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TradeSmart Highlights

Tariff Amendments

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Highlights
This edition of TradeSmart highlights:

- **Customs valuation and transfer pricing adjustments**

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Background to customs valuation
Customs valuation is the determination of the economic value of goods declared for importation. The value of imported goods is also one of the three components of indirect tax that determines the amount of duty that must be paid, the other ones being the origin of the goods and the classification of the goods that is the customs tariff.

Section 74A of the Customs and Excise Act, No. 91 of 1964 (the Customs Act) provides for Article VII of the General Agreement on Tariffs and Trade (GATT). Article VII of the GATT provides the six valuation methods to be used when determining the correct customs value when importing goods. These methods must be applied in strict hierarchical order.

Transaction value
The primary and preferred method for customs valuation is the transaction value method.

Section 65 of the Customs Act states that the value for customs duty purposes of any imported goods will be based on the transaction value.

The transaction value of any imported goods is defined in Section 66 of the Customs Act as the price actually paid or payable for the goods when sold for export to South Africa.

There are certain restrictions on the transaction value methodology and the two key elements to consider are the terms “related parties” and “arm’s length transaction”.

Related parties
Subsection 2(a) of section 66 of the Customs Act define related parties and it can be summarised to include, for example, multinational companies.

The transaction value is still deemed to be acceptable if it can be demonstrated that the relationship between the parties did not influence the price actually paid or payable, i.e. it occurred at arm’s length.

Arm’s length principle
Companies operating across many jurisdictions will routinely buy and sell goods, as well as services, from each other. In doing so, these entities follow the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines to derive at the arm’s length prices for all inter-group transactions.

The arm’s length principle ensures 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.

As a result of the arm’s length principle, transfer prices are periodically set, monitored and adjusted to ensure the correct profitability for a period of time. Therefore, at the end of a financial year, the financial results are reviewed and if required, a transfer pricing adjustment (TP adjustment), i.e. a debit and/or credit note, will be issued to bring the company in line with the targeted operating profit margin that has been set for the year of assessment.

Adjustments at the end of a financial year are considered retroactive adjustments and this is done to ensure that the transactions occurred at arm’s length.

Transfer pricing adjustments
TP adjustments has become an extreme focus area for the South African Revenue Service (SARS) and the Customs Administration. SARS for a number of years has adopted an initiative by using the Income Tax Return (ITR14) of a company to confirm whether a company has disclosed any year-end adjustments.

It is our understanding that the SARS uses the ITR14 of a company to establish if all legal requirements in terms of the Customs Act where correctly adhered to.

To confirm the customs compliance of a company, SARS specifically considers Section 41(4)(b)(i) and (ii) of the Customs Act. This section provides the following:

> *"(bb) the importer shall produce such amended invoice or certificate or credit or debit note to the Controller* ***within one month*** *of receipt thereof and report the circumstances to him."*

Therefore, if an importer receives a debit and/or credit note in relation to goods previously imported, the importer has one month from the date of such amendment to notify SARS.

After notifying SARS on the respective debit and/or credit note, the importer needs to proportionally apply the adjustment over all the imports for the affected year. The adjustment will amend the customs values declared at the time of import and bring any over and/or underpaid customs duties and import value-added tax (VAT) to account. It can be challenging to reconcile the adjustments back to a specific customs declaration in order to prepare and submit the relevant voucher of correction to SARS.

It is important to note that this section of the Act provides the importer with the opportunity to voluntary disclose this adjustment to SARS. If SARS becomes aware of such adjustment, i.e. by means of the ITR14 and the importer has not notified SARS within the required one-month period, SARS may raise an assessment.

Companies should bear in mind that the customs duty liability covers a two year retrospective period. In relation to the liability period for the underpayment of import VAT, SARS could go back five years.

SARS may also raise additional penalties and interest in terms of the Customs Act as well as the Value-Added Tax Act, No. 89 of 1991.

Conclusion

As illustrated, the customs value is crucial and all aspects such as the relationship between the trading parties and the arm's length principle, is key when determining the customs value to be declared when the goods are imported into South Africa.

SARS is proactively finding new methods to identify any non-compliance. As a result companies should continuously ensure that they have processes in place to mitigate potential risks of non-compliance when importing goods from related parties.

Should you require assistance with the aforementioned information, kindly reach out to any one of the **Deloitte Africa Tax & Legal contacts**.

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