

South Africa

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The South African transfer pricing legislation and its application in practice is based on the OECD Transfer Pricing Guidelines ("the Guidelines"). The South African transfer pricing legislation provides a mechanism through which the adoption of the internationally accepted "arm's length principle" is achieved.

It is specifically stated that the OECD Guidelines must be followed in the absence of any specific guidance in South Africa. Business Restructurings are not specifically dealt with in the South African transfer pricing legislation nor in the supporting practice documentation. Accordingly, the Guidelines will inevitably be used as a point of reference.

In the context of Business Restructurings, the Guidelines start from the premise that the arm's length principle should not apply differently to restructurings or post-restructuring transactions than to transactions that were structured as such from the beginning. The transfer pricing rules will apply in a South African context in a similar fashion.

I. Issue One

Are there any specific tax regulations on business restructurings (in terms of moving activities) in South Africa?

In the context of the Guidelines, business restructuring is defined as the cross-border redeployment by a multinational enterprise of functions, assets and/or risks.

In a South African domestic context, there are a number of legislative provisions in the income tax legislation which provide for business restructurings and group reorganisations. These provisions allow for the tax-efficient transfer of capital assets, assets on which tax allowances are being claimed and trading stock between group companies. The provisions effectively provide for the rollover of an asset's historical tax value from the person disposing of the asset to the person acquiring the asset. The ultimate tax cost will therefore be borne by the person who ultimately disposes of the asset and not by the person transferring the assets in terms of the restructuring transaction.

The provisions have very limited application in a cross-border context, however. In any event, they are not akin to transfer pricing rules if one considers the effect of their application.

However, it is possible that a South African restructuring be undertaken to facilitate a subsequent cross-border restructuring. This may be the case for example, where IP is transferred to a specific entity within a group with a view to charging royalties to other associate enterprises going forward.

II. Issue Two

If not, then are business restructurings covered by general, transfer pricing or intangible property regulations? Are arrangements involving cross-border redeployment of functions, assets and/or risks covered by such regulations?

As noted in the Guidelines, business restructurings are typically accompanied by a reallocation of profits among the members of a group, either immediately after the restructuring or over a few years.

In a South African domestic context, business restructurings will not be subject to the South African transfer pricing rules nor to any intangible property regulations.

The transfer pricing rules will find application, however, to the extent that the restructuring involves a cross-border deployment of functions, assets and risks and the transaction and subsequent transactions are entered into between associated enterprises (or "connected persons" as defined in the South African income tax legislation).

III. Issue Three

Does South Africa impute a compensation/exit charge upon business conversion, say from a full risk marketing distributor to limited/low risk distributor or agent, only when there is transfer of intangibles (say marketing intangibles in the form of customer list, distribution network, etc.) along with flight of functions; or even if there is mere flight of functions without any transfer of intangibles attached to the functions?

There is no compensation or exit charge in the case of a transfer of intangibles along with flight of functions; or in the case of a mere flight of functions without any transfer of intangibles attached to the functions.

South Africa does levy an exit tax, but only if a South African domestic entity restructures to such an extent that its tax residence moves to another jurisdiction.

IV. Issue Four

Does South Africa recognise "workforce-in-place" to itself constitute an intangible, thus requiring payment of compensation on its movement in the course of a business conversion?

South Africa does not recognise "workforce" as an intangible requiring payment of compensation upon transfer.

However, an entity's "work force" may indeed have a comparable value and will accordingly, in theory, be subject to the transfer pricing rules upon transfer.

V. Issue Five

Does South Africa disregard business restructuring, which is driven entirely by tax savings, without having any other commercial justification or rationale?

Yes. There is a complicated set of legislative provisions in South Africa which operate to essentially discourage certain transactions (or steps thereof) which as their sole and main purpose, have the object of obtaining a tax benefit and *inter alia* lack commercial substance or would not ordinarily be employed for *bona fide* business purposes.

The legislation also contains certain provisions which oblige participants to report certain types of tax arrangements that they enter into.

VI. Issue Six

Do the South African tax authorities view risks as only transferring with the relevant people/risk managers? What do the South African tax authorities place more reliance on, examination of contractual terms or actual behaviour/conduct of the parties?

The South African income tax legislation and supporting practice documentation set out detailed information with regard to the completion of a functional analysis ("an analysis"). An analysis is a means to establish what sort of comparables should be sought in determining a transfer price.

The appraisal of risk which is undertaken as part of the process of performing an analysis includes determining *inter alia*:

- Risks of change in cost, price, or stock;
- Risks relating to success or failure of research and development;

- Financial risks, including change in the foreign exchange and interest rates;
- Risks of lending and payment terms;
- Risks for manufacturing liability; and
- Business risk related to ownership of assets or facilities.

Accordingly, the transfer of people will be considered a factor in the overall appraisal process and will not be solely determinative.

In performing an analysis in South Africa for transfer pricing purposes, the actual contractual terms of the transaction must be addressed, as it will provide evidence about the form in which the responsibilities, risks and benefits have been assigned between the parties to a transaction.

It must also be considered whether a purported allocation of risk is consistent with the economic substance of the transaction. In this regard, the parties' conduct should generally be taken as the best evidence concerning the true allocation of risk.

VII. Issue Seven

Are there any special/contemporaneous documentation/reporting requirements for extraordinary transactions and business restructurings, including justifying the rationale for business restructuring, expected benefits, testing of the compensation paid/received, etc.?

As noted, South African income tax legislation contains certain provisions which oblige participants to report certain types of tax arrangements that they enter into.

Furthermore, a taxpayer must inform the revenue authorities of *inter alia*:

- Any transactions entered into with connected persons; and,
- Any domestic business restructuring transactions in terms of which certain provisions of the income tax legislation were availed of.

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