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New Transfer Pricing Rules from SARS

New transfer pricing disclosure requirements for companies have recently been issued by SARS. Those companies that don't comply could face criminal charges, warns Michael Honiball

The main new transfer pricing requirement issued by the South African Revenue Service (SARS) is that it is compulsory for all companies that enter into international transactions with related companies and persons, to attach a transfer pricing policy document to the IT14 form that has to be submitted to the revenue service. In terms of the wording of section 65 of the Income Tax Act, it's clear that SARS has an absolute discretion to require companies to do this. And section 75 of the same act essentially prescribes penalties for non-compliance with these formalities in the form of a fine or imprisonment for a maximum of 24 months. These new requirements apply to all companies, irrespective of their size.

Until last year, it was unclear whether it was compulsory to have a transfer pricing policy document. Although South Africa has had this legislation in place since 31st July 1995, SARS has been slow in issuing detailed transfer pricing compliance guidelines. For example, a practice note in this regard was only issued some four years later, and that didn't contain any such requirement.

A confused history

The first mention of the requirement to submit a transfer pricing policy document was in the 2002 Income Tax: Information Brochure (IT14B), in which the company was required to "furnish" its transfer pricing policy if it had any international transactions with a connected person.

However, the 2002 IT14 form itself didn't refer to the information brochure when stipulating what supporting schedules were required to be submitted with the return, which resulted in uncertainty as to whether



Michael Honiball is the head of international corporate tax at KPMG

taxpayers were required to submit their transfer pricing policy documents with the 2002 IT14 form. This, despite the fact that in terms of the already mentioned section 65, the SARS commissioner is entitled to

prescribe any information necessary to come to an assessment of tax due.

This uncertainty continued in relation to the 2003 IT14 form. The Income Tax Guide 2003 is also numbered IT14, supporting the argument that the tax return and the brochure

are one and the same document. The 2003 tax return also specifically refers to the schedules requested in the income tax guide. This also forms part of the declaration of a company's public officer that all information, as well as details and schedules requested, have been furnished. So SARS has argued that it was compulsory to attach a transfer pricing policy document to the 2003 IT14. Many advisors did not agree with this argument, as the actual 2003 IT14 form did not require the company to attach its transfer pricing policy document.

Clarification at last

The new 2004 IT14 form itself, in part I5, now clarifies the position by requiring the company to furnish the information stipulated in the accompanying brochures. This fact, together with declarations for 2004 which are similar to those described in respect of the 2003 IT14 form, makes it clear that it is now compulsory to submit a transfer pricing policy document, failing which penalties will apply.

SARS has also, through the South African Institute of Chartered Accountants, recently issued a notice that with effect from tax years commencing on or after 1st January 2004, where the commissioner has prescribed a certain form, or has stipulated that a particular schedule of information must be attached to the tax return, and where the taxpayer has ignored this requirement, SARS will regard that particular tax return as not having been submitted. SARS is empowered to do this in terms of section 65, read with section 74A, of the Income Tax Act. The result would be the same in that the stipulated penalties could be imposed.

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Now that it is clearly obligatory to prepare and submit a transfer pricing policy document, the question that arises is – what exactly is a transfer pricing policy document? It is not defined in the Income Tax Act, and is only mentioned once in SARS Practice Note 7 on Transfer Pricing. It is also not described in the SARS Information on Income Tax brochure.

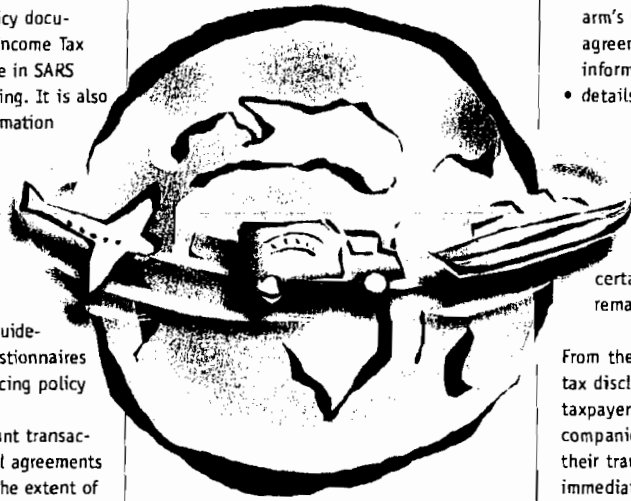
What to include

According to Oliver et al in the book *International Tax: A South African Perspective*, in terms of SARS' documentation guidelines and the latest general questionnaires sent to taxpayers, a transfer pricing policy document should include:

- an identification of the relevant transactions in terms of international agreements with connected parties, and the extent of any other commercial or financial relations with connected persons within the scope of section 31 of the Income Tax Act;
- copies of the international agreements entered into with connected parties;
- a description of the nature and terms,

including prices, of all relevant transactions, including a series of transactions and any off-setting transactions;

- the method that has been used to arrive



at the nature and terms of the relevant transaction;

- an explanation of the process used to select and apply the method used to

establish the transfer prices, and the reason why it is considered to provide a result that is consistent with the arm's length principle;

- information relied upon in arriving at the arm's length terms, such as commercial agreements with third parties, financial information, budgets, and forecasts;
- details of any circumstances that may have influenced the prices that have been set.

These guidelines as to what a transfer pricing policy document should contain are not law, and a certain amount of uncertainty therefore remains.

From the above, it's clear that the income tax disclosure requirements for corporate taxpayers have increased substantially, and companies will have to commence preparing their transfer pricing policy documents immediately in order to prevent the imposition of penalties.

Thankfully, the above relatively onerous transfer pricing disclosure requirements only apply to companies, and not to individuals and trusts.

THE SARS large business centre (LBC), located in on the outskirts of Johannesburg in Megawatt Park, Sunninghill, and which became operational in September 2004, replaces the corporate tax centre (CTC). BDO Spencer Steward have set out what services this centre will provide to taxpayers.

The focus of the LBC is to expand on SARS' interactions with large corporations. Its objectives are to:

- improve interaction between SARS and South Africa's largest corporate taxpayers;
- provide service excellence and customer intimacy through expert tax advisers;
- improve SARS' audit capacity;
- address the gap in skilled auditors;
- facilitate a culture of voluntary tax compliance;
- address lower effective tax rates in certain sectors.

The LBC offers specific economic sector teams which will be self-sufficient, and which will consist of experts in tax and customs. They will contain their own integrated assessing, audit, and collections abilities across all tax types, with one dedicated relationship manager who will deal with clients within specific sectors. As such, these sector teams will provide a "one-stop" service to large corporations.

There will be eight sector teams which will provide income tax services to clients from inception, but with the full bouquet of services being introduced in a staggered approach. The first sector to offer such a full service package to clients is the financial services sector, and this has been operational since October 2004. Other sectors should be fully operational within the next six months.

The tax services to be offered by each of these sector teams include:

- income tax;
- secondary tax on companies (STC);
- value added tax (VAT);
- PAYE, including the Unemployment Insurance Fund and the Skills Development Levy;
- marketable securities tax and uncertified securities tax;
- donations tax;
- royalties tax;
- stamp duty;
- certain customs services.

The LBC's main clients, says BDO Spencer Steward, will include companies listed on the JSE Securities Exchange, parastatals, unlisted companies with a turnover in excess of R250 million, major financial institutions, multi-national corporations and their local branches, and high-net-worth individuals.