



# **Transfer Pricing Country Summary**

## **South Africa**

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## 1. Introduction

South Africa is not a member state of the OECD, yet follows the OECD Guidelines. The arms' length principle was adopted in South Africa and the legislative framework surrounding transfer pricing can be found in section 31 of the Income Tax Act No. 58 of 1962 ("ITA" or "the Act") and SARS Revenue Practice Note No. 7 (1999).

It can be observed that South Africa is implementing BEPS documentation requirements and has recently amended its transfer pricing legislation to include the OECD concept of "associated enterprises". Section 1 of the SA Income Tax provides for a definition of "connected person".

## 2. Laws & Regulations

Section 31 of the ITA contains the main legislative provisions relating to the South African transfer pricing rules. The current, revised, version of section 31 of the Act was introduced by the Taxation Laws Amendment Act, 2011 with effect from 1 April 2012, and is applicable in respect of years of assessment commencing on or after that date ("South African transfer pricing rules").

The South African transfer pricing rules will apply, broadly speaking, to any transaction, operation, scheme, agreement or understanding where:

- a) that transaction constitutes an "affected transaction" as defined; and
- b) results or will result in any tax benefit being derived by a person that is a party to the affected transaction.

The term "affected transaction" is defined in section 31(1) and includes, inter alia, any transaction, operation, scheme, agreement or understanding which has been directly or indirectly entered into or effected between or for the benefit of either or both, inter alia, a resident and a non-resident which are connected persons in respect to each other and where any of the terms or conditions agreed upon are not of an arm's length nature.

In terms of the South African Taxation Law Amendment Bill (TLAB), section 31 of the ITA it is to be amended to include the "associated enterprise" definition as provided in Article 9 of the OECD MTC. This change is effective from 1 January 2021.<sup>1</sup>

Section 31(3) of the Act further provides for a secondary adjustment on the basis that any "adjustment amount" (i.e., the difference between the tax payable calculated in accordance with the provisions of section 31(2) and otherwise) will, in the case of an affected transaction between a resident company and inter alia, any other person that is not a resident, be deemed to be a dividend in specie paid by the resident company to that other person.

The deemed dividend in specie will be deemed to have been declared and paid on the last day of a period of six months following the end of the year of assessment in which the adjustment is made.

In terms of section 64EA of the Act, a company that is a resident that declares and pays a dividend that consists of a distribution of an asset in specie is liable for dividends tax in respect of that dividend. Dividends tax is calculated at 20% of the amount of any dividend paid (increased from 15% for any dividend paid on or after 22 February 2017), but might be reduced by the applicable double taxation agreement entered into between South Africa and the jurisdiction where the non-resident is resident for tax purposes if the non-

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<sup>1</sup> SOUTH AFRICA - Amendments to South African transfer pricing regulations - BDO.

resident would have been entitled to a reduction in the rate had it been liable for the dividends tax and provided certain documentation requirements are met.

#### a) References to OECD/EU/Local Rules

Although South Africa is not a member country of the Organisation for Economic Co-operation and Development ("OECD"), it was awarded OECD observer status in 2004 and is also a member of the OECD BEPS Committee. South Africa closely follows the guidance contained in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines") in respect of transfer pricing matters in the absence of specific South African guidance. In this regard, it has been acknowledged by SARS that the OECD Guidelines are an important document that reflect unanimous agreement amongst the member countries, reached after an extensive process of consultation with industry and tax practitioners in many countries and, as the OECD Guidelines are also followed by many countries that are not OECD members, they have effectively become a globally accepted standard. SARS also endorses the standard OECD transfer pricing methods, including the traditional transaction methods, such as the CUP method, the resale price method and the cost-plus method, as well as the transactional profit methods, such as the TNMM and profit split method.

In this regard, it should be noted that SARS' interpretation notes are not law, but provide insight into the prevailing practice of SARS and guidelines on SARS' view on the interpretation and application of the provisions of the tax acts. In addition, this interpretation note is still only in draft format. We are expecting SARS to update the Draft Interpretation Note in line with the latest guidance of the OECD (as discussed in more detail below), but considering that further work is still envisaged by the OECD in this regard, we are not sure when to expect such an update.

#### b) Definition of Related Party

Related parties are defined as "connected persons" for South African tax and transfer pricing purposes. The definition of a "connected person" is contained in section 1 of the ITA. In terms of the general definitions in the ITA, 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 below threshold of "at least 70 per cent of the equity shares in" is replaced by "more than 50 per cent of the equity shares or voting rights in". In addition, any 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, as long as no shareholder holds the majority voting rights in the company. In respect of transactions involving intellectual property or financial assistance, the above qualification "as long as no shareholder holds the majority of the voting rights in the company" falls away, therefore a 20 per cent shareholding is sufficient to constitute connected persons for transactions involving intellectual property or financial assistance, independent of whether any other shareholder holds the majority of voting rights in the company or not. A connected person relationship between two companies may also exist where a connected person in relation to one company (or a connected person in relation to such person) manages or controls the other company. The connected person definition is extensive and requires careful consideration. Structures involving trusts are especially likely to include connected persons.

#### c) Nature of Transfer Pricing Documentation

There is some controversy surrounding the status and application of the OECD Commentaries to South Africa, since it is not a member state of the OECD. This argument could potentially be extended to the application of OECD transfer pricing rules.

Yet, the courts have applied the OECD Commentaries on various occasions (*ITC 1503* (53), SATC 342 and *CSARS v. Tradehold Ltd* 2012 ZASCA 61). Also, it has been argued that the OECD Commentaries (and therefore also TP Guidelines) fall under customary international law according to section 232 of the Constitution.

Furthermore, SARS makes reference to OECD Guidelines in Practice Note 7 and notes in paragraph 3.2 that the OECD Guidelines will be applied to determine the transfer price.

#### d) Tax Havens & Blacklists

South Africa does not have a tax haven or 'black list' for non-cooperative jurisdictions.

#### e) Advance Pricing Agreement (APA)

At this stage, South Africa does not provide for Advance Pricing Agreements. Although taxpayers may make an application for an Advance Tax Ruling ("ATR") from SARS to confirm the tax treatment of a proposed transaction where uncertainty as to the tax treatment thereof exists, transfer pricing related transactions are specifically excluded in terms of the "No Rulings List" published by SARS in terms of a Public Notice.

#### f) Audit Practice

The tax authorities (SARS) can implement an audit in terms of Chapter 5 of the Tax Administration Act 2011 (TAA). In terms of section 46 and 48 of the TAA, the authorities may gather and request "relevant material", as well as conducting a field audit. This encompasses functional analysis interviews with employees to allocate functions, assets and risks.

The audit policy of SARS is to follow a risk-based approach where so-called high-risk transactions, in particular in the mining and resources sectors, are more likely to be audited.

The tax authority is obliged to provide the taxpayer with an outcome together with justifications. The taxpayer has the right to respond to the audit outcome.

In terms of the ITR14 tax return, it is important to indicate whether transfer pricing documentation was prepared. Failure to do so will in all likelihood result in an audit.

### 3. Transfer Pricing Documentation

#### a) Level of Documentation

South Africa has committed itself to introducing transfer pricing documentation requirements in line with the three-tiered approach as suggested by the OECD. The requirements for country-by-country ("CbC") reporting were finalised on 23 December 2016 while the master file and local country file requirements were finalised on 20 October 2017 in a Public Notice.

##### *CbC returns*

On 23 December 2016, the Minister of Finance issued regulations governing CbC reporting which closely follow the implementation package in Annex IV to Chapter V of the OECD Guidelines. The main requirements in respect of CbC reporting may be summarized as follows:

- MNE Groups with consolidated group revenue of less than R10 billion are not required to file CbC returns.
- Returns are to be filed electronically, using the CbC01 form, which captures CbC information according to the OECD's CbC XML Schema.

- CbC returns are to be submitted within 12 months of the last day of the Reporting Fiscal Year. The notice applies in respect of Reporting Fiscal Years commencing on or after 1 January 2016, and the first returns will therefore be due by 31 December 2017.

#### Master file and local file returns

On 20 October 2017, the Minister of Finance issued regulations governing transfer pricing documentation. In the Public Notice, requirements for the master file and local file were set out which closely follow Annexes I and II to Chapter V of the OECD Guidelines.

The key requirements in terms of the Public Notice are as follows:

- Persons who have the filing obligation to submit CbCR returns or have “potentially affected transactions” for the year of assessment that exceeds or is reasonably expected to exceed R100 million in aggregate value are required to submit a return in the form and containing the information specified in the Business Requirement Standard: CbC and Financial Data Reporting (“BRS”) in relation to the master file and local file
- The BRS incorporates the master file and local templates from Annexes I and II of Chapter V of the OECD Guidelines. In respect of the master file, the BRS notes that the information required in terms of Annex I represents a minimum requirement for the master file. No set format exists for the presentation of the master file information. The BRS notes however that, given this flexibility, MNEs are encouraged to prepare the master file as a “real-life summary”, depicting the overall TP policy and supply chain for each of their businesses in such a manner that any person reading the document may understand the intercompany pricing policies adopted. The BRS does not provide any guidance in respect of the local file contents beyond that contained in Annex II to Chapter V.
- The master file and local file are to be submitted electronically via the South African Revenue Service (“SARS”) e-filing system. MNEs are therefore able to prepare the master file and local file returns in a form which they choose, and upload those documents to the system.
- The master file and local file returns are to be submitted within 12 months of the last day of the year of assessment. The submission deadline therefore coincides with that for the corporate tax return.

In the case of persons who have the filing obligation to submit CbCR returns, the requirement for submission applies for Reporting Fiscal Years commencing on or after 1 January 2016 and for subsequent Reporting Fiscal Years.

In the case of persons do not have the filing obligation to submit CbCR returns but have “potentially affected transactions” (essentially cross-border transactions with connected persons) for the year of assessment that exceeds or is reasonably expected to exceed R100 million in aggregate value, the requirement for submission applies for financial years commencing on or after 1 October 2016 and for subsequent financial years.

No documentation is required to be submitted by a person whose potentially affected transactions are below the R100 million threshold. However, on submission of the ITR 14 tax return, the taxpayer is required to disclose whether it has prepared transfer pricing documentation. In terms of the guide to the ITR 14 this should only be confirmed if such documentation is readily available.

#### b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

#### c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity, including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

#### d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines at paragraph 1.51.

#### e) Choice of Transfer Pricing Method

As mentioned before, SARS generally follows the guidance of the OECD Transfer Pricing Guidelines. Accordingly, all transfer pricing methods accepted by the OECD in the OECD Transfer Pricing Guidelines are accepted by SARS, including the CUP method, the resale price method, the cost-plus method, the profit split method and the transactional net margin method. 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.

The authorities follow OECD Guidelines and accept OECD prescribed transfer pricing methods (SARS Practice Note 7).

#### f) Economic Analysis – Benchmark Study

South Africa follows the guidance on comparability analysis as outlined in Chapter III of the OECD Transfer Pricing Guidelines.

The South African domestic transfer pricing legislation does not contain specific legislation or guidelines for the selection and or use of domestic or foreign comparables. However, the OECD Transfer Pricing Guidelines are consulted to provide guidance on comparability analysis.

The South African domestic transfer pricing legislation does not contain a specific provision that allows or requires the use of an arm's length range and/or statistical measure for determining the arm's length range.

However, South Africa follows the OECD Transfer Pricing Guidelines, which provide in-depth guidance on the use of an arm's length range and/or statistical measure for determining arm's length remuneration. This is reflected in Practice Note No. 7 at a high level. For example, in Practice Note No. 7 SARS notes that it will take into consideration foreign comparables as long as the taxpayer justifies and highlights the effects of geographic differences (paragraph 11.2.1 of Practice Note 7).

### g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalizes the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept.

### h) Financial Statements

Since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept, parties need to also make sure their conduct is in line with what is reported in their accounts.

All annual financial statements which are prepared in accordance with the IFRS are supposed to disclose all related party transactions within the related financial period. Further guidance can be obtained in IFRS standard IAS 24.

### i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. This information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)*(If "No", it can be filed in English)
<b>Corporate Income Tax</b>	File	ITR14	12 months after financial year end	No	No	No
<b>Master File</b>	File	OECD Guidelines 2017	12 months after financial year end	No	Yes	No
<b>Local File</b>	File	OECD Guidelines 2017	12 months after financial year end	No	Yes	No
<b>CbCR</b>	File	CbC01 Form	12 months after financial year end	12 months after financial year end	Yes	No
<b>Local form</b>	N/A	N/A	N/A	N/A	N/A	N/A
<b>Annual Accounts</b>	Prepare	Local Tax GAAP or IFRS	The latest on the last day of the seventh	No	No	No



			month following the end of the financial year			
<b>Segmented P&amp;L</b>	Prepare	Excel/Other	Ready upon filing CIT/TP documents.	No	No	No
* South Africa has signed the MCAA agreement for the filing of CBCR.						
* South Africa does not request as much and detailed information from smaller and less complex enterprises (SME's included) than it does from large and complex enterprises.						

#### j) Mandatory Language

Transfer pricing documentation should be drafted in the Commissioner's functional language, which is English, even though, in theory, all 11 official languages of South Africa are accepted.

#### k) Notification Requirement

In the scenario where no requirement to submit any transfer pricing documentation, on submission of the ITR14 tax return, the taxpayer is required to disclose whether it has prepared transfer pricing documentation. In terms of the guide to the ITR14 this should only be confirmed if such documentation is readily available. The failure to confirm the preparation of transfer pricing documentation is generally an audit trigger.

#### l) Record Keeping

In addition to the documentation requirements described above, SARS has issued a public notice specifying records, books of account or documents which must be kept for transfer pricing purposes ("Record-Keeping Requirements"). Persons whose potentially affected transactions for the year of assessment exceed or are reasonably expected to exceed R100 million in aggregate value, are required to keep certain records regarding their structure and operations. Such persons are additionally required to keep transaction-specific records in respect of any potentially affected transaction which exceeds or is reasonably expected to exceed R5 million in value. Particularly detailed record-keeping is required in respect of "financial assistance transactions". Persons whose potentially affected transactions fall below the R100 million threshold are nevertheless required to keep such records as allow them to ensure and for SARS to be satisfied that such transaction are conducted at arm's length. The information specified in the Record-Keeping Requirements is not required to be submitted as a matter of course but must be available in case of audit. The Record Keeping Requirements apply for years of assessment commencing on or after 1 October 2016 and for subsequent years of assessment.

As described above, no documentation is required to be submitted by a person whose potentially affected transaction are below the R100 million threshold. The Record-Keeping Requirements in respect of such persons are also reduced.

#### m) Penalties and Interest Charges

Administrative non-compliance penalties comprise fixed amount penalties as well as percentage-based penalties as per sections 210(1) and 211 of the TAA. The penalty amount that will be charged depends on a taxpayer's taxable income and can range from R250 up to R16 000 a month for each month that the non-compliance continues.