the Commissioner intends to follow the general guidelines set out in this Practice Note...

The Commissioner's access to and use of information

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:

- 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).*

Use of publicly undisclosed information

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 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."

SPECIFIC TRANSFER PRICING PENALTIES

The Income Tax Act, no 58 of 1962 or Tax Administration Act no 28 of 2011 do not impose specific transfer pricing penalties.

The understatement penalty provisions contained in Chapter 16 of the Tax Administration Act no 28 of 2011 will also apply to an omission from a return and an incorrect statement in a return relating to transfer pricing.

7. Relevant regulations on Advance Pricing Arrangements

South Africa does not offer an APA programme at present.

8. Link to relevant Government Internet sites

<http://www.sars.gov.za/>

9. Other relevant information

[...]

Note

1. Relevant provisions of domestic legislation referring to the Arm's Length Principle.
2. Reference if any to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in domestic legislation or regulations.
3. Relevant legislation or regulations containing a definition of related parties or associated enterprises.
4. Relevant legislation or regulations containing guidance on transfer pricing methods including hierarchy among them if any.
5. Relevant regulations if any in relation to transfer pricing documentation requirements.
6. Relevant regulations if any on specific transfer pricing audit procedures and / or specific transfer pricing penalties.
7. Relevant regulations if any on Advance Pricing Arrangements.
8. Addresses of the Internet sites of the relevant authorities in charge of transfer pricing policy, its administration and Advance Pricing Arrangements.
9. Other relevant information, for instance having gone through a peer review, or having new transfer pricing regulations in preparation.