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A CRITICAL ANALYSIS FROM A SOUTH AFRICAN PERSPECTIVE OF ADVANCE PRICING AGREEMENTS FOR MULTINATIONAL ENTERPRISES

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ABSTRACT

Tax Base Erosion and Profit Shifting (BEPS)[1] has become an epidemic of global legal tax avoidance being used by Multinational Enterprises (MNEs). BEPS has resulted in the structuring of transactions within groups of companies, with these including: transfer pricing, manipulating prices of goods, services, management fees, professional fees, royalties, interest and dividends.

This study is a critical analysis of South African legislation in relation to the Double Taxation Agreement (DTA) with the United Kingdom (UK). Reference is made to the Mutual Agreement Procedure (MAP) as proposed by the Organisation for Economic Co-operation and Development (OECD).[2] Even though South Africa follows the OECD guidelines (2010),[3] Advance Pricing Agreements (APA) are not included in South African legislation, which may result in double non-taxation or double taxation and disputes. Recourse in the event of double taxation is examined in this research report.

The application of APA legislation in the UK, as a leading tax authority,[4] is analysed, as well as Davis Tax Committee recommendations in relation to Transfer Pricing.

KEYWORDS

Advance Pricing Agreement, Arm’s length price, Base Erosion and Profit Shifting, Davis Tax Committee, Double Taxation, Double Taxation Agreement, Multinational Enterprises, Mutual Agreement Procedure, OECD, South African Revenue Service, Transfer Pricing.

[1] Organisation for Economic Co-operation and Development (OECD). (n.d.a), *‘About BEPS and the inclusive framework’*, <http://www.oecd.org/ctp/beps-about.htm>, retrieved 5 November 2016.

[2] Organisation for Economic Co-operation and Development (OECD). (2010b), *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.* Paris: OECD.

[3] *Supra* note 2.

[4] Broomberg, E. B. (2007), Tax avoidance then and now, *Tax Planning Corporate and Personal*, vol. 21, no. 5, pp112-118.

DECLARATION

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted for any other degree or examination at any other university.

Mariska Gray

31 March 2017

DEDICATION

To my dear husband Andrew, thank you for your support, understanding and love
during this difficult time of our lives. You are my best friend, the one I laugh with as
we share life’s wondrous zest,
…as we find new enjoyments and experience all that is best.
The one I live for because the world seems brighter as our happy times are better
and our burdens feel much lighter,
…the one I love with every fibre of my soul.

To our dear children Michael and Jessica,
you completed our lives and we will always love and cherish you.
You may not understand the sacrifices and hardship we had to go through as a
family in this time; I truly hope that you will grasp at every opportunity life has to offer
for you to get a good education.

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the writing of this research report.
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LIST OF ACRONYMS AND ABBREVIATIONS

APA - Advance Pricing Agreement

BBC - British Broadcasting Corporation

BEPS - Base Erosion and Profit Shifting

DTC - Davis Tax Committee

DTA - Double Taxation Agreement

FDI - Foreign Direct Investment

HMRC - Her Majesty’s Revenue and Customs

MEMAP - Manual on Effective Mutual Agreement Procedures

MNE(s) - Multinational Enterprise(s)

MAP - Mutual Agreement Procedure

OECD - Organisation for Economic Co-operation and Development

PE - Permanent Establishment

SA - South Africa

SARS - South African Revenue Service

TIOPA - Taxation International and Other Provisions Act

TIWB - Tax Inspectors Without Borders

TP - Transfer Pricing

UK - United Kingdom

UN - United Nations

USA - United States of America

CHAPTER 1: INTRODUCTION

INTRODUCTION ON BASE EROSION AND PROFIT SHIFTING

The Organisation for Economic Co-operation and Development (OECD) recognises globalisation as the integration of economies, industries and markets.[5] Through the global network of trade, taxpayers can transact business across borders. This is due to the revolutionary developments in communication and technology, the free movement of capital and the disappearance of trade barriers.[6]

The tax consequences of international transactions have resulted in Multinational Enterprises (MNEs) conducting their business in such a manner as to reduce the tax burden of the groups concerned. The British Broadcasting Corporation (BBC) has reported[7] on rising tax evasion and the increase in tax inequalities. Due to increasing public interest, tax evasion and tax avoidance were further exposed.[8] Helman (2014) highlighted profit shifting in an article published by Forbes media titled: 'What America's 15 most profitable companies pay in taxes'.[9] The article highlighted the fact that international companies such as Google, Apple, Amazon, Facebook and Starbucks made use of complex tax structures to shift profits and thus minimise their tax bills. The conclusion that can be drawn from the article[10] is that MNEs are not making a fair fiscal contribution in the economies in which they have a substantial economic footprint.

[5] Organisation for Economic Co-operation and Development (OECD). (2013a), *Action Plan on Base Erosion and Profit Shifting.* Paris: OECD, p7.

[6] *Supra* note 5.

[7] Barford, V. and Holt, G. (2013), *'Google, Amazon, Starbucks: The rise of tax shaming'*, <http://www.bbc.com/news/magazine-20560359>, retrieved 4 November 2016.

[8] Barford, *Supra* note 7.

[9] Helman, C. (2014), *'What America's most profitable companies pay in taxes'*, <http://www.forbes.com/sites/christopherhelman/2014/04/15/what-americas-most-profitable-companies-pay-in-taxes/#48779b29489e>, retrieved 8 July 2016.

[10] Helman, *Supra* note 9.

In another example Reuters reported, in an article by Bergin (2012)[11], that the Seattle-based MNE, Starbucks—a multinational coffee retailer with a subsidiary based in the United Kingdom (UK)—had avoided tax. Starbucks UK paid only £8,6 million in taxes on total sales in excess of £3 billion, since it opened the company in 1998.[12] In the context of legal[13] tax avoidance Bergin stated that the Starbucks case 'sheds light on perfectly legal tactics used by multinationals the world over'.[14] It further identified that 'Starbucks stands out because it has told investors one thing and the taxman another'.[15]

In the United States of America (USA) prior to 2012 it was announced that government spending would be reduced, resulting in job losses.[16] In the multimedia publication 'We're not broke' (2012)[17] it was emphasised that MNEs are not making a fair fiscal contribution, with some US-based MNEs paying minimal or zero taxes in the USA. It was recognised by the OECD[18] that Base Erosion and Profit Shifting (BEPS) is a global problem experienced by revenue authorities.

MNEs make use of complex tax structures to minimise their tax liability. This immoral tax behaviour by the exposed MNEs has created awareness regarding profit shifting. Syal (2015)[19] highlighted that the tax gap due to aggressive tax avoidance in the UK alone amounted to £4.4 billion (2015).[20] The question thus arises: Are MNEs making a fair fiscal contribution in the countries where their main economic activities occur?

[11] Bergin, T. (2012), *Special Report: How Starbucks avoids UK taxes*, <http://www.reuters.com/article/us-britain-starbucks-tax-idUSBRE89E0EX20121015>, retrieved 27 October 2016.

[12] Bergin, *Supra* note 11.

[13] A clear differentiation between legal avoidance and illegal tax evasion has to be emphasised. Legal tax avoidance could form part of tax legal planning mechanisms.

[14] Bergin, *Supra* note 11.

[15] Bergin, *Supra* note 11.

[16] Hayes, K. and Bruce, V. (2012), *We're not broke*, video recording, Onshore Productions LLC, USA, <http://werenotbrokemovie.com>.

[17] *Supra* note 16.

[18] *Supra* note 5.

[19] Syal, R. (2015), *'UK tax fraud costs government £16bn a year, audit report says'*, <https://www.theguardian.com/politics/2015/dec/17/uk-tax-costs-government-16bn-each-year-audit-report-says>, retrieved 27 October 2016.

[20] Syal, *Supra* note 19.

The OECD launched a research project in 2013 to study the prevention of BEPS.[21] The BEPS project also addressed concerns about transfer pricing, as this is one methods used by MNEs to extract profits from a jurisdiction with higher tax rates to a jurisdiction with lower or zero tax rates.

Through complex tax planning structures, MNEs obtain a tax benefit: by implication it could be said that taxpayers are legally avoiding tax.[22] This indicates that globally a tax avoidance attitude has emerged and needs to be addressed.

The recommendations on the Actions, as stated in the BEPS project,[23] were published by the OECD[24] and revenue authorities have taken the recommendations into consideration. In South Africa the Davis Tax Committee[25] indicated in the introductory report that it was appointed to review, *inter alia,* the OECD considerations and recommendations and to publish commentary and recommendations, specifically from a South African perspective.[26] In the UK a similar commission was appointed to review the OECD's recommendations.[27]

The Davis Tax Committee identified ambiguities in its general comments[28] on section 31 of the Income Tax Act, 58 of 1962 and made a specific recommendation[29] in this regard. Section 31[30] relates to 'Tax payable in respect of international transactions to be based on arm's length principle'.

[21] Organisation for Economic Co-operation and Development (OECD). (2013a), *Action Plan on Base Erosion and Profit Shifting.* Paris: OECD.

[22] Bergin, T. (2012), *Special report: How Starbucks avoids UK taxes*, <http://www.reuters.com/article/us-britain-starbucks-tax-idUSBRE89E0EX20121015>, retrieved 27 October 2016.

[23] Organisation for Economic Co-operation and Development (OECD). (2015), *BEPS 2015 Final Reports*, <http://www.oecd.org/tax/beps-2015-final-reports.htm>, retrieved 15 December 2016.

[24] *Supra* note 21.

[25] Davis Tax Committee (DTC). (2015), *Addressing base erosion and profit shifting in South Africa, Davis Tax Committee interim report*. Pretoria: The Davis Tax Committee.

[26] *Supra* note 25.

[27] The All-Party Parliamentary Group (APPG). (n.d.), *An examination of the OECD'S BEPS recommendations to the G20*, <http://www.appgresponsibletax.org.uk/ourwork/oecd-beps/>, retrieved 15 December 2016.

[28] Davis Tax Committee, (2015), *BEPS Interim Report on Action Plan 8 – Transfer Pricing of Intangibles,* p16.

[29] *Supra* note 28.

[30] Section 31, Income Tax Act, 58 of 1962.

The Davis Tax Committee's recommendation states the following:

> The legislators should ensure that section 31 of the Income Tax Act refers to the OECD guidelines. This is stated in SARS Practice Note 7, but SARS Practice Notes are not legally binding. At least one legally binding General Ruling, as provided for in section 89 of the Tax Administration Act, 2011, should be enacted on section 31.[31]

In the context of the research conducted on the commentary and the recommendations, *inter alia,* by the OECD[32] and the Davis Tax Committee,[33] together with the lack of Advance Pricing Agreement (APA) legislation in South Africa,[34] the following research questions need to be addressed:

- Firstly, would Advance Pricing Agreement legislation reduce double taxation and transfer pricing disputes?
- Secondly: Would Advance Pricing Agreement legislation result in taxpayer certainty?
- Thirdly, could South Africa address BEPS with Advance Pricing Agreement legislation?
- Lastly, could automatic exchange of information[35] be mutually beneficial to the core effectiveness of global tax administration and be an alternative to counter BEPS in South Africa?[36]

The aim of the research is to compare APAs set out in the OECD guidelines (2010)[37] with the application thereof by Her Majesty's Revenue and Customs (HMRC) and to make recommendations for South Africa.[38] The need for South Africa to follow OECD guidelines (2010)[39] and the recommendations made by the Davis Tax Committee[40] will also be reviewed.

[31] *Supra* note 28.

[32] *Supra* note 23.

[33] *Supra* note 28.

[34] Section 80(1)(*a*)(iii), Tax Administration Act, 28 of 2011.

[35] *Supra* note 21.

[36] Organisation for Economic Co-operation and Development (OECD). (2016a), *Tax administrations and capacity building: A collective challenge.* Paris: OECD.

[37] Organisation for Economic Co-operation and Development (OECD). (2010b), *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.* Paris: OECD.

[38] Section 218 - 230, Taxation (International and Other Provisions), Act 2010.

[39] *Supra* note 37.

[40] *Supra* note 28.

Since South Africa has no APA legislation, the concept of APAs will be discussed together with their related reasons and benefits.

INTRODUCTION TO ADVANCE PRICING AGREEMENTS

The concept of APAs was introduced in Japan in 1987[41], one of the first countries to adopt such a system. The OECD included Advance Pricing Arrangements in the OECD guidelines (2010).[42] In this research report the term Advance Pricing Agreements (APA) have the same meaning as Advance Pricing Arrangements and the two terms are used interchangeably. The OECD defines Advance Pricing Arrangements as follows:

> Advance Pricing Arrangement (APA) – An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An advance pricing arrangement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations.[43]

'Controlled transactions' refers to transactions between associated enterprises, typically between MNEs. The opportunity could exist for a MNE to agree with a revenue authority in advance on how to account for a transaction or annual submission of a tax return, referred to as a controlled transaction.

Controlled transactions could *inter alia* include transfer pricing, payment for services, management fees, professional fees, royalties, dividends and interest. 'Transfer pricing is one of the most important issues in international tax.'[44]

[41] National Tax Agency JAPAN. (n.d.), *Reference case studies on application of transfer pricing taxation*, <https://www.nta.go.jp/foreign_language/08.pdf>, retrieved 15 December 2016.

[42] *Supra* note 21, at pp168 - 179.

[43] Organisation for Economic Co-operation and Development (OECD). (n.d.b), *Glossary of Tax Terms*, <http://www.oecd.org/ctp/glossaryoftaxterms.htm>, retrieved 5 November 2016.

[44] Tax Justice Network. (n.d.), *Transfer Pricing*, <http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/>, retrieved 6 August 2016.

The OECD defines transfer pricing as follows:

> Transfer pricing – A transfer price is the price charged by a company for goods, services or intangible property to a subsidiary or other related company. Abusive transfer pricing occurs when income and expenses are improperly allocated for the purpose of reducing taxable income.[45]

The improper allocation of income and expenses by MNEs could lead to profit shifting and the reduction of the liability to pay tax. The OECD recognises that transactions between MNEs should be conducted on an arm's length basis. It is also stated that if the arm's length basis is applied in the same manner as 'an international norm'[46] by revenue authorities, mismatches should not arise. The OECD defines the arm's length principle as follows:

> Arm's Length Principle – The international standard which states that, where conditions between related enterprises are different from those between independent enterprises, profits which have accrued by reason of those conditions may be included in the profits of that enterprise and taxed accordingly.[47]

It needs to be emphasised that the pricing of, *inter alia,* goods and services should be based on an open market value of such, or similar, goods and services. An open market value is the price independent enterprises would pay for such, or similar, goods and services under the same circumstances and at the same point in time.

Calculating the correct arm's length price in developing countries could be challenging since 'developing countries have a fundamental problem in their distinct lack of comparable data'.[48]

Therefore it can be difficult to calculate the correct arm's length price in relation to a transfer pricing transaction where part of the group has an economic presence in developing countries. This is one of the reasons why APAs could be beneficial to

[45] *Supra* note 43.

[46] SARS. (1999), *Income Tax Practice Note No. 7, Section 31 of the Income Tax Act, 1962 (the Act): Determination of the taxable income of certain persons from international transactions: Transfer Pricing*. Pretoria: SARS. para 7.4.

[47] Supra note 43.

[48] taxjustice.net (n.d.), *'Transfer pricing in developing countries, an introduction'* <www.taxjustice.net/wp-content/uploads/2013/04/TP_in_developing_countries.pdf>, retrieved 20 December 2016.

both the taxpayer and a revenue authority, as their use would most likely prevent future disputes. It is stated in the OECD guidelines (2010)[49] that:

> transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer.[50]

Revenue authorities frequently conduct examinations or transfer pricing audits on MNEs in relation to controlled transactions. Visser (2016)[51] reported that the risk of facing transfer pricing audits is rising for MNEs in South Africa.

Calculation of a MNE's cost allocation with regard to transfer pricing is 'subjective'[52] and could be based on considerations made by the MNEs to achieve a tax benefit. When a revenue authority makes transfer pricing calculations it could have a more 'objective'[53] view and result in a transfer pricing adjustment. A transfer pricing adjustment is defined by the OECD as follows:

> Transfer pricing adjustment – Adjustment made by the tax authorities after making a determination that a transfer price in a controlled transaction between associated enterprises is incorrect or where an allocation of profits fails to conform to the arm's length principle.[54]

Transfer pricing adjustments could be avoided in the event where a taxpayer approaches a revenue authority with an application to enter into an APA. The revenue authority would follow legislation and relevant processes and procedures and could approve the application for an APA. The obligation would be on the taxpayer to keep accurate transfer pricing records. Legislation may include an annual compliance report to be submitted with the annual tax return. The advantages of APAs as stated in the OECD (2012)[55] could include taxpayer certainty, protection

[49] *Supra* note 37.

[50] *Supra* note 37, at p36.

[51] Visser, A. (2016), *'The risk of transfer pricing audits is growing for multinationals'*, <https://www.businesslive.co.za/bd/economy/2016-11-19-the-risk-of-transfer-pricing-audits-is-growing-for-multinationals/>, retrieved 15 December 2016.

[52] Sikka, P. and Willmott, H. (2010), *The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness,* Centre for Global Accountability. Colchester: University of Essex.

[53] *Supra* note 52.

[54] *Supra* note 43.

[55] Organisation for Economic Co-operation and Development (OECD). (2012), *Advance Pricing Arrangements, Approaches to legislation*, <http://www.oecd.org/ctp/tax-global/4.%20Advance_Transfer_Pricing_Arrangements.pdf>, retrieved 6 July 2016.

against double taxation and promote a better investment climate. This will most likely lead to an increase in tax yield. It is important for taxpayers to have certainty regarding double taxation issues. The absence of APAs could lead to a situation where the taxpayer and a revenue authority are not in agreement on a transfer pricing matter. This may result in a transfer pricing adjustment with detrimental consequences for the taxpayer.

In the event that a revenue authority makes a transfer pricing adjustment, the taxpayer may be liable to pay penalties for the incorrect statement. The South African Revenue Service (SARS) has the authority to raise understatement penalties of up to 200 percent[56] on the tax amount understated.

The burden of proving that an understatement was not made rests on the taxpayer. This is stated in section 102(1) of the Tax Administration Act, 28 of 2011. Should an incorrect statement be made, the MNE could be exposed to a financial risk and be obliged to pay taxes that were most likely not budgeted for.

This highlights the need for taxpayers to have certainty on how to determine ‘arm’s length’ pricing between associated enterprises that are part of the same MNE. Taxpayers could seek professional advice from international tax, accounting, legal and advisory firms. In conjunction with professional advice, taxpayers could approach the revenue authority for guidance on the tax treatment of a transaction, which could be in the form of an Advanced Pricing Agreement or an advance ruling.

As previously stated, in South Africa, SARS does not give rulings on transfer pricing matters.[57] Therefore, should SARS make a transfer pricing adjustment, it could cause a situation of double taxation on a transaction or a portion of a transaction between MNEs. The taxpayer would need to seek recourse to correct the double taxation.

[56] Sections 221 – 224, Tax Administration Act, 28 of 2011.
[57] *Supra* note 34.

The first remedy a taxpayer should seek is to dispute the transfer pricing adjustment. In South Africa, a taxpayer would follow the dispute resolution procedures as set out in Chapter 9 of the Tax Administration Act, 28 of 2011. The first step in the dispute process is to lodge an objection against an assessment[58]. If the objection is not successful the taxpayer could appeal against the decision.[59] It was confirmed that no transfer pricing court cases have been reported in South Africa.[60] No case law exists to give guidance on transfer pricing disputes.

In the event of a transfer pricing dispute the process may involve a lengthy and costly legal battle. The fact that a valid dispute[61] with regard to double taxation exists, allows the taxpayer to make use of an alternative and second remedy, namely the Mutual Agreement Procedure (MAP).[62]

INTRODUCTION TO TAX TREATIES AND THE MUTUAL AGREEMENT PROCEDURE

The Mutual Agreement Procedure (MAP) is a mechanism available to taxpayers in the event of double taxation or when it is foreseen that double taxation could occur in future. The MAP is set out in article 25 of the OECD Model Tax Convention on Income and on Capital (2014). The definition and aim of Model Tax Conventions are to, *inter alia,* prevent double taxation. The Model Tax Convention is defined by the OECD as follows:

> Model Tax Conventions (Treaties) – A model tax treaty is designed to streamline and achieve uniformity in the allocation of taxing rights between countries in cross-border situations. Model tax treaties developed by OECD and UN are widely used and a number of countries have their own model treaties.[63]

[58] Section 104, Tax Administration Act, 28 of 2011.

[59] Section 107, Tax Administration Act, 28 of 2011.

[60] Honiball, M. (2016), e-mail, 19 December 2016.

[61] Section 104 - 107, Tax Administration Act, 28 of 2011.

[62] SARS. (n.d.), *Mutual Agreement Procedure (MAP),* <http://www.sars.gov.za/Legal/International-Treaties-Agreements/DTA-Protocols/Pages/Mutual-Agreement-Procedure.aspx>, retrieved 16 December 2016.

[63] *Supra* note 43.

It should be kept in mind that article 25 of the OECD Model Tax Convention on Income and on Capital (2014) should be read and applied in the context of the objective of the Convention[64] and regard should be given to the OECD commentary in relation to the Convention.

The MAP is defined by the OECD as follows:

> Mutual Agreement Procedure (MAP) – A means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorized by Article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.[65]

The MAP could be applied in the event of 'cross border tax disputes'.[66] It is also further stated that the MAP might 'include issues of transfer pricing'[67] in the event of double taxation on a cross border transaction within a MNE. A taxpayer who is not in agreement with the tax treatment of a transaction that attracts double taxation, should follow domestic dispute resolution procedures and could apply for a MAP as a mechanism to correct the disparity. The OECD has published[68] the profiles of competent authorities of participating countries in regard to how to apply for the MAP. It should be noted that once a taxpayer has applied for the MAP, the matter is not between the taxpayer and the revenue authority. It becomes a negotiation between the contracting states.

It is highlighted by the OECD that:

> it is important to note that article 25(2) obliges the two states to negotiate, but the two states are merely obliged to use their best endeavours to reach mutual agreement and are not obliged to reach a specific agreement.[69]

[64] OECD Model Tax Convention on Income and on Capital (2014).

[65] Article 25, OECD Model Tax Convention on Income and on Capital (2014).

[66] De Koker, A.P. and Brincker, E. (ed.), (2010), *Silke on International Income Tax*. Durban: LexisNexis, para 38.1.

[67] De Koker and Brincker, *Supra* note 66 at para 38.1.1.

[68] Organisation for Economic Co-operation and Development (OECD). (n.d.c), *'MAP Profiles',* <http://www.oecd.org/ctp/dispute/country-map-profiles.htm>, retrieved 17 December 2016.

[69] De Koker and Brincker, *Supra* note 66 at para 38.1.4.

The contracting states may give a mandate to the competent authorities of both contracting states in relation to a Double Taxation Agreement (DTA), who could then reach some form of agreement.

It is stated in the Manual on Effective Mutual Agreement Procedures (MEMAP)[70] that should the competent authorities reach an agreement, the contracting states should exchange letters 'and where required the taxpayer has accepted the resolution, a competent authority should give, or arrange to give, it effect in its jurisdiction'.[71]

It is important to note that a taxpayer should first follow the dispute process applicable in the tax jurisdiction where the double taxation has occurred. In South Africa the MAP is available if a valid dispute exists and could be applied for during any stage of the dispute process.[72] The MAP is available as remedy for the disparity but should not be undertaken in conjunction with the dispute process as applied in domestic law. The dispute process could be halted as applying the MAP and following the dispute process may lead to 'a duplication of efforts'[73], which should be avoided.

The MEMAP[74] gives clarity on the 'interaction between MAP and domestic recourse provisions'.[75] It is stated that should the MAP not be successful, the taxpayer could still choose 'domestic recourse'.[76]

The Convention[77] indicates that a taxpayer should submit the application within three years after having first received notification of the action resulting in taxation not in accordance with the provision of the Convention.[78] The MEMAP[79] indicates that the ideal time frame for a MAP to reach finalisation should be within two years.

[70] Organisation for Economic Co-operation and Development (OECD). (2007), *Manual on Effective Mutual Agreement Procedures (MEMAP).* Paris: OECD.

[71] *Supra* note 70 at para 3.8.

[72] De Koker and Brincker, *Supra* note 66 at para 38.1.5.

[73] De Koker and Brincker, *Supra* note 72 at para 38.1.5.

[74] *Supra* note 70, at para 4.1.

[75] *Supra* note 74.

[76] *Supra* note 74.

[77] Organisation for Economic Co-operation and Development (OECD). (2014), *Model tax convention on income and on capital.* Paris: OECD.

[78] Article 25(1), OECD model tax convention on income and capital (2014).

Double taxation occurs, *inter alia,* when multiple revenue authorities either apply different interpretations of the arm's length principle or apply different interpretations on the allocation of taxing rights as set out in a treaty.

For example, in the UK the MAP would be applied when it is foreseen that double taxation is imminent. APAs are therefore included in the domestic law[80] of the UK.

To illustrate the disparity in the treatment of transfer pricing and APAs, the tax treaty[81] between South Africa and the UK is used as an example. The UK is a member of the OECD, HMRC is a leading tax authority[82] and UK tax legislation makes provision for Advance Pricing Arrangements.

South Africa and the UK entered into a tax treaty. The full title of the treaty is: The Convention between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on Income and Capital gains. The treaty is commonly referred to as the DTA with the UK.[83]

The treaty between South Africa and the UK is based on the OECD Model Tax Convention on Income and on Capital,[84] also referred to as the OECD Model Tax Convention.

The aim of tax treaties is to establish taxing rights between contracting states as well as prevent double taxation. Tax treaties do not address the fact that in certain instances, double non-taxation could occur with little or no remedy.

[79] Organisation for Economic Co-operation and Development (OECD). (1999), *Guidelines for conducting Advance Pricing Arrangements under the Mutual Agreement Procedure ('MAP APAs')* Annex (1999)*.* Paris: OECD.

[80] Section 218 - 230, Taxation (International and Other Provisions), Act 2010.

[81] South African Government Gazette. (2003), *SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003*.

[82] Broomberg, E. B. (2007)*,* Tax avoidance then and now*, Tax planning corporate and personal*, vol. 21, no. 5, pp112-118.

[83] *Supra* note 81.

[84] *Supra* note 77.

Article 24(2) of the SA/UK DTA[85] could be interpreted and applied differently by SARS and HMRC. South Africa does not recognise the possibility of double taxation, since the MAP is only available as a remedy after the occurrence of double taxation.

The UK recognises that double taxation could occur and then follows the OECD guidelines (2010)[86], and may engage in negotiations with other contracting states where such double taxation could occur. An APA could be made with other contracting states under the provisions of article 24(2).[87]

South Africa does not follow this application of the OECD guidelines (2010)[88] and therefore application of the OECD Model Tax Convention on Income and on Capital (2014) could lead to inconsistency and double taxation.

The specific exclusion of APAs in South Africa[89] creates a direct disparity of the application of the MAP by SARS and HMRC. This creates the possibility of double taxation and could detract from taxpayer certainty with regard to the treatment of a transfer pricing transaction.

[85] Article 24(2), SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[86] *Supra* note 37.

[87] *Supra* note 85.

[88] *Supra* note 37.

[89] *Supra* note 34.

RESEARCH PROBLEM AND SUB-PROBLEMS

The statement of the problem

The key problem is the specific exclusion of pricing agreements from the Advance Ruling provisions as set out in Chapter 7 of the South African Tax Administration Act, 28 of 2011. The absence of APA legislation in South Africa may create a disparity due to the fact that the MAP is not available as a remedy in South Africa, until after the event of tax. A mismatch occurs that may cause double taxation with regard to international transactions and disputes.

Oguttu (2006)[90] has conducted research on APAs. International developments since the BEPS project (OECD 2013)[91] and the introduction of the Tax Administration Act[92] have added new dimensions to the problem of resolving transfer pricing disputes and these developments need to be critically analysed. The Davis Tax Committee[93] has made recommendations on the BEPS project, which will be considered.

In South Africa the MAP is a process governed under treaty provisions and is only applicable firstly, after the event of tax; secondly, after a transfer pricing adjustment has been made by the relevant revenue authority; and lastly after any double taxation disputes have arisen within domestic legislation.

The OECD (2012)[94] has conducted research on Advance Pricing Arrangements[95] as applied in the UK. It was reported that Advance Pricing legislation is available to taxpayers in the UK seeking certainty on the tax treatment of a transfer pricing transaction, before the event of tax. This could create a disparity in the tax treatment of a transaction by SARS and HMRC. Double taxation of a transaction or a portion thereof could lead to the taxpayer following the dispute process. The dispute process is set out in Chapter 9 of the South African Tax Administration Act, 28 of 2011. The

[90] Oguttu, A.W. (2006), Resolving transfer pricing disputes: Are Advance Pricing Agreements the way forward for South Africa? *SA Mercantile Law Journal* 18 pp60-485.

[91] *Supra* note 21.

[92] Tax Administration Act, 28 of 2011.

[93] *Supra* note 28.

[94] *Supra* note 55.

[95] *Supra* note 55.

taxpayer bears the burden[96] of proving that an amount, transaction, event or item is exempt or otherwise not taxable. Taxpayer uncertainty and the dispute process have a direct link. The burden is on the taxpayer to prove that the transaction had been conducted at an arm's length basis.[97] When SARS conducts an audit and makes a transfer pricing adjustment, with which the taxpayer is not in agreement, this could lead to the dispute process. If taxpayers had the opportunity to obtain certainty on the treatment of a transaction in advance, this could eliminate transfer pricing adjustments and disputes. This in turn could eliminate unnecessary time and resources being wasted on resolving transfer pricing disputes.

The objective of this report is to critically analyse APAs[98] and highlight the benefits, risks, advantages, disadvantages and challenges of introducing such from a South African perspective.

The second objective of this report is to critically analyse and compare the Davis Tax Committee's recommendations with the OECD proposals on the treatment of arm's length transactions. This would assist in recommending a way forward to prevent BEPS on the basis of the equal treatment of arm's length transactions across borders.

The sub-problems

The first sub-problem aims to highlight the issues arising from the exclusion of APAs from South African tax legislation, specifically since the introduction of the Tax Administration Act, 28 of 2011. A critical analysis of how Advanced Pricing Agreements are applied in the UK by HMRC should further explain the concept under review.

The second sub-problem deals with the event of taxation and the DTA between South Africa and the UK. The question is aimed at the mismatch of legislation

[96] Section 102(1), Tax Administration Act, 28 of 2011.
[97] Davis Tax Committee, (2015) BEPS Interim Report on Action Plan *13 – Transfer Pricing Documentation,* p15.
[98] *Supra* note 96.

regarding APAs and the treatment of transfer pricing adjustments by the relevant tax authorities. Transfer pricing guidelines, as published by the OECD (2010), are viewed as international best practice and will be discussed. The MAP in the event of double taxation will also be reviewed.

The third sub-problem arises from the question of whether APAs could reduce disputes between SARS and taxpayers with regard to transfer pricing adjustments and disputes. The question also seeks to address the possibility of an increase or a decrease in revenue from Multinational Enterprises.

The last sub-problem questions the factors that need to be considered in relation to APAs. The question is whether BEPS could be prevented or reduced if South African legislation permitted APAs. Alternatively, would multilateral and bilateral information sharing agreements between revenue authorities resolve the problem of mispricing?

SCOPE AND LIMITATIONS

The scope of this research is to determine whether the South African domestic legislation and the specific exclusion of advance tax rulings are in line with the OECD (2010) recommendations. The scope of the research is based on the OECD Model Tax Convention on Income and on Capital (2014) and compares the SA/UK DTA in relation to APAs. The UK makes use of APA legislation and is an OECD partner.

The research report also examines the reasons for the exclusion in legislation of advance rulings relating to transfer pricing of goods and services between MNEs and focuses on the following facts and uncertainties:

- South Africa is a developing country;
- South Africa may not have the skills or capacity to conduct an APA programme; and
- Alternative measures that could be taken to avoid double taxation and disparities that might occur in the application of legislation and DTAs.

METHODOLOGY OF THE STUDY

In the light of BEPS, a critical analysis was undertaken to compare the APAs as included in the OECD Guidelines on transfer pricing (2010). South African domestic legislation was investigated to address situations of disparity should double taxation occur. Tax legislation governing situations of double taxation was reviewed. The absence of advance tax rulings on transfer pricing of goods and services was also analysed and compared with APAs as applied in the UK. Legislation, together with the DTA between South Africa and the UK, was analysed. Information was gathered, critically analysed and investigated. The main resources pertain to literature in the form of articles, books and publicly published information.

CHAPTER 2: SOUTH AFRICAN LEGISLATION CONTRASTED WITH THE APPLICATION OF ADVANCE PRICING AGREEMENTS IN THE UNITED KINGDOM BASED ON OECD GUIDELINES (2010)

THE EXCLUSION OF ADVANCE RULINGS ON ADVANCE PRICING AGREEMENTS FROM SOUTH AFRICAN LEGISLATION

Chapter 7 of the Tax Administration Act, 28 of 2011, deals with how the South African Revenue Service (SARS) administers advance rulings. Broadly, 'advance rulings'[99] are differentiated between 'binding general rulings', 'binding private rulings' and/or 'binding class rulings'.[100]

It should be emphasised that SARS does not give 'advance rulings'[101] on transfer pricing matters. The provisions of section 80(*a*)(iii) of the Tax Administration Act, 28 of 2011,[102] indicate that SARS will not even consider an application if it relates to transfer pricing between connected persons.

Section 80 states:[103]

> Rejection of application for advance ruling.—(1) SARS may reject an "application" for an "advance ruling" if the "application"—
>
> (*a*) requests or requires the rendering of an opinion, conclusion or determination regarding—
>
> (iii) the pricing of goods or services supplied by or rendered to a connected person in relation to the "applicant" or a "class member"; …

Reasons for the exclusion of 'advance rulings'[104] on transfer pricing matters, between connected parties, are not known.[105] It is certain that the specific exclusion

[99] Section 75, Tax Administration Act, 28 of 2011.

[100] Sections 75 - 90, Tax Administration Act, 28 of 2011.

[101] *Supra* note 100.

[102] Tax Administration Act, 28 of 2011.

[103] *Supra* note 102.

[104] Section 80(1)(*a*)(iii), Tax Administration Act, 28 of 2011.

of ‘advance rulings’, in this context, is not in line with the guidelines[106] published by the Organisation for Economic Co-operation and Development (OECD). The guideline, *inter alia,* includes transfer pricing and Advance Pricing Agreements (APAs).[107]

Before or during the structuring of a cross border transaction, Multinational Enterprises (MNEs) would give careful consideration to the tax implications of the transaction. MNEs would aim to structure a cross border transaction in such a way as to pay the least amount in tax legally allowable. Also, MNEs would give careful consideration to determining a fair and reasonable price at which goods and services are provided for. The arm’s length price[108] of a transaction must be calculated.

The MNE may be liable for tax in various jurisdictions and the relevant tax legislation in each tax jurisdiction needs to be considered. Various revenue authorities may deal with transfer pricing differently in relation to the same transaction.

Therefore MNEs may seek certainty regarding the tax treatment of a transaction, when conducting cross border transactions. Certainty would be required to reduce the risk of transfer pricing adjustments and penalties. The tax treatment of a transaction could mean a greater or smaller profit margin for the group. One should not forget that the reputation of a company, in handling its tax affairs, could influence investors’ confidence.

Research conducted on Advance Pricing Arrangements: Approaches to Legislation[109] indicated that certain OECD and non-OECD countries have adopted

[105] Olivier, L. and Honiball, M. (2011), *International tax: A South African perspective*, 5th edn. Cape Town: Siber Ink, p638.

[106] Organisation for Economic Co-operation and Development (OECD). (2010b), *Transfer pricing guidelines for multinational enterprises and tax administrations.* Paris: OECD.

[107] *Supra* note 106.

[108] taxjustice.net (n.d.), *Transfer pricing in developing countries, an introduction* <www.taxjustice.net/wp-content/uploads/2013/04/TP_in_developing_countries.pdf>, retrieved 20 December 2016.

[109] Organisation for Economic Co-operation and Development (OECD). (2012), *advance pricing arrangements, approaches to legislation*, <http://www.oecd.org/ctp/tax-global/4.%20Advance_Transfer_Pricing_Arrangements.pdf>, retrieved 6 July 2016.

Advance Pricing rules to allow APAs. The definition of Advance Pricing Arrangements[110] is cited in the OECD's terms of reference as:

> An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An advance pricing agreement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations.[111]

The OECD also recognises the arm's length principle, which is:

> [t]he international standard which states that, where conditions between related enterprises are different from those between independent enterprises, profits which have accrued by reason of those conditions may be included in the profits of that enterprise and taxed accordingly.[112]

The OECD adopted APAs in October 1999[113] to supplement the traditional, administrative, judicial and treaty mechanisms of resolving transfer pricing issues.[114] The concept of APAs is based on a taxpayer or MNE approaching one or more revenue authorities, in order to agree in advance on the transfer pricing methodology and variables applicable to each unique case. For example, a company should determine the profit margin of selling a product to another company in the group at an arm's length price and the terms of the APA will be agreed between the taxpayer and the revenue authority during the process of reaching the terms of agreement.

The same arm's length principle would apply to the pricing of goods, services, management fees, professional fees, royalties, interest and the payment of dividends.

The taxpayer is responsible for making clear declarations to the revenue authorities and is aware of the fact that if any misrepresentations or fraud are later discovered,

[110] Organisation for Economic Co-operation and Development (OECD). (n.d.b), *Glossary of tax terms*, <http://www.oecd.org/ctp/glossaryoftaxterms.htm>, retrieved 5 November 2016*.*

[111] *Supra* note 110.

[112] *Supra* note 110.

[113] *Supra* note 106, at p168.

[114] *Ibid* note 113.

the APA will be null and void. The regulations regarding the burden of proof would differ depending on the domestic legislation of each treaty party.

The OECD identified that 'some countries allow for unilateral arrangements where the tax administration and the taxpayer in its jurisdiction establish an arrangement without the involvement of the other interested tax administrations'.[115] If a unilateral APA was reached, it is the responsibility of the tax administration to inform the other relevant tax administrations of the APA reached with the taxpayer.

Where a taxpayer makes use of a unilateral APA, it should be clearly indicated that the taxpayer is not waiving its right to access the Mutual Agreement Procedure (MAP),[116] should a transfer pricing dispute arise. It is important that a taxpayer party to an APA should be able to dispute double taxation under treaty provisions, such as the MAP.

Should a transfer pricing dispute arise which cannot be resolved, it would mean that the MNE would be taxed twice on the same transaction or a portion thereof.

MNEs should be aware of the fact that a tax jurisdiction could view a transaction as not being at arm's length and make a transfer pricing adjustment. In order to eliminate or reduce the risk of a transfer pricing adjustment, they would enter into an APA with the relevant tax administration.

It could be said that the purpose of an APA[117] would be to provide the taxpayer with certainty of the tax treatment of a transaction prior to the implementation. APAs between a taxpayer and the relevant tax authority could avoid pricing adjustments and penalties for the incorrect treatment of a transaction for tax purposes. APAs could aid in the prevention of double taxation.

[115] *Supra* note 106, at p169.
[116] *Supra* note 106, at p169.
[117] *Supra* note 109.

It should be pointed out that the annex to Chapter IV[118] indicates that it is possible for revenue authorities to follow the MAP[119] to agree on a multilateral APA. Such an agreement would be referred to as a 'MAP APA' by the OECD.[120] It should be noted that the OECD guidelines on Transfer Pricing were based on the OECD Model Tax Convention on Income and Capital (2010). The articles of the convention should be referred to when considering the following interpretation.

The MAP is set out in article 25 of the OECD Model Tax Convention on Income and on Capital (2014).[121] Article 25[122] provides a guideline for the allocation of taxing rights and is not obligatory but rather an endeavour to reach an agreement.[123]

Before the MAP is considered, article 9 of the OECD Model Tax Convention on Income and on Capital, which deals with associated enterprises, should be considered and applied. Associated enterprises are connected parties in relation to a MNE.

Article 9 [124] specifically addresses associated enterprises which conduct business in several tax jurisdictions and stipulates that transactions should be dealt with at an arm's length basis. The provisions of article 9[125] grant authority to allocate taxing rights to the relevant tax authorities when cross border transactions take place.

Taxpayers and revenue authorities may enter into a unilateral APA or a similar agreement where the revenue authority is in agreement with a taxpayer's transfer pricing method and profit allocation to its revenue jurisdiction. Another revenue authority may not view the method as being applicable in its economy and could make a transfer pricing adjustment.

[118] *Supra* note 106.
[119] *Supra* note 106*.*
[120] Organisation for Economic Co-operation and Development (OECD). (1999), *Guidelines for conducting Advance Pricing Arrangements under the Mutual Agreement Procedure ('MAP APAs')* Annex (1999)*.* Paris: OECD, para 7.
[121] Organisation for Economic Co-operation and Development (OECD). (2014), *Model tax convention on income and on capital.* Paris: OECD.
[122] Article 25, OECD Model Tax Convention on Income and on Capital (2010).
[123] *Supra* note 106, at p149.
[124] Article 9, OECD Model Tax Convention on Income and on Capital (2010).
[125] *Supra* note 124.

Since transfer pricing disputes could lead to lengthy disputes between taxpayers and revenue authorities, and eventual disputes between revenue authorities under treaty provisions, it would be preferable if revenue authorities could enter into bilateral or multilateral APAs before the event of taxation. This ‘reduces the risk of double taxation, will be equitable to all tax administrations and taxpayers involved and will provide greater certainty to the taxpayers concerned’.[126]

The OECD Transfer Pricing guidelines (2010) identified that some countries' domestic provisions do not permit the tax administration to enter into binding agreements directly with taxpayers. It also states that APAs can be concluded with the competent authority of a treaty partner only under the MAP.[127] The main problem is that South Africa does not have Advance Pricing legislation and that Advance Pricing is specifically excluded from the Advance Ruling process, set out in Chapter 7 of the Tax Administration Act, 28 of 2011.

This disparity could directly lead to double taxation of a transaction or a portion of a transaction.

DOUBLE TAXATION IN RELATION TO THE SAME TRANSACTION

The event of double taxation could be illustrated with the following example. Where a Multinational Enterprise consists of entities that hold residency in South Africa, the United Kingdom (UK) and perhaps in an additional tax jurisdiction, for taxation purposes it would be treated differently in South Africa than in the other jurisdictions. The probability exists that in the event of SARS making a transfer pricing adjustment, the taxpayer would be taxed on the same income in more than one tax jurisdiction and that the MAP, together with domestic legislation, would be available to the taxpayer in order to correct this disparity.

[126] *Supra* note 106, at p169.

[127] *Supra* note 106, at p170.

The dispute resolution procedure as set out in Chapter 9 of the Tax Administration Act,[128] together with article 9[129] and the MAP between competent authorities is an administrative burden on the taxpayer and the relevant tax authorities, which could have been avoided by an APA.

The UK has an Advance Pricing programme and this illustrates how disputes and the administrative burden could be shifted to the taxpayer prior to assessment. The Advance Pricing programme could prevent double taxation to some extent.

Double taxation could occur if one or more tax administrations take a different view of the arm's length principle, upon examining the transactions between MNEs. It would be ideal to have a mutual APA between the MNE and the relevant tax authorities. Since the domestic legislation of each country differs, the tax treatment of transactions by different revenue authorities could vary and this could lead to double taxation.

The predicament of double taxation would occur when an MNE has a unilateral advance pricing agreement only with its own tax authority. The group still does not have certainty over the tax treatment of the transaction by revenue authorities in other jurisdictions. The arm's length principle could be interpreted in varying ways and result in transfer pricing adjustments by other revenue authorities in jurisdictions where the MNE trades. The South African view on arm's length transactions is that this is an international standard, which should be applied equally by tax authorities in order to 'minimise the potential for double taxation'.[130]

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax administrations (2010) clearly point out that they seek to facilitate both equitable

[128] *Supra* note 102.

[129] Broomberg, E. B. (2007), 'Tax avoidance then and now*, Tax Planning Corporate and Personal*, vol. 21, no. 5, pp112-118.

[130] SARS. (1999), *Income Tax Practice Note No. 7, Section 31 of the Income Tax Act, 1962 (the Act): Determination of the taxable income of certain persons from international transactions: Transfer Pricing*. Pretoria: SARS. para 7.4.

allocation of taxes between jurisdictions and the prevention of double taxation of taxpayers.[131]

For the purposes of this paper, the OECD Model Tax Convention on Income and on Capital (2014) forms the basis on which double taxation is addressed in South Africa as well as in the UK. The UK has an Advance Pricing programme illustrating how APAs are applied by Her Majesty's Revenue and Customs (HMRC).

ADVANCE PRICING AGREEMENTS AS APPLIED IN THE UNITED KINGDOM

The OECD conducted research on the treatment of APAs in the UK.[132] It stated that the UK adopted unilateral, bilateral and multilateral APAs in practice. The scope of the APAs[133] includes the determination of arm’s length pricing between connected enterprises, plus the attribution of profit when an enterprise is liable for tax in another jurisdiction as well as in the UK. APAs for transfer pricing related matters are usually agreed in advance and would be effective for a time period of three to five years.[134] When the term expires, the taxpayer would apply for a new APA.

Thin capitalisation matters are dealt with in a separate programme by HMRC namely: Advance Thin Capitalisation Agreements (ATCA).[135]

The effect of the APA would be that HMRC provides certainty on how it will treat the transfer pricing matters as agreed on. From the taxpayer’s perspective, an obligation is created to ensure that the agreed methods of pricing or allocation of profits are adhered to. The taxpayer also has to furnish an annual report[136] confirming adherence to the APA: this accompanies the taxpayer’s annual return. From the revenue authority’s perspective, this reduces transfer pricing audits and builds capacity for compliance.

[131] *Supra* note 106, at p132.
[132] *Supra* note 109.
[133] *Supra* note 109, at p21.
[134] *Supra* note 109, at p21.
[135] *Supra* note 109, at p21.
[136] *Supra* note 109, at p21.

HMRC frequently updates the Statement of Practice 2 (2010).[137] The policy paper by HMRC is a general guide in relation to APAs and the interpretation of legislation. It is stated that ‘the legislation that relates to APAs appears at Sections 218 - 230 of the Taxation (International and Other Provisions) Act 2010 (TIOPA)’.[138]

Legislation in the UK regarding APAs is well-developed and has been applied since 1999. Since taxpayers’ affairs are subject to secrecy provisions, HMRC does not make APAs public. HMRC will engage with the competent authority of another tax jurisdiction in the event where a bilateral or multilateral pricing agreement is sought or to be agreed upon. HMRC may provide the APA to another tax jurisdiction where the taxpayer or the group of companies has a direct or indirect economic presence.

For this reason no commentary could be given on how effective the APA programme is in the UK. It could be said that the legislation is meticulous and the application process can take between 18 and 21 months[139] to reach an agreement.

An ‘advance pricing agreement’ is defined in section 218[140] as a written agreement between the Commissioners with any person in terms of an application for an agreement which relates to one or more matters regarding the attribution of income in relation to international trading as well as the treatment for tax purposes between the company and any associate as defined in section 219[141].

The Statement of Practice[142] clearly indicates that the terms to be adhered to are the agreed method for dealing with transfer pricing issues and that a regular compliance report is required as stipulated in section 228.[143] It further states that the taxpayer must identify critical assumptions that are material to the agreed transfer pricing

[137] HM Revenue and Customs. (2010), *Policy Paper, Statement of Practice 2 (2010), updated 8 November 2016*. London: HMRC.
[138] Taxation (International and Other Provisions), Act 2010.
[139] *Supra* note 137.
[140] Section 218, Taxation (International and Other Provisions), Act 2010.
[141] Section 219, Taxation (International and Other Provisions), Act 2010.
[142] *Supra* note 137.
[143] Section 228, Taxation (International and Other Provisions), Act 2010.

method. If the taxpayer does not notify HMRC of any changes to the critical assumptions, the APA may be rendered invalid.[144]

Analysis of the provisions relating to APAs[145] shows that a major, in-depth process must be followed before finally reaching an agreement… that could still be revoked or invalidated as a result of unintentional miscalculation, omission of reporting or intentional misrepresentation.

It is clear that HMRC has the authority to modify or revoke[146] an agreement when it is found that the transfer pricing method or any critical assumptions have changed due to external influences, such as the economy or the economies of other countries or industries. The agreement will be modified on the terms HMRC proposes and a new agreement will be entered into between HMRC and the taxpayer.

If the taxpayer and HMRC cannot agree on new terms of an agreement, the previous APA will be revoked. In essence this means the agreement is nullified, as if it had never existed. It could be said that the application process and the revocation of an agreement might be as much of an administrative process as a transfer pricing audit. The only difference is that the taxpayer would have guidance regarding recourse before submitting a tax return, where a transfer pricing audit is conducted after an assessment on income has been issued. Transfer pricing adjustments could lead to heavy penalties and compounded interest.

The risk of a taxpayer misleading the revenue authorities will always be a reality. Taxpayers will always attempt to minimise their tax liability within the boundaries of legislation. The interpretation of legislation—and in particular the complex transfer pricing methods and limited comparable data available—could lead to a situation where a taxpayer takes advantage and misleads the tax authorities.

During the application process and reaching of an Advanced Pricing Agreement, the taxpayer submits relevant information over a period of up to 21 months. If agreement

[144] *Supra* note 137.

[145] Sections 218 - 230, Taxation (International and Other Provisions), Act 2010.

[146] Section 225, Taxation (International and Other Provisions), Act 2010.

is reached, HMRC enters into the Advanced Pricing Agreement based on the facts presented and declarations made by the taxpayer. The facts should have been carefully scrutinised before an agreement was reached. The taxpayer would still need to report on an annual basis upon submission of the annual tax return. HMRC would scrutinise the annual report and retrospectively test if the terms of the agreement are valid. In the event of misrepresentation of facts, HMRC will nullify the APA.[147] The penalty for misrepresentation in connection with an Advanced Pricing Agreement is not more than £10,000.[148] This is a fixed penalty without discretion to reduce, remit or waive it.

The UK's Advance Pricing legislation makes provision for the modification of agreements for double taxation purposes.[149] Modification of Advanced Pricing Agreements would be applicable firstly, if double taxation occurred and the MAP was followed in terms of any Double Taxation Agreement (DTA). Secondly, if any DTA is inconsistent with the terms of an APA.

This provision[150] provides flexibility in the event of a transfer pricing adjustment made by a treaty partner of the UK. In the process of resolving double taxation, the contracting states will follow the MAP[151] and agree on allocation of profits.[152] Double taxation will be avoided, even though the necessary process may be lengthy.

In contrast with South Africa, the UK allows for APAs and determines in advance the transfer pricing method, before assessment of tax. South Africa has not yet formalised the self-assessment process for income tax. This could, *inter alia,* be one reason why transfer pricing audits are conducted after the annual assessment and in the event of tax being levied.

[147] Section 226, Taxation (International and Other Provisions), Act 2010.

[148] Section 227, Taxation (International and Other Provisions), Act 2010.

[149] Section 229, Taxation (International and Other Provisions), Act 2010.

[150] *Supra* note 149.

[151] Article 25, OECD Model Tax Convention on Income and on Capital (2014).

[152] Article 9, OECD Model Tax Convention on Income and on Capital (2014).

THE SOUTH AFRICAN TREATMENT OF INTERNATIONAL TRANSACTIONS IN RELATION TO TRANSFER PRICING

The history of transfer pricing in South Africa is significant. The content of old Section 31 of the Income Tax Act, 58 of 1962 was replaced by new content in 1995.[153] This formed the basis of the transfer pricing basic principles still applied today. The legislation was reformed in 1995 after international trading restrictions against South Africa had been lifted in 1994.

SARS issued Practice Note 7 (1999) to serve as a guide for the interpretation and application of section 31,[154] and this specifically refers to the 'determination of taxable income of certain persons from international transactions and transfer pricing'.[155] Practice Note 7 (1999) was based on the OECD Report on Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (1995).[156] The OECD has since updated and issued new guidelines on transfer pricing, the latest ones being published in 2010.[157] Practice Note 7 (1999) is the only endorsed guide on transfer pricing matters in South Africa. It is however not a binding document.

Section 108 of the Income Tax Act, 58 of 1962 empowers SARS to enter into DTAs. DTAs aim to prevent, or grant relief from, double taxation.[158] During this research, the DTA between South Africa and the UK was compared with the OECD Model Tax Convention on Income and on Capital (2014). It is concluded that numerous articles in the DTA and the OECD Model Tax Convention on Income and on Capital (2014) have similar headings and the content of these articles is similar.

South Africa is a not a member of the OECD, however, participates as a key partner of the OECD.[159] SARS, as the Tax Administration in South Africa, applies OECD

[153] Section 23, Income Tax Act, 21 of 1995.
[154] Section 31, Income Tax Act, 58 of 1962.
[155] *Supra* note 154.
[156] Definition of OECD Guidelines, Practice Note 7 of 1999.
[157] *Supra* note 106.
[158] Section 108, Income Tax Act, 58 of 1962.
[159] Organisation for Economic Co-operation and Development (OECD). (n.d.d), *Members and Partners,* <https://www.oecd.org/about/membersandpartners/>, retrieved 3 December 2016.

policies, recommendations and the OECD Model Tax Convention on Income and on Capital (2014), with reservations on matters with which it is not in agreement.[160]

The main South African reservation regarding the OECD Model Tax Convention on Income and on Capital (2014) was that South Africa reserved the right to apply the allocation of business profits as stated in article 7.[161]

Article 14[162] was deleted from the OECD Model Tax convention on Income and on Capital prior to 2008. For this reason the numbering of articles in the South African DTA does not match the numbering of the OECD Model Tax Convention (2014). This observation is important since the MAP discussed in this research makes reference to the numbering of the articles.[163] The DTA refers to article 24.[164]

A DTA is an agreement between two contracting states. The purpose of a DTA is to avoid double taxation and to determine the allocation of profits and taxing rights. During the interpretation process of a DTA, relevant provisions should be analysed and it should be determined which provisions are applicable. In order to illustrate the point, provisions set out in article 7[165] should be applied before the provisions in article 9 are interpreted and applied.[166] Firstly, article 7[167] directs how business profits are attributed to Permanent Establishments (PE) in the case of a MNE that conducts business in both contracting states. Secondly, article 9[168] stipulates the taxing rights of contracting states in relation to the same transaction in the case of associated enterprises conducting business in both tax jurisdictions.

[160] Refer to the Non-OECD Economies' Positions on: Organisation for Economic Co-operation and Development (OECD). (2014), *Model tax convention on income and on capital.* Paris: OECD.

[161] *Supra* note 160, at para 3, sub para 14.

[162] Article 14 previously dealt with the taxation of professional services and other activities of an independent character.

[163] The provisions of the South African double taxation agreement with the UK refer to article 24, the Mutual Agreement Procedure: this is based on article 25 of the OECD Model Tax convention on Income and on Capital (2014).

[164] South African Government Gazette. (2003), *SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003*.

[165] Article 7 of the Double Taxation Agreement and article 7 of the OECD Model Tax Convention (2008) are almost identical and will be referred to as article 7 for the purpose of the discussion of article 7.

[166] SARS. (1999), *Income Tax Practice Note No. 7, Section 31 of the Income Tax Act, 1962 (the Act): Determination of the taxable income of certain persons from international transactions: Transfer Pricing*. Pretoria: SARS, para 6.

[167] Article 7, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[168] Article 9, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

Oguttu (2006) carried out research on *Resolving transfer pricing disputes: Are 'Advance Pricing Agreements' the way forward for South Africa?*[169] The paper makes reference to the SARS Practice Note 7 (1999) and also commented that the guide is not binding and that taxpayers were uncertain about how SARS would interpret the arm's length principle. Commentary[170] included the observation that the Commissioner of SARS may not accept any application from a taxpayer for an advance ruling in respect of the pricing of goods or services supplied by, or rendered to, a connected person in relation to the applicant or to a class member in the case of an application for a binding class ruling.[171]

Critical remarks in the paper[172] indicate that SARS should consider Advance Pricing legislation irrespective of the criticism that APAs would not solve all transfer pricing disputes.

With the introduction of the Tax Administration Act[173] no new solutions to transfer pricing disputes were addressed, although recommended in the research.[174] The new provisions in the Tax Administration Act[175] are still applied as previously stated in the Income Tax Act, 58 of 1962.

The Tax Administration Act[176] came into effect on 1 October 2012 and Practice Note 7 (1999) was not retracted. It is still available as a guide even though it is not binding.[177] SARS published a draft Interpretation Note[178] in relation to section 31.[179] The due date for commenting by the public was on 30 June 2013. The Interpretation

[169] Oguttu, A.W. (2006), Resolving transfer pricing disputes: Are advance pricing agreements the way forward for South Africa? *SA Mercantile Law Journal* 18 pp60-485.

[170] *Supra* note 169.

[171] Section 76G(1)(*a*)(iii), Income Tax Act, 58 of 1962. This section came into effect on 1 October 2006 and was repealed when the Tax Administration Act, 28 of 2011, was enacted.

[172] *Supra* note 169.

[173] *Supra* note 154.

[174] *Supra* note 169.

[175] Section 80(1)(*a*)(iii), Tax Administration No. Act, 28 of 2011.

[176] *Supra* note 173.

[177] Davis Tax Committee, (2015) BEPS Interim Report on Action Plan 8 – Transfer Pricing of Intangibles, p16.

[178] SARS. (n.d.), *Draft interpretation note, determination of taxable income of certain international transactions, thin capitalisation*. Published 3 April 2013. Pretoria: SARS.

[179] Section 31, Income Tax Act, 58 of 1962.

Note[180] is still in draft format and could be revised or retracted by SARS. The draft Interpretation Note deals with Section 31,[181] with the subject title ‘Determination of the taxable income of certain persons from international transactions: Thin Capitalisation’.[182]

Firstly, the subject title of the draft Interpretation Note makes it appear the document only relates to ‘Thin Capitalisation’.[183] This is the interest rate agreed on between connected persons in relation to a cross border transaction that is not at arm’s length. In layman’s terms, the capital invested and the terms of the agreement between connected companies that are part of a MNE do not justify the high interest payments claimed as a deduction.

Secondly, by implication the subject title is misleading since it quotes section 31 of the Income Tax Act, 58 of 1962 and omits to state that the document excludes transfer pricing matters related to goods and services supplied and rendered between associated enterprises. Thus it actually only covers interest payments between associated enterprises, which is not at arm’s length.

Lastly, it could be said that the draft Interpretation Note[184] does give some guidance on SARS’ intentions in regard to the application of the arm’s length principle. Even though it is applied to Thin Capitalisation, it states that:

> [g]uidance on the application of and adherence to the arm’s length basis can be found in the OECD guidelines.[185]

The Draft Interpretation Note[186] further states that the Advance Agreement Process is not currently available in South Africa.

[180] *Supra* note 178.
[181] *Supra* note 154.
[182] *Supra* note 178.
[183] The concept of Thin Capitalisation is dealt with in Section 31(2), Income Tax Act, 58 of 1962.
[184] *Supra* note 178.
[185] *Supra* note 178 at para 5.1.
[186] *Supra* note 178 at para 12.

It is not known why the document is still in draft format and why it has not been formalised and published as a final document. Formalisation of the draft Interpretation Note could have been delayed, since frequent adjustments are made to the Income Tax Act, 58 of 1962, and new considerations could be applicable.

TAX REFORMATION IN LIGHT OF INTERNATIONAL TAX DEVELOPMENTS AND RECOMMENDATIONS BY THE DAVIS TAX COMMITTEE

It is good practice for a tax administration to keep up to date with international developments and best practice. Since MNEs trade across borders, South Africa should not ignore Base Erosion and Profit Shifting (BEPS). The British Broadcasting Corporation's coverage of the case of Barford and Holt (2013) 'Google, Amazon, Starbucks: The rise of tax shaming', indicated that profit shifting and legal tax avoidance is a reality.[187] Revenue authorities are exposed to the risk of tax leakage, which is to the detriment of their economies and citizens.

This led in 2013 to the OECD commencing a research project focussing on BEPS.[188] At the instruction of the Minister of Finance,[189] South Africa—as an observer of the OECD—participated in the BEPS project. The research mandate[190] was to investigate and make recommendations, *inter alia,* on Profit Shifting and tax leakage.

Tax leakage and transfer pricing have a direct link. Research was conducted by the OECD[191] with regard to transfer pricing guidelines for MNEs. After the launch of the BEPS project[192] further research with regard to transfer pricing was conducted and dealt with in action plans 8, 9, 10 and 13.[193] The Davis Tax Committee (DTC) was appointed to 'inquire into the role of South Africa's tax system in the promotion of

[187] Barford, V. and Holt, G. (2013), *Google, Amazon, Starbucks: The rise of tax shaming*, <http://www.bbc.com/news/magazine-20560359>, retrieved 4 November 2016.

[188] Organisation for Economic Co-operation and Development (OECD). (2013a), *Action plan on base erosion and profit shifting.* Paris: OECD.

[189] Davis Tax Committee, (2015) *BEPS introductory report*. p1.

[190] Davis Tax Committee (DTC). (2015), *Addressing base erosion and profit shifting in South Africa, Davis Tax Committee interim report*. Pretoria: The Davis Tax Committee.

[191] *Supra* note 106.

[192] *Supra* note 188.

[193] *Supra* note 188.

inclusive economic growth, employment creation, development and fiscal sustainability'[194] and was required to address concerns about BEPS.

The OECD published[195] its final report on harmful tax practices and stated that:

> there is no suggestion that a unilateral Advance Pricing programme is by itself a preferential [tax] regime.

Thus the OECD recognises there is no suggestion that APAs or advance tax rulings are viewed as a preferential tax regime. It was further recommended that the spontaneous exchange of key information on APAs and advance tax rulings between tax administrations would provide a useful cross check.[196]

In its interim report the Davis Tax Committee[197] commented on APAs in the light of harmful tax practices as discussed above. In summary, it stated that transparency between revenue authorities was especially important in connection with rulings, including Unilateral APAs and certain administrative practices.[198]

Subsequently the Davis Tax Committee has made comments and recommendations[199] on South African legislation. Section 31 of the Income Tax Act, 58 of 1962 regulates how taxpayers should declare and account for international transactions. The same provision empowers SARS to make transfer pricing adjustments, if it is found to disagree with how a taxpayer calculated pricing between connected parties.

As previously observed, SARS Practice Note 7 (1999) gives guidance on how transfer pricing should be approached by taxpayers in South Africa. The Practice

[194] *Supra* note 190*.*

[195] Organisation for Economic Co-operation and Development (OECD). (2015a), *Countering harmful tax practices more effectively, taking into account transparency and substance, Action 5 - 2015 Final report, OECD/G20 base erosion and profit shifting project.* Paris: OECD.

[196] *Ibid* note 195.

[197] Davis Tax Committee, (2015) BEPS Interim Report on Action Plan 5 – Harmful Tax Practices*,* p10.

[198] *Supra* note 197.

[199] Davis Tax Committee, (2015) BEPS Interim Report on Action Plan 8 – Transfer Pricing of Intangibles, p16.

Note is based on the OECD Guidelines in relation to Transfer Pricing (1995).[200] From the Davis Committee commentary[201] on BEPS Action Plan 8, it appears the committee assumed that the OECD Guidelines (2010)[202] are applied, rather than the previous OECD guidelines on transfer pricing.

The Davis Tax Committee made an important general recommendation on transfer pricing in South Africa:

> The legislators should ensure that section 31 of the Income Tax Act refers to the OECD guidelines. This is stated in SARS Practice Note 7, but SARS Practice Notes are not legally binding. At least one legally binding General Ruling, as provided for in section 89 of the Tax Administration Act, 2011, should be enacted on section 31.[203]

As stated in its recommendation,[204] the Davis Committee makes reference to section 89 of the Tax Administration Act, 28 of 2011. When the provision is scrutinised, a Senior SARS official as defined in section 6(3) of the same Act:

> may issue a "binding general ruling" that is effective for …an indefinite period …and the "binding ruling" must state that it is a "binding ruling" under this section[205] and the provisions of a tax Act which are the subject of the "binding ruling".[206]

Section 89(3) then provides the option for SARS to issue the general binding ruling in the format of an Interpretation Note or in another manner the Commissioner prescribes.

The Davis Tax Committee's recommendation is valid since the Practice Note is not binding and the draft Interpretation Note[207] on Section 31 of the Income Tax Act, published on 3 April 2013, is in draft format and does not address the issues of transfer pricing on goods and services between connected persons.

[200] Organisation for Economic Co-operation and Development (OECD) (1995) *Report on transfer pricing guidelines for multinational enterprises and tax administrations*, OECD: Paris.
[201] *Supra* note 199.
[202] *Supra* note 200.
[203] *Supra* note 199.
[204] *Supra* note 199.
[205] Section 89, Tax Administration Act, 28 of 2011.
[206] *Supra* note 205.
[207] *Supra* note 178.

For reasons stated above, it could be said that the South African taxpayer enjoys no certainty on how SARS will treat a transfer pricing in relation to cross border transactions within a group. Due to the wide interpretation of legislation and omission of the fact that the transfer pricing legislation is based on the OECD guidelines (2010),[208] South African taxpayers' and companies' part of a MNE are exposed to the risk of double taxation and, eventually, the lengthy legal process of dispute.

South African taxpayers also have no general binding ruling on how international transactions are viewed from the perspective of SARS. HMRC has clear guidelines[209] as discussed earlier in this research report.

The key problem is the specific exclusion of pricing agreements from the Advance Ruling provisions as set out in Chapter 7 of the South African Tax Administration Act, 28 of 2011. It is stated in section 80 of the Tax Administration Act, that SARS will not even consider an application with regard to the 'the pricing of goods or services supplied by or rendered to a connected person in relation to the applicant'.[210]

The absence of APA legislation and the exclusion of advance rulings on transfer pricing in South Africa may create a disparity in the differential application of transfer pricing methods by SARS and revenue authorities in other tax jurisdictions. The South African DTA with the UK is based mainly on the OECD Model Tax Convention on Income and on Capital (2014).[211]

[208] The general binding ruling could refer to future Transfer Pricing Guidelines which could be published.

[209] *Supra* note 145.

[210] Section 80(1)(*a*)(iii), Tax Administration Act, 28 of 2011.

[211] OECD Model Tax Convention on Income and on Capital (2014), with reservations as previously mentioned.

THE APPLICATION OF THE MUTUAL AGREEMENT PROCEDURE IN CONTEXT OF THE SA/UK DOUBLE TAXATION AGREEMENT

The question is whether a transfer pricing adjustment could be prevented by article 24 of the SA/UK DTA,[212] should double taxation occur.[213] Article 24 is referred to as the Mutual Agreement Procedure (MAP). The MAP would be applicable in the case of a South African taxpayer who is part of a MNE that is also liable for tax in the UK. In this case, the SA/UK DTA[214] would be applied to determine the profit attributable to each entity. HMRC applies the MAP in advance where multilateral agreements are in place and gives guidance on pricing between connected persons, before a taxpayer submits a return.[215]

Due to the fact that South African domestic legislation does not allow for the APA, no remedy exists for the taxpayer until after the annual event of taxation. The MAP would only become applicable after the event of tax and only in the scenario where a dispute exists.

CONCLUSION – DOUBLE TAXATION AS A RESULT OF DISPARITIES IN SA/UK LEGISLATION

The tax treaty between South Africa and the UK[216] makes no provision for mutual agreement on the treatment of a transaction prior to the event of tax. It is important to highlight the fact that in the UK, HMRC allows for self-assessment with regard to income tax. In South Africa, SARS has not yet formalised self-assessment for income tax. Self-assessment is defined as follows:

[212] SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[213] The provisions of the South African double taxation agreement with the UK refer to article 24, the Mutual Agreement Procedure; this is based on article 25 of the OECD Model Tax convention on Income and on Capital (2014).

[214] *Supra* note 212.

[215] At the time that this research was conducted HRMC allowed taxpayers to make a self-assessment for income tax whereas in South Africa this is not yet the case for Income Tax purposes.

[216] *Supra* note 212.

> Self-Assessment – System under which the taxpayer is required to declare the basis of his assessment (e.g. taxable income), to submit a calculation of the tax due and, usually, to accompany his calculation with payment of the amount he regards as due. The role of tax authorities is to check (perhaps in random cases) that the taxpayer has correctly disclosed his income.[217]

It could happen that HMRC gives an APA to a taxpayer in relation to a transaction concluded with a South African company. The UK taxpayer renders a return based on the APA and the South African taxpayer renders a tax return based on the same principles. Since SARS is not bound to accept or agree with the principles of the APA between HMRC and the UK taxpayer, SARS could still make a transfer pricing adjustment. The South African taxpayer could be negatively impacted with double taxation and understatement penalties.[218] It could be said that the South African taxpayer was not afforded the opportunity to seek clarity on the treatment of a pricing transaction and might not have made the perceived understatement had there been an opportunity to seek advance clarity, as in the case of the UK taxpayer.

The next chapter will discuss the SA/UK DTA and will illustrate the disparity in tax treatment of a hypothetical transaction by HMRC and by SARS, causing double taxation and disputes.

[217] *Supra* note 110.
[218] Section 222, Tax Administration Act, 28 of 2011.

CHAPTER 3: THE APPLICATION OF THE DOUBLE TAXATION AGREEMENT BETWEEN SOUTH AFRICA AND THE UNITED KINGDOM WITH AN EMPHASIS ON THE MISMATCH OF LEGISLATION

ANALYSIS OF THE SA/UK DOUBLE TAXATION AGREEMENT WITH AN EMPHASIS ON THE EVENT OF DOUBLE TAXATION.

A Double Taxation Agreement (DTA) is an international contractual agreement between contracting states. South Africa and the United Kingdom (UK) entered into a DTA with the full title: The Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on Income and Capital gains.[219] The main purpose of the SA/UK DTA is to avoid double taxation with regard to taxes withheld at source in South Africa after 1 January 2003. Taxes withheld at source and 'other taxes'[220] relate to income tax, capital gains tax and dividends tax.[221] A protocol between South Africa and the UK was signed and published by the South African Revenue Service (SARS) on 2 February 2012.[222] The protocol made provision for the treatment of dividends tax, since the change in South African domestic legislation was effective from 1 April 2012.[223] The Constitution of the Republic of South Africa, Act No. 108 of 1996, authorizes international agreements, and should the international agreement comply with the provisions set out in Section 231[224] of the Constitution, the international agreement may be approved by Parliament.

[219] South African Government Gazette. (2003), *SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003*.

[220] *Supra* note 219.

[221] SARS. (2012), *Government Notice, South African Revenue Service, no. 52, Income Tax Act, 1962, protocol between the government of the Republic of South Africa and the government of the United Kingdom of Great Britain and Northern Ireland to amend the convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains, signed at London on 4 July 2002',* <http://www.sars.gov.za/AllDocs/LegalDoclib/Agreements/LAPD-IntA-DTA-2012-81%20-%20DTA%20Protocol%20United%20Kingdom%20GG%2034971.pdf>, retrieved 21 December 2016.

[222] *Supra* note 221.

[223] Section 64E, Income Tax Act, 58 of 1962.

[224] Constitution of the Republic of South Africa Act, 108 of 1996.

Section 108 of the Income Tax Act[225] is included in legislation to provide for entering into DTAs, which fundamentally are international agreements.

The legislation is set out as follows:

> 108. Prevention of or relief from, double taxation:
>
> (1) The National Executive may enter into an agreement with the Government of any other country, whereby arrangements are made with such Government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.
>
> (2) As soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the *Gazette* and the arrangements so notified shall thereupon have effect as if enacted in this Act.

From the above legislation it is clear that the SA/UK DTA and South African domestic legislation co-exist. The provisions set out in the DTA will not necessarily override[226] the provisions of the Income Tax Act[227] or *inter alia* the provisions of the Tax Administration Act.[228]

The SA/UK DTA is based on the OECD Model Tax Convention on Income and on Capital (2014).[229] The interpretation and application of the Double Taxation by SARS or Her Majesty's Revenue and Customs (HMRC) may be different. One area of concern could involve interpretation of the allocation of business profits, dealt with in article 7,[230] which states in paragraph 1:

[225] Income Tax Act, 58 of 1962.

[226] De Koker, A.P. and Brincker, E. (ed.), (2010), *Silke on international income tax*. Durban: LexisNexis, para 12.2.

[227] *Supra* note 225.

[228] Tax Administration Act, 28 of 2011.

[229] Organisation for Economic Co-operation and Development (OECD). (2014), *Model Tax Convention on Income and on Capital.* Paris: OECD.

[230] *Supra* note 219.

> The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.[231]

The interpretation of Permanent Establishment (PE) is set out in article 5 of the SA/UK DTA, paragraphs (1) and (2):[232]

It is stated in paragraph one:

> For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.[233]

In paragraph 2 the composition of a PE comprises is further defined:

> The term “permanent establishment” includes especially:
> (a) a place of management;
> (b) a branch;
> (c) an office;
> (d) a factory;
> (e) a workshop;
> (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
> (g) an installation or structure for the exploration for natural resources.[234]

It is therefore quite possible for Multinational Enterprises (MNEs) to have an economic presence in another tax jurisdiction. In the application of the SA/UK DTA as stated in article 9,[235] it is acknowledged that profits and expenses between associated enterprises should be allocated based on the arm’s length principle[236] and as if they are independent enterprises. Article 9[237] governs the allocation of profits and should be interpreted before the tie breaker clause, article 24[238] the Mutual Agreement Procedure (MAP), becomes available to resolve the correct allocation of profit and expenses in the context of double taxation.

[231] Article 7(1), SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[232] Article 5 para 1 and 2, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[233] Article 5 para 1, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[234] Article 5 para 2, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[235] Article 9, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

[236] Organisation for Economic Co-operation and Development (OECD). (2014), *Commentaries on the Articles of the Model Tax Convention with respect to taxes on income and on capital*, <www.oecd.org/tax/treaties/2014-model-tax-convention-articles.pdf>, retrieved on 14 November 2016, p181 para 1.

[237] *Supra* note 235.

[238] Article 24, SA/UK DTA, Government Gazette No. 24335 dated 31 January 2003.

In the UK, taxpayers may use Advanced Pricing Agreements (APAs)[239] to determine the arm's length price of transactions between MNEs prior to entering into transactions or prior to the declaration of profits and expenses. Taxpayers residing in the UK therefore have certainty on how a transaction will be treated by HRMC. In South Africa, advance rulings[240] on pricing goods and services supplied to associated enterprises are not provided for in local tax legislation.

In the event of differing treatment of an international transaction by SARS and HMRC, the taxpayer would have to seek recourse to avoid double taxation. A hypothetical case study was compiled to illustrate possible double taxation and how the SA/UK DTA would be applied.

HYPOTHETICAL CASE STUDY

The hypothetical case study is based on the observation made by the OECD (2013) in the action plan on the prevention of Base Erosion and Profit Shifting (BEPS). [241] The following was identified:

> Multinational Enterprises (MNE) now represent a large proportion of global GDP. Also, intra-firm trade represents a growing proportion of overall trade. Globalisation has resulted in a shift from country-specific operating models to global models based on matrix management organisations and integrated supply chains that centralise several functions at a regional or global level.[242]

One objective of the OECD during the BEPS project, in the context of transfer pricing, was to improve the rules and place more emphasis on value creation in integrated groups. The main issue to be considered in the context of transfer pricing and value creation is 'the use of intangibles, risks, capital and other high-risk transactions to shift profits'.[243]

[239] Sections 218 - 230, Taxation (International and Other Provisions) Act 2010.

[240] Section 80(1)(*a*)(iii), Tax Administration Act, 28 of 2011.

[241] Organisation for Economic Co-operation and Development (OECD). (2013a), *Action plan on Base Erosion and Profit Shifting.* Paris: OECD, p7.

[242] *Supra* note 241.

[243] *Supra* note 241, at p14.

The OECD published a report on the impact of BEPS in low-income countries.[244] The report recognises that BEPS has a greater impact on developing countries where MNEs have affiliates.[245] It is recognised that affiliates of MNEs with a presence in developing countries are most often 'recipients rather than the providers of finance, services and intellectual property'.[246] This could therefore result, *inter alia,* in excessive payments for services, professional fees management fees, interest, royalties and dividends.

It is reported that 'as a share of all revenue, corporate income tax is more important to the poorest developing countries than in the developed countries'.[247]

> [The] revenue loss from BEPS may be particularly important for resource-rich developing countries. …the taxation of natural resources is possibly the single biggest make or break fiscal concern.[248]

The hypothetical case study is further based on this remark made by the OECD[249] and includes cross border transactions between MNEs in a developed country such as the UK and a developing country such as South Africa where natural resources are exported. A similar example was discussed in an article published on transfer pricing.[250]

Figure 1 illustrates the hypothetical group structure of an MNE. The value creation—'the use of intangibles, risks and capital'[251]—should be kept in mind for the purposes of the hypothetical case study.

The possibility exists that some key directors hold directorships in more than one company in the group.

[244] Organisation for Economic Co-operation and Development (OECD). (2014a), *Part 1 of a report to G20 Development working group on the impact of BEPS in low income countries*. Paris OECD.

[245] *Supra* note 241, at p15.

[246] *Supra* note 245.

[247] *Supra* note 244, at p10.

[248] *Supra* note 244, at p11.

[249] *Supra* note 244, at p10.

[250] Tax Justice Network. (n.d.), *Transfer Pricing*, <http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/>, retrieved 6 August 2016.

[251] Organisation for Economic Co-operation and Development (OECD). (2014b), *Part 2 of a report to G20 Development working group on the impact of BEPS in low income countries*, Paris: OECD, p10.

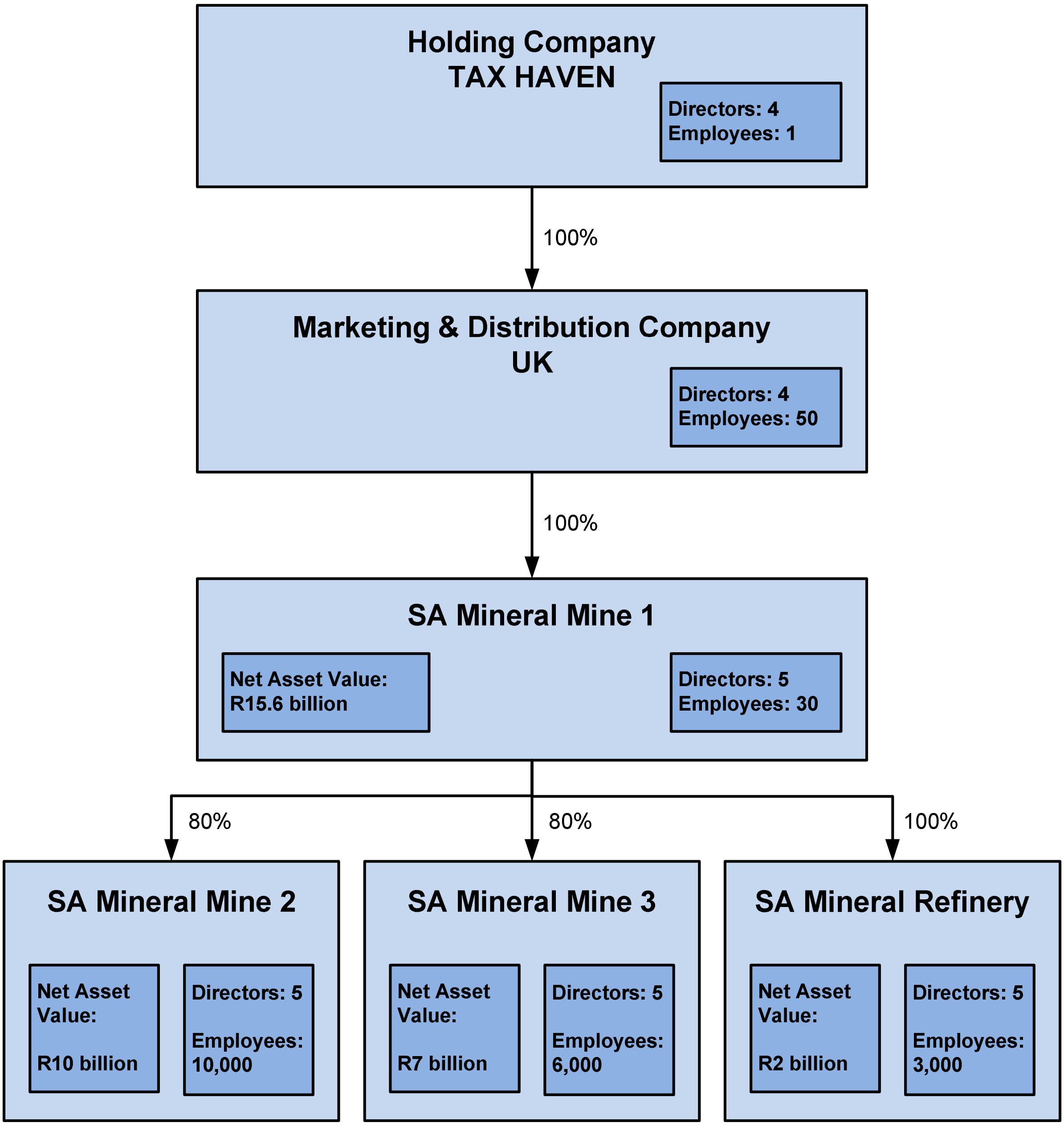
Holding Company
TAX HAVEN
Directors: 4
Employees: 1
100%
Marketing & Distribution Company
UK
Directors: 4
Employees: 50
100%
SA Mineral Mine 1
Net Asset Value:
R15.6 billion
Directors: 5
Employees: 30
80%
80%
100%
SA Mineral Mine 2
Net Asset Value:
R10 billion
Directors: 5
Employees:
10,000
SA Mineral Mine 3
Net Asset Value:
R7 billion
Directors: 5
Employees:
6,000
SA Mineral Refinery
Net Asset Value:
R2 billion
Directors: 5
Employees:
3,000

Figure 1: Schematic of Hypothetical Group Structure.

From the above schematic of the hypothetical group structure of an MNE, consideration should be given to value creation, the use of intangibles, risks and capital. The supply chain is the key to value creation.

Supply Chain

The supply chain is illustrated in Figure 2. The South African Mineral Mine Group is responsible for the mining activities and has a subsidiary with refinery capabilities. The UK Marketing and Distribution Company could import the ore or any of the refined product or bye products. The value-adding and main economic activity takes place in South Africa. The marketing and distribution activities are conducted by the UK Company and then sold to either associated or independent enterprises.

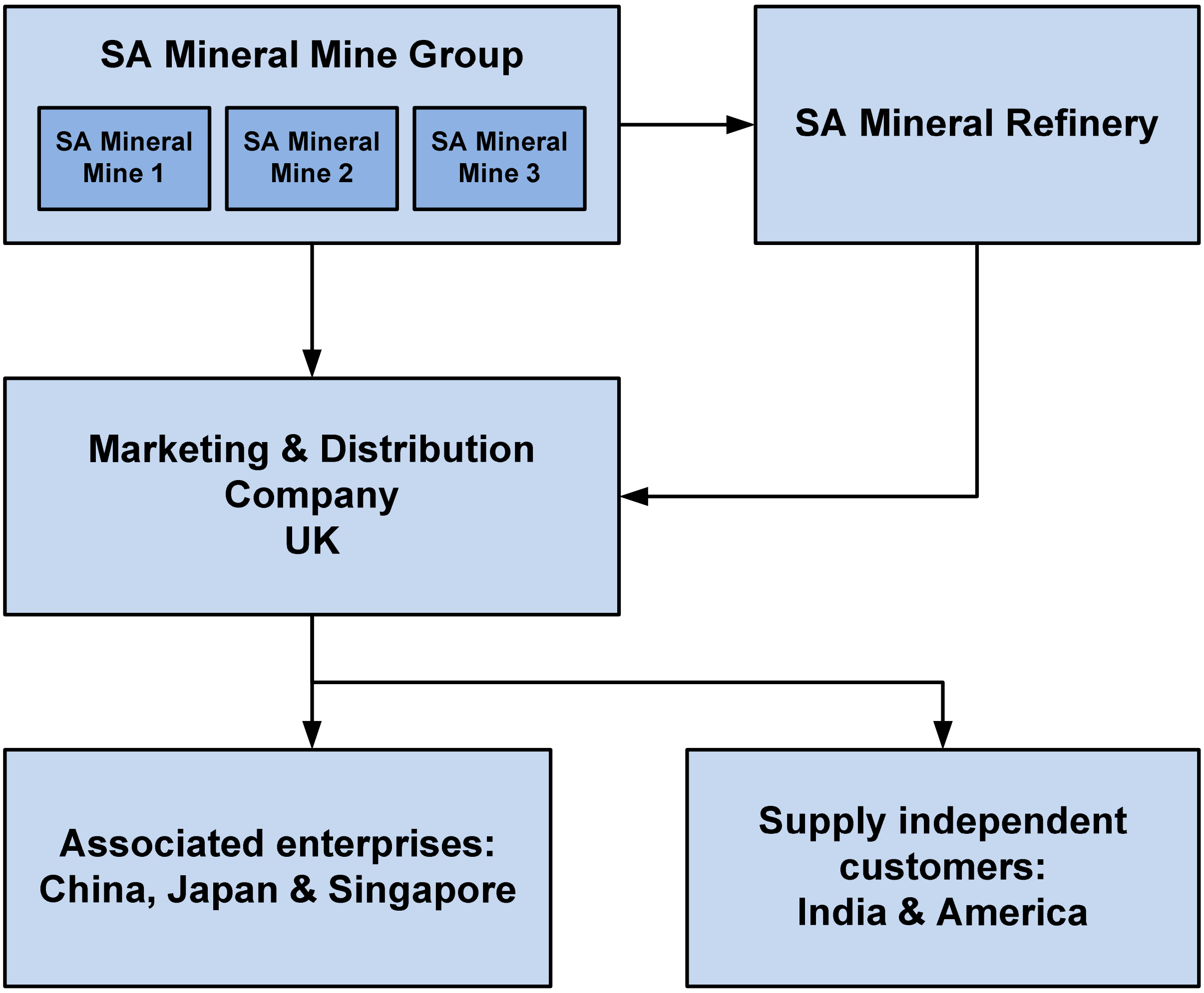
SA Mineral Mine Group
SA Mineral Mine 1
SA Mineral Mine 2
SA Mineral Mine 3
SA Mineral Refinery
Marketing & Distribution Company UK
Associated enterprises: China, Japan & Singapore
Supply independent customers: India & America

Figure 2: Schematic of Hypothetical Supply Chain.

Value Creation

In the hypothetical case study, the physical operations of the mining activities are conducted in South Africa. The ore supply chain, as illustrated in Figure 2 above, indicates that the main economic activities of the MNE take place in South Africa.

The opportunity for the MNE to make use of transfer pricing in order to shift profit is a possibility. The South African-associated enterprises of the MNE could shift the profit to the UK as a tax planning mechanism.

It should be further noted that the UK-based MNE invested heavily in intellectual property and in part of the infrastructure constructed in South Africa. The UK-based MNE should be entitled to receive interest on the capital invested and royalties on the intellectual property used to make the mining operations more efficient.

The use of Intangibles

Comparable data used in the determination of an arm’s length price could be applied differently by developed countries and developing countries. This could be the first intangible identified.

The OECD (2014)[252] identified that MNEs could exploit the fact that comparable data is not easily obtainable within the context of a transfer pricing transaction between associated enterprises.

Further research conducted by the OECD (2015)[253] indicates that challenges exist due to ‘a lack of comparability between the intangible related transactions undertaken between associated enterprises and those transactions that can be identified between independent enterprises’.[254]

[252] *Supra* note 251, at p14.

[253] Organisation for Economic Co-operation and Development (OECD). (2015b), *Aligning transfer pricing outcomes with value creation, Actions 8-10 – 2015 Final Reports, OECD/G20 Base erosion and profit shifting project.* Paris: OECD, p74.

[254] *Supra* note 253.

In the hypothetical case study, the pricing of marketing, distribution, professional services, management fees, interest and royalties could be difficult to compare with transactions between independent enterprises.

The pricing of minerals could be comparable in unique situations where rare minerals are in high demand and mainly produced in a developing country, when MNEs could make use of intangibles.

Risks and Capital

In the hypothetical case study, the risks involved in operations are assumed by the South African group of mineral companies. The risk of borrowing capital from the parent MNE and local sources could place additional pressure on the South African company to produce income to fund its operations and service its debt.

Since the South African group of companies has assumed the risk of employment, it is indicative that the MNE's main business risk and capital was assumed in South Africa.

The South African Group of Companies also assumes the risk of fluctuation in the foreign exchange rate and could be making interest payments based on British Pounds. Fluctuations in the exchange rate and the volatility of the Rand could raise the South African company's expenses.

Transfer Pricing Adjustment

In the event of a transfer pricing audit by SARS, and in the event of a difference in application of the arm's length principle, SARS could raise an additional assessment[255] if it was found that prejudice to the *fiscus* had occurred.

The UK-based MNE could have applied for an APA with HMRC and would have had certainty on how to calculate the arm's length prices. The APA would not have been

[255] Section 92 of the Tax Administration Act, 28 of 2011.

enforceable on the South African group of companies since it would not have been a party to the agreement. The UK-based MNE is therefore exposed to the risk of double taxation as a result of a possible transfer pricing adjustment.

Due to the lack of comparable data in developing economies as against developed economies, the arm's length price of transactions between associated enterprises of the MNE could be calculated differently by the different revenue authorities. In the hypothetical case study above, the transfer pricing transactions between the associated enterprises part of the MNE could be treated differently by SARS and HMRC. For example, it could be said that the sales of the South African group of companies were understated and that excessive management fees, royalties and interest were paid to the UK-based MNE. SARS could increase the tax liability of the South African group of companies. The UK-based MNE would not have treated the transaction in the same way and should be able to reduce the profit declared in the UK by the same amount that the profit of the South African group of companies was increased. This disparity in the treatment of the international transaction between associated enterprises could have been avoided if advance rulings[256] or APAs had been available to the South African taxpayer.

THE EVENT OF TAXATION

Taxpayers in South Africa are obliged to submit an annual tax return. Upon submission of a return, the annual event of tax occurs. The Tax Administration Act, 28 of 2011, defines a 'taxable event'[257] as 'an occurrence which affects or may affect the liability of a person to tax'.[258]

It is interesting to note that ambiguity in the above interpretation exists with the inclusion of the concept that an event may be a future possibility, which would affect the taxpayer's tax liability.

[256] Sections 75 - 90, Tax Administration Act, 28 of 2011.

[257] Section 1, definition 'taxable event'.

[258] *Supra* note 257.

Without giving the definition of ‘taxable event’ a wide interpretation, the first taxable event would occur when a taxpayer submits its return in the first place. The second possible ‘taxable event’ could occur if an audit was conducted and an adjustment made. This would be in the instance where it was found that prejudice to the *fiscus* had occurred.

It should be kept in mind that in the event of double taxation, the provisions set out in the DTA would be applied to seek remedy for the disparity.

THE SITUATION OF DOUBLE TAXATION

Where it is found that prejudice to the *fiscus* occurred, SARS may raise an additional[259] assessment. The taxpayer has the right, within domestic legislation, to dispute[260] the additional assessment and the tax liability, including any penalties that could have been raised. If the taxpayer and SARS cannot reach agreement on the treatment, in the context of a transfer pricing adjustment, and application of the arm’s length principle, double taxation could become a reality.

Double taxation could have occurred since the MNE might have already submitted a declaration in the UK, as illustrated in the hypothetical case study, and might have calculated the allocation of profits and expenses on the arm’s length principle as interpreted and applied by the MNE. The taxpayer would have to seek recourse to correct the disparity.

[259] Section 92, Tax Administration Act, 28 of 2011.

[260] Chapter 9, Tax Administration Act, 28 of 2011.

REMEDIES TO CORRECT THE DISPARITY

A South African resident would be able to lodge a notice of objection.[261] The dispute could be a lengthy and a costly process. If SARS disallows the grounds of the objection, the taxpayer has recourse and could lodge an appeal.[262] It is confirmed that there have been no transfer pricing court cases in South Africa,[263] which leads to the question: What remedies are available to correct the disparity of double taxation?

The disparity of double taxation could be addressed through the DTA if the South African taxpayer applies to the competent authority of the contracting state. The event of double taxation is two-fold. Firstly, as illustrated in the hypothetical case study, in South Africa the taxpayer's tax liability would have increased due to the possible increase in income and the decrease in expenses. Secondly, the related adjustment would not have been made by the UK resident in its declaration to HMRC.

The disparity and the occurrence of double taxation are direct results of the differences in the domestic law of both South Africa and the UK, as illustrated in the hypothetical case study. The main difference applicable to the hypothetical case study is the application of the arm's length principle and the fact that domestic legislation in South Africa lacks APAs.

It could also be noted that in the APA process, HMRC has the advantage of being able to agree on a transfer pricing method, or arm's length price, in advance. It could be said that the transfer pricing examination occurs in real time in the UK, for taxpayers who have applied for an APA. In the UK, transfer pricing examinations are conducted both in advance and subsequent to the submission of a return. In South Africa, SARS may conduct a transfer pricing audit on a taxpayer for previous tax years. The difference in auditing a transfer pricing transaction in advance could be both an advantage and a disadvantage for the UK taxpayer.

[261] Section 104, Tax Administration Act, 28 of 2011.

[262] Section 107, Tax Administration Act, 28 of 2011.

[263] Honiball, M. (2016), e-mail, 19 December 2016.

The UK taxpayer is subject to domestic law in the UK and time limits for tax assessments[264] might be applicable. UK taxpayers have four years to make a correction to a return.[265] If a transfer pricing adjustment was made in South Africa and the UK taxpayer had to make a downward adjustment in its tax return in the UK after the expiration period, there would be little or no remedy for correcting the disparity within the domestic legislation of the UK. In this case, double taxation in relation to the same transfer pricing transaction between associated enterprises of an MNE would occur.

The same disparity could occur if HMRC makes a transfer pricing adjustment that could possibly affect a South African taxpayer. The expiration period for assessments in South Africa is three years.[266] Domestic legislation in South Africa extends the expiration period by an extra three years[267] where an assessment has been issued by SARS in relation to a transfer pricing adjustment.[268] Double taxation could apply to the South African taxpayer in the same manner as indicated previously.

The following chapter deals with the dispute process after a transfer pricing adjustment has been made and where remedies are sought to correct the disparity. It also deals with the consequences of double taxation.

[264] Author unknown. (updated August 2016) *Time limits for tax assessments, claims and refunds,* <http://www.rossmartin.co.uk/tax-guides/347-time-limits-for-assessment-and-claims>, retrieved 22 December 2016.

[265] *Supra* note 264.

[266] Section 99(1)(*a*), Tax Administration Act, 28 of 2011.

[267] Section 99(4)(iv)

[268] *Supra* note 267.

CHAPTER 4: THE DISPUTE PROCESS AFTER A TRANSFER PRICING ADJUSTMENT

THE DISPUTE PROCESS AFTER A TRANSFER PRICING ADJUSTMENT

Revenue authorities could conduct an audit on examination of a return submitted by a taxpayer. The South African Revenue Service (SARS) audit process is described by Olivier and Honiball[269] who state that 'SARS issues the revised tax assessments, together with a letter explaining the reasons for the assessment'.[270] As illustrated in Chapter 3, the example in the hypothetical case study could have led to double taxation of a transfer pricing transaction or a portion thereof. This chapter discusses the remedies a taxpayer should follow.

In the Tax Administration Act, 28 of 2011, the provisions dealing with dispute resolution are set out in Chapter 9.[271] It is important to note that certain 'rules' exist within the dispute resolution process. In section 103(2)[272] it is stated that:

> [t]he "rules" may provide for alternative dispute resolution procedures under which SARS and the person aggrieved by an assessment or "decision" may resolve a dispute.

The 'rules' as set out in Public Notice No. 550 were published in the Government Gazette No. 37819 dated 11 July 2014. The South African Revenue Service issued these 'rules' as provided for in section 103.[273]

Figure 3 below is a schematic illustration of the process that could be followed by SARS and taxpayers. The schematic illustrates the process from the time of assessment by SARS until the case goes to appeal. The process as illustrated in

[269] Olivier, L. and Honiball, M. (2011), *International tax: A South African perspective*, 5th edn. Cape Town: Siber Ink, p503.

[270] *Supra* note 269.

[271] Tax Administration Act, 28 of 2011.

[272] *Supra* note 271.

[273] South African Government Gazette. (2014), *South African Revenue Service, Government Notice No. 550, Government Gazette No. 37819 dated 11 July 2014.* Pretoria: Government Printing Works.

Figure 3 should be interpreted together with the ‘rules’ published in the Government Gazette No. 37819, dated 11 July 2014.

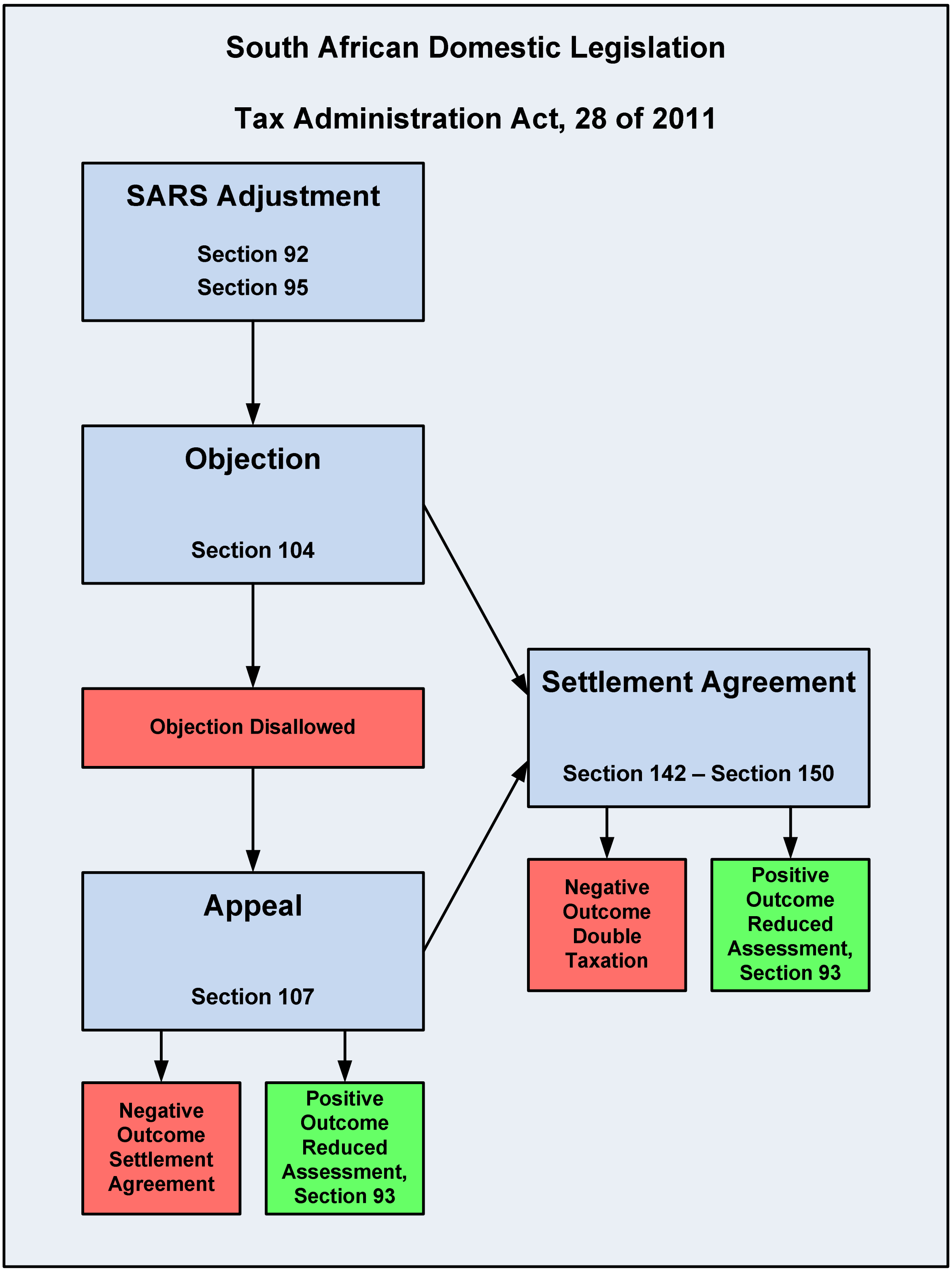
South African Domestic Legislation
Tax Administration Act, 28 of 2011
SARS Adjustment
Section 92
Section 95
Objection
Section 104
Objection Disallowed
Appeal
Section 107
Negative Outcome Settlement Agreement
Positive Outcome Reduced Assessment, Section 93
Settlement Agreement
Section 142 – Section 150
Negative Outcome Double Taxation
Positive Outcome Reduced Assessment, Section 93

Figure 3: Schematic of the dispute resolution process.

The remedies to correct the disparity of double taxation as discussed in this chapter are the most likely ones to follow in the case of a transfer pricing adjustment and do not include other provisions in the Tax Administration Act, 28 of 2011, which could also be utilised to seek correction of an assessment

In rule 7 of the public notice[274] it is required that any objection against an assessment[275] must be delivered in the required format and within 30 business days of the assessment. Where a taxpayer exercises the right to request reasons for the assessment, the taxpayer should submit the objection within 30 business days after SARS has furnished reasons for the assessment. It is also stated that a taxpayer should 'specify the grounds of the objection in detail'. [276]

Taxpayers should be aware that the 'rules'[277] and the application of the provisions as set out in Chapter 9: Dispute Resolution[278] are applied in conjunction and should the 'rules' not be adhered to, an objection may be deemed invalid or may be disallowed by SARS.

Emphasis must be placed on the fact that the grounds of an objection need to be detailed and specific in respect of the assessment that had been issued. Lack of sufficient grounds could lead to an objection being disallowed by SARS. If an objection is disallowed, the taxpayer could lodge an appeal against an assessment.

Section 107 of the Tax Administration Act, is the governing provision that deals with an appeal against an assessment. Rule 10[279] states that the appeal must be lodged within 30 business days of the date on which the notice of disallowance of the appeal was delivered. It is further stated that the appeal must be in the prescribed format; in rule 10(*c*) it is stated:

[274] South African Government Gazette. (2014), *South African Revenue Service, Government Notice No. 550, Government Gazette No. 37819 dated 11 July 2014.* Pretoria: Government Printing Works.

[275] Section 104, Tax Administration Act, 28 of 2011.

[276] *Supra* note 274.

[277] *Supra* note 274.

[278] Sections 104 – 115, Tax Administration Act, 28 of 2011.

[279] *Supra* note 274.

(c) specify in detail-

(i) In respect of which grounds of the objection referred to in rule 7 the taxpayer is appealing;

(ii) the grounds for disputing the basis of the decision to disallow the objection referred to in section 106(5); and

(iii) any new ground on which the taxpayer is appealing;

In terms of section 107(2) a senior SARS official may in two instances extend the period within which an appeal must be lodged. The first instance is that where reasonable grounds exist, the time period may be extended by 21 business days. The second instance is where ‘exceptional circumstances exist that justify an extension beyond 21 business days’.[280]

The appeal against an assessment is dealt with by the tax board[281] and the decision by the tax board must be delivered to the taxpayer within 60 days of the hearing.[282] If the taxpayer or SARS are not satisfied with the outcome of the appeal, it may be referred to a tax court.[283]

Since no transfer pricing cases have been reported in South Africa,[284] the dispute process with regard to litigation is not discussed. If a taxpayer is still not satisfied with the outcome of a dispute or an appeal as set out in sections 104 and 107[285] the taxpayer could approach SARS and request a settlement.[286] The procedure for a settlement is set out in the provisions of section 147.[287] A settlement would only be considered in the following circumstances as stated in section 146:[288]

[280] Section 107(2)(*b*), Tax Administration Act, 28 of 2011.

[281] Sections 108 - 115, Tax Administration Act, 28 of 2011.

[282] Section 114(2), Tax Administration Act, 28 of 2011.

[283] Section 115, Tax Administration Act, 28 of 2011.

[284] Honiball, M. (2016), e-mail, 19 December 2016.

[285] *Supra* note 271.

[286] Sections 142 - 150, Tax Administration Act, 28 of 2011.

[287] Tax Administration Act, 28 of 2011.

[288] *Supra* note 287.

> The Commissioner may, if it is to the best advantage of the state, "settle" a "dispute", in whole or in part, on a basis that is fair and equitable to both the person concerned and to SARS, having regard to—
> (a) whether the "settlement" would be in the interest of good management of the tax system, overall fairness, and the best use of SARS' resources;
> (b) SARS' cost of litigation in comparison to the possible benefits with reference to the prospects of success in court;
> (c) whether there are any—
> (i) complex factual issues in contention; or
> (ii) evidentiary difficulties,
> which are sufficient to make the case problematic in outcome or
> unsuitable for resolution through the alternative "dispute" resolution procedures or the courts;[289]

The above description of circumstances in which it is appropriate to settle could be applied to cases where a dispute exists in relation to a transfer pricing adjustment. A typical transfer pricing dispute satisfies most of the circumstanced laid out in section 146 of the Tax Administration Act, where a settlement is appropriate. In such cases it could be more cost-effective to resolve the dispute through a settlement, especially in cases where the facts and issues are complex. If 'evidentiary difficulties'[290] exist within transfer pricing disputes, reaching an outcome could be problematic.

The taxpayer and SARS may come to a settlement agreement that is final if the taxpayer meets all the obligations set out in the terms of the settlement agreement. Section 148 of the Tax Administration Act, states that the agreement would be void if the taxpayer had made any false declarations during the agreement process and of the taxpayer fails to make payment of the amount agreed upon.

It needs to be highlighted that should SARS agree to settle with a taxpayer, SARS is obliged to maintain a register of settlements and processes followed. This should be reported to Auditor General of South Africa and to the Minister of Finance. It should further be emphasised that a settlement agreement's main objective is to seek the fair treatment of a taxpayer in cases where no fair outcome could be reached through the normal dispute process.

[289] Section 146, Tax Administration Act, 28 of 2011.
[290] *Supra* note 289.

In transfer pricing cases, taxpayers could also apply for the relief of double taxation through the Mutual Agreement Procedure (MAP).[291]

THE MUTUAL AGREEMENT PROCEDURE AFTER A TRANSFER PRICING ADJUSTMENT

The MAP is a mechanism available to taxpayers in the event of double taxation or when it is foreseen that double taxation could occur in future. The MAP is set out in article 25 of the OECD Model Tax Convention on Income and on Capital (2014). The definition and aim of Model Tax Conventions are, *inter alia,* to prevent double taxation.

It should be kept in mind that article 24[292] should be read and applied in the context of the objective of the Convention[293] and regard should be given to the OECD commentary in relation to the Convention.

The MAP is defined by the OECD as follows:

> Mutual Agreement Procedure (MAP) – A means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorized by article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.[294]

The MAP could be applied when 'cross border tax disputes'[295] arise. It is also further indicated that the MAP 'will include issues of transfer pricing'[296] in the event of double taxation on a cross border transaction within a MNE. A taxpayer who is not in agreement with the tax treatment of a transaction, resulting in double taxation, should follow domestic dispute resolution procedures and could apply for a MAP as a mechanism to correct the disparity.

[291] Article 24, OECD Model Tax Convention on Income and on Capital (2014).
[292] OECD Model Tax Convention on Income and on Capital (2014).
[293] *Supra* note 291.
[294] *Supra* note 291.
[295] De Koker, A.P. and Brincker, E. (ed.), (2010), *Silke on International Income Tax*. Durban: LexisNexis, para 38.1.
[296] *Supra* note 295, at para 38.1.1.

The first question that arises is: When should a taxpayer apply for a MAP? The second question would be: Is the MAP the only mechanism available as remedy to seek recourse for the disparity in the event of double taxation? Lastly, should a taxpayer be able to follow the dispute resolution process and follow the MAP at the same time?

Figure 4 is a schematic illustration of possibly the most cost-effective manner for a taxpayer to make use of the MAP as a mechanism to resolve a tax treatment disparity. This is an illustration of how the dispute resolution process could be incorporated with the MAP.

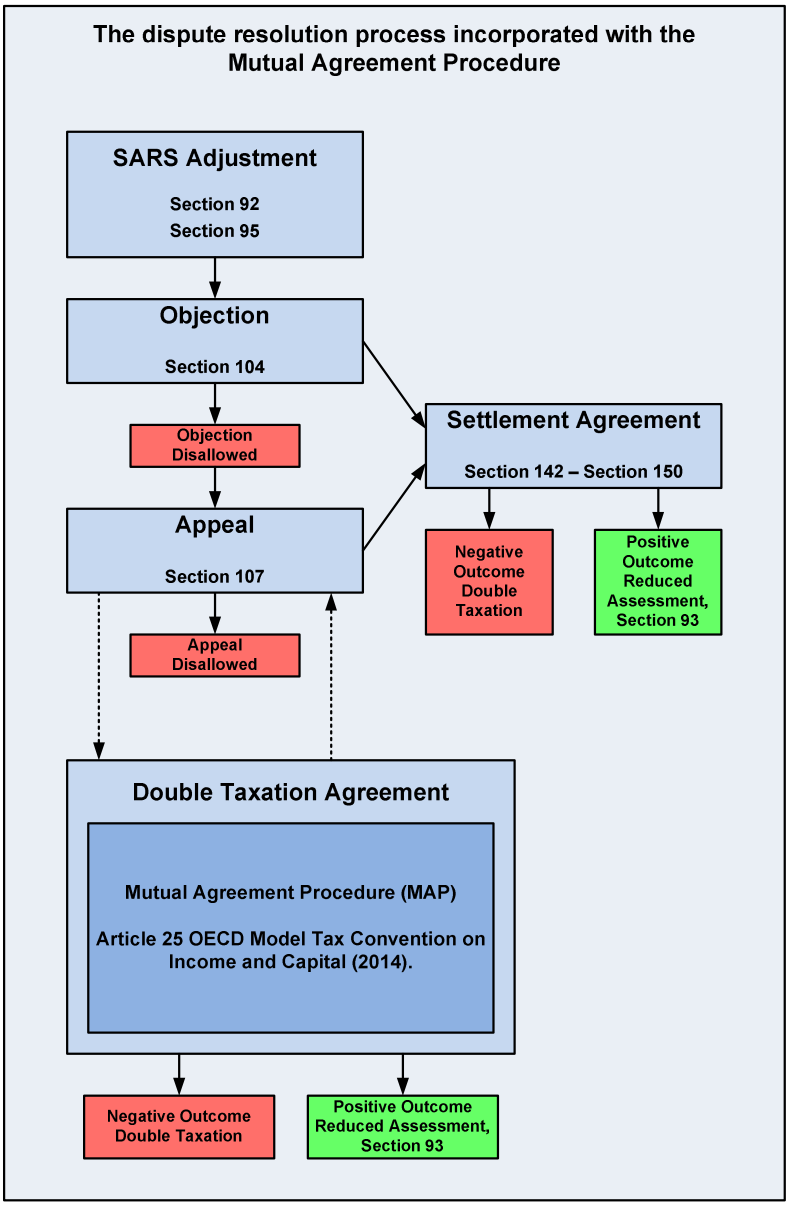
The dispute resolution process incorporated with the Mutual Agreement Procedure
SARS Adjustment
Section 92
Section 95
Objection
Section 104
Objection Disallowed
Appeal
Section 107
Appeal Disallowed
Settlement Agreement
Section 142 – Section 150
Negative Outcome Double Taxation
Positive Outcome Reduced Assessment, Section 93
Double Taxation Agreement
Mutual Agreement Procedure (MAP)
Article 25 OECD Model Tax Convention on Income and Capital (2014).
Negative Outcome Double Taxation
Positive Outcome Reduced Assessment, Section 93

Figure 4: Schematic of the dispute resolution process incorporated with the Mutual Agreement Procedure.

Olivier and Honiball recognise that:[297]

> the most common cases for which the Mutual Agreement Procedure is used are …the attribution of profits and expenditure to a Permanent Establishment, …adjustments between associated enterprises, …the treatment of interest as dividend expenditure under thin capitalisation rules.[298]

Olivier and Honiball[299] also state that 'it is specifically provided that the Mutual Agreement Procedure exists irrespective of any domestic remedies' and then refer to article 25(1) of the OECD Model Tax Convention on Income and on Capital (2010). It is also stated that: [300]

> the result is that a taxpayer who makes use of the Mutual Agreement Procedure may still want or need to object and appeal against an assessment in terms of domestic law.'[301] It is further stated[302] that 'the use of the Mutual Agreement Procedure is not subject to domestic remedies first being exhausted.[303]

This is indicative that the MAP and the domestic dispute resolution process could be applied independently of one another. It is important to highlight that from a South African perspective, a taxpayer's Mutual Agreement application could be viewed more seriously if a valid dispute within domestic legislation existed. Should a taxpayer wish to apply for a MAP, in seeking the correction of a disparity of a tax treatment, protocol could be followed as indicated by the OECD.[304]

The OECD has published[305] the profiles of the MAP for participating countries. It should be noted that once a taxpayer has applied for the MAP, the matter is not between the taxpayer and the revenue authority. It becomes a negotiation between the contracting states.

[297] Olivier, L. and Honiball, M. (2011), *International Tax: A South African Perspective*, 5th edn. Cape Town: Siber Ink, p474.

[298] *Ibid* note 297.

[299] *Supra* note 297, at p473.

[300] *Supra* note 297, at p473.

[301] *Supra* note 297, at p473.

[302] *Supra* note 297, at p473.

[303] *Supra* note 297, at p473.

[304] Article 24, OECD Model Tax Convention on Income and on Capital (2010).

[305] Organisation for Economic Co-operation and Development (OECD). (n.d.c), *MAP Profiles,* <http://www.oecd.org/ctp/dispute/country-map-profiles.htm>, retrieved 17 December 2016.

It is recognised that 'it is important to note that article 25(2) obliges the two states to negotiate, but the two states are merely obliged to use their best endeavours to reach mutual agreement and are not obliged to reach a specific agreement'.[306]

The contracting states may give a mandate to the competent authorities of both contracting states in relation to a Double Taxation Agreement (DTA), and these authorities could then reach some form of agreement.

It is stated in the Manual on Effective Mutual Agreement Procedures (MEMAP)[307] that should the competent authorities reach an agreement, the contracting states should exchange letters 'and where required the taxpayer has accepted the resolution, a competent authority should give, or arrange to give, it effect in its jurisdiction'.[308]

The comment made by Olivier and Honiball[309] should be taken seriously upon deciding if it is appropriate for an associate of an MNE to apply for the MAP within a DTA. It is stated that 'taxpayers are not directly involved …the outcome of the arbitration is not binding on the taxpayer, only on the competent authorities'.[310] The outcome and reasons for reaching an agreement, reaching a partial agreement or not reaching an agreement at all, might not be disclosed to the taxpayer due to secrecy provisions within domestic legislation.

It is important to note that a taxpayer should first follow the dispute process applicable in the tax jurisdiction where the double taxation has occurred. It needs to be emphasised that a South African taxpayer should first declare a dispute before applying for the MAP. In South Africa the dispute resolution process is transparent and SARS is obliged to communicate reasons for not allowing a dispute.

[306] *Supra* note 295, at para 38.1.4.

[307] Organisation for Economic Co-operation and Development (OECD) (2007), *Manual on Effective Mutual Agreement Procedures (MEMAP)*. Paris: OECD.

[308] *Supra* note 307, at para 3.8.

[309] *Supra* note 297, at p477.

[310] *Supra* note 307.

The MAP is available as remedy for the disparity and could be used in conjunction with the dispute process as applied in domestic law. It would be the taxpayer's decision, based on the affordability of professional advice and the value of the double taxation in question. It should be kept in mind that the MAP and remedies within domestic legislation could be applied at the same time. This could lead to a 'duplication of effort'. [311] This should not be the main reason why both remedies could not be pursued at the same time. It would be the taxpayer's choice to follow either the MAP, domestic remedies for the disparity, or the MAP in conjunction with domestic legislation.

The MEMAP[312] gives clarity on the 'interaction between MAP and domestic recourse provisions'.[313] It is stated that should the MAP not be successful, the taxpayer could still choose 'domestic recourse'.[314]

The Convention[315] indicates that a taxpayer should submit the application within three years after first receiving the notification of the action resulting in taxation not in accordance with the provisions of the Convention.[316] The MEMAP[317] indicates that the ideal time frame for a MAP to reach finalisation should be within two years.

The time and effort taken to solve the disparity of double taxation could be lengthy and costly for both a taxpayer and a revenue authority. This is the main reason a taxpayer's request for a settlement agreement[318] could be entertained by SARS.

Should advance rulings or advance pricing legislation be available to taxpayers in relation to South African transfer pricing transactions, the need to follow the dispute resolution process would be avoided or dramatically reduced.

[311] De Koker, A.P. and Brincker, E. (eds.), (2010), *Silke on International Income Tax*. Durban: LexisNexis, para 38.1.5.

[312] Organisation for Economic Co-operation and Development (OECD). (2007), *Manual on Effective Mutual Agreement Procedures (MEMAP).* Paris: OECD at para 4.1.

[313] *Supra* note 312.

[314] *Supra* note 312.

[315] OECD Model Tax Convention on Income and on Capital (2014).

[316] Article 25(1), OECD Model Tax Convention on Income and on Capital (2014).

[317] Organisation for Economic Co-operation and Development (OECD). (1999), *Guidelines for conducting Advance Pricing Arrangements under the Mutual Agreement Procedure ('MAP APAs')* Annex (1999). Paris: OECD.

[318] Section 142 - Section 150, Tax Administration Act, 28 of 2011.

DECREASE IN TAX YIELD

It could be possible that as a result of the dispute resolution process and the settlement of a transfer pricing transaction, South Africa would receive less tax in relation to a transfer pricing transaction than if a bilateral Advance Pricing Agreement (APA) was entered into.

If advance rulings on transfer pricing transactions were available to taxpayers in South Africa, both the taxpayer and SARS would have certainty on the pricing of a cross border transaction and this could lead to an increase in tax yield.

If a bilateral APA was entered into, it would have fairly allocated the profits of associated enterprises in advance, rather than resulting in a situation where double taxation occurred.

In order to correct the disparity of double taxation, SARS and the taxpayer could enter into a settlement agreement. This would ensure the taxpayer was treated fairly. It could however mean that the South African tax authority is at a loss due to the lack of APAs in South Africa and the mismatch in legislation of another jurisdiction.

The OECD (2012)[319] states it is important to note:

> that Advance Pricing Agreements are not used to provide preferential or advantageous treatment to individual taxpayers as part of a "tax incentive" strategy. Not only would such an approach undermine tax yield, …it would lead to uncertainty …[320]

It is further stated that APAs could be implemented and be in accordance with 'internationally accepted standards on transfer pricing'.[321] It would be ideal if one revenue authority did not collect more revenue at the expense of another revenue authority due to the disparity of legislation of either jurisdiction.

[319] Organisation for Economic Co-operation and Development (OECD). (2012), *Advance Pricing Arrangements, Approaches to legislation*, <http://www.oecd.org/ctp/tax-global/4.%20Advance_Transfer_Pricing_Arrangements.pdf>, retrieved 6 July 2016.

[320] *Supra* note 319.

[321] *Supra* note 319.

The application of domestic legislation and preferential tax regimes could attract Foreign Direct Investment (FDI). This may be due to the likelihood that a MNE would be exposed to a less burdensome tax obligation and that the MNE would have more certainty on the tax treatment of cross border transactions.

With globalisation and the integration of economies it has become easier for a MNE to change the place of effective management and therefore disinvest from a country where there is little certainty on the tax treatment of global transactions.

DISINVESTMENT BY MULTINATIONAL ENTERPRISES

The economic climate in South Africa has been reported as 'slow and deteriorating'.[322] It was indicated in the Economic Overview conducted by the South African National Treasury that:

> the global economic growth outlook has weakened in recent months, led by a sharp slowdown in developing countries. The outlook for the South African economy has also deteriorated as a result of lower commodity prices, higher borrowing costs and diminished confidence. Currency weakness is putting upward pressure on inflation and the agriculture sector is suffering the effects of a severe drought. GDP growth is expected to improve gradually over the medium term, reaching 2.4 per cent in 2018.[323]

Disinvestment from one country to another may be linked to the economic climate and the volatility of the currency. Disinvestment by MNEs would be detrimental for the National Treasury, as the likelihood of revenue collection would decrease.

It was reported by Hogg (2016) in an article published by Fin24 that the 'falling Rand means Barclays to lose £400m on decade-long Absa investment'.[324] It was also reported that:

[322] Statistics South Africa. (2016), *Community Survey 2016*, <http://cs2016.statssa.gov.za/wp-content/uploads/2016/07/NT-30-06-2016-RELEASE-for-CS-2016-_Statistical-releas_1-July-2016.pdf>, retrieved 24 December 2016.

[323] *Supra* note 322.

[324] Hogg, A. (2016), *Falling Rand means Barclays to lose £400m on decade-long Absa investment*, <http://www.fin24.com/BizNews/falling-rand-means-barclays-to-lose-400m-on-decade-long-absa-investment-20160227>, retrieved 24 December 2016.

> according to the Financial Times of London, the new Barclays management team has gone through the motions over the past three months and is set to confirm the biggest disinvestment in South Africa since the spate that hit the country during the mid 1980s. Sceptics are concerned that the Barclays sale will spark a similar exodus.[325]

From observation of the movement of capital by South African companies or their investors, it is clearly visible that disinvestment from South Africa is occurring. The lack of substantial economic growth, lack of employment opportunities and the occurrence of emigration have become pressing issues. Emigration of skilled people is a loss to the domestic tax base. These emigrants will be taxed in the jurisdiction of their new residence.

Statistics South Africa conducted a Community Survey (2016) *inter alia* on emigration. Statistics South Africa in its Community Survey (2016)[326] reported data indicated that most emigrants who left the country between 2006 and 2016:

> were aged between 25 and 29 years old and left South Africa between 2011 and 2015, with the highest proportion leaving in 2015. Gauteng reported the highest proportion of emigrants. The highest proportion of emigrants moved to Mozambique, Zimbabwe and Australia. Individuals emigrated for a wide variety of reasons which included employment, study and business.[327]

Disinvestment has a direct link with the economic climate of a country. FDI in a country could be promoted if a country had a favourable tax regime together with business opportunities.

[325] *Supra* note 324.
[326] *Supra* note 322.
[327] *Supra* note 322.

Fair fiscal policies ensure that revenue authorities have the sovereign right to apply domestic legislation and to collect revenue. It is paramount for all countries to collect revenue in order to sustain development. The OECD (2016) recognised that:

> effective tax systems are a critical building block for increased domestic resource mobilisation which is essential for sustainable development, promoting self-reliance, good governance, growth and stability, with particular relevance to developing countries.[328]

For a country's tax system to be fair, taxpayer's rights and obligations play an important role. Taxpayer certainty is one of the aspects MNEs would consider, should they consider to invest and conduct cross border transactions.

[328] Organisation for Economic Co-operation and Development (OECD). (2016a), *Tax administrations and capacity building: A collective challenge.* Paris: OECD, p5.

CHAPTER 5: FACTORS TO BE CONSIDERED IN RELATION TO ADVANCE PRICING AGREEMENTS

TAXPAYER CERTAINTY

It was reported by the OECD, in 'Taxpayers' rights and obligations',[329] that most countries' tax systems include the following basic rights: the right to be informed, assisted and heard; the right of appeal; the right to pay no more than the correct amount of tax; the right to certainty; the right to privacy; the right to confidentiality and secrecy.[330]

It is acknowledged in the publication dealing with taxpayers' rights and obligations:

> that a survey was conducted in 1990 and these rights were identified as most important to taxpayers. It is stated that "Taxpayers also have a right to a high degree of certainty as to the tax consequences of their actions". Of course, certainty is not always possible. For example, taxpayers may not always know in advance the effect of rules that are dependent on the facts and circumstances in a particular case. Also, tax authorities may not be obligated to provide the taxpayer with certainty in relation to the application of anti-abuse provisions aimed at taxpayers seeking to circumvent the intent of the legislation. However, it is clearly a goal that taxpayers should be able to anticipate the consequences of their ordinary personal and business affairs. Achieving this goal is often difficult because modern tax systems are complex and evolving.[331]

In South Africa a taxpayer has the right to request an advance ruling.[332] One exception to advance rulings is that the South African Revenue Service (SARS) would not accept the application of an advance ruling if the request is made in relation to the pricing of goods and services[333] between associated enterprises that form part of a MNE, as mentioned previously.

It may not always be possible to provide taxpayers with certainty regarding all tax treatments by a revenue authority as in certain cases the facts and circumstances

[329] Organisation for Economic Co-operation and Development (OECD). (2003), *Taxpayers' Rights and Obligations*, <https://www.oecd.org/tax/administration/Taxpayers'_Rights_and_Obligations-Practice_Note.pdf>, retrieved 24 December 2016.

[330] *Supra* note 329.

[331] *Supra* note 329, at para 10.

[332] Chapter 7, Tax Administration Act, 28 of 2011.

[333] Section 80(1)(*a*)(iii), Tax Administration Act, 28 of 2011.

could be unique. The need for taxpayers to have certainty on the treatment of transfer pricing transactions between associated enterprises could lead to a likely increase in tax yield.

LIKELY INCREASE IN TAX YIELD

The question remains whether a revenue authority would achieve an increase in tax yield if it had an Advance Pricing Agreement programme? Two of the 'taxpayer rights' identified by the OECD[334] are firstly: to have a 'right of appeal'; and secondly 'the right to pay no more than the correct amount of tax'.[335]

It would not be good practice to implement an Advance Pricing Agreement (APA) programme if the main reason was to increase the tax yield of a revenue authority. It is also stated by the OECD (2012)[336] 'that Advance Pricing Agreements are not used to provide preferential or advantageous treatment to individual taxpayers as part of a "tax incentive" strategy. Not only would such an approach undermine tax yield…' but it could also bring the revenue authorities' reputation into disrepute.

If an APA programme is brought into South African legislation, it should be based on the taxpayer's right 'to pay no more than the correct amount of tax' and 'the right to certainty'.[337] Taxpayer certainty could lead to a more stable investment climate. This may lead to MNEs trading within the South African jurisdiction and could, *inter alia,* lead to an indirect increase in tax yield.

[334] *Supra* note 329, at paras 8 to 9.

[335] *Supra* note 329, at paras 8 to 9.

[336] Organisation for Economic Co-operation and Development (OECD). (2012), *Advance Pricing Arrangements, Approaches to legislation*, <http://www.oecd.org/ctp/tax-global/4.%20Advance_Transfer_Pricing_Arrangements.pdf>, retrieved 6 July 2016.

[337] *Supra* note 329.

AVAILABILITY OF RESOURCES AND SKILLS

The availability of resources and skills within a revenue authority would be one of the first aspects to take into account, should it consider introducing an APA programme. The OECD (2012)[338] recognises that the same resources and skills are used in the auditing function of a revenue authority as would be used in an Advance Pricing Arrangement programme. It is stated that:

> It is likely that an APA can be carried out more efficiently than an audit into the same transaction(s). An APA will normally use contemporaneous data, and the taxpayer will have an incentive to co-operate and provide all relevant data and information. As mentioned above, it is arguable that only compliant taxpayers will apply for an APA, and there is thus a danger that scarce and valuable resource is tied up with compliant taxpayers, at the expense of time spent on auditing high risk cases.[339]

It could be said that a revenue authority would need to weigh up the advantages and disadvantages of dividing the available resources and skills between an Advance Pricing programme and its current transfer pricing audit department. It would need to establish if enough resources are available to maintain a good balance in allocating them between the transfer pricing auditing function and the APA programme. If the transfer pricing auditing function does not have the capacity to conduct an Advance Pricing Arrangement programme, it would not be advantageous for the revenue authority to implement such a programme.

CAPACITY TO CONDUCT AN ADVANCE PRICING PROGRAMME

If capacity does not exist within a revenue authority to conduct an Advance Pricing Arrangement programme (APA), it would not be feasible to implement such a programme on a large scale. It could also be said that revenue authorities would be able to collect valuable data that could be applied in future transfer pricing audits.

[338] *Supra* note 336.
[339] *Supra* note 336.

The OECD (2012)[340] made an important observation:

> It is sometimes argued that less experienced tax administrations may lack the knowledge and skills to negotiate fair APAs, especially when faced with large, well-advised multinational enterprises. Similarly, in the case of bilateral and multilateral APAs, there is a perceived risk that less experienced countries may be disadvantaged in negotiations by more experienced countries. [341]

International advisory firms may have better-skilled transfer pricing specialists. Olivier and Honiball[342] identified that:

> the unavailability of an APA procedure to South Africa and the specific exclusion of the ability to obtain an advance tax ruling on the matter of the pricing of goods and services …is presumably because of a lack of administrative capacity within SARS.

It was previously also observed by Oguttu[343] that a lack of capacity within SARS might exist. The observation made by the OECD (2012)[344] could be valid in the case where a lack of skills exists to conduct an Advance Pricing Arrangement programme. The lack of capacity could be detrimental to a revenue authority should it embark on an Advance Pricing Arrangement programme without the necessary skills. This is especially relevant if MNEs are well advised and that the outcome of an advance tax ruling could result in a disadvantage for the revenue authority.

The utilisation of an APA programme could have an effect on the stability of the tax base.

[340] *Supra* note 336.

[341] *Supra* note 336.

[342] Olivier, L. and Honiball, M. (2011), *International Tax: A South African Perspective*, 5th edn. Cape Town: Siber Ink, p638.

[343] Oguttu, A.W. (2006), Resolving transfer pricing disputes: Are Advance Pricing Agreements the way forward for South Africa? *SA Mercantile Law Journal* 18 pp60-485

[344] *Supra* note 336.

STABILITY OF THE TAX BASE

Stability in tax and taxpayer certainty are closely connected. It was stated in an article by Piper, ‘Stability in Tax’, that ‘[i]f taxpayers are making a decision today which will affect them into the future, they will benefit from being able to predict the impacts of that decision’.[345]

The question is whether APAs or advance tax rulings would bring certainty and stability for MNEs conducting cross border transactions to and from South Africa?

A minority of the South African population bears the burden of acting as the tax base. Joubert (2013)[346] concluded from analysis of attribution to the tax base, that there are far fewer contributing taxpayers in South Africa than statistics released by SARS indicate. It is stated that:

> there is clearly a much larger imbalance between the number of people who are paying tax and the total population than is implied by SARS when they quote 13,7 million as the number of taxpayers. Actually, only 3,3 million taxpayers pay 99% of all income tax …a very small number of South African taxpayers bear almost the entire weight of the South African state on their tired shoulders.[347]

It would be beneficial to all South Africans if tax base erosion and, *inter alia,* profit shifting could be prevented. Further stability in the tax base could be promoted if taxpayer certainty with regard to transfer pricing was available to South African taxpayers.

Due to a possible constraint in capacity, SARS could still in future consider an APA programme. Alternatives to the solution need to be analysed and compared with the OECD’s recommendations made during the Base Erosion and Profit Shifting (BEPS) project. The utilisation of a multilateral or a bilateral information-sharing agreement through treaty provisions was reviewed by the OECD during the BEPS project.

[345] Piper, J. (2015), *Stability in tax*, <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/tax-publications/ea-stability-in-tax.pdf >, retrieved 26 December 2016.

[346] Joubert, P. (2013), *How many taxpayers are there really?*, <http://www.moneyweb.co.za/archive/less-taxpayers-than-sars-reports-solidarity/>, retrieved 26 December 2016.

[347] *Supra* note 346.

The sharing of information could be useful as an alternative to an APA programme. Should revenue authorities work together and create a platform where information is shared, MNEs would have no place to hide their profits.

It is possible that the utilisation of a multilateral or bilateral information sharing agreement could be the answer to preventing BEPS in the absence of an APA programme in South Africa.

ALTERNATIVE UTILISATION OF MULTILATERAL AND BILATERAL INFORMATION SHARING AGREEMENTS BETWEEN REVENUE AUTHORITIES

During the BEPS project, the OECD endeavoured within action 15 to:

> Develop a multilateral instrument – [to] analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.[348]

The action plan on the mandate to develop a multilateral instrument on tax treaty measures to tackle BEPS is only enforceable on OECD participating members. Since South Africa is not a member of the OECD, South Africa is not obliged to follow or agree to any multilateral or bilateral tax treaty measures. South Africa did agree to participate in the interim programme to share information on the basis of mutual assistance.

[348] Organisation for Economic Co-operation and Development (OECD) (2015c*) Action 15: A mandate for the development of a multilateral instrument on tax treaty measures to tackle BEPS*, OECD: Paris.

This was analysed by the Davis Tax Committee[349] and summarised as follows:

> South Africa has so far signed the following multilateral agreements:
> African Tax Administration Forum Agreement on Mutual Assistance in Tax Matters (signed 17 January 2014);
> OECD Multilateral Convention on Mutual Administrative Assistance on Tax Matters (in operation from 1 March 2014);
> Southern African Development Community Agreement on Assistance in Tax Matters (signed 17 August 2013).[350]

The Davis Tax Committee recommendations further encouraged South Africa to update: 'existing multilateral agreements …in accordance with BEPS proposals, once finalised'.[351] The Davis Tax Committee also expressed concern that 'South Africa should wait for OECD BEPS proposals before signing further multilateral agreements'.[352] The last and final recommendation the Davis Tax Committee made was that the:

> proposed OECD multilateral instrument to amend numerous bilateral treaties via a single instrument should be supported as a general principle, subject to such amendments being appropriate in the context of South Africa's treaties.[353]

Even though South Africa has followed OECD best practice as indicated in the BEPS project to prevent BEPS, the answer on whether APAs could aid in the prevention of BEPS is still uncertain. In conclusion, the advantages, disadvantages and the possible alternatives of implementing an APA programme in South Africa need to be analysed.

[349] Davis Tax Committee, (2015) BEPS Interim Report on Action Plan 15 – Develop a multinational instrument.
[350] *Supra* note 349.
[351] *Supra* note 349.
[352] *Supra* note 349.
[353] *Supra* note 349.

CHAPTER 6: CONCLUSION

GENERAL COMMENTS AND RECOMMENDATIONS

The lack of Advance Pricing Agreements (APAs) in South Africa could be seen as a negative aspect regarding taxpayer certainty from the point of view of Multinational Enterprises (MNEs). It would be advantageous for the South African Revenue Service (SARS) to consider the inclusion of APAs if an MNE already has a unilateral or bilateral APA in another tax jurisdiction. This could prevent double taxation and also the event of double non-taxation, as previously mentioned in this research report.

Advance rulings on transfer pricing of goods and services are not available to South African taxpayers or MNEs with an economic presence in South Africa. The reason for exclusion of advance rulings on transfer pricing is not known. The OECD (2012)[354] recognised that revenue authorities may have to 'face a balance between using scarce resources in an APA programme and in auditing'.[355] Many options are available to SARS. Some considerations to be taken into account when considering the options are: efficiency, effectiveness and scarcity of resources involved. The resources could involve litigation costs during a dispute as well the value of tax leakage caused by double non-taxation.

Firstly, APAs form part of the OECD guidelines (2010)[356] on transfer pricing matters. It is recognised that APAs could be agreed upon for a period of three to five years and could be reviewed on an annual basis. If SARS considers implementing an APA programme, it is recommended that a value be placed on the amount for which such applications would be considered. This would ensure that only high value advance rulings could be made for the transfer pricing of goods and services.

[354] Organisation for Economic Co-operation and Development (OECD). (2012), *Advance Pricing Arrangements, approaches to legislation*, <http://www.oecd.org/ctp/tax-global/4.%20Advance_Transfer_Pricing_Arrangements.pdf>, retrieved 6 July 2016.

[355] *Supra* note 354.

[356] Organisation for Economic Co-operation and Development (OECD). (2010b), *Transfer pricing guidelines for multinational enterprises and tax administrations.* Paris: OECD.

If SARS considers permitting advance rulings on transfer pricing cases, it could consider following similar wording to that used in section 103 of the Tax Administration Act, 28 of 2011. A guide on the governing of advance rulings for transfer pricing cases could be formalised in a Government Gazette, similar to the public notice 550[357] relating to dispute resolution.

This could in effect resolve a dispute, should the taxpayer object to a transfer pricing adjustment made by SARS. The dispute process could be costly and absorb scarce transfer pricing resources. The implementation of advance tax rulings on transfer pricing cases could also prevent double non-taxation. This could be viewed as tax leakage that should be avoided.

Secondly, if SARS does not have the capacity to conduct an Advance Pricing programme, the alternative options should be reviewed. SARS could build capacity in this area and implement a programme for advance rulings in the future. This would be advantageous to SARS since international developments[358] are ongoing and further research may be required.

Lastly, SARS could utilise available information on transfer pricing documentation as required in the submission of annual tax returns. The information could be utilised to establish risk and could focus on auditing high tax yield cases. SARS could also develop a programme to monitor the fluctuation of comparable data declared by taxpayers in order to determine the risk that may occur over a period of time.

The Davis Tax Committee also made recommendations[359] on transfer pricing risk assessment that are applicable to transfer pricing audits, in the absence of an APA programme.

[357] South African Government Gazette. (2014), *South African Revenue Service, Government Notice No. 550, Government Gazette No. 37819 dated 11 July 2014.* Pretoria: Government Printing Works.

[358] Organisation for Economic Co-operation and Development (OECD). (2016a), *Tax administrations and capacity building: A collective challenge.* Paris: OECD.

[359] Davis Tax Committee, (2015), BEPS Interim Report on Action Plan 13 – Transfer Pricing Documentation.

DAVIS TAX COMMITTEE RECOMMENDATIONS ON TRANSFER PRICING RISK ASSESSMENT

The OECD (2015d)[360] conducted research on the reporting requirements between multiple tax jurisdictions. The Davis Tax Committee recognises this as 'necessary to conduct an informed transfer pricing risk assessment'. [361] It further indicates that:

> Effective risk identification and assessment constitute an essential early stage in the process of selecting appropriate cases for transfer pricing audits or enquiries and in focusing such audits on the most important issues. Because tax administrations operate with limited resources, it is important for them to accurately evaluate, at the very outset of a possible audit, whether a taxpayer's transfer pricing arrangements warrant in-depth review and a commitment of significant tax enforcement resources.[362]

In the absence of an APA programme, SARS should be focused on the early risk identification of possible transfer pricing cases and utilise scarce resources effectively.

South Africa should consider international developments on capacity building, which should be available to tax administrations in future. It is important to note that the building of skills and sharing of information could be available through 'Tax Inspectors Without Borders (TIWB)'.[363]

INTERNATIONAL DEVELOPMENTS ON TAX ADMINISTRATIONS AND CAPACITY BUILDING

The OECD released a report on 'Tax Administrations and Capacity Building' (2016).[364] It is recognised that tax administrations should work together in order to streamline processes to avoid duplication and to ensure fair taxation of MNEs.

[360] Organisation for Economic Co-operation and Development (OECD). (2015d), *Action 13: Guidance on the implementation of transfer pricing documentation and country-by-country reporting.* Paris: OECD.

[361] Davis Tax Committee, (2015) *BEPS interim report on action plan 13 – transfer pricing documentation.*

[362] *Supra* note 361.

[363] *Supra* note 358.

[364] *Supra* note 358.

It is recognised that ‘[t]he increasing demand for capacity building’ exists. It further emphasises that ‘the extent to which it draws on scarce knowledge and skills, compels tax administrations to work smarter in delivering assistance’.[365]

> In practice, not only does this call for more cohesive and strategic ways of working with other stakeholders to avoid duplication and better identify best practices, but also that innovation be embraced. In this regard, solutions – such as the Knowledge Sharing Platform, a global online tool that enables tax administrations and tax organisations to more broadly and instantaneously share knowledge, expertise and innovative practices with counterparts.[366]

SARS could consider conducting further research on how it as a revenue authority could participate and benefit from the capacity building platform that could in future ensure protection of the tax base and aid in the prevention of Tax Base Erosion and Profit Shifting (BEPS). Through the knowledge-sharing platform, double taxation and double non-taxation could also be addressed.

‘An investment in knowledge always pays the best interest.’ – Benjamin Franklin

[365] *Supra* note 358.
[366] *Supra* note 358.

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