**Transfer Pricing – Key questions answered**

**Durban: 28 February 2018**

*Finance Minister Malusi Gigaba in his 2018 Budget Speech has re-emphasised the Government's commitment to address Base Erosion and Profit Shifting (BEPS) by multinational companies and that the implementation and tightening of the various measures in line with G20 recommendations would continue. The Minister also indicated that the ability of companies to structure their tax affairs to reduce their tax base in South Africa and shift their profits to low-tax countries threatened the sustainability of our tax base, a challenge with which most governments are struggling. Country by Country Reporting is seen by Government as a key measure to ensure that companies pay their fair share of tax.*

*As SARS joins other revenue authorities around the world in clamping down on cross-border tax-minimisation schemes through the introduction of the various BEPS measures,* ***Deloitte Associate Director, Bradley Pearson,*** *answers some key questions about the onerous transfer pricing measures that have been introduced so far.*

**Question 1**

What does transfer pricing legislation seek to achieve?

**Answer**

The aim of the legislation is to ensure that the cross-border transactions between related parties take place at the same price and on the same terms and conditions as they would have taken place had the parties not been related.

**Question 2**

Why has transfer pricing become such a focus area recently?

**Answer**

Increased globalisation has created the potential for multi-national enterprises (MNEs) to manipulate profits and shift them to lower tax jurisdictions, resulting in revenue authorities becoming increasingly protective of their tax base.

The Organisation for Economic Cooperation and Development (OECD) was therefore commissioned by the G20 to look into BEPS by MNEs.

The main goal of BEPS is to ensure that profits are taxed in the country in which the economic activity that gave rise to those profits took place. The OECD came up with 15 action points to address BEPS.

SARS represented South Africa (as a G20 member) in the OECD's BEPS project and agreed to implement, as part of the minimum standards, a number of the BEPS action points. One of these was Action 13 which deals with revised Transfer Pricing Documentation requirements and the introduction of Country-by-Country Reporting.

**Question 3**

What is the impact of these changes for South African taxpayers?

**Answer**

SARS has implemented Action Point 13 in a three-tiered approach. This means that South African taxpayers now have the following compulsory compliance responsibilities:

- ***Country-by-Country Reporting ("CbCR")***

  MNEs are required to disclose information about their global operations in all countries where they do business. This information (referred to as the CbCR), must be disclosed in a format specified by the OECD and submitted to SARS by the ultimate parent company for South African MNEs with a group consolidated turnover of R10 billion or more.

  The threshold is €750 million where the ultimate parent is non-South African. CbCR is effective for years of assessment commencing on or after 1 January 2016. SARS has already taken the necessary steps to enable these reports to be shared among the revenue authorities in the countries in which the group operates and is currently in a position to share the CbCRs submitted in South Africa with approximately 54 countries.

  The first of these CbCRs will need to be filed through the SARS e-filing portal for South African MNEs with a 31 December 2016 financial year end by 28 February 2018.

  All South African subsidiaries where the ultimate parent is non-South African are required to notify SARS of the identity and tax residence of the entity required to file the CbCR.

  The latest version of the company income tax return now also contains questions related to CbCR that will need to be answered as part of the annual income tax return process.

- ***Master File***

  South African taxpayers that are the ultimate parent company of an MNE are now required to prepare a Master File. The Master File includes key information about the Group's global operations including an overview of the business operations and important information on global transfer pricing policies.

  Where a South African MNE (and in certain circumstances a South African entity that is part of a foreign MNE) is required to file a CbCR they will also be required to file the Master File as part of the CbCR filing on the SARS e-filing portal. The first MNEs impacted by this requirement are those with a 31 December 2016 financial year end.

  Other South African companies are required to file a Master File where aggregate cross border related party transactions exceed R100m and this requirement is applicable for years of assessment commencing on or after 1 October 2016.

  Where there is no filing requirement, companies will need to retain the document and will only be required to submit if the document is requested by SARS.

- ***Local File***

  Taxpayers are now required to prepare a Local File for submission to SARS. Local File(s) have detailed information and support on the intercompany transactions that the local company engages in with its foreign related parties. This file is required per legal entity and will be similar to the traditional transfer pricing document previously prepared, but the information typically included will need to be supplemented in line with the OECD prescribed requirements for a Local File.

  Over and above the local file, South African taxpayers with cross border related party transactions that exceed R100m per year (whether these are charged out or not) are required to keep significant additional records to support those individual categories of transactions which exceed R5m.

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Other South African companies are required to file a Local File where aggregate cross border related party transactions exceed R100m and this requirement is applicable for years of assessment commencing on or after 1 October 2016.

Where there is no filing requirement, companies will need to retain the document and will only be required to submit if the document is requested by SARS.

**Question 4**

If a taxpayer has cross border transactions for example, the provision of accounting services to a subsidiary in a foreign country but does not charge for these services, will the transfer pricing rules still apply?

**Answer**

The transfer pricing legislation applies regardless of whether payment is made or not. In fact, there is generally more exposure if goods/services are received/provided and no payments are made as the transaction would not be at arm's length. It is also important to remember that the legislation is not limited to the purchase/sale of goods or the receipt/provision of services with cross border related parties. It also extends to intellectual property that may be used or transferred between cross border related parties as well as financial assistance transactions (including loans and guarantees).

**Question 5**

What are the consequences of not charging an arm's length price for the services mentioned?

**Answer**

The taxpayer is obliged to make a transfer pricing adjustment in its tax return to reflect the arm's length fee that should have been earned for providing the accounting services. This will give rise to normal tax at 28%. There is also a further consequence in the form of dividends tax at 20% on the transfer pricing adjustment.

Should the taxpayer not make these adjustments, there is a risk that SARS could make an adjustment for the income tax and dividends tax payable and in addition to this, seek to levy understatement penalties (up to 200% of the tax adjustment) and interest.

**Question 6**

What action should be taken by taxpayers to ensure that they are compliant?

**Answer**

All taxpayers that have cross border transactions with related parties should ensure that they have transfer pricing documentation that is compliant with the revised OECD Transfer Pricing Guidelines and that supports the arm's length nature of related party transactions.

There may be taxpayers who feel that documentation is not warranted as they transact with related parties on the same basis as unrelated parties and can defend their position. It is important to remember that this stance is no longer acceptable as transfer pricing documentation is now mandatory.

Without undertaking a transfer pricing study to determine an arm's length price and documenting this process formally, a taxpayer will not be able to evidence to SARS that related party transactions are occurring at arm's length. In addition, the question in the company's tax return dealing with whether a taxpayer has a transfer pricing document that supports the pricing policy for each of its related party transactions would have to be answered "no" if the taxpayer does not have compliant transfer pricing documentation. This is likely to raise a red flag.

Taxpayers also need to consider whether they are required to prepare a Master File or ensure that the ultimate parent is preparing a Master File for their use and to submit a CbCR.

**Question 7**

Would a taxpayer be able to rely on group transfer pricing documentation?

**Answer**

Only if the group documentation covers the transactions of the SA entity, supports the pricing of these transactions and also meets the SA documentation requirements. Should this not be the case, the taxpayer would have to prepare locally compliant documentation.

*Given the complexities around the legislation and the onerous nature of the new documentation and compliance requirements, taxpayers are advised to consult with transfer pricing specialists to minimise their risk of non-compliance.*

**Contacts**

Bradley Pearson
**Associate Director**
+27 (0)82 579 8001
brpearson@deloitte.co.za

Kamy Reddy
**Senior Manager**
+27 (0)83 377 0126
kreddy@deloitte.co.za

Surina Reddy
**Senior Consultant**
+27 (0)72 284 6514
sreddy@deloitte.co.za