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Presentation to the Portfolio Committee on Trade and Industry

Transfer pricing in South Africa

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Purpose of Transfer Pricing Rules

- Transfer Pricing (TP) rules are anti-avoidance rules
- They are designed to ensure taxpayers do not manipulate prices within multi-national groups, thereby group shifting profits to lower tax jurisdictions
- This behaviour potentially has the effect of eroding the tax base of the countries with higher tax rates
- Combined effect is referred to as BEPS
- TP done in a very similar way around the world.

Impact on Industrialisation

- TP rules themselves are probably neutral as regards promoting industrialization; their purpose is simply to achieve arm's length profits across value chain.
- Therefore they are designed to achieve arm's length profits regardless of whether a particular economy is highly industrialized or not. They follow the inherent attributes of the economy.
- However, TP rules based on international best practice provide investors with certainty.
- They also protect the tax base of the relevant country.
- They can be compared to a tug-of-war (between authorities)
- Therefore they are an essential part of any tax system (except for very low tax jurisdictions)

Impact on Real transformation on Economy

- TP rules neutral here as well: do not promote any specific economic policy.
- However, protection of tax base and promotion of investor certainty equally vital in this context.

The global standard

- The OECD adopts the arm's length standard as the globally accepted standard for transfer pricing – it eliminates the opportunity for Multinationals to manipulate pricing between entities within the same group.
- The Transfer pricing Guidelines adopts this standard as guidance for the application of Article 9 of the Model Tax Convention (MTC).
- South Africa widely adopts the MTC in the treaties it signs to avoid the incidence of double tax.
- The TP Guidelines are a consensus document of Working Party 6 of the Centre for Tax Policy at the OECD of which South Africa is an observer and active contributor.
- This is critical to align with the tax policies adopted by most of South Africa's trading partners.
- This ensures each jurisdiction is able to tax its fair share of the profit.

The global standard

- The United Nations Practical Manual on Transfer Pricing also endorses the arm's length principle.
- South Africa has adopted the arm's length standard in its domestic transfer pricing rules and endorses this as the globally accepted standard.
- South Africa has been and continues to be an active contributor to the various discussions at Working Party 6 in relation to on going transfer pricing developments, including discussion on BEPS.

South African transfer pricing rules

- Originated in 1995 and provided a discretion to the Commissioner to adjust consideration paid or received if transaction not arm's length.
- Recognised the importance of the global standard and endorsed this in the legislation borrowing heavily from countries such as Australia and New Zealand (both OECD member countries).
- One of the first countries in Africa to adopt specific transfer pricing rules.
- Has recruited and developed a dedicated transfer pricing audit team at SARS to audit potential transfer pricing mispricing.
- Result is revenue generation of approx. R5bn over last three years from 30 audits and adjustments totally R20bn.
- South Africa also one of the lead countries in noting that the legislation had weaknesses and needed overhauling.

South African transfer pricing rules

- New legislation brought in affective from 2012 year.
- More closely aligned the global standard as endorsed by Article 9 of the MTC to extend the legislative teeth to adjust not just the consideration, but any of the terms and conditions of a transaction.
- Changed the transfer pricing rules to a self assessment provision.
- Introduced a secondary adjustment mechanism.
- New rules are more closely aligned to the global standard and are ahead of many other countries e.g. Australia.

BEPS

- Four actions focusing on transfer pricing
- Improved documentation and country by country reporting
- Transfer pricing of intangibles
- Focus on high risk transactions such as management services.

South Africa legislative remedy supporting transfer pricing and BEPS

- Introduction of interest limitation rules and anti-avoidance rules for hybrid instruments.
- Introduction of broader withholding tax rules.
- Restrictions on deductions for certain IP transactions.
- Exchange control restrictions impacting ability to pay certain fees.
- Self assessment provisions and inherent requirement for transfer pricing documentation requirements.
- IT14 and IFRS disclosure requirements for cross border transactions
- Stringent CFC rules.
- Davis Committee recommendations.

Weaknesses and areas of development

- Resource capacity at SARS to implement audit plan.
- Strong reliance on use of Alternate Dispute Resolution to resolve transfer pricing disputes as opposed to litigation or Mutual Agreement Procedure which provides for greater certainty.
- No APA program which encourages greater compliance and eases international trade and direct foreign investment.
- Lack of certainty in terms of outdated Practice Notes (2 and 7) and delay in issue of final IN.
- Limited guidance on implementation of new secondary adjustment mechanism and interaction with the Double Tax Agreements.

Summary and conclusions

- South Africa adopts and implements the recognised global standard for transfer pricing.
- Its legislation is world standard being ahead of many developed countries.
- It is an active contributor to global best practice through its input to Working Party 6.
- SARS has already adopted and implemented many legislative remedies to counter BEPS and is ahead on disclosure requirements for transfer pricing.
- South Africa has robust measures through CFC rules and Exchange Controls to compliment the already robust transfer pricing legislative regime.
- SARS has recognised the need for greater certainty in transfer pricing and is considering an APA program.
- SARS also notes that transfer mispricing is not a major concern in the mining industry.