



UNIVERSITY OF THE WITWATERSRAND

**RECOMMENDATIONS FOR THE IMPLEMENTATION OF TRANSFER PRICING
SIMPLIFICATION MEASURES IN THE REPUBLIC OF SOUTH AFRICA**

LEEVEN DUBE

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(SPECIALISING IN TAXATION)

SUPERVISOR: HENRIETTE ERASMUS

Declaration

I declare that this research report is my own unaided work. It is submitted in partial fulfilment for the degree of Master of Commerce (specialising in Taxation) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree of examination in any other university.

Leeven Dube

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Abstract

Concerns about multinational entities shifting profits to exploit differences in corporate tax rates have resulted in the evolution of transfer pricing regulations. This has resulted in taxpayers and tax authorities experiencing challenges in complying and administering transfer pricing regulations. To address these challenges, transfer pricing simplification measures can be implemented. This research report examined the simplification measures recommended by the Organisation for Economic Co-operation and Development and those available in five selected Commonwealth jurisdictions, namely the United Kingdom, India, Australia, Canada and Zambia. It evaluated the rationale for implementing these measures as well as their benefits and drawbacks. The simplification measures recommended to be implemented in the Republic of South Africa are the establishment of safe harbours, a simplified approach to low value-adding intragroup services, the simplification of Advance Pricing Arrangement procedures and reduced fee charges, the adoption of the Commodity Rule and the implementation of the simplified and streamlined approach for routine baseline marketing and distribution activities. While these measures can provide certainty and reduce the compliance and administrative burden, there is a risk of double taxation if they are not designed to achieve an arm's length outcome or a reasonable estimate of an arm's length outcome.

Keywords: Transfer pricing Simplification measures, Arm's Length Principle, Low value-adding intra group services, Advance Pricing Arrangement, Commodity Rule, Simplified and Streamlined Approach to baseline marketing and distribution activities

List of abbreviations and acronyms

Abbreviations and Acronyms	Terms
ADR	Alternative Dispute Resolution
APA	Advance Pricing Agreements
AU\$	Australian Dollar
CA\$	Canadian Dollar
CbCR	Country by Country Report
CPM	Cost-Plus Method
CRA	Canada Revenue Authority
CUP	Comparable Uncontrolled Price
DOJ & CD	Department of Justice & Constitutional Development
EU	European Union
EY	Ernest & Young
FMMB	Fast Markets Metal Bulletin
HMRC	His Majesty's Revenue and Customs
IGF	intergovernmental Forum on Mining, Minerals, Metals and Sustainable Development
IMF	International Monetary Fund
INR	Indian Rupee
IT	Information Technology
K/BPO	Knowledge and Business Process Outsourcing
LF	Local File
LME	London Metal Exchange
MAP	Mutual Agreement Procedures
MF	Master File
MNE	Multinational entity
OECD	Organisation for Economic Co-operation and Development
PCG	Practical Compliance Guideline
PN	Practical Note
PwC	PricewaterhouseCoopers
PSLA	Practice Statement Law Administration
PSM	Profit Split Method
RPM	Resale Price Method
SARS	South African Revenue Services
SA-TIED	Southern Africa -Towards Inclusive Economic Development
SME	Small and Medium Entities
SP	Statement of Practice
SSA	Simplified and Streamlined Approach
TAA	Tax Administration Act
TIOPA	Taxation International and Other Provisions Act
TLAA	Taxation Laws Amendment Act
TLAB	Taxation Laws Amendment Bill
TNMM	Transactional Net Margin Method
UK	United Kingdom

US\$	United States dollar
ZAR	South African Rand
ZRA	Zambia Revenue Authority

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Chapter 1: Introduction

1.1. Background

Multinational entities (“MNEs”) are often reported to be major contributors to base erosion and profit shifting.¹ Operating in multiple jurisdictions with different corporate tax rates, MNEs can take advantage of the mismatch in corporate tax rates to reduce their overall tax liabilities. These differences can be exploited by shifting profits from high-tax jurisdictions to those with lower tax rates or no taxes, therefore, shifting profits from the jurisdictions with the economic activity that produced these profits.² Profit shifting often occurs through the mispricing of controlled transactions.³ Controlled transactions refer to transactions arising from transferring goods and services between related entities within the same group.⁴

The United Nations Conference on Trade and Development (“UNCTAD”) published a report in 2015 that estimated the annual tax revenue losses in developing jurisdictions to approximate US\$100 billion per year.⁵ According to Organisation for Economic Co-operation and Development (“OECD”), jurisdictions lose approximately US\$100 billion to US\$240 billion in tax revenue annually owing to base erosion and profit shifting.⁶ A study by Southern Africa Towards Inclusive Economic Development (“SA-Tied”) in 2019, noted that entities operating in the Republic of South Africa (hereinafter referred as the “Republic”) with a related entity in a tax haven reported 80% less profit than a domestic entity without a related entity in a tax haven.⁷ The OECD noted that MNEs with related entities in lower tax rate jurisdictions tend to report lower profits than domestic comparable entities without related parties in lower tax rate jurisdictions owing to profit shifting.⁸

¹ UNCTAD, *World Investment Report 2022: International Tax Reforms and Sustainable Investment* (New York: United Nations Publishing, 2022), 100 -102. (hereinafter UN, *World Investment Report 2022*).

² OECD, Economics Department, *Tax planning by multinational firms: Firm-level evidence from a cross-country database* (Paris: OECD Publishing, 2016) 6. (hereinafter after OECD, *Tax planning by multinational firms*).

³ UN, *World Investment Report 2022*, 109 & 124.

⁴ OECD, Centre for Tax Policy and Administration, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD Publishing, 2022). 21. (hereinafter OECD, *2022 TP Guidelines*)

⁵ United Nations, *World Investment Report 2022*, 170.

⁶ OECD, “Base erosion and profit shifting (BEPS),” <https://www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html> (accessed October 20, 2023).

⁷ SA-TIED, “The impact of tax havens on South African revenue,” <https://sa-tied-archive.wider.unu.edu/article/impact-tax-havens-south-african-revenue> (accessed February 14, 2023).

⁸ OECD, *Tax planning by multinational firms*, 6&7.

Developing jurisdictions introduced comprehensive transfer pricing regulations or arm's length provisions to limit profit shifting.⁹ Transfer pricing refers to the practice of pricing goods or services between related entities.¹⁰ Transfer pricing regulations require that the pricing of goods or services amongst related entities be conducted at arm's length. Arm's length is defined as concluding controlled transactions on open market terms and conditions.¹¹

The implementation of regulations is often based on the OECD Transfer Pricing Guidelines ("OECD Guidelines"). The OECD Guidelines can be challenging and complex for developing jurisdictions to apply, owing to their need for extensive comparable data and resources which are often lacking in these jurisdictions.¹² This contributed to uncertainty and transfer pricing disputes between taxpayers and tax authorities.¹³ There is also a lack of comprehensive guidelines or practice notes for developing jurisdictions that can assist taxpayers in interpreting and applying the OECD Transfer Pricing Guidelines.

Further, tax authorities in developing jurisdictions are increasingly exchanging taxpayer information with the tax authorities of other jurisdictions and becoming more adept at addressing complex controlled transactions. This has resulted in heightened scrutiny of benchmarking studies that taxpayers use to price-controlled transactions, especially when they involve the provision of intangible assets (such as patents, trademarks and copyrights), management services, royalty payments and financial assistance.¹⁴

⁹ OECD, *2022 TP Guidelines*, 29. See also *Mauritius vs Avago Technologies Trading Ltd*, (ARC/IT/602/15 ARC/IT/145-16 ARC/IT/265-17) [2024]. *ABD Limited v Commissioner for the SARS*, (14302) [2024] ZATC 2.

¹⁰ OECD, *2022 TP Guidelines*, 12,19,29 and 30.

¹¹ OECD, *2022 TP Guidelines*, 19,29 and 30.

¹² Grant Thornton, "Africa Transfer Pricing Landscape Guide 2023/2024," <https://www.grantthornton.global/contentassets/c0cf1fed5d7242b49ca2a737f6c3ae50/africa-tax-desk-tp-landscape-guide.pdf> (accessed November 20, 2024). See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, i. See also UN, Department of Economic and Social Affairs, *Practical Manual on Transfer Pricing for Developing Countries*, (New York: United Nations Publishing, 2021) 115 (hereinafter UN, *Practical Manual on Transfer Pricing for Developing Countries*). See also Graphene Economics, "The fundamentals of transfer pricing in Africa," <https://grapheneeconomics.com/the-fundamentals-of-transfer-pricing-in-africa/> (accessed September 26, 2024).

¹³ Graphene Economics, "The fundamentals of transfer pricing in Africa," <https://grapheneeconomics.com/the-fundamentals-of-transfer-pricing-in-africa/> (accessed September 26, 2024). See also Graphene Economics, "Regional African Trends in Transfer Pricing Audits," <https://grapheneeconomics.com/regional-african-trends-in-transfer-pricing-audits/> (accessed September 6, 2024).

¹⁴ Graphene Economics, "The fundamentals of transfer pricing in Africa," <https://grapheneeconomics.com/the-fundamentals-of-transfer-pricing-in-africa/> (accessed September 26, 2024). See also Graphene Economics,

The International Monetary Fund (“IMF”) working paper published in 2018, noted that the introduction of transfer pricing regulations resulted in an average decrease of 11% in foreign direct investment compared to investments made by similar domestic entities. The decline can be attributed to the perceived risk of transfer pricing adjustments (adjustments) in the Republic.¹⁵ Several developing jurisdictions also use exchange control and outsourcing regulations to limit the outflow of funds to related parties in other jurisdictions.¹⁶

Ernest & Young (“EY”) conducted a survey in 2024 involving 1000 senior tax officials and finance executives from 47 jurisdictions. The survey noted that 84% of participants were concerned about the increased risk of double taxation resulting from transfer pricing and global tax reforms. The survey also found that taxpayers increasingly sought certainty regarding their transfer pricing positions. This was evidenced by a growing interest in other measures (such as advance pricing arrangements (“APAs”)).¹⁷

Simplification measures provide certainty and compliance with transfer pricing regulations without the taxpayers incurring disproportionately high compliance and administrative costs.¹⁸ Improved certainty can offer taxpayers a stable environment in which to grow their businesses and can improve relations with tax authorities.¹⁹ Transfer pricing regulations incorporating simplification measures can further ease the burden on tax authorities to ensure compliance.²⁰ Transfer pricing simplification measures include safe harbours for low-risk transactions, a standard markup for low value-adding intragroup services, documentation exemption and simplification options

“Regional African Trends in Transfer Pricing Audits,” <https://grapheneeconomics.com/regional-african-trends-in-transfer-pricing-audits/> (accessed September 6, 2024).

¹⁵ Ruud De Mooij and Li Liu, “At A Cost: the Real Effects of Transfer Pricing Regulations” *IMF Working Papers*, no. 69 (2018):5&7.

¹⁶ UNCTAD, *Series on issues in international investment agreements: Transfer Pricing* (New York: United Nations Publishing, 199) 5,29&32.

¹⁷ EY, “2024 EY International Tax and Transfer Pricing Survey released: How to ensure TP certainty in uncertain times?” https://www.ey.com/en_be/technical/tax/tax-alerts/2024/2024-ey-international-tax-and-transfer-pricing-survey-released (accessed November 15, 2024). See also Aitor Navarro, Simplification in Transfer Pricing: A Plea for the Enactment of Rebuttable Predetermined Margins and Methods within Developing Countries.” *Florida Tax Journal* 22, No. 3 (2019): 758&788. (hereinafter Navarro, “Simplification in Transfer Pricing”) See also OECD, *2022 TP Guidelines*, 33.

¹⁸ Navarro, “Simplification in Transfer Pricing”:758&788.

¹⁹ Graphene Economics, “Regional African Trends in Transfer Pricing Audits,” <https://grapheneeconomics.com/regional-african-trends-in-transfer-pricing-audits/> (accessed September 6, 2024).

²⁰ Navarro, “Simplification in Transfer Pricing”: 756-758.

from transfer pricing for low-risk transactions and small taxpayers,²¹ the Commodity Rule (“Sixth Method”) to price commodities,²² simplified APA procedures or reduced APA charges and a simplified and streamlined approach (“SSA”) for baseline marketing and distribution functions.²³

The Republic has no transfer pricing simplification measures other than transfer pricing documentation exemption and simplification measures for related party transactions with a value less than a set threshold.²⁴

1.2. Objectives and research questions

This research report aims to identify transfer pricing simplification measures that can benefit the Republic.

The research report examined the development of transfer pricing regulations in the Republic, the transfer pricing methodologies recommended by the South African Revenue Service (“SARS”) and challenges associated with transfer pricing regulations in the Republic. This research report examined the simplification measures recommended by the OECD and those available in five selected Commonwealth jurisdictions (India, the United Kingdom (“UK”), Canada, Australia and Zambia) regarding the rationale for implementing these measures, the benefits of and the drawbacks associated with such measures. Finally, the research report assessed the feasibility of implementing such simplification measures in the Republic.

The Republic is a member of the Commonwealth. The five selected Commonwealth jurisdictions are India, the UK, Canada, Australia and Zambia. These jurisdictions share similar legislative systems rooted in English common law.²⁵

²¹ OECD, Committee on Fiscal Affairs, *Multi-country analysis of existing transfer pricing simplification measures* (Paris: OECD Publishing, 2011), 5. (hereinafter OECD, *Multi-country analysis of existing transfer pricing simplification measures*)

²² IGF, Metals and Sustainable Development, African Tax Administration Forum, *Using the Sixth Method to Simplify the Pricing of Related-Party Mineral Sales and Safeguard Mining Revenues* (Ottawa: IGF Publishing, 2022). (hereinafter IGF, *Using the Sixth Method to Simplify the Pricing*).

²³ OECD, OECD/G20 Base Erosion and Profit Shifting Project, *Pillar One - Amount B: Inclusive Framework on BEPS* (Paris: OECD Publishing 2024), 14.

²⁴ SARS, “Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011”, *Government Gazette* 41186:628 (October 20, 2017).

²⁵ Commonwealth of nations, “The legal sector in the Commonwealth,” <https://www.commonwealthofnations.org/?sectors=business/legal#:~:text=The%20vast%20majority%20of%20legal,law%2C%20customary%20law%20and%20Shariah> (accessed May 15, 2024).

1.3. Research question

The research question to be addressed is:

How should transfer pricing regulations in the Republic of South Africa be simplified?

To answer the research question, the questions were stratified into the following sub-questions:

First, what is transfer pricing? How did transfer pricing regulations develop in the Republic? Which transfer pricing methodologies are recommended by SARS?

Secondly, which simplification measures were recommended by the OECD and those available in the selected Commonwealth jurisdictions? What was the rationale for implementing these simplification measures? What were the benefits of and the drawbacks associated with these simplification measures?

Finally, how can these simplification measures be implemented in the Republic?

1.4. Importance

This research report added to the limited literature on transfer pricing simplification measures.

1.5. Research methodology

The research method used in this report was a detailed literature review. Following the literature review, the literature was analysed. The literature reviewed included journal articles, legislation, reports, manuals, and opinions from industry practitioners on transfer pricing practices. The research was conducted using a qualitative approach.

1.6. Scope and limitations

This research was limited to transfer pricing regulations that apply to juristic persons and cross-border controlled transactions. The focus was on transfer pricing regulations and simplification measures recommended by the OECD and those available in the selected Commonwealth jurisdictions.

Chapter 2: Transfer pricing regulations of the Republic of South Africa

2.1. Introduction

This chapter examined the development of transfer pricing regulations in the Republic, the transfer pricing methodologies recommended by SARS and the challenges transfer pricing regulations present for taxpayers and tax authorities.

2.1.1. Exchange control regulations

Exchange control (“Excon”) regulations controlled the movement of money in and out of the Republic since 1939. During the 1980s, authorities relied primarily on the Excon regulations to mitigate the transfer of profits and capital from the Republic owing to sanctions, trade boycotts and a deteriorating economy at the time.²⁶ The lifting of sanctions, and the ease of trade boycotts against the Republic in the 1990s, necessitated the relaxation of Excon regulations. In turn, legislators developed transfer pricing regulations to counter the relaxation of Excon regulations.²⁷

2.1.2. Transfer pricing regulations before 1995

2.1.2.1. Section 31 of Income Tax Act 58 of 1962

Transfer pricing provisions were incorporated into section 31 of the Income Tax Act²⁸ in 1995.²⁹ Before 1995, section 31 focused on the adjustment of profits by the Commissioner, when the expenditure was deemed to be grossly excessive using the general deduction formula or the general anti-avoidance rule contained in the Income Tax Act.³⁰ The Commissioner's power to affect adjustments using section 31 was restricted to the provisions of the related entity clause in the tax treaty between jurisdictions party to the cross-border transaction of a commodity.³¹

²⁶DOJ & CD, *Final Report of the Commission of Inquiry into the Rapid Depreciation of the Exchange Rate of the Rand and Related Matters Part III* (Pretoria: DOJ&CD Publishing, 2002), para. 162.

²⁷ Annet Oguttu, “Transfer pricing and Tax Avoidance: Is the Arm’s Length Principle Still Relevant in the eCommerce Era?” *SA Mercantile Law Journal* 18, no. 1 (2006): 141-142. See also Annet Oguttu, “South Africa's exchange control regulations and 'loop structures': The income tax implications on the removal of the restrictions with effect from 1 January 202,” *SA Mercantile Law Journal* 34, no. 1 (2022): 89.

²⁸ 58 of 1962. (hereinafter the ITA, 1962)

²⁹ PwC, *South Africa*, <https://www.pwc.com/gx/en/international-transfer-pricing/assets/south-africa.pdf> (accessed, March 6, 2023).

³⁰ S 103(1) of the ITA, 1962. See also Lynette Olivier and Michael Honibal, *International Tax - A South African Perspective 2011* (Cape Town: Blue Weaver Marketing, 2011), 621-623. (hereinafter Olivier and Honibal, *International Tax*)

³¹ Olivier and Honibal, *International Tax*, 621-623. See also Annet Oguttu, “Transfer pricing and Tax Avoidance: Is the Arm’s Length Principle Still Relevant in the eCommerce Era?”:141.

2.1.2.2. Katz Commission

The Katz Commission was appointed in 1994 by the Minister of Finance to review the tax system of the Republic.³² The first interim report of the Commission highlighted the need for transfer pricing and thin capitalisation provisions to safeguard the tax base of the Republic, instead of relying on Excon regulations and other legislative provisions, such as customs duties.³³

2.1.3. Transfer pricing regulations for the period 1995 to 2012

2.1.3.1. Section 31 of the Income Tax Act 58 of 1962

Section 31³⁴ was amended in 1995 to incorporate transfer pricing provisions and implement the recommendations made by the Katz Commission.³⁵ Section 31(2) required related entities to conduct the supply of goods and/or rendering of services through an international agreement at arm's length. If the related entities failed to do so, the Commissioner could then adjust the transaction to reflect the arm's length price and ensure that the taxpayer's taxable income was correctly determined.³⁶

In terms of section 31(1)³⁷, "goods" are defined as all tangible things and real rights to such goods. A "service" is defined as a task or task to be performed. An "international agreement" refers to "a transaction, operation or scheme" between related parties that are tax residents in different jurisdictions.³⁸ Section 31(3)³⁹ addresses thin capitalisation, applicable where an entity outside the Republic financially assisted a South African-related entity and the Commissioner deemed such assistance excessive, relative to the fixed capital of such related entity. The taxpayer could be denied a deduction of the interest, or other charges payable in relation to such financial assistance to the extent that is related to the excessive amount.⁴⁰ Further, section

³² Michael Katz, *Interim Report of the Commission of Inquiry into certain aspects of the Tax Structure of South Africa* (Pretoria: National Treasury Publishing, 1994), 1. (hereinafter Katz, *Interim Report*).

³³ Katz, *Interim Report*, 231-233.

³⁴ of the ITA, 1962.

³⁵ SARS, *PN 7*, para 2.5.

³⁶ S 23 of the Income Tax Act, 1995. (hereinafter ITA, 1995).

³⁷ ITA, 1995.

³⁸ S 23 of the ITA, 1995.

³⁹ ITA, 1995.

⁴⁰ S 23 of the ITA, 1995.

64C(3)(e)⁴¹ states that any adjusted or disallowed amount in terms of section 31⁴² was subject to secondary tax on companies (“STC”) at the applicable rate.⁴³

2.1.3.2. SARS Practice Note 2 of 1996

Practice Note 2 (“PN 2”) was released by SARS in 1996.⁴⁴ PN 2 was published to provide guidance in determining the taxable income of a resident taxpayer when financial assistance was granted in terms of section 31(3)⁴⁵ by a non-resident to a resident of the Republic.⁴⁶ PN 2 provided the disallowable deduction of interest or related charges on excessive financial assistance.⁴⁷ According to PN 2, financial assistance within the debt-to-equity ratio that did not exceed the safe harbour threshold of 3:1, could be deducted.⁴⁸ If an entity exceeded the debt-to-equity ratio without commercial rationale,⁴⁹ it could be deemed to constitute profit shifting.⁵⁰

2.1.3.3. SARS Practice Note 7 of 1999

SARS released Practice Note 7 (“PN 7”) in 1999 as guidance on implementing of the arm’s length provisions in section 31.⁵¹ PN 7 stated that, in the absence of guidance from PN 7 and any other local legislation, taxpayers must apply the OECD Guidelines to interpret section 31,⁵² when pricing controlled transactions at arm’s length.⁵³ A “controlled transaction” is a transaction between related entities. An “uncontrolled transaction” is a transaction between unrelated entities.⁵⁴ The cornerstone of the Arm’s Length Principle is comparable data to price-controlled transactions at arm’s length.⁵⁵

⁴¹ ITA, 1995.

⁴² ITA, 1995.

⁴³ S 30 of the ITA, 1995.

⁴⁴ SARS practice notes do not have legal authority, they only assist with insights and guidance

⁴⁵ ITA, 1995.

⁴⁶ SARS, *Practice Note no. 2, Income tax: determination of taxable income where financial assistance has been granted by a non-resident of the republic to a resident of the Republic*, (1996). (hereinafter SARS, PN 2).

⁴⁷ SARS, PN 2, para 2.2&4.

⁴⁸ SARS, PN 2, para 4.

⁴⁹ SARS, PN 2, para 6.

⁵⁰ Michael Honibal and Lauren Delahaye, “Transfer pricing - uncertainty prevails international tax,” *Tax Professional* 13, no.1(2013): 16-17.

⁵¹ ITA, 1962.

⁵² ITA, 1962.

⁵³ SARS, PN 7, para 3.

⁵⁴ SARS, PN 7, para 1.2.

⁵⁵ SARS, PN 7, para 8.

The key drivers of calculating an arm's length price are:⁵⁶

First, the type of transaction (whether it relates to the sale of goods, provision of services, transfer of intangibles, or a financial arrangement).

Secondly, the comparability of the transactions with respect to the characteristics of goods or services, functions performed, risks assumed, assets used by the taxpayers, the contracts entered by taxpayers, economic circumstances and business strategies.

Finally, choosing the suitable transfer pricing method.

The five transfer pricing methods recommended in PN 7 compare the compensation for functions performed by parties in a controlled transaction to those in an uncontrolled transaction for the same or similar transactions to determine the arm's length price of the controlled transaction.⁵⁷ The Commissioner recommended five methods: the comparable uncontrolled price ("CUP") method, the resale price method ("RPM"), the cost-plus method ("CPM") (referred to as the three traditional transactional methods), the transactional net margin method ("TNMM"), and the transactional profit split method ("PSM") (referred to as the two transactional profit methods).⁵⁸

In terms of PN 7, comparability requires a functional analysis to be performed. A functional analysis provides information about an entity's functions, assets used, and risks assumed in a controlled transaction.⁵⁹ The functional analysis enables a taxpayer to compare the functions in a controlled transaction to those in an uncontrolled transaction and to establish the most suitable method for the controlled transaction.⁶⁰

a. Comparable uncontrolled pricing ("CUP") method

The CUP method compares the price of goods or services in a controlled transaction⁶¹ to the price of equivalent goods and services in an uncontrolled or third-party transaction.⁶² For example, an entity that manufactures leather bags and sells them to unrelated entities can benchmark the arm's length price of the leather bags in a

⁵⁶ OECD, *2022 TP Guidelines*, 40.

⁵⁷ SARS, *PN 7*, para 8.

⁵⁸ OECD, *2022 TP Guidelines*, 93.

⁵⁹ SARS, *PN 7*, para 8.3.

⁶⁰ SARS, *PN 7*, para 9.

⁶¹ Section 31(1) of the ITA, 1962.

⁶² SARS, *PN 7*, para 9.4.4.

controlled transaction using the price that the manufacturer charges for the same leather bag to unrelated entities or that other unrelated entities charge unrelated parties for the same or comparable leather bags.⁶³

If there is any price difference between the controlled and uncontrolled transactions for similar goods or services, the difference may suggest that the price of the goods and services in the controlled transaction violates the Arm's Length Principle. Adjustments that factor in differences in the quality of the comparable product can correct minor pricing differences between controlled and uncontrolled transactions.⁶⁴

The CUP method is more dependable when the supply involves goods or services of similar quality, with similar contractual terms, and subject to similar economic conditions. The CUP method is unreliable when the transactions compared differ materially, and adjustments cannot correct these differences.⁶⁵ The primary disadvantage of a CUP method stems from its reliance on comparable data, which may be lacking especially in developing jurisdictions such as the Republic. Finding comparable transactions can also be difficult, especially if products or services that make the transaction are unique or highly customisable.⁶⁶

b. Resale price method ("RPM")

The RPM relies on the price at which an item is sold to a third-party entity by a related entity, who initially acquired the product from a related entity. The resale price is then reduced by a resale price margin or gross margin.⁶⁷ The RPM accommodates a wide range of products with similar functionality.⁶⁸ Consequently, product differences are less important when using the RPM if the assets used, risks assumed, and functions performed are similar.⁶⁹ For example, toasters and blenders are different products, but as the distributors of these products perform similar functions to sell them, they should be comparable in terms of their resale price margins.⁷⁰

⁶³ SARS, *PN 7*, para 9.4.4.

⁶⁴ OECD, *2022 TP Guidelines*, 97-101.

⁶⁵ OECD, *2022 TP Guidelines*, 99-100.

⁶⁶ OECD, *2022 TP Guidelines*, 158-161.

⁶⁷ OECD, *2022 TP Guidelines*, 102.

⁶⁸ OECD, *2022 TP Guidelines*, 102.

⁶⁹ OECD, *2022 TP Guidelines*, 102.

⁷⁰ OECD, *2022 TP Guidelines*, 101-102. See also SARS, *PN 7*, 15-16.

The benefit of the RPM is that the method relies primarily on open market prices to make comparisons.⁷¹ The RPM method is widely recognised, particularly in industries specialising in resale activities.⁷² Differences in functions performed, contractual terms, market conditions and other factors affecting the resale price may necessitate adjustments to ensure comparability.⁷³ Differences in accounting practices can materially impact the accuracy of the resale price margins, affecting the reliability of the resale prices in controlled transactions.⁷⁴

c. Cost plus method (“CPM”)

The CPM adds a mark-up profit to costs incurred by the supplier of the goods or services.⁷⁵ The markup in a controlled transaction is calculated by evaluating the markup earned in an uncontrolled transaction, or the markup earned in a comparable transaction by an independent supplier. The comparable markup must be based on the supply of goods or services with similar characteristics, which assume similar risks, employ similar assets and undertake similar comparable functions.⁷⁶ For example, an entity that offers different software services to related and unrelated entities while performing the same functions and procedures can use a markup that the entity charges to unrelated entities for software services to benchmark its controlled transactions.⁷⁷

If additional expenses stem from functional differences, the taxpayer must account for these differences by making appropriate data adjustments.⁷⁸ The CPM is suitable for determining the arm's length price of services rendered, the delivery of semi-finished goods and joint facilities arrangements.⁷⁹ The primary drawback of CPM is that its reliability can be affected by differences in the cost-effectiveness of different businesses, the differences in accounting standards employed by different taxpayers, incomparable functions performed, risk assumed, and assets used.⁸⁰

⁷¹ OECD, 2022 *TP Guidelines*, 103.

⁷² OECD, 2022 *TP Guidelines*, 106.

⁷³ OECD, 2022 *TP Guidelines*, 103.

⁷⁴ OECD, 2022 *TP Guidelines*, 103.

⁷⁵ OECD, 2022 *TP Guidelines*, 108-111.

⁷⁶ OECD, 2022 *TP Guidelines*, 108-111.

⁷⁷ SARS, PN 7, para 9.6.4.

⁷⁸ OECD, 2022 *TP Guidelines*, 108.

⁷⁹ OECD, 2022 *TP Guidelines*, 107.

⁸⁰ OECD, 2022 *TP Guidelines*, 108-111.

d. Transactional net margin method (“TNMM”)

The TNMM evaluates the net profit margin a taxpayer achieves in a controlled transaction against the net profit margin obtained in a comparable uncontrolled transaction.⁸¹ TNMM applies the comparable net profit to the controlled transaction's relevant base (expenses, assets and sales).⁸² The TNMM is only concerned with the net profit margin (not the gross margin). Net profit is less sensitive to transactional and functional differences in comparison to gross profit. The reliability of the TNMM is comparatively lower than that of the CUP, RPM, and CPM, as the TNMM merely requires broad product and functional comparability.⁸³

Since TNMM focuses on an entity's functions, it aligns more closely with CPM and RPM.⁸⁴ Factors that have immaterial impact on the gross margins of comparable parties, such as cost structures can materially impact the net margin indicator.⁸⁵ TNMM is suitable as a “method of last resort”.⁸⁶

e. Profit split method (“PSM”)

The PSM is used for highly integrated transactions. It divides the relevant profits or losses in a manner that approximates the division of profits or losses in an uncontrolled transaction.⁸⁷ The taxpayer first determines the total combined profits or losses from the controlled transactions that require splitting. Thereafter, the value contributed by each party, based on duties fulfilled, resources used, and undertaken risks, informs the division of profits.⁸⁸

There are two types of PSMs: First, the contribution analysis, where profits are shared based on the relative contribution to value created. Secondly, the residual analysis, where profits are shared relative to the contribution of unique and valuable intangibles after routine profits have been allocated to the respective parties based on standard

⁸¹ OECD, 2022 *TP Guidelines*, 114.

⁸² OECD, 2022 *TP Guidelines*, 113.

⁸³ OECD, 2022 *TP Guidelines*, 15&116.

⁸⁴ OECD, 2022 *TP Guidelines*, 15&116.

⁸⁵ OECD, 2022 *TP Guidelines*, 15&116.

⁸⁶ SARS, PN 7, para 9.7.2.

⁸⁷ OECD, 2022 *TP Guidelines*, 136.

⁸⁸ OECD, 2022 *TP Guidelines*, 128, 129&136.

returns.⁸⁹ The PSM is more advantageous when the transaction is highly integrated, the respective contributions cannot be separated, or related parties to the transaction have contributed unique and valuable intangibles for which no reliable, comparable data is available to price the controlled transaction.⁹⁰ The PSM is more suitable for highly integrated operations that cannot be priced using a one-sided method.

The drawback of the PSM is that it may be difficult to apply because it relies less on comparable data from uncontrolled transactions. Additionally, it may be difficult to calculate the actual profits or costs contributed by parties to the transaction, which may require adjustments for differences in accounting practices applied and currencies.

PSM also requires subjective judgement which can result in disputes with tax authorities.⁹¹

2.1.4. Transfer pricing regulations from April 2012 to date

2.1.4.1. Section 31 of the Income Tax Act 58 of 1962.

Section 31 was amended by promulgating the Taxation Laws Amendment Act (“TLAA”) in January 2012.⁹² The promulgation revised section 31 with effect from April 2012.⁹³ The amended section 31(2) states that if any party enters into an affected transaction and obtains a tax benefit, the tax payable must be calculated as if the terms and conditions of the affected were at arm's length. In terms of section 31(1), an affected transaction, is “any transaction, operation, scheme, agreement or understanding concluded between related parties for the benefit of either or both and where the terms or conditions of this arrangement are not at arm's length”.⁹⁴ Section 31(1) defines a “tax benefit” as any avoidance, postponement or reduction of a tax liability.⁹⁵

Section 31 shifted its focus from individual transactions to transaction arrangements in their entirety. The revised wording of section 31 emphasises the economic nature

⁸⁹ Graphene Economics, “The fundamentals of transfer pricing in Africa,” <https://grapheneeconomics.com/the-fundamentals-of-transfer-pricing-in-africa/> (accessed September 26, 2024).

⁹⁰ OECD, 2022 *TP Guidelines*, 129&130.

⁹¹ OECD, 2022 *TP Guidelines*, 130.

⁹² TLAA Act, 2012.

⁹³ S 64 of the TLAA, 2012.

⁹⁴ S 31 (1) & (2) of the ITA, 1962.

⁹⁵ S 31(1) of the ITA, 1962.

of the arrangement between the related entities rather than merely the price of the transaction. Entities are to ensure that the transaction in its entirety, including its terms and conditions, does not violate the Arm's Length Principle.⁹⁶ The revised wording aligns with Article 9 of the OECD Model Convention on Income and Capital, which addresses adjusting transactions to reflect arm's length terms and conditions.⁹⁷

The Arm's Length Principle extends to financial assistance⁹⁸ including the interest rate of a loan, the debt amount and the maturity conditions.⁹⁹ With the amended section 31, the duty to make primary adjustments to prices that are not at arm's length shifted from the Commissioner to the taxpayer.¹⁰⁰ The primary adjustment that triggers a secondary adjustment is considered a distribution of an asset in *specie* (declared dividend) and is subject to dividends taxation in the Republic.¹⁰¹

2.1.4.2. Rationale underlying the 2012 revision of section 31 of the Income Tax Act 58 of 1962.

SARS announced its intention to revise transfer pricing regulations and align the regulations with internationally recognised best practice in 2010.¹⁰² The explanatory memorandum of the Taxation Laws Amendment Bill ("TLAB") of 2010 indicates that the wording of section 31 of the Income Tax Act (before the 2012 amendment) gave rise to the following three structural problems or ambiguities which needed to be addressed:¹⁰³

First, the focus of transfer pricing provisions shifted from individual transactions to the essence and purpose of the entire transaction or arrangement.¹⁰⁴ This transition from

⁹⁶ S 64 of the TLAA, 2012.

⁹⁷ National Treasury, SARS, *Explanatory Memorandum on Taxation Laws Amendment Bill 2010* (Pretoria: National Treasury Publishing, 2010). para 5.3. II. (hereinafter SARS, *Explanatory Memorandum on TLAB 2010*). See also TP Guidelines, "Article 9 Associated Enterprises," <https://tpguidelines.com/oecd-article-9-associated-enterprises-and-commentary/#:~:text=This%20Article%20deals%20with%20adjustments,other%20than%20arm's%20length%20terms> (accessed April 15, 2023).

⁹⁸ Financial arrangement can be assistance in the form of "debt or a security guarantee"

⁹⁹ S 31(1) of the ITA, 1962.

¹⁰⁰ S 31(2) & (3) of the ITA, 1962.

¹⁰¹ S 31(3) of the ITA, 1962.

¹⁰² SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

¹⁰³ TLAB, 2010.

¹⁰⁴ SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

a narrow to a wider focus was intended to decrease literal interpretation and emphasise the broader purpose and content of the controlled transaction;¹⁰⁵

Secondly, the wording of section 31 (before the 2012 amendment) focused on the CUP method.¹⁰⁶ The CUP method is not suitable for all transactions, and therefore, it cannot be given substantial weight in the regulations;¹⁰⁷

Thirdly, the wording of section 31 needed to be aligned with that used in treaties, as the treaties emphasised the use of the word “profits” instead of “price”.¹⁰⁸ The emphasis on “price” as opposed to “profits” could potentially create conflicts in mutual agreement procedures (“MAP”) provided under tax treaties;¹⁰⁹ and

Finally, the definition of an “affected transaction” was expanded to include an “associated enterprise”. The amendment became effective on 1 January 2023.¹¹⁰ The definition of an “affected transaction”¹¹¹ has further broadened its application as a result.¹¹²

2.1.4.3. Documentation requirements

MNEs were not required to prepare and file transfer pricing documentation before 2016.¹¹³ From 2016, taxpayers whose potentially affected transactions are above or are projected to be above ZAR100 million must prepare and submit a local file within 12 months after the financial year end and may be obligated to submit a master file with SARS. SARS introduced the ZAR100 million threshold by publishing Government Gazette Notice 1117 in 2017 in terms of section 25 of the Tax Administration Act, 28 of 2011 (“TAA”).¹¹⁴ Taxpayers whose potentially affected transaction are above or projected to be above R5 million only need to maintain documentation demonstrating

¹⁰⁵ SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

¹⁰⁶ SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

¹⁰⁷ SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

¹⁰⁸ SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

¹⁰⁹ SARS, *Explanatory Memorandum on TLAB 2010*, para 5.3. II.

¹¹⁰ S 66(1) of the TLAA, 2021.

¹¹¹ S 31(1) of the ITA, 1962.

¹¹² SARS, *Memorandum on the Objects of the Tax Administration Laws Amendment Bill 2023* (Pretoria: SARS Publishing, 2023), para 2.28.

¹¹³ Grant Thornton, “Transfer Pricing South Africa,” <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---South-Africa/> (accessed October 12, 2023).

¹¹⁴ SARS, “Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act 28 of 2011”, *Government Gazette* 41186:76, (June 3, 2022). See also SARS, “Duty to Keep the Records, Books of Account or Documents in Terms of Section 29 of the Tax Administration Act 28 Of 2011”, *Government Gazette* 40375:616, (October 28, 2016).

that the affected transaction is at arm's length.¹¹⁵ The Ultimate Parent Entity ("UPE"), resident in the Republic, with a group revenue of R10 billion or more during the previous financial year, must complete a country-by-country report ("CbCR"), master file and a local file.¹¹⁶

The master file provides a comprehensive overview of the group's intangible assets, transfer pricing policies and worldwide business operations. The local file provides related party transaction details, which include an entity overview, economic analysis, functional analysis, and the method adopted by the resident taxpayer for pricing its cross-border affected transaction. The CbCR provides the number of employees employed and financial and tax information for each respective jurisdiction in which the MNE operates, to assist tax authorities in assessing transfer pricing risks.¹¹⁷

2.1.4.4. Interpretation Note 127 ("IN 127")

Thin capitalisation rules were introduced in the Republic in 1995 by section 31(3) of the Income Tax Act.¹¹⁸ The Commissioner had the authority to deem international financial assistance excessive and disallow related deductions (such as loan charges and interest incurred).¹¹⁹ Examples of excessive international financial assistance were provided in PN 2 of 1996. Section 31(3)¹²⁰ and PN 2 have since been repealed. The thin capitalisation regulations only applied to assessment years before 1 April 2012.¹²¹

As from 1 April 2012, section 31 does not have a separate subsection that deal with thin capitalisation.¹²² Financial assistance is regulated by provisions of section 31(2).¹²³ In 2013, SARS released draft Interpretation Note 127 ("IN 127") as a

¹¹⁵ See also SARS, "Duty to Keep the Records, Books of Account or Documents in Terms of Section 29 of the Tax Administration Act 28 Of 2011", *Government Gazette* 40375:616, (October 28, 2016).

¹¹⁶ SARS, "Country-by-Country(CbC)," <https://www.sars.gov.za/types-of-tax/corporate-income-tax/country-by-countrycbc/> (accessed October 12, 2023). See also SARS, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act 28 of 2011", *Government Gazette* 41186:76, (June 3, 2022).

¹¹⁷ SARS, "Country-by-Country (CbC)," <https://www.sars.gov.za/types-of-tax/corporate-income-tax/country-by-countrycbc/> (accessed April 21, 2024).

¹¹⁸ ITA, 1995.

¹¹⁹ S 23 of the ITA, 1995.

¹²⁰ ITA, 1995.

¹²¹ SARS, *Interpretation Note: No. 127 Section 31 of the Income Tax Act, 1962 Determination of the Taxable Income of Certain Persons from International Transactions: Intra-Group Loans* (Pretoria: SARS Publishing, 2023). (hereinafter SARS, *IN 127*)

¹²² ITA, 1962.

¹²³ SARS, *IN 127*.

guideline for intragroup funding.¹²⁴ In terms of IN 127, a taxpayer with a debt-to-equity ratio exceeding 3:1 was at risk of being thinly capitalised. A taxpayer is thinly capitalised if the taxpayer has an elevated level of debt in comparison to equity capital.¹²⁵

SARS confirmed that the 3:1 ratio is not a safe harbour but a guideline for selecting taxpayers for audit purposes.¹²⁶ The finalised version of IN 127 was published in 2023.¹²⁷ IN 127 is silent on the safe harbour ratio for financial assistance but cautioned that taxpayers who are thinly capitalised may be at risk of contravening section 31.¹²⁸ Taxpayers must follow the arm's length regulations (outlined in section 31 and PN 7) when providing financial assistance to related parties, removing the need for separate thin capitalisation regulations.¹²⁹

2.2. Challenges affecting the transfer pricing of transactions in the Republic

Taxpayers may encounter challenges while attempting to comply with transfer pricing regulations in the Republic. The challenges stem from evolving transfer pricing regulations,¹³⁰ disputes between taxpayers and tax authorities, lack of comparable data¹³¹ the burden on record retention on smaller and medium taxpayers,¹³² the limited resources and expertise of tax authorities and SMEs¹³³ and outdated transfer guidelines.¹³⁴

¹²⁴ SARS, *IN 127*.

¹²⁵ATO, "Thinly Capitalised entities," <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/thin-capitalisation/understanding-thin-capitalisation/thinly-capitalised-entities> (accessed January 6, 2024).

¹²⁶ Bowmans, "South Africa: An overview of SARS' Interpretation Note 127," <https://bowmanslaw.com/insights/tax/south-africa-an-overview-of-sars-interpretation-note-127/> (accessed August 18, 2023).

¹²⁷ SARS, *IN 127*.

¹²⁸ ITA, 1962.

¹²⁹ SARS, *IN 127*, para 5.

¹³⁰ SARS, *IN 127*.

¹³¹ Deloitte, "Transfer pricing: Current trends and changes in the landscape," <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024).

¹³² Deloitte, "The tax compliance burden for small and medium enterprise," <https://www.deloitte.com/za/en/services/tax/perspectives/the-tax-compliance-burden-for-small-and-medium-enterprises.html> (accessed June 17 2024).

¹³³ OECD, Committee on Fiscal Affairs, *Dealing Effectively with the Challenges of Transfer Pricing* (Paris: OECD Publishing, 2022), 43,44,59&96. (hereinafter OECD, *Dealing Effectively with the Challenges of Transfer Pricing*).

¹³⁴ SAICA, "Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7," <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

2.2.1. Evolution of transfer pricing regulations and heightened scrutiny of controlled transactions

Transfer pricing provisions were introduced in the Republic in 1995. The provisions and supporting guidelines have evolved, becoming more complex.¹³⁵ During the last decade, SARS made amendments to section 31 provisions in 2012, introduced the three tier transfer pricing documentation requirements in 2016¹³⁶ due to the OECD BEPS initiatives,¹³⁷ and the APA programme in December 2023.¹³⁸

International initiatives, such as the OECD BEPS project, Tax Inspectors Without Borders (“TIWB”) and the African Tax Administration Forum (“ATAF”) capacity-building programmes contribute to the adoption of transfer pricing regulations and development of tax authorities’ expertise, especially in developing jurisdictions.¹³⁹ Tax authorities in developing jurisdictions are becoming more collaborative regardless of whether bilateral agreements were concluded to exchange taxpayer’s information. The tax authorities are becoming more adept and rigorous in the performance of transfer pricing audits.¹⁴⁰

The filing of transfer pricing documentation ensures that MNEs disclose essential information about cross-border intercompany transactions to tax authorities. This may assist tax authorities in identifying high-risk transactions for audit.¹⁴¹ The tax authorities in developing jurisdictions are increasingly scrutinising low value-adding intragroup controlled transactions and royalty payments with low tax jurisdictions, such as Singapore, Mauritius, Switzerland and the United Arab Emirates. Heightened

¹³⁵ Moneyweb, “South Africa gets its first transfer pricing guide,” <https://www.moneyweb.co.za/mymoney/moneyweb-tax/south-africa-gets-its-first-transfer-pricing-guide/> (accessed August 20, 2024).

¹³⁶ SARS, “Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011”, *Government Gazette* 41186:628 (October 20, 2017).

¹³⁷ ENS, “Eight challenges to consider in transfer pricing risk,” https://www.ey.com/en_za/tax/eight-challenges-to-consider-in-transfer-pricing-risk (accessed October 15, 2023).

¹³⁸ National Treasury, SARS, *Tax Administration Laws Amendment Bill, 2023* (Pretoria: National Treasury Publishing, 2023)

¹³⁹ ATAF, “Transfer Pricing,” <https://www.ataftax.org/TransferPricing> (accessed June 10, 2023).

¹⁴⁰ Graphene Economics, *The Evolution Landscape of Taxation: Transfer Pricing Trends in Africa – what 2024 may hold* (Johannesburg: Graphene Economics, 2023) 12. (hereinafter Graphene Economics, *Transfer Pricing Trends in Africa*)

¹⁴¹ EY, “How to prepare for a rise in tax controversy related to transfer pricing.” https://www.ey.com/en_za/transfer-pricing-international-tax-survey/how-to-prepare-for-a-rise-in-tax-controversy-related-to-transfer-pricing (accessed January 15, 2024).

scrutiny of controlled transactions is giving rise to increased transfer pricing disputes.¹⁴²

2.2.2. Transfer pricing disputes between taxpayers and tax authorities

Increased awareness and expertise of tax authorities have led to an increase in transfer pricing audits and adjustments, which taxpayers often dispute. Most disputes necessitate negotiation or litigation to reach consensus on a transaction's arm's length price.¹⁴³

The limited case law in the Republic suggests a lack of established legal precedents on the interpretation and implementation of transfer pricing regulations. It can be challenging for taxpayers to predict outcomes of transfer pricing court cases, making the Alternative Dispute Resolution (“ADR”) process more attractive¹⁴⁴ than litigation.¹⁴⁵ The objective of the ADR process is to resolve disputes on mutually agreeable terms. It can involve negotiation, mediation, arbitration, and reconciliation. The ADR process is less formal, complex, and adversarial in nature. Compared to traditional litigation, it is also cost-effective and expedited.¹⁴⁶ The lack of legal counsel with transfer pricing expertise, increased compliance requirements and the potential for unfavourable tax rulings can result in cases being settled through the ADR process rather than litigation.¹⁴⁷

Lately, a trend has been noted of taxpayers and tax authorities not reaching a resolution through the ADR process.¹⁴⁸ Consequently, taxpayers are exploring other

¹⁴² Graphene Economics, Transfer Pricing Trends in Africa, 12. See also Graphene Economics, “The fundamentals of transfer pricing in Africa,” <https://grapheneeconomics.com/the-fundamentals-of-transfer-pricing-in-africa/> (accessed September 26, 2024).

¹⁴³ OECD, *Dealing Effectively with the Challenges of Transfer Pricing*, 68&76.

¹⁴⁴ PwC, “International Transfer Pricing – Africa Region,” <https://www.pwc.com/gx/en/international-transfer-pricing/assets/south-africa.pdf> (accessed June 10, 2023).

¹⁴⁵ Deloitte, “Transfer pricing: Current trends and changes in the landscape,” <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024).

¹⁴⁶ SARS, *Alternative dispute resolution: Quick guide*, (2014).

¹⁴⁷ PwC, “International Transfer Pricing – Africa Region,” <https://www.pwc.com/gx/en/international-transfer-pricing/assets/south-africa.pdf> (accessed June 10, 2023).

¹⁴⁸ Deloitte, “Transfer pricing: Current trends and changes in the landscape,” <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024). See also *Mauritius vs Avago Technologies Trading Ltd*, (ARC/IT/602/15 ARC/IT/145-16 ARC/IT/265-17) [2024]. *ABD Limited v Commissioner for the SARS*, (14302) [2024] ZATC 2.

measures, such as litigation or Mutual Agreement Procedures (“MAPs”), to resolve disputes.¹⁴⁹

2.2.3. Resource constraints and lack of expertise of taxpayers and tax authorities

The tax authorities in developing countries, such as the Republic, may have limited in-house resources and may commission external experts for assistance with transfer pricing matters.¹⁵⁰ For example, in the case of *ABD Limited v Commissioner for the South African Revenue Service (ABD Ltd)*,¹⁵¹ SARS relied on external experts to initiate and advance the case against the taxpayer.¹⁵² Further, SARS has committed to capacitating its transfer pricing unit to reduce the duration of audits and to implement the recently introduced APAs fully.¹⁵³ Small taxpayers' transfer pricing departments (such as “SMEs”) are often not well resourced or have the expertise to deal with transfer pricing matters effectively while simultaneously attempting to grow their businesses.¹⁵⁴

2.2.4. Outdated Practice Note 7

Given the numerous amendments to the OECD Guidelines since the publication of PN 7 in year 1999, taxpayers in the Republic question the extent to which PN 7 can still serve as a transfer pricing guide.¹⁵⁵ PN 7 is based on the 1995 edition of the OECD Guidelines. The OECD Guidelines have, however, undergone multiple amendments since then, with the most recent guideline being published in 2022.¹⁵⁶ The Tax Administration Act (“TAA”) 28 of 2011 has since replaced the section in PN 7 that refer to record-keeping requirements.¹⁵⁷

¹⁴⁹ Deloitte, “Transfer pricing: Current trends and changes in the landscape,” <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024). See also *Mauritius vs Avago Technologies Trading Ltd*, (ARC/IT/602/15 ARC/IT/145-16 ARC/IT/265-17) [2024]. *ABD Limited v Commissioner for the SARS*, (14302) [2024] ZATC 2.

¹⁵⁰ OECD, *Dealing Effectively with the Challenges of Transfer Pricing*, 43,44,59&96.

¹⁵¹ (14302) [2024] ZATC 2.

¹⁵² (4302) [2024] ZATC 2, para 9.

¹⁵³ ENS, “Tax and South Africa 2024,” <https://www.taxand.com/wp-content/uploads/2024/01/South-Africa.pdf> (accessed June 10, 2023).

¹⁵⁴ OECD, *Dealing Effectively with the Challenges of Transfer Pricing*, 58-59.

¹⁵⁵ SAICA, “Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7,” <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

¹⁵⁶ SAICA, “Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7,” <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

¹⁵⁷ SARS, “Duty to Keep the Records, Books of Account or Documents in Terms of Section 29 of the Tax Administration Act 28 Of 2011”, *Government Gazette* 40375:121, (October 28, 2016).

SARS is, however, still of the view that PN 7 is the primary guideline for the implementation of transfer pricing regulations in the Republic, except for the outdated legislative sections.¹⁵⁸ Consequently, a taxpayer must be cautious when relying on PN 7 as a guide to section 31.¹⁵⁹ Amendments made to section 31 and updates to the OECD Guidelines have rendered certain sections of the PN 7 obsolete.¹⁶⁰ For example, section 31 refers to a “connected person”, a term that does not match the definition of a connected person in PN 7. PN 7 provides a 4-step approach to determine an arm’s length price,¹⁶¹ while the latest 2022 OECD Guidelines provide a 9-step approach to determine an arm’s length price.¹⁶²

2.2.5. Challenges associated with Interpretation Note 127

SARS published IN 127 in 2023 to provide guidance on implementing the Arm's Length Principle in the context of cross-border intragroup loans.¹⁶³ The Arm's Length Principle governs the maximum loan amount and interest rate applied to a related party. According to IN 127, the taxpayer has a duty to establish the amount and interest that the entity can loan to or from a related entity.¹⁶⁴ If the transaction is not conducted at arm's length, SARS can deny the deduction of all or part of the interest charge. The denied interest deduction would constitute a dividend *in specie*, subject to dividend tax.¹⁶⁵

The challenge associated with the provisions of IN 127 on intragroup loans is that determining arm’s length consideration for loans and interest can be exhaustive and complex, especially for entities that are not in the business of borrowing or lending money.¹⁶⁶ For example, to ensure compliance with section 31 of the Income Tax Act, the taxpayer may have to conduct an analysis before the loan agreement is entered

¹⁵⁸ SAICA, “Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7,” <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

¹⁵⁹ SAICA, “Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7,” <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

¹⁶⁰ SAICA, “Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7,” <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

¹⁶¹ SARS, PN 7, para 11.18.

¹⁶² OECD, 2022 TP Guidelines, 150-152.

¹⁶³ SARS, Interpretation Note: no.127 Section 31 of the Income Tax Act, 1962 *Determination of the taxable income of certain persons from international transactions: intra-group loans*, (2023), para.2 (hereinafter SARS, IN 127).

¹⁶⁴ SARS, IN 127, para 5.

¹⁶⁵ SARS, IN 127, para 5.

¹⁶⁶ BDO, “Draft Interpretation Note on Intra-group Financial Arrangements welcomed by BDO,” <https://www.bdo.co.za/en-za/insights/2022/tax/draft-interpretation-note-on-intra-group-financial-arrangements-welcomed-by-bdo> (accessed November 2, 2023).

into and periodically throughout the loan. This analysis may include calculating the liquidity and solvency ratios to determine the borrower's creditworthiness, amongst other considerations.¹⁶⁷ IN 127 suggests that SARS may require taxpayers to go beyond simply evaluating the recipient's creditworthiness.¹⁶⁸ This may be an impractical, unreliable and costly exercise for a resource-constrained entity.¹⁶⁹ Moreover, IN 127 places no value on bank opinions as an attestation to an arm's length interest rate, as bank opinions are merely opinions.¹⁷⁰

The absence of updated transfer pricing practice notes or guidelines, reliable benchmarks or safe harbours may cause uncertainty for taxpayers. Taxpayers may be required to employ resources and incur costs in determining the arm's length amounts of financial assistance arrangements with related parties, regardless of the loan amount or size of the entities involved.¹⁷¹ This can significantly burden taxpayers with limited resources who seek to comply with the Arm's Length Principle.¹⁷² In the past, complying with the Arm's Length Principle for intragroup loans was certain, simple and economical by using the safe harbour provided in the defunct PN 2.¹⁷³

2.2.6. Challenges associated with the application of IN 127 and sections 31 and 23M of the Income Tax Act

IN 127 and section 23M of the Income Tax Act contribute to the complexity with respect to the deductibility of interest by resident taxpayers in relation to funding from related

¹⁶⁷ SARS, *IN 127*, para 6-7. See also Webber Wentzel, "New Draft Interpretation Note on Intra-group Financial Transactions brings welcome clarity," <https://www.webberwentzel.com/News/Pages/New-Draft-Interpretation-Note-on-Intra-group-Financial-Transactions-brings-welcome-clarity.aspx>. (Accessed December 20, 2023).

¹⁶⁸ SARS, *IN 127*, para 6.

¹⁶⁹ SAICA, "Comments on the draft interpretation note on Section 31 – determination of the taxable income of certain persons from international transactions: intra-group loans (August 2022)," https://saicawebprstorage.blob.core.windows.net/uploads/resources/SAICA_submission_on_the_Draft_IN_on_Section_31.pdf (accessed November 8, 2023).

¹⁷⁰ SARS, *IN 127*, para 6.

¹⁷¹ CDH, "Are you 'affected' by the release of SARS' Interpretation Note 127?" <https://www.cliffedekkerhofmeyr.com/news/publications/2023/Practice/Tax/tax-and-exchange-control-alerts-16-february-2023-are-you-affected-by-the-release-of-sars-interpretation-note-127.html> (accessed 20 December 2023).

¹⁷² CDH, "Are you 'affected' by the release of SARS' Interpretation Note 127?" <https://www.cliffedekkerhofmeyr.com/news/publications/2023/Practice/Tax/tax-and-exchange-control-alerts-16-february-2023-are-you-affected-by-the-release-of-sars-interpretation-note-127.html> (accessed 20 December 2023).

¹⁷³ Bowmans, "South Africa: an overview of SARS' interpretation note 127," <https://bowmanslaw.com/insights/tax/south-africa-an-overview-of-sars-interpretation-note-127/> (accessed 17 February 2023).

parties.¹⁷⁴ Section 23M of the Income Tax Act limits the deduction of interest incurred by a related party if the interest is not taxable in the hands of the related entity that is paid the interest. The interest deductible is limited to the amount determined as per the formula provided in section 23M (3) of the Income Tax Act.¹⁷⁵ There is a debate on whether entities should prioritise compliance with provisions of section 31 or the interest deduction restriction rules of section 23M.¹⁷⁶ IN127 proposes that section 31 should be applied before section 23M.¹⁷⁷ Section 23M should, therefore, be applied to interest that is at arm's length. The requirement to perform costly and timely studies to comply with transfer pricing regulations requirements may be in vain, as section 23M (not section 31) may have the final word on the deductibility of the interest.¹⁷⁸

2.2.7. Advance Pricing Agreements in the Republic

The Taxation Laws Amendment Act ("TLAA") of 2023 amended the Income Tax Act of 1962 by incorporating the APA provisions.¹⁷⁹ The APA programme is expected to assist with the pricing of complex transactions, promote certainty and simplify documentation requirements for taxpayers in the Republic.¹⁸⁰ The APA programme will be piloted with bilateral APAs before it can be extended to other types of APAs.¹⁸¹ The APA agreement can be entered into for a maximum period of 5 years.¹⁸² APAs will have pre-application fees, application fees, processing fees, maintenance fees and fees related to the extension of existing APAs.¹⁸³ No guidance on the implementation and operation of APAs has to date been published by SARS.¹⁸⁴ SARS has committed

¹⁷⁴ SAICA, "Comments on the draft interpretation note on Section 31 – determination of the taxable income of certain persons from international transactions: intra-group loans (August 2022)," https://saicawebprstorage.blob.core.windows.net/uploads/resources/SAICA_submission_on_the_Draft_IN_on_Section_31.pdf (accessed November 8, 2023).

¹⁷⁵ S 23M (2) of the ITA, 1962.

¹⁷⁶ SARS, *IN 127*, para 14.

¹⁷⁷ SARS, *IN 127*, para 14.

¹⁷⁸ S 23M (2) of the ITA, 1962. See also Bowmans, "South Africa: an overview of SARS' interpretation note 127," <https://bowmanslaw.com/insights/tax/south-africa-an-overview-of-sars-interpretation-note-127/> (accessed 17 February 2023).

¹⁷⁹ Parliamentary Monitoring Group, "Taxation Laws Amendment Bill (B36-2023)" <https://pmg.org.za/bill/1188/> (accessed September 1, 2024).

¹⁸⁰ S 76A-76P of the ITA, 1962.

¹⁸¹ Memorandum on the objects of the Tax Administration Laws Amendment Bill, 2023

¹⁸² S 76K (5) of the Tax Administration Laws Amendment Bill, 2023.

¹⁸³ S 76D of the ITA, 1962.

¹⁸⁴ S 76G (5) of the Tax Administration Laws Amendment Bill, 2023. See also SARS, *Proposed Model for Establishing an Advance Pricing Agreement Programme in South Africa, and Release of Draft Legislation*, (Pretoria: SARS Publishing, 2021), 1. See also National Treasury, SARS, *Final Response Document on the 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill* (Pretoria: National Treasury Publishing, 2024), 73. (hereinafter National Treasury, *Final Response Document on the 2023 Draft Rates and Monetary*

to a 24-month streamlined APA turnaround from the application to the finalisation of an APA.¹⁸⁵

2.2.8. Record-keeping requirements

Before 2016, entities were not mandated to file transfer pricing documentation in the Republic. In line with recommendations outlined in the OECD BEPS Action 13 (2015 Final Report), eligible taxpayers must maintain and submit either a local file and master file or a local file, master file and the CbCR.¹⁸⁶ Entities with potentially affected transactions value that is not above or projected to be above the ZAR100 million threshold do not have to file documentation, but they must maintain records for any affected transaction above or projected to be above ZAR 5 million to evince that the transactions are at arm's length should SARS subject the taxpayer to a risk assessment or transfer pricing audit.¹⁸⁷

The requirement for resident taxpayers with cross-border transactions to maintain comprehensive documentation, regardless of the taxpayer's size, imposes an administrative and compliance burden on taxpayers.¹⁸⁸ Taxpayers must provide comprehensive and meticulous documentation to evince compliance with the Arm's Length Principle for related party transactions.¹⁸⁹ Demonstrating compliance may require human resources, time, and financial means.¹⁹⁰

Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill).

¹⁸⁵ National Treasury, *Final Response Document on the 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill*, 74.

¹⁸⁶ SARS, "Duty to Keep the Records, Books of Account or Documents in Terms of Section 29 of the Tax Administration Act 28 Of 2011", *Government Gazette* 40375:121, (October 28, 2016). See also SARS, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011", *Government Gazette* 41186:628 (October 20, 2017).

¹⁸⁷ SARS, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011", *Government Gazette* 41186:628 (October 20, 2017). See also SARS, "Duty to Keep the Records, Books of Account or Documents in Terms of Section 29 of the Tax Administration Act 28 Of 2011", *Government Gazette* 40375:616, (October 28, 2016).

¹⁸⁸ Grant Thornton, "Transfer Pricing South Africa," <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---South-Africa/> (accessed October 12, 2023).

¹⁸⁹ SAICA, "Feedback summary transfer pricing matters discussed with SARS," https://saicawebprstorage.blob.core.windows.net/uploads/resources/SAICA_Feedback_summary_Meeting_with_SARS_on_Transfer_Pricing_matters.pdf (accessed October 12, 2023).

¹⁹⁰ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

In terms of section 29 of the TAA,¹⁹¹ supporting documents must be kept for a period of five years from the date of filing, audit or disputed assessment.¹⁹² However, there is uncertainty regarding the period for which transfer pricing documentation should be kept by the taxpayer because certain transfer pricing audits exceeded the 5-year retention period or information requested exceeded the 5-year retention period, as specified in section 29 of the TAA.¹⁹³ If a taxpayer fails to comply with the record-keeping requirements,¹⁹⁴ SARS has the authority to impose an administrative penalty for any outstanding documentation.¹⁹⁵

Taxpayers typically keep information for business reporting in a designated business format which can differ from the format in which the tax authority requests transfer pricing information during a risk assessment or transfer pricing audit.¹⁹⁶ SARS normally provides a template, requiring the taxpayer to complete the risk assessment document and attach supporting documentation.¹⁹⁷ Collating information and attaching supporting documentation in a format not previously used by the taxpayer may be costly and time-consuming, given the limited time normally granted to submit supporting documentation in a particular format to SARS.¹⁹⁸

During risk assessments or transfer pricing audits, tax officials may request information that was previously submitted to SARS. Requesting information without coordinating amongst tax officials can be frustrating to taxpayers.¹⁹⁹ Owing to the

¹⁹¹ TAA, 2011.

¹⁹² SARS, "Record-Keeping," <https://www.sars.gov.za/client-segments/record-keeping/> (accessed June 5, 2023).

¹⁹³ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023) See also Deloitte, Transfer pricing: Current trends and changes in the landscape, <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024).

¹⁹⁴ Grant Thornton, "Transfer Pricing South Africa," <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---South-Africa/> (accessed October 12, 2023).

¹⁹⁵ Grant Thornton, "Transfer Pricing South Africa," <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---South-Africa/> (accessed October 12, 2023).

¹⁹⁶ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

¹⁹⁷ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

¹⁹⁸ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

¹⁹⁹ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

unique and circumstantial nature of transfer pricing audits and disputes, it is difficult to anticipate the specific information that would be requested in a dispute and to be kept by the taxpayer.²⁰⁰ Small taxpayers may be more burdened, as small taxpayers are required to allocate substantial resources (financial and human), and time to comply with transfer pricing regulations. A fine balance should be struck between the objectives of regulations and the ability of taxpayers to comply with these regulations.²⁰¹ There is still a lack of guidance on the extent to which taxpayers should prepare these time-consuming and costly compliance documents.²⁰²

2.2.9. Lack of comparable data

The cornerstone of the Arm's Length Principle is comparable data.²⁰³ Comparable data to price-controlled transactions often do not exist, especially in developing jurisdictions. In developing jurisdictions, there are fewer taxpayers in each sector compared to developed jurisdictions which can affect reliability and availability of comparable data.²⁰⁴ Taxpayers in developing jurisdictions depend on the databases of taxpayers in developed countries. Adopting a database from a different jurisdiction with a certain level of risk can require the taxpayer to make adjustments that consider the political, economic, and other jurisdiction-specific factors to make the comparable data reliable.²⁰⁵ Without reliable, comparable data, taxpayers continue to experience difficulties and uncertainty in determining the arm's length prices of controlled transactions.²⁰⁶

²⁰⁰ Graphene Economics, *Transfer Pricing Trends in Africa*, 12 and 36.

²⁰¹ SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

²⁰² SAICA, "Concerns regarding SARS transfer pricing information requests," https://saicawebprstorage.blob.core.windows.net/uploads/resources/2020_11_19_Transfer_Pricing_information_requests_b.pdf (accessed October 12, 2023).

²⁰³ Philippe Paumier, "is it the arm's length principle or our ability to apply it?" <https://www.linkedin.com/pulse/arms-length-principle-our-ability-apply-philippe-paumier> (accessed September 12, 2023).

²⁰⁴ Lorraine Eden, *The Arm's Length Standard: Making it Work in a 21st Century World of Multinationals and Nation States* (Oxford: Oxford University Press, 2015) 162-163.

²⁰⁵ Bert Steens, "Transfer Pricing Comparables: Preferring a Close Neighbour Over a Far-Away Peer?" *Journal of International Accounting, Auditing and Taxation* 47, no 1(2022):16-18.

²⁰⁶ OECD, "Transfer Pricing Comparability Data and Developing Countries," <https://www.oecd.org/ctp/transfer-pricing/transfer-pricing-comparability-data-developing-countries.pdf> (accessed September 13, 2023).

2.3. Simplification measures in the Republic

The Republic has no transfer pricing simplification measures, other than transfer pricing documentation exemption and simplification measures for related party transactions with a value less than a set threshold.²⁰⁷

2.4. Conclusion

This chapter examined the development of transfer pricing regulations in the Republic and the transfer pricing methodologies recommended by SARS. The chapter identified the challenges experienced with compliance with transfer pricing regulations in the Republic.

Taxpayers experience challenges when complying with section 31 owing to the evolving nature of transfer pricing regulations internationally,²⁰⁸ lack of tax certainty,²⁰⁹ the burden of the record retention requirements, especially on smaller and medium taxpayers,²¹⁰ the limited resources and transfer pricing expertise of SARS²¹¹ and outdated transfer pricing guidelines or practice notes.²¹² Increased scrutiny of controlled transactions has given rise to more transfer pricing audits and disputes.²¹³ Taxpayers are exploring measures other than the ADR process, such as litigation or engaging in proceedings through the MAP process to resolve transfer pricing disputes.²¹⁴

²⁰⁷ SARS, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011", *Government Gazette* 41186:628 (October 20, 2017).

²⁰⁸ SARS, *IN 127*.

²⁰⁹ Deloitte, "Transfer pricing: Current trends and changes in the landscape," <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024).

²¹⁰ Deloitte, "The tax compliance burden for small and medium enterprise," <https://www.deloitte.com/za/en/services/tax/perspectives/the-tax-compliance-burden-for-small-and-medium-enterprises.html> (accessed June 17 2024).

²¹¹ OECD, *Dealing Effectively with the Challenges of Transfer Pricing*, 43,44,59&96.

²¹² SAICA, "Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7," <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

²¹³ Graphene Economics, *Transfer Pricing Trends in Africa*, 12.

²¹⁴ Deloitte, "Transfer pricing: Current trends and changes in the landscape," <https://www.deloitte.com/za/en/services/tax/perspectives/transfer-pricing-current-trends-and-changes-in-the-landscape.html> (accessed May 5, 2024).

Chapter 3: Transfer pricing simplification measures recommended by the OECD and those available in the selected Commonwealth jurisdictions

3.1. Introduction

This chapter examined transfer pricing simplification measures recommended by the OECD and those available in the selected Commonwealth jurisdictions. It examined the rationale for implementing simplification measures and the benefits and drawbacks associated with these measures. The five selected Commonwealth jurisdictions were India, the United Kingdom, Canada, Australia, and Zambia. These Commonwealth jurisdictions share similar legislative systems rooted in English common law.²¹⁵

3.2. Transfer pricing simplification measures

Transfer pricing simplification measures seek to provide certainty for both taxpayers and tax authorities. These measures also seek to mitigate challenges associated with limited resources, the unavailability of comparable data, and compliance and administrative burden on taxpayers and tax authorities, without abandoning the objective of achieving an arm's length outcome or a reasonable estimate of an arm's length outcome.²¹⁶ A 2012 OECD survey revealed that numerous jurisdictions have implemented simplification measures in their local tax legislation.²¹⁷ The simplification measures are broadly classified into the following categories:²¹⁸

- Exemption from transfer pricing regulations;
- Documentation exemption and simplification measures;
- Safe harbour arm's length ranges or rates;
- The simplified transfer pricing method for low value-adding intragroup services;
- Simplified advance pricing arrangement procedures or reduced APA charges;
- The Commodity Rule ("Sixth Method");²¹⁹ and
- The simplified and streamlined approach ("SSA") for baseline marketing and distribution functions.²²⁰

²¹⁵ Commonwealth of nations, "The legal sector in the Commonwealth," <https://www.commonwealthofnations.org/?sectors=business/legal#:~:text=The%20vast%20majority%20of%20legal,law%2C%20customary%20law%20and%20Shariah> (accessed May 15, 2024).

²¹⁶ OECD, *2022 TP Guidelines*, 33. See also Navarro, "Simplification in Transfer Pricing": 756-758.

²¹⁷ OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 5.

²¹⁸ OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 6&20.

²¹⁹ IGF, *Using the Sixth Method to Simplify the Pricing*.

²²⁰ BDO, "South Africa - Pillar One and Amount B," <https://www.bdo.global/en-gb/insights/tax/transfer-pricing/south-africa-pillar-one-and-amount-b> (accessed September 20, 2024).

3.2.1. Exemption from transfer pricing regulations

Certain jurisdictions exempt certain taxpayers from transfer pricing regulations based on the size of the taxpayer or the transaction risk level. Qualifying taxpayers can elect to be exempt or opt out of the exemption. Exempt taxpayers are monitored for their eligibility to apply for the exemption.²²¹

- a. The rationale for the implementation and benefits of the exemption from transfer pricing regulations

The exemption is designed for low-risk taxpayers that engage in minor transactions.²²² The exemption from transfer price regulations benefits low-risk taxpayers who lack the resources to comply with them.²²³ Tax authorities will then be able to direct their limited resources to auditing transactions involving substantial amounts or risk.²²⁴

- b. The drawbacks of the exemption from transfer pricing regulations

Exempt taxpayers may still have to comply with transfer pricing regulations as required in the corresponding transacting jurisdiction. There is, therefore, a risk of double taxation if the tax authority of the corresponding transacting jurisdiction does not recognise the exemption from transfer regulation.²²⁵ The exemption from transfer pricing regulations also presents an opportunity for exploitation, as taxpayers may engage in tax planning and understate their revenue or the value of transactions to qualify for the exemption.²²⁶

²²¹ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed May 20, 2024).

²²² European Commission, EU joint Transfer Pricing Forum, *Background information on SMEs* (Brussels: EU Publishing, 2010) 2&3. (hereafter, EU, *Background information on SMEs*.)

²²³ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed May 20, 2024). See also ATO, "Simplifying transfer pricing record-keeping," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/international-transfer-pricing-introduction-to-concepts-and-risk-assessment/simplifying-transfer-pricing-record-keeping> (accessed March 14, 2024).

²²⁴ EU, "Background information on SMEs," 2&3. See also Chris Evans et al, eds., *Tax Simplification an African Perspective*, (Pretoria: Pretoria University Law Press, 2019), 15.

²²⁵ European commission, "Explanatory Memorandum to COM(2012)516 - Work of the EU Joint Transfer Pricing Forum in the period July 2010 to June 2012 and related proposals," https://www.eumonitor.eu/9353000/1/j4nvhdjdk3hydzq_j9vvik7m1c3gyxp/vj31rr6dfzyz (accessed March 17, 2024).

²²⁶ OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 36. Tax Platform for Collaboration on Tax (PCT) et al, *Practical Toolkit to Support the Successful Implementation by Developing Countries of Effective Transfer Pricing Documentation Requirements* (Washington, DC: PCT Publishing, 2021) 25, 26, 33-37. (hereinafter PCT et al, *Practical Toolkit to Support the Successful Implementation by Developing Countries of Effective Transfer Pricing Documentation Requirements*.)

While there is no requirement to file transfer pricing documents when exempt, there is no certainty that the tax authority will automatically approve the transaction price as being at arm's length and not adjust the transfer price should the tax authority revoke the exemption relied upon by the taxpayer. Exempt taxpayers should, therefore, still maintain documentation to evince compliance with the arm's length principle for all material transactions.²²⁷ A taxpayer who relied on the exemption and did not prepare contemporaneous documentation to evince compliance with the Arm's Length Principle, may be vulnerable to adjustments or penalties.²²⁸

c. The exemption from transfer pricing regulations in the United Kingdom

The European Union ("EU") recommended in 2011 that small and medium-sized enterprises ("SMEs") be exempted from transfer pricing regulations. The recommendation was made owing to concerns regarding the limited resources of SMEs. The exemption of SMEs from regulations is only suitable if other EU members also exempt SMEs, because the unequal treatment of SMEs by different member states or jurisdictions could lead to uncertainty and the risk of double taxation.²²⁹

Legislation in the UK grants an exemption to SMEs from transfer pricing rules.²³⁰ A taxpayer that qualifies as an SME must have a maximum of 250 employees and meet one or both financial limits. The limits are a turnover of less than €50 million and/or balance sheet value of up to a maximum of €43 million.²³¹ Further, these limits apply to the entire group (not a particular entity) where the taxpayer is part of an MNE group.²³²

²²⁷ OECD, 2022 TP Guidelines, 229-231,234&235. See also ATO, "Simplifying transfer pricing record-keeping," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/international-transfer-pricing-introduction-to-concepts-and-risk-assessment/simplifying-transfer-pricing-record-keeping> (accessed March 14, 2024).

²²⁸ European Commission, EU Joint Transfer Pricing Forum, *on the work of the EU Joint Transfer Pricing Forum in the period April 2009 to June 2010 and related proposals 1. Guidelines on low value adding intra-group services and 2. Potential approaches to non-EU triangular cases* (Brussels: EU Publishing, 2011), 19. See also EU, *Background information on SMEs*, 4 -5.

²²⁹ European Commission, EU joint Transfer Pricing Forum, *Report on Small and Medium Enterprises and Transfer Pricing*, (EU Publishing: Brussels, 2011) 3&4.

²³⁰ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

²³¹ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412080> (accessed February 17, 2024).

²³² HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412080> (accessed February 17, 2024).

The exemption is not absolute. It is not applicable to the below

- First, where an SME transacts with a related entity in a jurisdiction without “an appropriate non-discrimination article” in the treaty with the UK. An appropriate non-discrimination article ensures that taxpayers from both the contracting and other states receive fair and equitable treatment;²³³
- Secondly, if an SME is involved in a transaction relating to a patent box claim, the tax authority reserves the right to notify the taxpayer to calculate their profits according to the transfer pricing regulations and restrict the SME from relying on the exemption;²³⁴
- Thirdly, the UK tax authority may issue a notice to an exempt SME demanding that the taxpayer calculate their taxable profits according to the transfer pricing regulations per the notice; and
- Finally, if the SME elects to opt out of the exemption and comply with the transfer pricing regulations.²³⁵ The election is irrevocable for a specific period and will apply to all transactions during that period.²³⁶

The SME exemption aims to ease compliance with transfer pricing regulations.²³⁷ However, the SME exemption can expose taxpayers to double taxation in jurisdictions outside the EU that do not recognise it. This can trigger tax disputes with foreign tax authorities. The taxpayer can mitigate such risks and achieve tax certainty by complying with transfer pricing regulations rather than relying on the exemption, especially where the corresponding transacting jurisdiction does not offer a similar SME exemption.²³⁸ His Majesty's Revenue and Customs (“HMRC”) can revoke the SME exemption for any reason it deems legally suitable.²³⁹

²³³ HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

²³⁴ HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

²³⁵ HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

²³⁶ HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

²³⁷ European Commission, EU joint Transfer Pricing Forum, *Report on Small and Medium Enterprises and Transfer Pricing*, 3&4.

²³⁸ European Commission, EU joint Transfer Pricing Forum, *Report on Small and Medium Enterprises and Transfer Pricing*, 3&4.

²³⁹ HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

3.2.2. Safe harbours

Safe harbours are a set of prescribed rules that apply to specific categories of taxpayers or transactions and relieve qualifying taxpayers from the requirements of transfer pricing regulations.²⁴⁰ Safe harbours allow taxpayers to calculate transfer prices using safe harbour ranges or interest rates.²⁴¹ Safe harbours are recommended by the OECD Guidelines where benefits outweigh the associated concerns. The OECD Guidelines encourage jurisdictions with limited administrative resources to adopt simplified transfer pricing regulations by using safe harbours.²⁴²

a. The rationale for the implementation and benefits of safe harbours

Safe harbours are appropriate for SMEs or for low-risk transactions and when adopted by multiple tax authorities.²⁴³ Generally, taxpayers need to perform benchmarking studies, which assist them in pricing controlled transactions at arm's length.²⁴⁴ Tax authorities, especially in developing jurisdictions, have been stringently evaluating and challenging these benchmark studies. Several tax authorities in developing jurisdictions have rejected benchmarking studies, as the comparable data used by the taxpayer did not constitute reliable local or regional comparable data. Consequently, the tax authorities may adjust the markup or margin applied by the taxpayer for such controlled transactions.²⁴⁵

Various jurisdictions are encouraged to use bilateral or multilateral safe harbours to lower the risk of adjustments. Safe harbours may be customised to the arm's length price in multiple jurisdictions.²⁴⁶ Safe harbours can also be established selectively with jurisdictions that have similar tax rates to reduce the likelihood of the abuse of safe harbours.²⁴⁷

Developing jurisdictions could adopt bilateral or multilateral safe harbours through Memoranda of Understanding ("MOU") with treaty partners as a strategy to safeguard

²⁴⁰ OECD, *2022 TP Guidelines*, 204&205.

²⁴¹ OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 6&20.

²⁴² OECD, *2022 TP Guidelines*, 204&205.

²⁴³ OECD, *2022 TP Guidelines*, 204&205.

²⁴⁴ OECD, *2022 TP Guidelines*, 93-95&223.

²⁴⁵ Graphene Economics, "Regional African Trends in Transfer Pricing Audits," <https://grapheneeconomics.com/regional-african-trends-in-transfer-pricing-audits/> (accessed September 6, 2024).

²⁴⁶ OECD, *2022 TP Guidelines*, 212, 213&495. See also Navarro, "Simplification in Transfer Pricing": 770.

²⁴⁷ OECD, *2022 TP Guidelines*, 212, 213&495.

local tax revenue.²⁴⁸ For example, Mexico and the United States have a bilateral safe harbour programme in place, offering a standard formula to determine the tax profit for a targeted industry, known as *Maquiladora*.²⁴⁹ The use of safe harbours may also allow the tax authorities to redirect their limited resources to high-risk transactions and taxpayers.²⁵⁰

b. The drawbacks of safe harbours

Safe harbours have limited application. They only apply to certain transactions and to low-risk taxpayers. Unilateral safe harbours increase the risk of double taxation when the predetermined fixed margin, mark-up, or ratio is not recognised in the corresponding transacting jurisdiction. Safe harbours may also assist with tax planning and tax avoidance. However, their use can raise legal questions about tax uniformity and equality.²⁵¹

c. Safe harbours in India

Sections 92C and 92CA of the India Income Tax Act provide safe harbour regulations.²⁵² Transactions concluded with related entities in jurisdictions that are seen to be tax havens are ineligible for safe harbours.²⁵³ The tax authority introduced the Safe Harbour Provisions in 2013.²⁵⁴ Rule 10TD of the Income Tax Rules specifies the following safe harbour margins:²⁵⁵

²⁴⁸ OECD, *2022 TP Guidelines*, 495.

²⁴⁹ OECD, *2022 TP Guidelines*, 495.

²⁵⁰ OECD, *2022 TP Guidelines*, 204&206.

²⁵¹ OECD, *2022 TP Guidelines*, 207. See also Navarro, “Simplification in Transfer Pricing”:782 -785.

²⁵² S 92 of the Tax Act 43 of 1961. (hereinafter Tax Act).

²⁵³ R 10TF of the Tax Rules, 1962. (hereinafter Tax Rules).

²⁵⁴ R 10TE (2) of the Tax Rules.

²⁵⁵ R 10TD of the Tax Rules. See also BDO, “CBDT amends the Safe Harbour Rules,” <https://www.bdo.in/en-gb/insights/alerts-updates/transfer-pricing-cbdt-amends-the-safe-harbour-rules#:~:text='Safe%20harbour%20rules'%20means%20circumstances,price%20declared%20by%20the%20taxpayer.pdf> (accessed February 17, 2024).

Eligible cross-border transactions:²⁵⁶	Transaction threshold limit value (in Indian Rupees (“INR”)):	Safe harbour margins:²⁵⁷
Provision of software development services and information technology-enabled services:	Up to 1 billion	17% or more to total operating costs
	Up to 2 billion but more than 1 billion	18% or more to total operating costs
Provision of knowledge process outsourcing services with insignificant risks:	Up to 2 billion	At least 24% and employee costs to operating expenses of at least 60%
		At least 21% and employee costs to operating expenses of at least 40% but no more than 60%
		At least 18% and employee costs to operating expenses of at least 40% or less
Providing corporate guarantees:	No threshold	At least 1% per annum on the amount guaranteed
Provision of contract research and development services and	Up to 2 billion	At least 24% margin to total operating costs

²⁵⁶ R 10TB and 10 TC of the Tax Rules.

²⁵⁷ BDO, “CBDT amends the Safe Harbour Rules,” <https://www.bdo.in/en-gb/insights/alerts-updates/transfer-pricing-alert-cbd-t-amends-the-safe-harbour-rules-to-fiscal-year-2022-23> (accessed February 17, 2024). See also EY, “India Tax Administration extends applicability of transfer pricing safe harbour rules to financial year 2019-20,” <https://taxnews.ey.com/news/2020-1393-india-tax-administration-extends-applicability-of-transfer-pricing-safe-harbour-rules-to-financial-year-2019-20> (accessed February 17, 2024).

Eligible cross-border transactions:²⁵⁶	Transaction threshold limit value (in Indian Rupees (“INR”)):	Safe harbour margins:²⁵⁷
related software development with considerable risks:		
Providing contract research and development services related to generic pharmaceutical products, with considerable risks:	Up to 2 billion	At least 24% margin to total operating costs
Manufacturing and export of auto components:	No threshold	At least 12% margin to total operating costs for core components At least 8.5% margin to total operating costs for non-core components
low value-adding intragroup services:	Up to 100 billion inclusive of markup	Markup on costs not exceeding 5%; and The accountant must certify the cost pooling method, the exclusion of any duplicates, shareholders’ costs and the reasonableness of allocation keys

Eligible cross-border transactions	Threshold limit value (in Indian rupees (“INR”))	Basis points (“bps”)	Credit rating of a related entity²⁵⁸
Advance intragroup loans in foreign currency:	More than 2.5 billion	150bps	AAA; AA+; AA; AA-; A+; A; A- or equivalent
		300bps	BBB+; BBB; BBB- or equivalent
		450bps	BB+; BB; BB-; B+; B; B- or equivalent
		600bps	C+; C; C-; D or equivalent or where the credit ratings of the associated enterprise are not available
	Less than 2.5 billion	150bps	AAA, AA+; AA; AA-; A+; A; A- or equivalent
		300bps	BBB+; BBB; BBB- or equivalent
		400bps	BB+; BB; BB-; B+; B; B-; C+; C; C-; D or equivalent or where the credit ratings of the associated enterprise are not available
Advance intragroup loans in local currency:	No threshold	175bps	AA to A or equivalent
	No threshold	325bps	BB-; BBB or BBB+ or equivalent

²⁵⁸ by a registered credit agency and accredited by Reserve Bank of India (RBI).

Eligible cross-border transactions	Threshold limit value (in Indian rupees (“INR”))	Basis points (“bps”)	Credit rating of a related entity ²⁵⁸
	No threshold	475bps	BB to B or equivalent
	No threshold	675bps	C to D or equivalent
	1 billion	425bps	Where the credit ratings of the associated enterprise are not available

Since the introduction of transfer pricing regulations in India, many challenges with these regulations have been noted. India witnessed an increase in transfer pricing audits owing to taxpayers' inappropriate pricing of related party transactions.²⁵⁹ This resulted in adjustments to the profits of taxpayers. Potential adjustments created obstacles for taxpayers seeking to attract foreign direct investment, as the adjustments undermined the fundamental objectives of offshoring to India owing to lower costs and access to a skilled workforce.²⁶⁰

Indian tax authorities deemed it appropriate to implement safe harbour regulations in 2013 to reduce taxpayer uncertainty while maintaining the tax base.²⁶¹ The safe harbours were initially not well received by taxpayers owing to their perceived high margins and ambiguity in the categorisation of services.²⁶² Minor amendments were

²⁵⁹ Embassy of India, “Safe Harbour Rules,” <https://www.indianembassyusa.gov.in/taxdata?id=12> (accessed February 17, 2024).

²⁶⁰ Bathiya, “Safe Harbour Concept,” <https://www.bathiya.com/safe-harbour-a-primer-into-a-promising-transfer-pricing-concept/> (accessed February 17, 2024).

²⁶¹ Bathiya, “Safe Harbour Concept,” <https://www.bathiya.com/safe-harbour-a-primer-into-a-promising-transfer-pricing-concept/> (accessed February 17, 2024).

²⁶² KPMG, “CBDT notifies revised Safe Harbour Rules,” <https://www.in.kpmg.com/taxflashnews/KPMG-Flash-News-CBDT-notifies-revised-Safe-Harbour-Rules-2.pdf> (accessed February 17, 2024).

affected to India's safe harbours in 2017, 2019, 2021 and 2024 to reflect economic changes and address taxpayers' concerns.²⁶³

A drawback associated with India's safe harbours is that they may not receive equal recognition in other jurisdictions, since the safe harbours are unilaterally adopted and may pose a risk of double taxation to taxpayers.²⁶⁴ Further, India's low value-adding services safe harbour differs from that recommended by the OECD, in that India's safe harbours exclude services such as information technology ("IT"), knowledge, and business process outsourcing ("K/BPO") from the definition of low value-adding intragroup services.²⁶⁵

3.2.3. Simplified approach to low value-adding intragroup services

A low value-adding intragroup service is a service that is rendered by a related entity (or entities) of a MNE group to its related entities.²⁶⁶ The service must be supportive in nature, should not constitute the main source of income for the MNE group nor make a major economic contribution to the group. The service must not be core to the business operations of a MNEs but be ancillary in nature. The service should not require the use of or produce unique or valuable tangibles. The service should not require the service provider to assume a sizeable risk nor result in a significant risk for the service provider.²⁶⁷

Low value-adding intragroup services include back-office functions (for example, accounting, human resources, compliance, audits, information technology, communications, and legal services) that are not core to the entity's primary business operations.²⁶⁸ These services exclude activities such as financial transactions, services that relate to extraction and sale of commodities, distribution activities and management services.²⁶⁹ Certain services are excluded owing to the material risk

²⁶³ Deloitte, "India issued Safe harbour rates for FY 2019-20 for determining arm's length price for certain specified transactions," <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/Transfer%20Pricing/in-tax-tp-alert-india-issued-safe-harbour-rates-for-fy-2019-20-for-determining-arms-length-price-for-certain-specified-transactions-noexp.pdf> (accessed February 17, 2024).

²⁶⁴ International Tax Review, "India Budget offers safe harbour as fast track solution to disputes," <https://www.internationaltaxreview.com/article/2a6a094t07nejpmmb7j7k/india-budget-offers-safe-harbour-as-fast-track-solution-to-disputes> (accessed March 3, 2024).

²⁶⁵ Grant Thornton, "Navigating the Revised Indian Safe Harbour Rules," <http://gtw3.grantthornton.in/assets/TP-Niche/Article-on-Safe-Harbour.pdf> (accessed March 3, 2024).

²⁶⁶ OECD, *2022 TP Guidelines*, 327.

²⁶⁷ OECD, *2022 TP Guidelines*, 327&332.

²⁶⁸ OECD, *2022 TP Guidelines*, 327–329.

²⁶⁹ OECD, *2022 TP Guidelines*, 327–330.

associated with them or because these transactions contributed to unique and valuable intangibles.²⁷⁰

A simplified approach to calculate low value-adding intragroup services charges the beneficiary of the services for expenses incurred and then adds a 5% set profit markup. The MNE group first determines the pool of costs incurred in carrying out the low value-adding service. Pass-through costs and costs related to shareholder activities are then subtracted from the total pool of costs.²⁷¹ Pass-through costs²⁷² are recovered without a mark-up, as no commercial benefit is provided. Shareholder services are primarily for the benefit of the service provider (not the recipient); hence, the cost of these services is removed from the cost pool.²⁷³ The MNE then distributes a share of the pooled costs to each entity that benefited from the low value-adding intragroup service using a standard allocation key. The allocation key must reflect the extent to which each recipient benefited from the service. The party that provided the service then recovers the cost of the service and adds a 5% profit mark-up (per the OECD Guidelines) to the cost.²⁷⁴

a. The rationale for the implementation and benefits of low value-adding intragroup services

The low value-adding intragroup services simplification measure benefits taxpayers by not requiring taxpayers to perform a benchmarking study to justify the standard markup of 5% (the markup as recommended by the OECD). The standard markup simplifies the complexity involved in determining transfer prices for intragroup services.²⁷⁵ Furthermore, the transfer pricing community widely recognises the OECD Guidelines. The OECD Guidelines are the cornerstone for transfer pricing regulations. The guidelines provide a common framework to encourage uniformity across jurisdictions and mitigate the risk of double taxation and disputes between tax authorities and taxpayers.²⁷⁶

²⁷⁰ OECD, *2022 TP Guidelines*, 329–330.

²⁷¹ OECD, *2022 TP Guidelines*, 332–334.

²⁷² Pass-through costs are costs that a related party incurs on behalf of a related party from a third party and then transfers these costs to the related party as they are.

²⁷³ OECD, *2022 TP Guidelines*, 332&334.

²⁷⁴ OECD, *2022 TP Guidelines*, 334.

²⁷⁵ OECD, *2022 TP Guidelines*, 331.

²⁷⁶ OECD, *2022 TP Guidelines*, 12.

By using the 5% standard markup to calculate the transfer prices of low value-adding intragroup services, it reduces the cost of compliance, streamlines the compliance process, offers certainty to taxpayers and reduces documentation to be submitted to the tax authority.²⁷⁷ The taxpayer that relies on the simplified method merely needs to evince that the services rendered are of low value and the recipient benefited from these services, for which a third party in similar circumstances would ordinarily source and pay for such services or source such services in-house.²⁷⁸

b. The drawbacks of low value-adding intragroup services

Tax authorities in developing jurisdictions are likely to contest these services, especially those that relate to support services.²⁷⁹ Tax authorities believe that some of the low value-adding intragroup services should be sourced locally or be pre-approved before being sourced from a related party in another jurisdiction.²⁸⁰ Tax authorities may challenge the cost markup, or the allocation keys used to determine the charges. It is highly probable that the tax authority will still examine the low value-adding services and require benchmarking studies instead of readily accepting the OECD's standard markup of 5%.²⁸¹

Although the taxpayers are subject to reduced transfer pricing documentation requirements, they are still required to document the categories of services rendered and the underlying cost base for these services. This further includes maintaining all written contracts entered for the services rendered and the allocation keys used.²⁸² Documenting the cost base and the nature of services rendered from these written contracts may be time-consuming for the taxpayer.²⁸³ Levying withholding taxes on low value-adding intragroup services can limit the service provider from fully

²⁷⁷ OECD, *2022 TP Guidelines*, 333&327.

²⁷⁸ OECD, *2022 TP Guidelines*, 331.

²⁷⁹ Graphene Economics, "Regional African Trends in Transfer Pricing Audits," <https://grapheneeconomics.com/regional-african-trends-in-transfer-pricing-audits/> (accessed September 6, 2024).

²⁸⁰ FSB, *Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships* (Basel: FSB publishing, 2020) See also BOT, *Outsourcing Guidelines for Banks and Financial Institutions*, (Dar es Salaam: BOT publishing, 2008).

²⁸¹ KPMG, "Transfer Pricing low-value-adding intercompany services." <https://kpmg.com/ch/en/insights/taxes/transfer-pricing-low-value-adding-intercompany-services.html> (accessed May 1, 2024). See also Graphene Economics, "Regional African Trends in Transfer Pricing Audits," <https://grapheneeconomics.com/regional-african-trends-in-transfer-pricing-audits/> (accessed September 6, 2024).

²⁸² OECD, *2022 TP Guidelines*, 335.

²⁸³ KPMG, "Transfer Pricing low-value-adding intercompany services" <https://kpmg.com/ch/en/insights/taxes/transfer-pricing-low-value-adding-intercompany-services.html> (accessed May 1, 2024).

recovering the costs associated with rendering the services. The OECD encourages taxpayers to levy a withholding tax on the profit mark-up (not on the service charges).²⁸⁴

The 5% markup may not accurately represent the true value of the services rendered. Services may add varying degrees of value. Using a standard markup could result in pricing discrepancies.²⁸⁵ Some jurisdictions may not acknowledge a standard markup for similar services as being at arm's length.²⁸⁶ This could result in adjustments or an increase in the risk of double taxation. The standard markup may encourage taxpayers to manipulate transfer prices to reduce their tax liabilities.²⁸⁷

c. Simplified approach to low value-adding intragroup services in the United Kingdom

The HMRC International Manual 440071 prescribes the principles and best practices as established by the OECD Guidelines for low value-adding intragroup services to be applied.²⁸⁸ The OECD Guidelines provide for a simplified method when dealing with low value-adding intragroup services.²⁸⁹ The HMRC Manual agrees that a simplified approach to low value-adding intragroup services is appropriate, since these services are low risk and do not warrant substantial resource use.²⁹⁰

The arm's length price for low value-adding intragroup services is equal to the service cost incurred by the related entity plus a 5% markup on the relevant service cost. The markup does not require justification through a benchmarking study.²⁹¹ The low value-adding intragroup service simplification measure seeks to establish the equitable treatment and compensation for these services across multiple jurisdictions

²⁸⁴ OECD, *2022 TP Guidelines*, 336.

²⁸⁵ KPMG, "Transfer Pricing low-value-adding intercompany services." <https://kpmg.com/ch/en/insights/taxes/transfer-pricing-low-value-adding-intercompany-services.html> (accessed May 1, 2024).

²⁸⁶ OECD, *2022 TP Guidelines*, 335.

²⁸⁷ OECD, *2022 TP Guidelines*, 204&207

²⁸⁸ OECD, "The United Kingdom and the OECD," <https://www.oecd.org/unitedkingdom/united-kingdom-and-oecd.htm#:~:text=The%20United%20Kingdom%2C%20along%20with,achieving%20the%20Organisation's%20fundamental%20aims> (accessed March 18, 2023). See also HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm440071> (accessed February 17, 2024).

²⁸⁹ OECD, *2022 TP Guidelines*, 327-330.

²⁹⁰ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm440071> (accessed February 17, 2024).

²⁹¹ OECD, *2022 TP Guidelines*, 334.

(especially for OECD member states). This measure allows the UK tax authority to allocate resources to high-risk services.²⁹²

The taxpayer will be assessed on whether the transaction qualifies to apply a 5% markup on low value-adding intragroup services, without applying the underlying arm's length test. The HMRC requires a taxpayer relying on these services simplification measure to keep records outlining the nature of each type of low value-adding intragroup service, the rationale for categorising the services as low value-adding intragroup services, the benefit derived by recipients of the low value-adding intragroup services, the allocation keys used for each category, contracts concluded between the involved parties and the computation of the costs.²⁹³

3.2.4. Commodity Rule ("Sixth Method")

The Commodity Rule ("Sixth Method") is a simplified version of the OECD CUP method. It is specifically designed to address challenges such as the lack of comparable data owing to different commodities' unique nature.²⁹⁴

The Commodity Rule is characterised by its reliance on publicly published prices from the commodity exchange market on shipment date.²⁹⁵ In some jurisdictions, the related party price for a commodity is determined as the higher price between when the commodity is sold to a related party, or on the shipment date to a third-party buyer.²⁹⁶ Jurisdictions follow different approaches in applying the Commodity Rule, resulting in no universal approach. Several jurisdictions use publicly published prices to establish an acceptable arm's length price for the commodity sale involving related entities.²⁹⁷

²⁹² OECD/G20 Base Erosion and Profit Shifting Project, *Aligning Transfer Pricing Outcomes with Value Creation*, Actions 8-10 (Paris: OECD Publishing, 2015) 142. See also HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm440071> (accessed February 17, 2024).

²⁹³ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm440071> (accessed February 17, 2024).

²⁹⁴ Alexandra Readhead, Natural Resources Governance Institute, *Special Rules for Commodity Sales: Zambia's Use of the 'Sixth Method'* (2017) 3.

²⁹⁵ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 200.

²⁹⁶ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 202.

²⁹⁷ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 202.

a. The rationale for and benefits of the Commodity Rule

The Commodity Rule offers the benefit of certainty and simplicity, especially in jurisdictions with limited comparable data.²⁹⁸ The OECD Guidelines support the use of publicly published prices for applying the CUP method to commodities.²⁹⁹ In terms of the OECD Guidelines, taxpayers must make adjustments to commodity transactions and account for the physical characteristics, the quality of the commodity and other considerations, such as transportation, insurance, variations in foreign exchange rates and payment terms.³⁰⁰

The Commodity Rule is a more objective method (compared to the CUP method) to price commodities in jurisdictions lacking reliable comparable data. The Rule only allows for limited adjustments if necessary. The Commodity Rule offers an unbiased frame of reference when pricing commodity transactions.³⁰¹ Commodity Rule prices are subject to fewer adjustments and are, therefore, less likely to be manipulated. Compliance with the Commodity Rule may be easily examined by tax authorities with limited resources.³⁰² Taxpayers can opt out of the Commodity Rule and rely on the OECD's recommended transfer pricing methods to determine arm's length prices provided that the Commodity Rule may be rebutted.³⁰³

b. The drawbacks of the Commodity Rule

The Commodity Rule deviates from the OECD's Guidelines on pricing commodities. This may result in the method not being widely accepted by tax authorities.³⁰⁴ The lack of or limited adjustments may result in commodity prices that are not at arm's length and do not reflect the actual economic conditions of the transaction.³⁰⁵ The Commodity Rule may lead to overcompensation, as it may fail to consider material adjustments required to bring the commodity price to an arm's length price.³⁰⁶ The

²⁹⁸ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 200&201.

²⁹⁹ OECD, *2022 TP Guidelines*, 99.

³⁰⁰ OECD, *2022 TP Guidelines*, 99.

³⁰¹ IGF, *Using the Sixth Method to Simplify the Pricing*, 1. See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, 202,205&206.

³⁰² IGF, *Using the Sixth Method to Simplify the Pricing*, 1-6. See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, 205-207.

³⁰³ EY, "The 6th Method," https://www.un.org/esa/ffd/wp-content/uploads/2014/11/10STM_PresentationVanHerksen.pdf (accessed August 3, 2024)

³⁰⁴ IGF, *Using the Sixth Method to Simplify the Pricing*, 8-9.

³⁰⁵ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 208. See also IGF, *Using the Sixth Method to Simplify the Pricing*, 9.

³⁰⁶ IGF, *Using the Sixth Method to Simplify the Pricing*, 9.

publicly traded prices for commodities do not consider specific agreements, quality variations, geographic disparities, operational expenses, or other associated expenditures. Consequently, prices are merely determined based on supply and demand of the commodity.³⁰⁷

c. The Commodity Rule in Zambia

Owing to individual development agreements, mining entities enjoyed favourable financial terms from the late 1990s to the mid-2000s, which resulted in the growth of mining activities in Zambia during this period.³⁰⁸ Despite an increase in the mining of commodities, primarily copper, the copper prices and tax revenue collected therefrom remained disproportionately low. The Zambia Revenue Authority (“ZRA”) reported not receiving an equitable portion of its mining tax revenues. ZRA identified the mispricing of related party transactions as the primary reason for the low revenue collected.³⁰⁹

Taxpayers extract and then sell the extracted resources to related party smelting facilities, refineries, marketing or trading entities. Mispricing involves taxpayers deliberately manipulating the price of mineral sales to such related parties to lower their tax liability in the country of origin and increase profits in the foreign jurisdictions which may have lower tax rates.³¹⁰

The ZRA implemented the Commodity Rule following a case of mispricing involving Glencore International AG (“Glencore”). The ZRA discovered that Mopani Copper Mines Plc (“Mopani”) was selling copper to a related cross-border party (Glencore) at a selling price lower than the selling prices charged to unrelated entities. ZRA issued an assessment to Mopani for the understatement of tax revenue. Mopani consequently appealed to the Supreme Court. The Supreme Court held in favour of the ZRA and Mopani was ordered to pay US\$13 million in taxes for the 2007, 2008 and 2010 tax years.³¹¹

³⁰⁷ EY, “The 6th Method,” https://www.un.org/esa/ffd/wp-content/uploads/2014/11/10STM_PresentationVanHerksen.pdf (accessed August 3, 2024).

³⁰⁸ Readhead, *Special Rules for Commodity Sales: Zambia’s Use of the ‘Sixth Method’*, 2.

³⁰⁹ Readhead, *Special Rules for Commodity Sales: Zambia’s Use of the ‘Sixth Method’*, 2.

³¹⁰ Readhead, *Special Rules for Commodity Sales: Zambia’s Use of the ‘Sixth Method’*, 2.

³¹¹ ZRA, *Practice Note no. 1/2021*, para 16.13. See also *Mopani Copper Mines PLC v Zambia revenue Authority* [2020] ZMSC 29.

Section 97A of the Income Tax Act³¹² was amended in 2008 by inserting sections 13, 14, and 15, which introduced the Commodity Rule.³¹³ Section 97A (13)³¹⁴ provides a method for establishing an arm's length price for a transaction between related parties involving the sale of a base metal or any substance containing it. Section 97A (13)³¹⁵ prescribes reference prices to determine the price of base metals, any substance containing such base metals or precious metal transactions involving related parties. Section 97A (1)³¹⁶ defines the "reference price" as the average monthly commodity cash price, as quoted on the London Metal Exchange ("LME"), the Fast Markets Metal Bulletin ("FMMB") to the extent that the commodity is not quoted on the LME and any other authorised metal exchange market approved by the Commissioner to the extent that the commodity price is not quoted on either the LME or FMMB.³¹⁷ Section 97A (14)³¹⁸ allows for limited adjustments to the reference price based on the quality or grade of the base metal or precious metal.³¹⁹ When a taxpayer files a tax return electronically in Zambia, the ZRA system automatically determines the appropriate quoted commodity price for related party sales transactions and computes the tax accordingly.³²⁰

3.2.5. Simplified Advance Pricing Arrangement procedures or reduced APA charges

An APA is a legally enforceable contract that establishes a predetermined transfer price and provides for the appropriate treatment of a transaction between related entities.³²¹ An APA can be unilateral, bilateral or multilateral.³²² A unilateral APA is an arrangement that exclusively involves the taxpayer and the tax authority of the same jurisdiction. A bilateral APA is established by the taxpayer and tax authorities of two tax jurisdictions through a mutual agreement or as stipulated in the applicable treaty. A multilateral APA consists of multiple APAs.³²³ The OECD recommends the use of

³¹² 32 of 1967.

³¹³ ZRA, *Practice Note no. 1/2008*, 2008, para 3.17.

³¹⁴ 32 of 1967.

³¹⁵ 32 of 1967.

³¹⁶ 32 of 1967.

³¹⁷ ZRA, *Practice Note no. 1/2021*, para 16.13.

³¹⁸ 32 of 1967.

³¹⁹ ZRA, *Practice Note no. 1/2020*, 2020, para 13.8.5 – 13.8.6.

³²⁰ IGF, *Using the Sixth Method to Simplify the Pricing*), 4.

³²¹ OECD, *2022 TP Guidelines*, 516.

³²² OECD, *2022 TP Guidelines*, 219&518.

³²³ OECD, *2022 TP Guidelines*, 516.

bilateral and multilateral APAs as a supplement to the traditional transfer pricing methods, especially for complex transactions.³²⁴

The APA process can differ and can broadly be grouped into six stages:³²⁵

- First stage, early engagement and pre-application;
- Second stage, formal application and acceptance;
- Third stage, processing and examination of the application;
- Fourth stage, positioning of the preliminary APA with the foreign tax authority to reach an agreement;
- Fifth stage, APA finalisation;
- Sixth stage, APA implementation and ongoing monitoring.

The APA simplification measures include reduced APA fees,³²⁶ and simplified APA procedures.³²⁷ Simplified APA procedures can include fewer stages for low-risk taxpayers (SMEs), reduced timeframes for concluding all stages of the APA process within OECD's best practice timeframe,³²⁸ and facilitated benchmarking analysis by the tax authorities.³²⁹

a. The rationale for the implementation and benefits of simplified Advance Pricing Arrangement procedures or reduced APA charges

APAs are beneficial for complex or unique transactions. Bilateral and multilateral APAs³³⁰ minimise the risk of double taxation and ensure certainty for taxpayers.³³¹ Taxpayers are exempt from conducting periodic benchmarking studies for

³²⁴ OECD, *2022 TP Guidelines*, 213,518&532. See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, 521.

³²⁵ OECD, Forum on Tax Administration, *Bilateral Advance Pricing Arrangements Manual* (Paris: OECD Publishing, 2022) 37. (hereinafter OECD, *Bilateral Advance Pricing Arrangements Manual*) See also SARS, *Proposed Model for Establishing an Advance Pricing Agreement Programme in South Africa, and Release of Draft Legislation*, 2.

³²⁶ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 521. See also, OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 6.

³²⁷ OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 6.

³²⁸ OECD, Forum on Tax Administration, *Bilateral Advance Pricing Arrangements Manual*, 73. See also OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 6&20.

³²⁹ Navarro, "Simplification in Transfer Pricing": 778-779.

³³⁰ OECD, *2022 TP Guidelines*, 516-518.

³³¹ OECD, *2022 TP Guidelines*, 516.

transactions covered by the APA for the duration of the APA. APAs, therefore, simplify a taxpayer's administrative burden for the duration of the arrangement.³³²

The reduced APA charges make APAs more accessible, particularly to small taxpayers such as SMEs.³³³ Simplified APA procedures can include fewer stages for low-risk taxpayers or reduced timeframes for the conclusion of the APAs, resulting in a realistic timeframe expectation and resources required by taxpayers and tax authorities to reach an agreement.³³⁴ The OECD Manual for bilateral APA best practices stipulates that the APA process should be concluded within a 24-month period³³⁵

b. The drawbacks of the simplified Advance Pricing Arrangement procedures or reduced APA charges

The process of applying, negotiating and finalising a bilateral APA can be lengthy. If the process is not simplified or does not comply with the OECD best practices timeframe of 24 months, it may undermine certainty and predictability of the APA programme.³³⁶ APAs without reduced charges can be costly to secure, making APAs accessible primarily to well-resourced taxpayers.³³⁷ Balancing reduced fees with resource availability is essential. A reduced APA fee structure could broaden access to different taxpayers. If the APA process is, however, not simplified, less resourced taxpayers may find it difficult to allocate sufficient resources to the APA programme. The taxpayer may be required to reallocate resources designated initially for other uses to the APA programme.³³⁸

³³² OECD, *2022 TP Guidelines*, 538&539.

³³³ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 521. Bloomberg Tax, "China Announces Fast-Track Unilateral Advance Pricing Agreements," <https://news.bloombergtax.com/transfer-pricing/china-announces-fast-track-unilateral-advance-pricing-agreements> (accessed June 6, 2023).

³³⁴ OECD, Forum on Tax Administration, *Bilateral Advance Pricing Arrangements Manual*, 8 & 18. See also Annet Oguttu, "Challenges of Applying the Comparability Analysis in Curtailing Transfer Pricing: Evaluating the Suitability of Some Alternative Approaches in Africa": 99-100.

³³⁵ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 521.

³³⁶ OECD, *Bilateral Advance Pricing Arrangements Manual*, 29-31.

³³⁷ OECD, *Bilateral Advance Pricing Arrangements Manual*, 29-31.

³³⁸ OECD, *Bilateral Advance Pricing Arrangements Manual*, 29-31.

c. The Advance pricing Arrangement procedures and APA charges in India

The Finance Act of 2012³³⁹ introduced APAs in India by including sections 92CC and 92CD in the Income Tax Act.³⁴⁰ The APA rules are contained in rules 10F to 10T and 44FA of the Income Tax Rules, which became effective in August 2012.³⁴¹

The APA agreement can be entered into for a maximum of five years and rolled back for up to four years.³⁴² Taxpayers can enter into unilateral, bilateral, and multilateral APAs. Those opting for unilateral APAs must motivate their choice of unilateral APAs over bilateral or multilateral APAs.³⁴³ India does not have a simplified APA fee structure. The APA fees depend on the size of the controlled transactions and are considered high.³⁴⁴ India's turnaround periods for APA applications are lengthy.³⁴⁵ The average time taken to conclude a bilateral APA was four years and 11 months in 2022, and, therefore, the APA process is not streamlined.³⁴⁶

d. The Advance Pricing Arrangement procedures and APA charges in the United Kingdom

The APA programme in the UK was introduced in 1999. The provisions are set out in sections 218 to 230 of the Taxation (International and Other Provisions) Act ("TIOPA").³⁴⁷ Statement of Practice SP02/10, 01/12 and 01/18 provide guidance on APA matters. APAs are entered into for a period of 3 to 5 years. In exceptional circumstances, a longer term may be considered. Although the intended application of an APA is for prospective periods, it can also be concluded after the proposed period has passed.³⁴⁸ The HMRC aims to complete the APA process within two years and

³³⁹ Finance Act, 2012.

³⁴⁰ Tax Act.

³⁴¹ Tax Rules.

³⁴² S 92CC (4) and (7) of the Tax Act.

³⁴³ R 10I (2) of the Tax Rules.

³⁴⁴ PwC, "Advance pricing agreements Frequently asked questions,"

<https://www.pwc.in/assets/pdfs/publications/2014/advance-pricing-arrangements.pdf> (accessed February 17, 2024).

³⁴⁵ Government of India, Income Tax Department, *Advance Pricing Agreements APA Programme of India annual report* (New Delhi: CBDT Publishing, 2023), 9-12. See also South Centre, Tax Cooperation Policy Brief, *A Decade of the Indian Advance Pricing Agreement Programme: Achievements and Challenges* (Geneva: South Centre Publishing, 2023), 4-5. (hereinafter South Centre, *A Decade of the Indian Advance Pricing Agreement Programme: Achievements and Challenges*).

³⁴⁶ South Centre, *A Decade of the Indian Advance Pricing Agreement Programme: Achievements and Challenges*, 3.

³⁴⁷ TIOPA, 2010.

³⁴⁸ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm422050> (accessed December 15, 2023).

e. The Advance Pricing Arrangement procedures and APA charges in Australia

³⁴⁹HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm422090> (accessed February 17, 2024).

<https://www.gov.uk/government/publications/transfer-pricing-and-diverted-profits-tax-statistics-2022-to-2023/transfer-pricing-and-diverted-profits-tax-statistics-2022-to-2023> (accessed December 28, 2024). See also South Centre, *A Decade of the Indian Advance Pricing Agreement Programme: Achievements and Challenges*, 3

³⁵¹ Grant Thornton, “Transfer Pricing UK,” <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---uk/> (accessed December 15, 2023)

³⁵² HMRC, “Internal Manual,” <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm422020>

³⁵³ ATO, “PS LA 2015/4.”

<https://www.atg.gov.au/law/view/document?DocID=PSR%2FSPS20154%2FNAT%2FATO%2F00001&PiT=99991231235958&document=document#LawTimeLine> (accessed October 12, 2023).

³⁵⁴ SARS, *Discussion Paper: Advance Pricing Agreements* (Pretoria: SARS Publishing, 2020, 17. (SARS, *Discussion Paper: Advance Pricing Agreements*))

³⁵⁵ ATO, “PS LA 2015/4,”

<https://www.ato.gov.au/law/view/document?DocID=PSR%2FSPS20154%2FNAT%2FATO%2F00001&PiT=99991231235958&document=document> (accessed October 12, 2023).

³⁵⁶ ATO, “PS LA 2015/4,”

<https://www.atg.gov.au/law/view/document?DocID=PSR%2FSPS20154%2FNAT%2FATO%2F00001&PiT=99991231235958&document=document> (accessed October 12, 2023).

³⁵⁷ SARS, *Discussion Paper: Advance Pricing Agreements*, 18.

³⁵⁸ ATO, “APA and MAP statistics,”

<https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/advance-pricing-arrangements/apa-and-map-statistics> (accessed October 12, 2023).

³⁵⁹ OECD, *Bilateral Advance Pricing Arrangements Manual*.

f. The Advance Pricing Arrangement procedures and APA charges in Canada

The Canada Revenue Authority (“CRA”) introduced the APA programme in 1993 to address the transfer pricing challenges experienced by large MNE taxpayers. Circular 94-4R provides for unilateral, bilateral and multilateral APAs. The CRA, however, prefers bilateral APAs as these APAs reduce the risk of double taxation.³⁶⁰ The average time to conclude an APA was three years and one month in 2022 and, therefore, the process is not streamlined. APAs are not considered simplified because the time frame for the conclusion of APAs is considered lengthy, and taxpayers must pay fees for APAs.³⁶¹

Canada simplified the APA programme for small taxpayers in 2005 by means of Information Circular 94-4R(SR).³⁶² The simplified APA for small businesses is limited to a unilateral APA for a maximum of five years. The taxpayer may not request a rollback. The APA application has a non-refundable fee of CA\$5 000.³⁶³ The CRA aims to conclude the APA request within a year from receipt of the application.³⁶⁴ These simplified APAs for small taxpayers are not ideal, because the OECD discourages the use of unilateral APAs, owing to the risk of double taxation should a corresponding transacting jurisdiction not recognise the APA.³⁶⁵

3.2.6. Documentation exemption and simplification measures

Qualifying taxpayers are exempt from preparing transfer pricing documentation or simplified documentation requirements can apply without necessarily being exempt

³⁶⁰ Government of Canada, “International Transfer Pricing: Advance Pricing Arrangements (APAs),” <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4/international-transfer-pricing-advance-pricing.html> (accessed June 20, 2024).

³⁶¹ Government of Canada, “Special Release – Advance Pricing Arrangements for Small Businesses,” <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

³⁶² Government of Canada, “Special Release – Advance Pricing Arrangements for Small Businesses,” <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

³⁶³ Government of Canada, “Special Release – Advance Pricing Arrangements for Small Businesses,” <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

³⁶⁴ Government of Canada, “Special Release – Advance Pricing Arrangements for Small Businesses,” <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

³⁶⁵ OECD, *2022 TP Guidelines*, 219.

from applying the underlying Arm's Length Principle.³⁶⁶ The documentation exemption and simplification measures are designed for small taxpayers or transactions that are considered to be low-risk by tax authorities.³⁶⁷ OECD Guidelines emphasise that documentation requirements must be fair and not place excessive financial or administrative burdens on taxpayers relative to their resource capacities.³⁶⁸

Simplified transfer pricing documentation still requires taxpayers to provide documentation evincing that transactions were conducted at arm's length.³⁶⁹ The documents, however, need not be in the format of an OECD's local file but need to evince compliance with the Arm's Length Principle.³⁷⁰ The taxpayer should maintain and document service contracts, electronic correspondence (emails) and comparative data demonstrating that the provision of goods and services was at arm's length.³⁷¹

The documentation exemption and simplification measures can be grouped as follows for the respective documentation types:³⁷²

Documentation type	Type of simplification measures available in respect of documentation requirements for specific taxpayers or transactions
Local file	Exemption or simplification for low-risk taxpayers and SMEs; Exemption or simplification for immaterial transactions;

³⁶⁶ OECD, Multi-country analysis of existing transfer pricing simplification measures, 6&20. See also PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 24.

³⁶⁷ PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 14,36&52.

³⁶⁸ OECD, *2022 TP Guidelines*, 394,395&229.

³⁶⁹ KPMG, "Transfer Pricing low-value-adding intercompany services," <https://kpmg.com/ch/en/insights/taxes/transfer-pricing-low-value-adding-intercompany-services.html> (accessed May 1, 2024).

³⁷⁰ PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 24. See also KPMG, "Transfer Pricing low-value-adding intercompany services," <https://kpmg.com/ch/en/insights/taxes/transfer-pricing-low-value-adding-intercompany-services.html> (accessed May 1, 2024).

³⁷¹ KPMG, "Transfer Pricing low-value-adding intercompany services," <https://kpmg.com/ch/en/insights/taxes/transfer-pricing-low-value-adding-intercompany-services.html> (accessed May 1, 2024).

³⁷² PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 26.

Documentation type	Type of simplification measures available in respect of documentation requirements for specific taxpayers or transactions
	Exemption or simplification for taxpayers belonging to a group of entities with a turnover less than a set threshold by each respective jurisdiction.
Master file	Exemption or simplification for taxpayers belonging to a group of entities with a turnover less than a set threshold by each respective jurisdiction.
Country -by - Country-report	Exemption or simplification of MNE groups with a consolidated revenue of less than a set threshold by each respective jurisdiction.

a. The rationale for the implementation and benefits of the documentation exemption and simplification measures

The documentation simplification measures can reduce compliance costs, especially for SMEs, given their low profit margins and limited resources.³⁷³ Tax authorities will be able to prioritise high-risk taxpayers and transactions in audits and risk assessments, ensuring resources are used effectively, while simultaneously allowing low-risk taxpayers the resources to grow their businesses.³⁷⁴

b. The drawbacks of the documentation exemption and simplification measures

The exemption from preparing documentation in one jurisdiction does not guarantee exemption in another jurisdiction.³⁷⁵ Different jurisdictions apply different definitions for low-risk taxpayers and SMEs. Therefore, there is a risk that a taxpayer may not be

³⁷³ OECD, *2022 TP Guidelines*, 235.

³⁷⁴ Australian Government, Australian Tax Office (ATO), *Discussion paper: options to simplify Transfer pricing documentation* (Sydney: ATO Publishing 2014), 17.

³⁷⁵ PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 27&36.

granted such an exemption in another jurisdiction. Taxpayers may also understate the size of transactions, revenue or group turnover to qualify for the exemption.³⁷⁶

The documentation exemption and simplification measures limit tax authorities' access to information in master files and local files.³⁷⁷ Tax authorities may find it difficult to determine if a taxpayer applied the Arm's Length Principle appropriately to cross-border transactions reported in their tax returns in instances where limited information is available.³⁷⁸ The exemption may be revoked if the tax authority suspects that a taxpayer is not conducting related party transactions at arm's length. The taxpayer may then be required to provide transfer pricing documentation (often within a short time frame) to evince compliance with the Arm's Length Principle or face adjustments and penalties.³⁷⁹

c. The documentation exemption and simplification measures in India

Sections 92 to 92F and 286 of the Income Tax Act contain the transfer pricing documentation requirements.³⁸⁰ The rules of interpretation and implementation are set out in rules 10D, 10E, 10DA and 10DB of the Income Tax Rules.³⁸¹ Qualifying taxpayers must maintain transfer pricing documentation to evince the arm's length price of cross-border intragroup transactions and submit them when required by the tax authority.³⁸²

Taxpayers with an aggregate value of cross-border controlled transactions exceeding INR10 million must maintain a local file. The local should be filed only upon request by the tax authority. The master file and CbCR need to be filed where the cross-border

³⁷⁶ PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 27&36.

³⁷⁷ Evelyn, "The transfer pricing SME exemption: A false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/> (accessed February 15, 2024).

³⁷⁸ Evelyn, "The transfer pricing SME exemption: A false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/>, (accessed February 15, 2024).

³⁷⁹ Evelyn, "The transfer pricing SME exemption: A false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/>, (accessed February 15, 2024).

³⁸⁰ Tax Act.

³⁸¹ Tax Rules.

³⁸² OECD, "Transfer Pricing Country Profile India," <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-india.pdf> (accessed February 17, 2024)

controlled transactions exceed INR500 million and INR64 billion, respectively, each year.³⁸³

The table below sets out the documentation exemption and simplification measures for cross-border transactions between related parties in India:³⁸⁴

Documentation type:	Eligibility criteria:	Simplification measures:
Local file	A taxpayer with related party transactions with an annual aggregate value that does not exceed INR10 million.	Preparing and submitting a local file (in the OECD's format) is not required. However, it is recommended that the taxpayer maintains documentation to evince compliance with the Arm's Length Principle.
Master file	A taxpayer that is part of an MNE group with related party transactions with an annual aggregate value that does not exceed INR500 million (or INR100 million, if it relates to intangible asset transactions).	The preparation of a master file is not required.
Country-by-Country Report	A taxpayer who is a parent of an MNE group with an annual total consolidated group revenue that does not exceed INR64 billion.	The preparation of a CbCR is not required.

³⁸³ Grant Thornton, "Transfer Pricing – India," <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---India/> (accessed February 17, 2024).

³⁸⁴ Grant Thornton, "Transfer Pricing – India," <https://www.grantthornton.global/en/insights/articles/transfer-pricing-guide/transfer-pricing---India/> (accessed February 17, 2024).

d. The documentation exemption and simplification measures in the United Kingdom

The Financing Act of 2023 requires taxpayers with a consolidated group revenue of €750 million or more to prepare a local file, master file and CbCR following the OECD Guidelines.³⁸⁵ Transactions not exceeding £1 million need not be reported in the local file unless the HMRC lists them as material.³⁸⁶ Material transactions include those priced using the PSM, incorporeal assets, strategic or leadership services and assets, cost distribution agreements, business restructures and initiation or termination of transactions within a relevant timeframe.³⁸⁷

Exempt entities are encouraged to maintain supporting documentation, such as intragroup agreements, transfer pricing policy documents and other relevant documents to evince adherence to the arm's length principle, if requested by the HMRC.³⁸⁸ The table below sets out documentation exemption and simplification measures for cross-border transactions between related parties in the UK:³⁸⁹

Documentation type:	Eligibility criteria:	Simplification measures:
Local file	SMEs	Exemption from preparing a local file.
	Immaterial transactions: (controlled transactions that do not exceed £1 million).	Exempt from preparing a local file.

³⁸⁵ HMRC, "Transfer pricing documentation requirements for UK businesses," <https://www.gov.uk/government/publications/transfer-pricing-documentation-requirements-for-uk-businesses/transfer-pricing-documentation#detailed-proposal> (accessed December 15, 2023).

³⁸⁶ HMRC, "INTM450104 - Transfer pricing records: materiality of a category of controlled transactions," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm450104> (accessed May 1, 2024).

³⁸⁷ HMRC, "INTM450104 - Transfer pricing records: materiality of a category of controlled transactions," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm450104> (accessed May 1, 2024).

³⁸⁸ PwC, "UK transfer pricing documentation: New law comes into force, guidance issued," <https://www.pwc.com/gx/en/tax/newsletters/pricing-knowledge-network/assets/pwc-tp-new-uk-tp-doc-law-in-force-guidance-issued.pdf> (accessed May 1, 2024).

³⁸⁹ PwC, "UK transfer pricing documentation: New law comes into force, guidance issued," <https://www.pwc.com/gx/en/tax/newsletters/pricing-knowledge-network/assets/pwc-tp-new-uk-tp-doc-law-in-force-guidance-issued.pdf> (accessed May 1, 2024).

Documentation type:	Eligibility criteria:	Simplification measures:
	A taxpayer in an MNE group with an annual total consolidated group revenue of less than €750 million.	It is recommended that the taxpayer maintains documentation to evince compliance with the Arm's Length Principle in a format prescribed by the OECD.
Master file	SMEs A taxpayer in an MNE group with an annual total consolidated group revenue of less than €750 million.	Exemption from the preparation of a master file. The preparation of a master file is not required, but it is recommended for large taxpayers.³⁹⁰
Country-by-Country Report	A taxpayer who is a parent of an MNE group with an annual total consolidated group revenue of less than €750 million.	The taxpayer is not required to prepare a CbCR.

e. The documentation exemption and simplification measures in Australia

The Australia Tax Office ("ATO") introduced simplified transfer pricing record-keeping options in 2014 to reduce the administrative burden and expenses associated with recordkeeping for low-risk transactions and taxpayers. Practical Compliance Guideline ("PCG") 2017/2 contains guidance on simplified transfer pricing record-keeping options.³⁹¹ The ATO will assess a taxpayer's eligibility to apply one or more simplification record-keeping options. The ATO will not allocate resources to review transactions covered by the simplification options for compliance with the Arm's

³⁹⁰ A taxpayer that is part of an MNE group with a total group revenue that is less than 750 million euros but is not an SME.

³⁹¹ ATO, "PCG 2017/2,"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

Length Principle. Taxpayers are expected to self-assess and ensure these transactions are at arm's length.³⁹²

The seven simplified transfer pricing record-keeping options requirements are as follows:³⁹³

i. Small taxpayers

These taxpayers must have an "Australian economic group"³⁹⁴ annual turnover of less than AU\$50 million, not have controlled transactions exceeding AU\$500 000 in royalties, licenses fees or research and development arrangements, specified service-related-party dealings³⁹⁵ not exceeding 15% of turnover and cannot be distributors. This option excludes international related party dealings involving royalties, license fees, research and development arrangements, financial transactions or arrangements of a capital nature.³⁹⁶

ii. Low-value intragroup service³⁹⁷

Low-value intragroup service must have a value of less than AU\$2 million in total. If the total value exceeds AU\$2 million, the total cost of services rendered should not exceed 15% of the Australian economic group's total expenses, the total amount from the services rendered should not exceed 15% of the total revenue, and the low value-adding intragroup services expenses (not exceeding 25% of the pre-intragroup

³⁹² ATO, "Simplifying transfer pricing record-keeping,"

<https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/international-transfer-pricing-introduction-to-concepts-and-risk-assessment/simplifying-transfer-pricing-record-keeping> (accessed February 18, 2024).

³⁹³ ATO, "Simplifying transfer pricing record-keeping,"

<https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/international-transfer-pricing-introduction-to-concepts-and-risk-assessment/simplifying-transfer-pricing-record-keeping> (accessed February 18, 2024).

³⁹⁴ These entities are under the same ownership regardless of whether the owner is a natural or juristic persons; See ATO, "Definitions," <https://www.ato.gov.au/forms-and-instructions/reportable-tax-position-schedule-2019-instructions/definitions#ato-Economicgroup> (accessed November 28, 2024).

³⁹⁵ This is any other service that is not low value add; See ATO, "PCG 2017/2"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

³⁹⁶ ATO, "PCG 2017/2,"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

³⁹⁷ ATO, "PCG 2017/2,"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

services charge profits), must have a maximum mark-up of 5% on services received or a minimum mark-up of 5% on the costs of services rendered.³⁹⁸

iii. Distributors

The taxpayer must be a distributor with an Australian economic group annual turnover of less than AU\$50 million, a profit before tax ratio³⁹⁹ of less than 3% and no controlled transactions exceeding AU\$500 000 in royalties, license fees or research and development arrangements. This option does not apply to controlled transactions involving royalties, license fees, research and development arrangements, financial transactions or arrangements of a capital nature.⁴⁰⁰

iv. Low-level inbound loans

The total cross-border loan balance for the Australian economic group during the financial year must not exceed AU\$50 million. The interest rate for each inbound loan had to be less than 5.65% for the 2022 to 2023 and less than 5.81% for the 2023 to 2024 income years respectively. The loan amounts and related expenses must be denominated in Australian dollars.⁴⁰¹

v. Low-level outbound loans

The total cross-border loan balance for the Australian economic group during the financial year, must not exceed AU\$50 million. The interest rate for each outbound loan had to be 5.65% or more for the 2022 to 2023 and 5.81% or more for the 2023 to 2024 income years respectively. The loan amounts and related expenses must be denominated in Australian dollars.⁴⁰²

³⁹⁸ ATO, "PCG 2017/2,"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

³⁹⁹ "Profit before tax ratio = (total income – total expenses) ÷ total income". See ATO, "PCG 2017/2," <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

⁴⁰⁰ ATO, "PCG 2017/2," <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

⁴⁰¹ ATO, "PCG 2017/2," <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

⁴⁰² ATO, "PCG 2017/2," <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

vi. Low materiality

Low materiality exists where an Australian economic group's total controlled transactions do not exceed 2.5% of its overall turnover, and the total turnover for the Australian economic group does not exceed AU\$100 million. The controlled transactions must not exceed \$500,000 in royalties, license fees, or research and development arrangements. This option excludes any controlled transactions involving royalties, license fees, research and development arrangements, financial transactions or arrangements of a capital nature.⁴⁰³

vii. Technical services

The taxpayer's income and expense from technical services must not exceed 50% of the Australian economic group's total cross-border controlled transactions. The taxpayer must add a minimum mark-up of 10% for the services rendered or a maximum mark-up of 10% for services received.

The above-mentioned seven listed simplification record-keeping options have three additional criteria to be met for a taxpayer to be eligible for these options:

- First, the taxpayer must not have sustained losses over a 3-year period (including the current period);
- Secondly, the taxpayer must not have been restructured within a year; and
- Finally, the taxpayers must have evaluated their compliance with transfer pricing rules.⁴⁰⁴

Taxpayers with transactions not qualifying for the above simplified record-keeping options may still be required to prepare comprehensive documentation to evince compliance with the Arm's Length Principle.

The transfer pricing documentation requirements are contained in subdivision 815–E of the Income Tax Assessment Act 1997. Taxpayers with a consolidated group

⁴⁰³ ATO, "PCG 2017/2,"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

⁴⁰⁴ ATO, "PCG 2017/2,"

<https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

revenue of AU\$1 billion or more must prepare and file a local file, master file and CbCR.⁴⁰⁵

The table below sets out documentation exemption and simplification measures for cross-border transactions between related parties in Australia:⁴⁰⁶

Documentation type:	Eligibility criteria:	Simplification measures:
Local file	A taxpayer who is a parent of an MNE group with an annual global income of less than AU\$1 billion.	The preparation and submission of a local file (in the OECD's format) is not required. However, it is recommended that a taxpayer maintains documentation to evince compliance with the Arm's Length Principle.
Master file	A taxpayer who is a parent of an MNE group with an annual global income of less than AU\$1 billion.	The preparation of a master file is not required.
Country-by-Country Report	A taxpayer who is a parent of an MNE group with an annual global income of less than AU\$1 billion.	The taxpayer is not required to prepare a CbCR.

⁴⁰⁵ ATO, "Country-by-country reporting," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/country-by-country-reporting> (accessed October 12, 2023). See also ATO, "Local file Instructions," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/local-file-instructions> (accessed October 12, 2023). See also, ATO, "Subdivision 815-E of the Income Tax Assessment Act 1997: Country-by-Country reporting," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/country-by-country-reporting/country-by-country-reporting-guidance/what-is-country-by-country-reporting> (accessed December 21, 2024.)

⁴⁰⁶ ATO, "PCG 2017/2," <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

f. The documentation exemption and simplification measures in Canada

There are no OECD local file nor master file documentation requirements applicable in Canada. Taxpayers must still maintain records to evince compliance with the Arm's Length Principle for all cross-border transactions. Although transfer pricing regulations bind Canadian taxpayers, taxpayers are not required to comply with the local file and master file formats as prescribed by the OECD Guidelines.⁴⁰⁷ Taxpayers only need to maintain documentation as required by section 247(4) of the Income Tax Act,⁴⁰⁸ which is similar to the local file documentation requirements prescribed in Chapter V of the OECD Guidelines.⁴⁰⁹ Taxpayers must furnish the required evidence demonstrating compliance with the Arm's Length Principle to the CRA within three months of the request. The parent of an MNE with a consolidated revenue of €750 million or more in a fiscal year must file a CbCR.⁴¹⁰

The table below sets out the documentation exemption and simplification measures for cross-border transactions between related parties in Canada.⁴¹¹

Documentation type:	Eligibility criteria:	Simplification measures:
Local file	No threshold prescribed.	The preparation and submission of a local file (in the OECD's format) is not required. However, a taxpayer must maintain documentation in terms of section 247(4) of the Income Tax Act ⁴¹² to

⁴⁰⁷ Government of Canada, "Transfer Pricing", <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/transfer-pricing/09.html#ContemporaneousDocumentationUnderSubsection2474> (accessed August 2, 2024).

⁴⁰⁸ R.S.C., 1985, c. 1 (5th Supp.)

⁴⁰⁹ Government of Canada, "Transfer Pricing", <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/transfer-pricing/09.html#ContemporaneousDocumentationUnderSubsection2474> (accessed August 2, 2024).

⁴¹⁰ Government of Canada, "Transfer Pricing", <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/transfer-pricing/09.html#ContemporaneousDocumentationUnderSubsection2474> (accessed August 2, 2024).

⁴¹¹ Government of Canada, "Transfer Pricing", <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/transfer-pricing/09.html#ContemporaneousDocumentationUnderSubsection2474> (accessed August 2, 2024).

⁴¹² R.S.C., 1985, c. 1 (5th Supp.)

Documentation type:	Eligibility criteria:	Simplification measures:
		evince compliance with the Arm's Length Principle.
Master file	No threshold prescribed.	The preparation of a master file is not required.
Country by Country Report	A taxpayer who is a parent of an MNE group with an annual total consolidated group revenue of less than €750 million.	The taxpayer is not required to prepare a CbCR.

3.2.7. Simplified and Streamlined Approach for baseline marketing and distribution activities

Jurisdictions can choose to adopt the OECD's Simplified and Streamlined Approach ("SSA") for baseline marketing and distribution activities, effective from 2025. The SSA offers a simplified approach to calculating the arm's length price for these activities.⁴¹³ Baseline distribution activities entail acquiring products from related entities and selling them to third-party entities (rather than directly to the end customers). This excludes retail sales, services, digital product sales, and commodities sales.⁴¹⁴ Qualifying transactions must have economic attributes and be priced using traditional transfer pricing methods. The distributor, sales agent, or commissionaire must be the tested party. The tested party's yearly operational expenses must be less than 3% or higher than the upper bound of 20% to 30% of annual net revenues.⁴¹⁵

The SSA prices transactions using a pricing matrix to determine the appropriate return on sales for baseline distribution and marketing activities. The pricing matrix provides

⁴¹³ OECD, OECD/G20 Base Erosion and Profit Shifting Project, *Pillar One - Amount B: Inclusive Framework on BEPS*, 14.

⁴¹⁴ OECD, *Pillar One - Amount B: Inclusive Framework on BEPS*, 10,11&18.

⁴¹⁵ OECD, *Pillar One - Amount B: Inclusive Framework on BEPS*, 18. See also BDO, "South Africa - Pillar One and Amount B," <https://www.bdo.global/en-gb/insights/tax/transfer-pricing/south-africa-pillar-one-and-amount-b#:~:text=Scope%20of%20Amount%20B,-The%20final%20OECD&text=The%20qualifying%20transaction%20must%20exhibit,commissionaire%20being%20the%20tested%20party> (accessed August 1, 2024).

predetermined fixed returns, which is adjusted for the operating expense cross-check and the data availability mechanism for different jurisdictions.⁴¹⁶ Adjustments to returns may be made for differences in economies, market sizes, competition, laws, and costs. Therefore, the return can differ depending on the geographic jurisdictions of the transacting entities and the industries in which these taxpayers operate.⁴¹⁷

a. The rationale for the implementation and benefits of the Simplified and Streamlined Approach for baseline marketing and distribution activities

The SSA provides taxpayers with a “guard rail” for setting prices for in-scope transactions and mitigates over and undercompensation. If multiple jurisdictions adopt the SSA, it may reduce transfer pricing disputes and the risk of double taxation.⁴¹⁸

The SSA can assist low-capacity jurisdictions. The low-capacity jurisdictions often experience transfer pricing disputes related to distribution activities. Approximately 30% to 70% of all disputes arise owing to a lack of comparable data to price baseline marketing and distribution transactions. The SSA can lower compliance and administrative costs.⁴¹⁹

If the tax authorities permit it, a taxpayer can choose to use the simplified approach or any other reliable transfer pricing method.⁴²⁰

b. The drawbacks of the SSA simplified and streamlined approach for baseline marketing and distribution activities

There is a difference in opinion amongst various jurisdictions on whether to adopt the SSA. There is a risk of double taxation if the SSA is not adopted in the other transacting jurisdictions.⁴²¹ The ATO has already indicated that it will not adopt SSA in its tax regulations. The Indian tax authority has expressed reservations about the adoption

⁴¹⁶ OECD, *Pillar One - Amount B: Inclusive Framework on BEPS*, 26-28.

⁴¹⁷ OECD, *Pillar One - Amount B: Inclusive Framework on BEPS*, 30,31&32.

⁴¹⁸ OECD, *Pillar One - Amount B: Inclusive Framework on BEPS*, 17.

⁴¹⁹ OECD, “Pillar One Amount B in a Nutshell,” <https://www.oecd.org/tax/beps/pillar-one-amount-b-in-a-nutshell.pdf> (accessed May 1, 2024).

⁴²⁰ KPMG, “Amount B: more sticky situation than honey sweet,” <https://kpmg.com/uk/en/home/insights/2024/02/tmd-amount-b-more-sticky-situation-than-honey-sweet.html>, (accessed April 20, 2024).

⁴²¹ KPMG, “OECD release of Amount B report,” <https://kpmg.com/ch/en/blogs/home/posts/2024/03/oecd-release-of-amount-b-report.html> (accessed May 1, 2024).

of the SSA and cited the qualitative and quantitative scoping criteria as subjective.⁴²² The determination of whether a transaction is in-scope may differ. Differences in the interpretation of the SSA may lead to disputes between taxpayers and tax authorities.⁴²³ It remains uncertain which jurisdictions will adopt the SSA into their transfer pricing regulations.⁴²⁴ Further, comparable data for benchmarking is necessary to efficiently implement the SSA. Certain jurisdictions lack local data to serve as comparables, requiring adjustments to comparable data obtained from other jurisdictions to account for disparities.⁴²⁵

Taxpayers seeking to apply the SSA must document (as part of the local file) all the in-scope transactions, service agreements, financial data used and computations indicating that transactions (and the entity) are in-scope. No meaningful attempt has been made to date to simplify the onerous documentation requirements.⁴²⁶

3.3. Conclusion

This chapter examined transfer pricing simplification measures recommended by the OECD and those available in the selected Commonwealth jurisdictions. It examined the rationale for implementing simplification measures and the benefits and drawbacks associated with these measures. The five selected Commonwealth jurisdictions were India, the United Kingdom, Canada, Australia and Zambia. These Commonwealth jurisdictions share similar legislative systems rooted in English common law.⁴²⁷

⁴²² Irish Tax Institute, "Response to the OECD Public Consultation on Pillar One – Amount B," <https://taxinstitute.ie/wp-content/uploads/2023/01/2023-01-25-ITI-response-to-OECD-consultation-on-Pillar-One-Amount-B-FINAL.pdf> (accessed May 1, 2024). See also KPMG, Amount B: A more sticky situation than honey.

⁴²³ Irish Tax Institute, "Response to the OECD Public Consultation on Pillar One – Amount B," <https://taxinstitute.ie/wp-content/uploads/2023/01/2023-01-25-ITI-response-to-OECD-consultation-on-Pillar-One-Amount-B-FINAL.pdf> (accessed May 1, 2024). See also KPMG, "Amount B: more sticky situation than honey sweet," <https://kpmg.com/uk/en/home/insights/2024/02/tmd-amount-b-more-sticky-situation-than-honey-sweet.html> (accessed March 16, 2024).

⁴²⁴ A&O Shearman, "Amount B or not to be? The OECD's Pillar One Amount B report," <https://www.aoshearman.com/en/insights/amount-b-or-not-to-be-the-oecd-s-pillar-one-amount-b-report> (accessed September 20, 2024).

⁴²⁵ Irish Tax Institute, "Response to the OECD Public Consultation on Pillar One – Amount B," <https://taxinstitute.ie/wp-content/uploads/2023/01/2023-01-25-ITI-response-to-OECD-consultation-on-Pillar-One-Amount-B-FINAL.pdf> (accessed May 1, 2024). See also IGF, Using the Sixth Method to Simplify the Pricing, 2&3.

⁴²⁶ Irish Tax Institute, "Response to the OECD Public Consultation on Pillar One – Amount B," <https://taxinstitute.ie/wp-content/uploads/2023/01/2023-01-25-ITI-response-to-OECD-consultation-on-Pillar-One-Amount-B-FINAL.pdf> (accessed May 1, 2024).

⁴²⁷ Commonwealth of nations, "The legal sector in the Commonwealth," <https://www.commonwealthofnations.org/?sectors=business/legal#:~:text=The%20vast%20majority%20of%20legal,law%2C%20customary%20law%20and%20Shariah> (accessed May 15, 2024).

The UK exempts small taxpayers (SMEs) from transfer pricing regulations. In the UK tax authorities can, therefore, redirect their resources from the examination of low-risk taxpayers to high-risk taxpayers.⁴²⁸ Exempt taxpayers run the risk of double taxation, as these taxpayers may still be required to comply with transfer pricing regulations in the corresponding transacting jurisdiction.⁴²⁹

The documentation exemption and simplification measures reduce the administrative burden and compliance costs, especially for small taxpayers, given their small profit margins and limited resources.⁴³⁰ The documentation exemption may simplify tax administration and compliance. It, however, limits tax authorities' access to information contained in local files and master files.⁴³¹ Tax authorities may experience difficulties in ascertaining if the taxpayer applied the Arm's Length Principle to the cross border transactions reported on tax returns.⁴³² Australia legislated and implemented seven simplified transfer pricing record-keeping options that taxpayers can rely on to simplify record-keeping.⁴³³ Only taxpayers that exceed certain set thresholds must prepare, maintain and/or submit documentation to the tax authority to evince compliance with the Arm's Length Principle.⁴³⁴

Bilateral or multilateral safe harbours reduce uncertainty. Safe harbours can also reduce taxpayers' compliance burdens by eliminating the need for taxpayers to conduct benchmarking studies and prepare comprehensive transfer pricing documentation demonstrating the application of the arm's length test.⁴³⁵ However, if the safe harbours are adopted unilaterally, the taxpayer may be subject to double

⁴²⁸ European Commission, EU Joint Transfer Pricing Forum, *Background information on SMEs*, (EU Publishing: Brussels, 2010) 2&3. See also Chris Evans et al., *Tax Simplification an African Perspective*, 15.

⁴²⁹ European commission, "Explanatory Memorandum to COM(2012)516 - Work of the EU Joint Transfer Pricing Forum in the period July 2010 to June 2012 and related proposals," https://www.eumonitor.eu/9353000/1/j4nvhdhdk3hydzq_j9vvik7m1c3gyxp/vj31rr6dfzyz (accessed March 17, 2024).

⁴³⁰ OECD, *2022 TP Guidelines*, 235.

⁴³¹ Evelyn, "The transfer pricing SME exemption: A false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/> (accessed February 15, 2024).

⁴³² Evelyn, "The transfer pricing SME exemption: A false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/>, (accessed February 15, 2024).

⁴³³ ATO, "Simplifying transfer pricing record-keeping," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/international-transfer-pricing-introduction-to-concepts-and-risk-assessment/simplifying-transfer-pricing-record-keeping> (accessed February 18, 2024).

⁴³⁴ OECD, *2022 TP Guidelines*, 233-236.

⁴³⁵ OECD, *2022 TP Guidelines*, 204&206.

taxation.⁴³⁶ Among the selected jurisdictions, India is the only jurisdiction with comprehensive safe harbour regulations. India also has a safe harbour rule for low value-adding intragroup services⁴³⁷

Low value-adding intragroup services in India are capped at a markup of 5% for services received and must be at least 5% for services rendered.⁴³⁸ The markup on costs in Australia for simplified low value-adding intragroup services is capped at 5% for services received and must be at least 5% for services rendered. The Australian approach, however, does not constitute a literal safe harbour since the taxpayer is still required to apply the underlying arm's length test to the low value-adding intragroup services.⁴³⁹ The UK transfer pricing legislation follows the OECD's simplified approach of a standard markup of 5% for calculating the arm's length price for low value-adding intragroup services.⁴⁴⁰ No benchmarking study needs to be performed for the cost markup of 5%.

APAs assist with pricing of complex controlled transactions to reduce disputes between taxpayers and tax authorities.⁴⁴¹ Simplified APAs measures include lower compliance costs (reduced or no APA fees), making APAs more accessible to taxpayers, particularly small taxpayers.⁴⁴² These measures also include a streamlined APA process to reduce delays in the conclusion of APAs.⁴⁴³

⁴³⁶ Navarro, "Simplification in Transfer Pricing": 770 -772.

⁴³⁷ R 10TD of the Tax Rules. See also BDO, "CBDT amends the Safe Harbour Rules," <https://www.bdo.in/en-gb/insights/alerts-updates/transfer-pricing-cbdt-amends-the-safe-harbour-rules#:~:text='Safe%20harbour%20rules'%20means%20circumstances,price%20declared%20by%20the%20taxpayer.pdf> (accessed February 17, 2024).

⁴³⁸ OECD, "Transfer Pricing Country Profile India," <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-india.pdf> (accessed February 17, 2024).

⁴³⁹ OECD, "Transfer Pricing Country Profile Australia," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-australia.pdf> (accessed February 17, 2024).

⁴⁴⁰ OECD, "The United Kingdom and the OECD," <https://www.oecd.org/unitedkingdom/united-kingdom-and-oecd.htm#:~:text=The%20United%20Kingdom%2C%20along%20with,achieving%20the%20Organisation's%20fundamental%20aims> (accessed March 18, 2023). See also HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm440071> (accessed February 17, 2024).

⁴⁴¹ OECD, *2022 TP Guidelines*, 516-518.

⁴⁴² UN, *Practical Manual on Transfer Pricing for Developing Countries*, 521. Bloomberg Tax, "China Announces Fast-Track Unilateral Advance Pricing Agreements," <https://news.bloombergtax.com/transfer-pricing/china-announces-fast-track-unilateral-advance-pricing-agreements> (accessed June 6, 2023).

⁴⁴³ OECD, Forum on Tax Administration, *Bilateral Advance Pricing Arrangements Manual*, 8. See also Annet Oguttu, "Challenges of Applying the Comparability Analysis in Curtailing Transfer Pricing: Evaluating the Suitability of Some Alternative Approaches in Africa": 99-100.

Canada implemented a simplified unilateral APA programme for small taxpayers.⁴⁴⁴ The OECD, however, discourages the adoption of unilateral APAs owing to its risk of double taxation.⁴⁴⁵ Australia has bilateral APAs that are simplified and streamlined because these APAs are free of charge⁴⁴⁶ and have a reasonable APA conclusion timeframe. The APA conclusion timeframe for the 2021-2022 period was one year and six months for bilateral APAs,⁴⁴⁷ which was in line with the OECD's best practice of 24 months (streamlined process).⁴⁴⁸

Zambia is the only selected jurisdiction that provides a Commodity Rule to price selected commodities. The Commodity Rule is a more objective method to price commodities (compared to the CUP method) in low-capacity jurisdictions (with limited comparable benchmarking data available). Since the rule allows only for limited adjustments to be made to comparable data,⁴⁴⁹ transfer prices are less vulnerable to manipulation through adjustments when compared to the CUP method.⁴⁵⁰ The Commodity Rule method deviates from the OECD's Transfer Pricing Guidelines on pricing commodities. This may result in the method not being widely accepted by tax authorities as being suitable for pricing commodities at arm's length.⁴⁵¹ As only limited adjustments are allowed; transfer prices may not be arm's length and may not reflect the true economic conditions of the transaction.⁴⁵²

⁴⁴⁴ Government of Canada, "Special Release – Advance Pricing Arrangements for Small Businesses," <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

⁴⁴⁵ OECD, *2022 TP Guidelines*, 219. See also Government of Canada, "Special Release – Advance Pricing Arrangements for Small Businesses," <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

⁴⁴⁶ SARS, *Discussion Paper: Advance Pricing Agreements*, 18.

⁴⁴⁷ ATO, "APA and MAP statistics," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/advance-pricing-arrangements/apa-and-map-statistics> (accessed October 12, 2023).

⁴⁴⁸ OECD, *Bilateral Advance Pricing Arrangements Manual*, 29.

⁴⁴⁹ IGF, Using the Sixth Method to Simplify the Pricing, 1. See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, 202, 205&206.

⁴⁵⁰ IGF, Using the Sixth Method to Simplify the Pricing, 1-6. See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, 205-207.

⁴⁵¹ IGF, Using the Sixth Method to Simplify the Pricing, 8-9.

⁴⁵² UN, *Practical Manual on Transfer Pricing for Developing Countries*, 208. See IGF, Using the Sixth Method to Simplify the Pricing, 9.

SSA may be applied to baseline marketing and distribution activities. However, various jurisdictions differ on whether to adopt the SSA, and it remains to be seen which jurisdictions will adopt it in the future.⁴⁵³

⁴⁵³ KPMG, “OECD release of Amount B report,” <https://kpmg.com/ch/en/blogs/home/posts/2024/03/oecd-release-of-amount-b-report.html> (accessed May 1, 2024).

Chapter 4: Recommendations for transfer pricing simplification measures in the Republic

4.1. Introduction

This chapter assessed the feasibility of implementing the transfer pricing simplification measures identified in the UK, India, Australia, Canada and Zambia in the Republic, by considering the rationale for the implementation of these simplification measures and the benefits and drawbacks associated with such measures.

4.2. Transfer pricing simplification measures

Transfer pricing methods may impose a significant compliance and administrative burden on taxpayers, such as SMEs.⁴⁵⁴ Transfer pricing simplification measures have been implemented to provide certainty, reduce the compliance and administrative burden. These simplification measures were discussed in detail in Chapter 3.

4.2.1. Exemption from transfer pricing regulations

Taxpayers in the Republic who engage in cross-border transactions with related entities are subject to transfer pricing regulations. This is in contrast with the UK, where SME taxpayers can apply an exemption from transfer pricing regulations, provided that the controlled transaction is with a related party in a treaty jurisdiction.⁴⁵⁵ The exemption may, however, place qualifying taxpayers (SMEs) in a vulnerable position, because the tax authority can revoke it any time. Taxpayers will then be left with no option but to comply with the transfer pricing regulations.⁴⁵⁶

Different jurisdictions define SMEs and exempt taxpayers differently. A limitation of exempting taxpayers from transfer pricing regulations in one jurisdiction is that there is no guarantee that an exemption will also be recognised in the corresponding transacting jurisdiction. This may expose the taxpayer to the risk of double taxation.⁴⁵⁷

⁴⁵⁴ Sol Picciotto, "Problems of Transfer Pricing and Possibilities for Simplification" *ICTD Working Paper*, no. 86 (2018): 27-30. See also OECD, Multi-country analysis of existing transfer pricing simplification measures, 5,6&20. See also Navarro, "Simplification in Transfer Pricing": 756.

⁴⁵⁵ S 31 of the ITA, 1962. See also HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed May 20, 2024).

⁴⁵⁶ Evelyn Partners, "The transfer pricing SME exemption: a false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/> (accessed March 8, 2024).

⁴⁵⁷ European Commission, EU joint Transfer Pricing Forum, *Report on Small and Medium Enterprises and Transfer Pricing*, 3&4. See also Evelyn Partners, "The transfer pricing SME exemption: a false friend, but a manageable problem," <https://www.evelyn.com/insights-and-events/insights/the-transfer-pricing-sme-exemption-a-false-friend-but-a-manageable-problem/> (accessed March 8, 2024).

The exemption of SMEs from transfer pricing regulations in the Republic is not a feasible consideration, because it discards the application of the arm's length test.

4.2.2. Documentation exemption and simplification measures

Taxpayers in the Republic with transactions meeting certain transfer pricing documentation thresholds must annually prepare and submit either a local file, master file, and/or CbCR to SARS. Taxpayers with transactions that do not meet certain documentation thresholds must prepare appropriate transfer pricing documentation and submit them if requested by SARS.⁴⁵⁸ India, Australia, the UK and Zambia also apply three-tier transfer pricing documentation requirements similar to those of the Republic.⁴⁵⁹ The UK exempts eligible SMEs from preparing transfer pricing documentation.⁴⁶⁰ Australia has a categorised list of transactions that the ATO considers low-risk. These listed transactions and qualifying taxpayers can apply the simplified transfer pricing record-keeping options.⁴⁶¹

Canada's documentation requirements differ from those of the UK, Australia and India, in that only a CbCR (no OECD local file nor master file) must be prepared by qualifying taxpayers. Taxpayers must keep supporting documentation demonstrating compliance with the Arms' Length Principle for all cross-border related party transactions.⁴⁶²

The documentation threshold requirements of the Republic align with the OECD three-tier transfer pricing documentation requirements for material transactions.⁴⁶³ The documentation requirements can be simplified by incorporating transfer pricing documentation simplification measures for small taxpayers (SMEs), low value-adding

⁴⁵⁸ South African Revenue Service, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011", *Government Gazette* 41186:628 (October 20, 2017).

⁴⁵⁹ EY, *Worldwide Transfer Pricing Reference Guide 2022-2023* (New York: Ernst & Young Global Ltd, 2024). (hereinafter EY, *Worldwide Transfer Pricing Reference Guide 2022-2023*)

⁴⁶⁰ HMRC, "Internal Manual" <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412080>(accessed February 17, 2024).

⁴⁶¹ ATO, "PCG 2017/2," <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20172/NAT/ATO/00001&PiT=99991231235958> (accessed October 12, 2023).

⁴⁶² Government of Canada, "Transfer Pricing," <https://www.canada.ca/en/revenue-agency/services/tax/international-non-residents/information-been-moved/transfer-pricing/09.html#ContemporaneousDocumentationUnderSubsection2474> (accessed August 2, 2024).

⁴⁶³ OECD, "Transfer Pricing Country Profile South Africa," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-south-africa.pdf> (accessed February 17, 2024).

transactions and other low-risk transactions, similar to those in Australia⁴⁶⁴ and the UK⁴⁶⁵, considering the risk profile of such transactions and taxpayers. Unilateral transfer pricing documentation simplification measures will, however, not benefit taxpayers in the Republic if the corresponding transacting jurisdictions do not have similar simplification measures. The benefits from simplified documentation requirements can only be fully realised if, the majority of tax authorities adopt similar documentation simplification measures.⁴⁶⁶

4.2.3. Safe harbours

The Republic does not have any legislated safe harbours.⁴⁶⁷ India has safe harbours as part of its transfer pricing regulations.⁴⁶⁸ Safe harbours can benefit both taxpayers and tax authorities. A taxpayer will benefit from not having to conduct extensive comparability analyses (benchmarking studies) for related party transactions. Tax authorities will be able to allocate their limited resources to complex transactions that are not covered by safe harbours.⁴⁶⁹ Transfer pricing disputes can be less complex, since they will be more concerned with whether the taxpayer correctly applied the safe harbour and less with the transfer pricing method used to determine the arm's length price of the transaction.⁴⁷⁰

The OECD recognises that applying the Arm's Length Principle can be cumbersome for taxpayers and tax authorities. The OECD recommends that safe harbour rules should be applied for smaller taxpayers and/or less complex transactions, if adopted bilaterally or multilaterally.⁴⁷¹ Safe harbours, however, does raise concerns for inappropriate tax planning, divergence from the Arm's Length Principle, issues of inequality and the risk of double taxation, if not adopted by other jurisdictions. Safe harbours are a trade-off between simplification and compliance. If the Republic adopts

⁴⁶⁴ OECD, "Transfer Pricing Country Profile Australia," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-australia.pdf> (accessed February 17, 2024).

⁴⁶⁵ OECD, "Transfer Pricing Country Profile United Kingdom," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-united-kingdom.pdf> (accessed February 17, 2024).

⁴⁶⁶ OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 36. See also PCT, *Practical toolkit to support the successful implementation by developing countries of effective transfer pricing documentation requirements*, 79.

⁴⁶⁷ SARS, PN 7.

⁴⁶⁸ S 92 of the Tax Act.

⁴⁶⁹ Navarro, "Simplification in Transfer Pricing": 780.

⁴⁷⁰ Navarro, "Simplification in Transfer Pricing": 781-884.

⁴⁷¹ OECD, *2022 TP Guidelines*, 203&204.

safe harbours that are well designed, adopted bilaterally or multilaterally, and that approximate the Arm's Length Principle, taxpayers and SARS can achieve benefits that outweigh the concerns raised regarding safe harbours.⁴⁷²

4.2.4. Simplified approach to low value-adding intragroup services

SARS previously indicated no intention of adopting a simplified approach to low value-adding intragroup services. The Republic does not have a legislated simplified approach to low value-adding intragroup services.⁴⁷³ Taxpayers, therefore, need to conduct a benchmarking study to ensure that transactions are priced at arm's length.⁴⁷⁴

The UK has a simplified approach to low value-adding intragroup services in their transfer pricing legislation.⁴⁷⁵ In Australia, low value-adding services form part of the simplified transfer pricing record-keeping options. The low value-adding services simplification approach does not, however, eliminate the underlying arm's length statutory test.⁴⁷⁶ India has a safe harbour for low value-adding intragroup service.⁴⁷⁷

The benefit of using a simplified approach for low value-adding intragroup services is that the approach is provided by the OECD Guidelines. This approach, therefore, provides certainty and is less likely to be disputed by tax authorities that follow the OECD Guidelines. Taxpayers are not required to perform costly benchmarking studies for in-scope services. A standard 5% mark-up can be relied upon as being at arm's length. Tax authorities are, therefore, able to redirect their limited resources to complex transactions.⁴⁷⁸

PN 7 provides guidance on implementing transfer regulations in the Republic. Although the Republic is not an OECD member, PN 7 recognises the need to follow

⁴⁷² OECD, *2022 TP Guidelines*, 206&207.

⁴⁷³ SAICA, "Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7," <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

⁴⁷⁴ OECD, "Transfer Pricing Country Profile South Africa," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-south-africa.pdf> (accessed February 17, 2024)

⁴⁷⁵ OECD, "Transfer Pricing Country Profile United Kingdom," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-united-kingdom.pdf> (accessed February 17, 2024).

⁴⁷⁶ OECD, "Transfer Pricing Country Profile Australia," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-australia.pdf> (accessed February 17, 2024)."

⁴⁷⁷ OECD, "Transfer Pricing Country Profile India," <https://www.oecd.org/tax/transfer-pricing/transfer-pricing-country-profile-india.pdf> (accessed February 17, 2024).

⁴⁷⁸ OECD, *2022 TP Guidelines*, 332-334.

the OECD Guidelines in the absence of specific guidance from PN 7, the Income Tax Act, or any treaty concluded with another jurisdiction by the Republic.⁴⁷⁹ PN 7 provides no guidance on the use of safe harbours for low value adding intragroup services. SARS' rejection of the OECD simplified approach for low value-adding intragroup services may contradict PN 7,⁴⁸⁰ which specifically states that OECD Guidelines should be applied when there is no other guidance.⁴⁸¹ Taxpayers of the Republic can benefit from the adoption of the simplified approach to low value-adding intragroup services through increased certainty as well as reduced administrative and compliance burdens.

4.2.5. Simplified Advance Pricing Arrangement procedures or reduced APA charges

The Republic introduced APAs into its tax legislation in December 2023.⁴⁸² No guidance on the implementation of APAs has been published by SARS.⁴⁸³ The APA programme is expected to assist with the pricing of complex transactions, promote tax certainty and simplify documentation requirements for taxpayers in the Republic.⁴⁸⁴ The UK, India, Australia and Canada have active APA programmes in place.

Simplified APAs can be characterised as having reduced APA fees,⁴⁸⁵ and streamlined APA procedures.⁴⁸⁶ For instance, bilateral APAs should be concluded within a timeframe of 24 months as recommended by the OECD best practices manual for bilateral APAs.⁴⁸⁷ Except for Australia, APA programmes of the UK, India, and Canada

⁴⁷⁹ SARS, PN 7, para 3.

⁴⁸⁰ SAICA, "Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7," <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

⁴⁸¹ SARS, PN 7, para 3.

⁴⁸² Parliamentary Monitoring Group, "Taxation Laws Amendment Bill (B36-2023)" <https://pmg.org.za/bill/1188/> (accessed September 1, 2024).

⁴⁸³ SARS, *Proposed Model for Establishing an Advance Pricing Agreement Programme in South Africa, and Release of Draft Legislation*, 2021, 1. See also National Treasury. *Final Response Document on the 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill* (Pretoria: National Treasury Publishing, 2024), 73.

⁴⁸⁴ S 76A-76P of the ITA, 1962.

⁴⁸⁵ UN, *Practical Manual on Transfer Pricing for Developing Countries*, 521

⁴⁸⁶ OECD, Forum on Tax Administration, *Bilateral Advance Pricing Arrangements Manual*, 73. See also OECD, *Multi-country analysis of existing transfer pricing simplification measures*, 6&20.

⁴⁸⁷ OECD, Forum on Tax Administration, *Bilateral Advance Pricing Arrangements Manual*, 73. See also Deloitte, "Advance Pricing Agreement Frequently Asked Questions," <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/thoughtpapers/in-tax-deloitte-apa-faqs-noexp.pdf> (accessed February 20, 2024).

have not met the recommended timeframe of 24 months for bilateral APA. Further, only the UK and Australia have simplified APA fee structures.⁴⁸⁸

The APA programme of the Republic does not appear to have a reduced APA fee structure, as APAs in the Republic will charge pre-application fees, application fees, processing fees, maintenance fees and fee related to the extension of existing APA.⁴⁸⁹ SARS is committed to a 24-month streamlined APA turnaround time from the application to finalisation of the APA.⁴⁹⁰ This is in line with the simplified APA approach and best practices of the OECD.⁴⁹¹

4.2.6. Commodity Rule (“Sixth Method”)

The Commodity Rule is not explicitly provided for in the OECD Guidelines.⁴⁹² The transfer pricing regulations of the Republic do not provide for the use of the Commodity Rule to price commodities.⁴⁹³ The OECD Guidelines permit the use of any other method that can effectively price the transaction at arm's length, other than the recommended transfer pricing methods.⁴⁹⁴

The regulations in Zambia include a Commodity Rule as a simplification measure to price mineral transactions between related parties.⁴⁹⁵ When a taxpayer files a tax return electronically in Zambia, the ZRA system automatically determines the appropriate quoted commodity price for related party sales transactions and computes the tax accordingly.⁴⁹⁶

The CUP method recommended by the OECD to price commodity transactions is difficult to apply without the taxpayers making material adjustments to comparable data.⁴⁹⁷ Adjustments to comparable data need to consider differences in mineral compositions, mining operations and cost efficiencies. This can expose the pricing of

⁴⁸⁸ EY, *Worldwide Transfer Pricing Reference Guide 2022-2023*.

⁴⁸⁹ S 76D of the ITA, 1962.

⁴⁹⁰ National Treasury, *Final Response Document on the 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill*, 74.

⁴⁹¹ OECD, *Bilateral Advance Pricing Arrangements Manual*, 28.

⁴⁹² OECD, *2022 TP Guidelines*.

⁴⁹³ S 31 of the ITA, 1962. See also SARS, *PN 7*.

⁴⁹⁴ OECD, *2022 TP Guidelines*, 93.

⁴⁹⁵ S 97A (13) of the Income Tax Act, 1967.

⁴⁹⁶ IGF, *Using the Sixth Method to Simplify the Pricing*, 4.

⁴⁹⁷ IGF, *Using the Sixth Method to Simplify the Pricing*, 2.

commodity transactions to tax planning or tax evasion schemes.⁴⁹⁸ The Commodity Rule only allows limited adjustments to public quoted commodity prices as a basis for pricing selected commodity transactions between related parties.⁴⁹⁹ The Commodity Rule is intended to reduce the risk of taxpayers engaging in under-pricing of transactions and simplify tax administration. The Commodity Rule relies on prices quoted on a relevant exchange to establish a clear and objective standard to determine the price of a related party mineral sale.⁵⁰⁰

The Commodity Rule is limited to commodities with transparent commodity prices or indices. Since it is not a recommended OECD transfer pricing method, other jurisdictions may challenge its application and expose the taxpayer to double taxation.⁵⁰¹

The Republic should consider adopting the Commodity Rule as an optional method to price selected commodities traded on authorised metal exchange markets. A range of predetermined comparable adjustments can accompany the method to limit the extent to which taxpayers can freely adjust prices of selected commodities. Taxpayers should be able to rebut the Commodity Rule if they can prove that their benchmarking price or the adjustments to comparable data will result in an arm's length price.⁵⁰²

4.2.7. Simplified and streamlined approach for baseline marketing and distribution activities

There is no certainty if SARS will adopt the OECD's simplified and streamlined approach for pricing baseline marketing and distribution activities.⁵⁰³ Taxpayers can benefit from administrative savings and simplified documentation requirements in respect of in-scope activities, since taxpayers are not required to perform benchmarking studies.⁵⁰⁴ The tax authorities of India and Australia have expressed

⁴⁹⁸ ENS Africa, "Navigating Transfer Pricing challenges in the mining sector," <https://www.ensafrika.com/news/detail/8828/navigating-transfer-pricing-challenges-in-the>, (accessed September 20, 2024).

⁴⁹⁹ IGF, Using the Sixth Method to Simplify the Pricing, 1-6. See also UN, *Practical Manual on Transfer Pricing for Developing Countries*, 205-207.

⁵⁰⁰ IGF, Using the Sixth Method to Simplify the Pricing, 1-4.

⁵⁰¹ IGF, Using the Sixth Method to Simplify the Pricing, 4&5.

⁵⁰² IGF, Using the Sixth Method to Simplify the Pricing, 5-6, 8&9.

⁵⁰³ BDO, "South Africa - Pillar One and Amount B," <https://www.bdo.global/en-gb/insights/tax/transfer-pricing/south-africa-pillar-one-and-amount-b> (accessed September 20, 2024)

⁵⁰⁴ A&O Shearman, "Amount B or not to be? The OECD's Pillar One Amount B report," <https://www.aoshearman.com/en/insights/amount-b-or-not-to-be-the-oecd's-pillar-one-amount-b-report> (accessed September 20, 2024).

their reservations about the adoption of SSA into legislation. There is a risk of double taxation for the taxpayer, should the corresponding transacting jurisdiction not recognise the simplified and streamlined approach for in-scope activities.⁵⁰⁵

The SSA provisions will be incorporated into the OECD Guidelines as an elective approach.⁵⁰⁶ PN 7 provides guidelines for implementing transfer pricing regulations in the Republic, recognises the need to follow the OECD Guidelines in the absence of specific guidance from PN 7, the Income Tax Act, or any treaty that the Republic has concluded with another jurisdiction.⁵⁰⁷ In the absence of any guidance from SARS concerning SSA, taxpayers may apply SSA.

4.3. Conclusion

This chapter assessed the feasibility of implementing the transfer pricing simplification measures identified in the UK, India, Australia, Canada, and Zambia in the Republic by considering the rationale for these simplification measures and the benefits and drawbacks associated with such measures.

The Republic's tax regulations do not include transfer pricing simplification measures, other than a transfer pricing documentation exemption and simplification measures for transactions with a value less than a set threshold.⁵⁰⁸

Exemption from transfer pricing regulations: The Republic does not grant any exemptions from transfer pricing regulations to any taxpayer.⁵⁰⁹ The UK, however, allows SMEs to opt out of transfer pricing regulations by applying the SME exemption.⁵¹⁰ The Republic's policy of not exempting any entity from transfer pricing regulations is appropriate to protect the tax base from being eroded by inappropriate pricing of related party transactions (especially for a developing jurisdiction).

⁵⁰⁵ A&O Shearman, "Amount B or not to be? The OECD's Pillar One Amount B report," <https://www.aoshearman.com/en/insights/amount-b-or-not-to-be-the-oecd-pillar-one-amount-b-report> (accessed September 20, 2024).

⁵⁰⁶ A&O Shearman, "Amount B or not to be? The OECD's Pillar One Amount B report," <https://www.aoshearman.com/en/insights/amount-b-or-not-to-be-the-oecd-pillar-one-amount-b-report> (accessed September 20, 2024).

⁵⁰⁷ SARS, PN 7, para 3.

⁵⁰⁸ SARS, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011", *Government Gazette* 41186:628 (October 20, 2017). See also SARS, PN 7. See also S 31 of the ITA, 1962.

⁵⁰⁹ SARS, PN 7. See also S 31 of the ITA, 1962.

⁵¹⁰ HMRC, "Internal Manual" <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm412070> (accessed February 17, 2024).

Documentation exemption and simplification measures: India, Australia and the UK have transfer pricing documentation requirements similar to those of the Republic. Under these requirements, taxpayers with transaction values exceeding set thresholds must prepare transfer pricing documentation in the form of a local file, master file and CbCR. Taxpayers with transactions below the set thresholds do not have to prepare local files that adhere to the OECD's local file format.⁵¹¹ However, it is recommended that these taxpayers retain contemporaneous transfer documentation demonstrating their compliance with the Arm's Length Principle.

Safe harbours: India has safe harbour regulations for low-risk transactions and taxpayers to ensure certainty.⁵¹² Safe harbours can be misused, leading to understated revenue and lower tax revenue collection by the tax authority. There is also a risk of double taxation if the corresponding transacting jurisdiction does not recognise the adopted safe harbour.⁵¹³ If the Republic adopts arm's length bilateral and multilateral safe harbours, designed for low-risk transactions and taxpayers, it can enhance certainty for taxpayers and reduce the compliance and the administrative burden for both taxpayers and SARS.

Low value-adding intragroup services: Transfer pricing regulations in the UK recognise the OECD's simplified approach to low value-adding intragroup services.⁵¹⁴ This approach applies a standard 5% markup on the low value-adding intragroup service costs.⁵¹⁵ The safe harbour regulations in India provide for a simplified approach to low value-adding intragroup services. The cost markup for simplified low value-adding intragroup services in India is capped at 5% for services received and at least 5% for services rendered.⁵¹⁶ Similarly, the cost markup in Australia for simplified low value-

⁵¹¹ SARS, "Return to be Submitted by Persons in Terms of Section 25 of the Tax Administration Act, 2011", *Government Gazette* 41186:628 (October 20, 2017). See also EY, *Worldwide Transfer Pricing Reference Guide 2022-2023*.

⁵¹² R 10TD of the Tax Rules. See also BDO, "CBDT amends the Safe Harbour Rules," <https://www.bdo.in/en-gb/insights/alerts-updates/transfer-pricing-cbdt-amends-the-safe-harbour-rules#:~:text='Safe%20harbour%20rules'%20means%20circumstances,price%20declared%20by%20the%20taxpayer.pdf> (accessed February 17, 2024).

⁵¹³ OECD, 2022 TP Guidelines, 212, 213&495. See also Navarro, "Simplification in Transfer Pricing": 770.

⁵¹⁴ HMRC, "Internal Manual," <https://www.gov.uk/hmrc-internal-manuals/international-manual/intm440071> (accessed February 17, 2024).

⁵¹⁵ OECD, 2022 TP Guidelines, 327 -330.

⁵¹⁶ R 10TD of the Tax Rules. See also BDO, "CBDT amends the Safe Harbour Rules," <https://www.bdo.in/en-gb/insights/alerts-updates/transfer-pricing-cbdt-amends-the-safe-harbour-rules#:~:text='Safe%20harbour%20rules'%20means%20circumstances,price%20declared%20by%20the%20taxpayer.pdf> (accessed February 17, 2024).

adding intragroup services is capped at 5% for services received and be at least 5% for services rendered. This approach does not constitute a literal safe harbour, since the taxpayer must still apply the underlying arm's length test to the low value adding intragroup services.⁵¹⁷ The ATO will not allocate resources to assess low value-adding intragroup services within the safe harbour range for transfer pricing purposes.⁵¹⁸ The taxpayer will be reviewed merely on the taxpayer's eligibility to apply the recommended markup for low value-adding intragroup services.

SARS does not recognise the OECD's standard 5% markup (a simplified approach to low value-adding intragroup services). The standard 5% markup may be challenged by SARS as not being at arm's length.⁵¹⁹ SARS' rejection of OECD's simplified method for low value-adding intragroup services may be in conflict with PN 7 guidance, which states that OECD Guidelines should be followed where no alternative guidance exists.⁵²⁰ Both taxpayers and SARS can benefit from implementing a simplified approach to low value-adding intragroup services, especially when transacting with jurisdictions that also follow the OECD Guidelines.

Simplified Advance Pricing Agreements and reduced APA charges: The APA provisions were introduced into legislation in the Republic in December 2023.⁵²¹ APAs in the Republic do not appear to be simplified, as the APAs involve multiple fees, such as pre-application, application, processing, maintenance, and fees related to the extension of existing APAs.⁵²² Further, there is no certainty that bilateral APAs in the Republic will be concluded within a period of 24 months (as recommended by the OECD's best practices).⁵²³ Several of the elected jurisdictions were experiencing difficulties in meeting the best practice timeframe of 24 months. For example, the average time frame to conclude a bilateral APA in India was four years and 11 months

⁵¹⁷ OECD, "Transfer Pricing Country Profile Australia," <https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/transfer-pricing/transfer-pricing-country-profile-australia.pdf> (accessed February 17, 2024).

⁵¹⁸ ATO, "Simplifying transfer pricing record-keeping," <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/pricing/transfer-pricing/international-transfer-pricing-introduction-to-concepts-and-risk-assessment/simplifying-transfer-pricing-record-keeping> (accessed February 18, 2024).

⁵¹⁹ SAICA, "Comments on a suggested draft interpretation note on transfer pricing to replace practice note 7," <https://www2.saica.org.za/resources/140077> (accessed March 23, 2024).

⁵²⁰ SARS, PN 7.

⁵²¹ Memorandum on the objects of the Tax Administration Laws Amendment Bill, 2023.

⁵²² S 76A-76P of the ITA, 1962. See also the Tax Administration Laws Amendment Bill, 2023.

⁵²³ National Treasury, *Final Response Document on the 2023 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill, 2023 Draft Taxation Laws Amendment Bill and 2023 Draft Tax Administration Laws Amendment Bill*), 74.

for the 2022 year. The average time frame to conclude a bilateral APA in the UK was four years and 10 months for the 2022 year.⁵²⁴ The average time frame to conclude a bilateral APA in Canada was three years and one month for the 2022 year.⁵²⁵

Commodity Rule (“Sixth Method”): Zambia’s regulations include a Commodity Rule, as a simplification measure to price certain mineral transactions between related parties. The Commodity Rule entails using publicly quoted commodity prices and allowing only limited adjustments to such prices, as a basis for pricing selected commodity transactions between related parties.⁵²⁶ The Commodity Rule is not explicitly provided for in the OECD Guidelines. Therefore, other jurisdictions may challenge it for not being at arm’s length and the taxpayer will be at risk of double taxation.⁵²⁷ The Republic should consider adopting the Commodity Rule as an optional method to price selected commodities traded on authorised metal exchange markets.

Simplified and streamlined approach for baseline marketing and distributing activities: The Simplified and Streamlined Approach (“SSA”) is designed to price in-scope routine baseline marketing and distribution activities.⁵²⁸ The SSA is designed explicitly for jurisdictions, like the Republic, which faces resource constraints and with limited comparable data.⁵²⁹ Jurisdictions, such as Australia and India, expressed reservations about the SSA.⁵³⁰ Given the Republic’s lack of comparable data, the benefits of adopting SSA as a simplification measure appear to outweigh the concerns raised by other jurisdictions.

In conclusion, taxpayers and SARS often experience challenges to comply and administer compliance with transfer pricing regulations. To address these challenges,

⁵²⁴ South Centre, *A Decade of the Indian Advance Pricing Agreement Programme: Achievements and Challenges* 2-5.

⁵²⁵ Government of Canada, “Special Release – Advance Pricing Arrangements for Small Businesses,” <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/ic94-4rsr/advance-pricing-arrangements-small-businesses.html> (accessed June 20, 2024).

⁵²⁶ Alexandra Readhead, Natural Resources Governance Institute, *Special Rules for Commodity Sales: Zambia’s Use of the ‘Sixth Method’* (2017)

⁵²⁷ IGF, *Using the Sixth Method to Simplify the Pricing*, 8-9.

⁵²⁸ OECD, OECD/G20 Base Erosion and Profit Shifting Project, *Pillar One - Amount B: Inclusive Framework on BEPS*, 14.

⁵²⁹ OECD, OECD/G20 Base Erosion and Profit Shifting Project, *Pillar One - Amount B: Inclusive Framework on BEPS*, 1-3.

⁵³⁰ Irish Tax Institute, “Response to the OECD Public Consultation on Pillar One – Amount B,” <https://taxinstitute.ie/wp-content/uploads/2023/01/2023-01-25-ITI-response-to-OECD-consultation-on-Pillar-One-Amount-B-FINAL.pdf> (accessed May 1, 2024).

various simplification measures should be implemented in the Republic to simplify the administration of transfer pricing regulations and compliance for taxpayers. The simplification measures that should be implemented in the Republic include the establishment of safe harbours, the adoption of a 5% standard mark-up on cost for low value-adding intragroup services, the simplification of APA procedures and reduced APA fee charges, the adoption of the Commodity Rule and the implementation of the SSA for in-scope activities.

Chapter 5: Conclusion

Concerns about profit shifting and base erosion by MNE taxpayers operating across multiple jurisdictions with different corporate tax rates have resulted in increased transfer pricing requirements and the evolution of transfer pricing regulations. Transfer pricing regulations aim to ensure that the controlled transactions are conducted at arm's length. Taxpayers may encounter challenges while attempting to comply with transfer pricing regulations.

The challenges associated with transfer pricing regulations include the limited resources and expertise of tax authorities and SME taxpayers, potential disputes between taxpayers and tax authorities, a lack of comparable data to apply the arm's length test, the burden of record retention and outdated practice notes or local guidelines on the implementation of transfer pricing regulations. Consequently, taxpayers are increasingly seeking certainty regarding their transfer pricing positions. Simplification measures provide certainty and reduce the compliance and administrative burden on taxpayers and tax authorities.

Transfer pricing simplification measures can differ among jurisdictions. Simplification measures recommended by the OECD and those available in the selected Commonwealth jurisdictions can broadly be classified into the following categories:

- Exemption from transfer pricing regulations;
- Documentation exemption and simplification measures;
- Safe harbour arm's length ranges or rates;
- Simplified approach to transfer pricing low value-adding intragroup services;
- Simplified Advance Pricing Arrangement procedures or reduced APA charges;
- Commodity Rule ("Sixth Method"); and
- Simplified and streamlined approach ("SSA") for baseline marketing and distribution functions.

To address the transfer pricing challenges, simplification measures should be implemented in the Republic, namely, the establishment of safe harbours, the adoption of a standard mark-up of 5% on cost for low value-adding intragroup services, the simplification of APA procedures or reduced APA fee charges, the adoption of the Commodity Rule and the implementation of the SSA for in-scope activities.

The primary drawback of these simplification measures is that they can result in double taxation if they are not designed to achieve an arm's length outcome or a reasonable estimate of an arm's length outcome. The primary benefits of these simplification measures are that they provide certainty, reduce the compliance and administrative burden on taxpayers and tax authorities.

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