



**University of the Witwatersrand**

**Transfer Pricing Documentation in a Post-BEPS Environment**

**A study of the evolution of transfer pricing documentation in South Africa  
and its alignment with the global standard**

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Management, University of the Witwatersrand, Johannesburg, in partial  
fulfilment of the requirements for the degree of Master of Commerce  
(Specialising in Taxation)

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## **Abstract**

In terms of the South African Income Tax Act 58 of 1962 (“the Act”), the South African Revenue Service (“SARS”) has the power to make transfer pricing adjustments. This arises when SARS deems that Multinational Entities (“MNE”) have been transacting at prices which do not reflect prices expected to be charged if parties to the transaction were independent persons dealing at arm’s-length. By having the ability to make transfer pricing adjustments, SARS can minimise the effects of Base Erosion and Profit Shifting (“BEPS”).<sup>1</sup>

BEPS refers to tax planning strategies that shift profits from high tax jurisdictions like South Africa to locations where little or no corporate tax is being paid.

In order to provide governments with the necessary domestic and international instruments to prevent companies from paying limited amounts of taxes, the Organisation for Economic Co-operation and Development (“OECD”) formulated the BEPS Action Plan at the request of the G20.

The BEPS Action Plan consists of 15 Action Points with the objective of minimising or eliminating transactions that erode or decrease a MNE’s tax base by routing its profits from high tax jurisdictions to low tax jurisdictions. The overriding concept of the BEPS Action Plan is that all taxable profits should be taxed once.

Among the 15 Action Points addressed in the BEPS Action Plan, Action 13 which provides guidance on transfer pricing documentation and Country-by-Country reporting (“CbCR”), provides one of the bigger challenges to taxpayers in terms of transparency and disclosure

This approach to transfer pricing documentation provides tax authorities with relevant and accurate information to perform an effective transfer pricing risk analysis.

## **Key words**

BEPS Action Plan, Master file, Local file, CbCR, MNE, SARS, BEPS Action 13, OECD, compliance, MCAA, CbC MCAA, BRICS

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<sup>1</sup> Sukhlal, L, 2018. ‘ENSAfrica ENSight Article: Time is Running out for Transfer Pricing Documentation Compliance’, ENSAfrica 2018.

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## ***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.

A handwritten signature in black ink, appearing to read 'Limahl Sukhlal', written over a horizontal line.

**Limahl Sukhlal**

April 2019

## ***Dedication***

To my family and friends

With sincere thanks

For their love and encouragement

During the writing of this research report

## ***Glossary of Terms and Abbreviations***

| <b>Glossary</b>                  |  |
|----------------------------------|--|
| Act                              | Income Tax Act, 58 of 1962   |
| B42                              | China's State Administration of Taxation (SAT) issued SAT Bulletin [2016]  |
| BEPS                             | Base Erosion and Profit Shifting   |
| BEPS Action Plan                 | Base Erosion and Profit Shifting 15 Point Action Plan, finalised October 2016  |
| CbCR                             | Country-by-Country Report  |
| CP                               | Cost Plus Method   |
| CUP                              | Comparable Uncontrolled Price  |
| GN 1117                          | Public Notice 1117 of 20 October 2017  |
| GN 1334                          | Public Notice 1334 of 28 October 2016  |
| MLI                              | Multilateral Instrument  |
| MAP                              | Mutual Agreement Procedures  |
| MNE                              | Multinational Enterprise   |
| OECD                             | Organisation for Economic Co-operation and Development   |
| OECD Guidelines                  | Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities, July 2017   |
| Potentially Affected Transaction | An "affected transaction" as defined in section 31 of the Act, without regard to paragraph (b) of the definition, but excluding any transaction, operation, scheme, agreement or understanding contemplated in section 31(5), 31(6) or 31(7) |
| PSM                              | Profit Split Method  |
| RM                               | Resale Minus Method  |
| RPSM                             | The Residual PSM   |
| SA                               | Republic Of South Africa   |
| SARB                             | South African Reserve Bank   |
| SARS                             | South African Revenue Service  |
| TAA                              | Tax Administration Act 28 of 2011  |
| TNMM                             | Transactional Net Margin Method  |
| TP                               | Transfer Pricing   |

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## **1. Introduction**

### **1.1. Introduction and background**

BEPS refers to tax planning strategies that shift profits from high tax jurisdictions like South Africa to locations where little or no corporate tax is being paid. In order to provide governments with the necessary domestic and international instruments to prevent companies from paying limited amounts of taxes, the OECD formulated the BEPS Action Plan at the request of the G20.

The BEPS Action Plan consists of 15 Action Points with the objective of minimising or eliminating transactions that erode or decrease a MNE's tax base by routing its profits from high tax jurisdictions to low tax jurisdictions. The overriding concept of the BEPS Action Plan is that all taxable profits should be taxed once.

Among the 15 Action Points addressed in the BEPS Action Plan, Action 13 which provides guidance on transfer pricing documentation and CbCR, provides one of the bigger challenges to taxpayers in terms of transparency and disclosure. In addition, several other Action Points build on the disclosure requirements set out in Action 13.

This approach to transfer pricing documentation will provide tax authorities relevant and accurate information to perform an effective transfer pricing risk analysis. In addition, it will provide a platform on which the information necessary for a transfer pricing audit can be developed and provide taxpayers with an incentive to expressively consider and describe their compliance with the arm's-length principle in material transactions.

The challenge is how various tax systems around the world can adapt to the global standard of transfer pricing documentation as set out in Action 13.

### **1.2. Purpose of research**

The purpose of this research report is to critically evaluate the challenges and issues that arise with adapting local transfer pricing documentation requirements in South Africa to align to the guidelines set out in Action 13 of the BEPS Action Plan. South Africa's implementation of Action 13 will then be compared to countries which are members of BRICS (Brazil, Russia, India, China, and South Africa). This report is based on recommendations from the OECD's BEPS Action Plan and local documentation requirements from a South African perspective as well as a view from different countries.

### **1.3. Research method and design**

The research method used in this report is primarily qualitative, comprising the analysis of various documentary sources of data. Relevant international case law, various countries' tax legislation and the OECD's recommendations have been used in this report.

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The purpose of this report is to analyse the relevant legal frameworks and important guidelines which affect the practitioners work in the drafting of transfer pricing documentation. This report will touch upon international and transfer pricing practices followed in different jurisdictions and will not analyse the fundamental laws of each country's legislation. As there are different legislations included in this report the word legislation will therefore be referred to laws, regulations and codes of the countries which it concerns.

### ***1.4. Delimitations***

The research will only analyse cross border transactions and the problems occurring when two jurisdictions are involved and not domestic transfer pricing. The research does not cover the following aspects:

- No detail regarding the transfer of intangible property;
- Value-Added Tax and indirect taxes;
- Double Tax Agreements; or
- Customs duty consequences.

### ***1.5. Outline of report***

This report consists of the following six chapters:

#### ***1.5.1. Chapter 1: Introduction***

This introductory chapter will introduce the problem statement, the research method as well as the design and outline of the report.

#### ***1.5.2. Chapter 2: A basic understanding of BEPS and the purpose of its Action Plan***

The purpose of this chapter is to provide a basic understanding of what the BEPS Action Plan is and what it set out to achieve.

#### ***1.5.3. Chapter 3: Discussing the key elements of BEPS Action 13***

This chapter illustrates the transfer pricing guidelines within BEPS Action 13. A detailed discussion on the guidance set out in BEPS Action 13 in terms of documentation design with focus on the Master file, Local file and CbCR. The guidelines for the design of each document will be discussed as well as the relevance of each point in the guidelines.

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#### ***1.5.4. Chapter 4: Discussing South Africa's Transfer pricing documentation requirements***

The purpose of this chapter is to discuss the development of South Africa's transfer pricing documentation requirements. This chapter will focus on past transfer pricing documentation requirements and how they have evolved into the current documentation requirements which include both the approach to documentation design as per BEPS Action 13 as well as SARS' own transfer pricing documentation retention requirements.

#### ***1.5.5. Chapter 5: Introduction to the interpretation of BEPS Action 13 by members of BRICS***

The purpose of this chapter is to introduce an investigation into how countries which are members of BRICS approach and interpret the transfer pricing documentation guidelines as per BEPS Action 13. The next four chapters set out a detailed comparison of the transfer pricing documentation design followed by countries which are members of BRICS and South Africa.

#### ***1.5.6. Chapter 6: Interpretation of BEPS Action 13 by Brazil***

The purpose of this chapter is to investigate Brazil's approach to the transfer pricing documentation guidelines as per BEPS Action 13. The research investigates three issues as they are the most relevant for purposes of this research.

Firstly, this research looks at Brazil's current legislations and practices and the legal compliance of transfer pricing documentation.

Secondly, an analysis of how Brazil has aligned its legislation and practices to BEPS Action 13 will be performed.

Thirdly, this research analyses how Brazil deals with taxpayers' non-compliance with the updated documentation requirements. The chapter will end with a comparison between the approaches followed by South Africa and Brazil.

#### ***1.5.7. Chapter 7: Interpretation of BEPS Action 13 by Russia***

The purpose of this chapter is to investigate Russia's approach to the transfer pricing documentation guidelines as per BEPS Action 13. The research investigates three issues as they are the most relevant for purposes of this research.

Firstly, this research looks at Russia's current legislations and practices and the legal compliance of transfer pricing documentation.

Secondly, an analysis of how Russia has aligned its legislation and practices to BEPS Action 13 will be performed.

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Thirdly, this research analyses how Russia deals with taxpayers' non-compliance with the updated documentation requirements. The chapter will end with a comparison between the approaches followed by South Africa and Russia.

#### ***1.5.8. Chapter 8: Interpretation of BEPS Action 13 by India***

The purpose of this chapter is to investigate India's approach to the transfer pricing documentation guidelines as per BEPS Action 13. The research investigates three issues as they are the most relevant for purposes of this research.

Firstly, this research looks at India's current legislations and practices and the legal compliance of transfer pricing documentation.

Secondly, an analysis of how India has aligned its legislation and practices to BEPS Action 13 will be performed.

Thirdly, this research analyses how India deals with taxpayers' non-compliance with the updated documentation requirements. The chapter will end with a comparison between the approaches followed by South Africa and India.

#### ***1.5.9. Chapter 8: Interpretation of BEPS Action 13 by China***

The purpose of this chapter is to investigate China's approach to the transfer pricing documentation guidelines as per BEPS Action 13. The research investigates three issues as they are the most relevant for purposes of this research.

Firstly, this research looks at China's current legislations and practices and the legal compliance of transfer pricing documentation.

Secondly, an analysis of how China has aligned its legislation and practices to BEPS Action 13 will be performed.

Thirdly, this research analyses how China deals with taxpayers' non-compliance with the updated documentation requirements. The chapter will end with a comparison between the approaches followed by South Africa and China.

#### ***1.5.10. Chapter 9: Conclusion***

This chapter concludes on the findings of this research report and aligns the findings with the purpose of the research. It discusses recommendations as to what taxpayers should think about if they encounter such problems described in the purpose of this report and how further research may solve them.

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## **2. A basic understanding of BEPS and the purpose of its Action Plan<sup>2</sup>**

In order to have a better understanding of where Action 13 fits in the bigger picture, the purpose of this chapter is to provide a basic understanding of what the BEPS Action Plan is and what it sets out to achieve.

### **2.1. Introduction**

BEPS refers to tax planning strategies that take advantage of gaps and hybrid mismatches in tax rules and legislation to artificially shift profits to low or no-tax locations where there is little or no economic activity. Although some of the schemes used are illegal, most are not. This undermines the integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see MNEs legally avoiding income tax, it undermines voluntary compliance by all taxpayers.

BEPS is vital for developing countries due to their heavy reliance on corporate income tax, particularly from MNEs. Developing countries have been engaged since the beginning of the BEPS Project. Over 80 developing countries and other non-OECD/non-G20 economies discuss the challenges of BEPS through direct participation in the Committee on Fiscal Affairs, regional meetings in partnership with regional tax organisations, and thematic global fora.

BEPS can therefore be summarised as follows:



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<sup>2</sup> OECD, 2015a. *Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project*. Paris: OECD. Available at: [www.oecd.org/tax/beps-explanatory-statement-2015.pdf](http://www.oecd.org/tax/beps-explanatory-statement-2015.pdf) [accessed 09 January 2019]

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## **2.2. The BEPS Action Plan**

International tax issues have never been as high on the political agenda as they are today. The integration of national economies and markets has increased substantially in recent years. This has put a strain on the international tax framework, which was designed more than a century ago.

The current rules have revealed weaknesses that create opportunities for BEPS, thus requiring an audacious move by policy makers to restore confidence in the tax system and ensure that profits are taxed where the economic activities take place and where the value is created. In September 2013, G20 leaders endorsed the comprehensive Action Plan on BEPS. This package of 15 reports, which was finalised in 2015, includes new or reinforced international standards as well as concrete measures to help countries challenge BEPS. The Action Plan represents the results of a major and extensive effort by OECD and G20<sup>3</sup> countries working together with the inputs of an increasing number of developing countries.

The following paragraphs summarises each of the 15 Action Points that make up the BEPS Action Plan:<sup>4</sup>

### ***Action 1: Address the tax challenges of the digital economy***

The purpose of this Action is to identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a complete approach and considering both direct and indirect taxation.

### ***Action 2: Neutralize the effects of hybrid mismatch arrangements***

The purpose of this Action is to develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (for example, double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities.

### ***Action 3: Strengthen CFC rules***

The purpose of this Action is to develop recommendations regarding the design of controlled foreign company rules.

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<sup>3</sup> Argentina, Australia, Brazil, Canada, China, the European Union, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States.

<sup>4</sup> KPMG, 2013. *OECD's 15 Point Action Plan*. Available at: <https://home.kpmg/xx/en/home/insights/2014/01/beeps-action-plans.html> [accessed: 09 January 2019]

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***Action 4: Limit base erosion via interest deductions and other financial payments***

The purpose of this Action is to develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example, through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments.

***Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance***

The purpose of this Action is to overhaul the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings<sup>5</sup> related to preferential regimes, and on requiring substantial activity for any preferential regime.

***Action 6: Prevent treaty abuse***

The purpose of this Action is to develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

***Action 7: Prevent the artificial avoidance of Permanent Establishment status***

The purpose of this Action is to further define and widen the definition of Permanent Establishment (“PE”) to prevent the artificial avoidance of Permanent Establishment status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.

***Action 8: Assure that transfer pricing outcomes are in line with value creation: intangibles***

The purpose of this Action is to develop rules to prevent BEPS by moving intangibles among group members.

***Action 9: Assure that transfer pricing outcomes are in line with value creation: risks and capital***

The purpose of this Action is to develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also ensure the alignment of returns with value creation.

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<sup>5</sup> Rulings are a system seeks to promote clarity, consistency and certainty about the interpretation and application of the applicable tax laws

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***Action 10: Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions***

The purpose of this Action is to develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties.

This will involve adopting transfer pricing rules or special measures to:

- clarify the circumstances in which transactions can be re-characterized;
- clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and
- provide protection against common types of base eroding payments, such as management fees and head office expenses.

***Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address***

The purpose of this Action is to develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

***Action 12: Require taxpayers to disclose their aggressive tax planning arrangements***

The purpose of this Action is to develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax authorities and businesses and drawing on experiences of the increasing number of countries that have such rules.

***Action 13 Re-examine transfer pricing documentation***

The purpose of this Action is to develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.

***Action 14: Make dispute resolution mechanisms more effective***

The purpose of this Action is to develop solutions to address obstacles that prevent countries from solving treaty-related disputes under Mutual Agreement Procedures ("MAP"), including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

## Action 15: Develop a multilateral instrument (“MLI”)

The purpose of this Action is to analyse the tax and public international law issues related to the development of a MLI to enable jurisdictions, at their discretion, to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties.

### 2.3. Main themes of the BEPS Action Plan<sup>6</sup>

Three main themes have been derived from the 15 Action Points of the BEPS Action Plan. These themes are as follows:

- Coherence of international tax systems:

The coherence actions aim to remove gaps in tax systems which could lead to profit shifting. Actions 2, 3, 4 and 5 have been designed to ensure that there is coherence in tax systems.

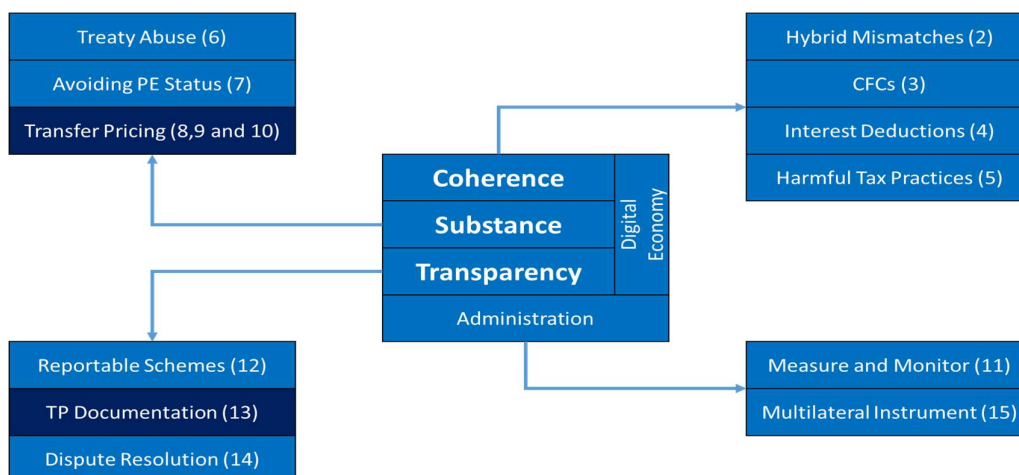
- Addressing substance:

Substance actions seek to align taxing rights with the relevant value-adding activity. Actions 6, 7, 8, 9 and 10 have been designed to ensure that substance issues are addressed.

- Transparency:

Transparency actions are intended to provide significant additional disclosure such as CbCR and the Master file and Local file guidance set out in Action 13. In addition to Action 13, Actions 12 and 14 have been derived to improve transparency in tax systems.

The three themes as described above as well as the relevant Action Points relating to each of the three themes can be depicted as follows:



<sup>6</sup> Engel, K June 2017. *WITS Tax Masters Lecture – International Tax, BEPS, SAIT*: South Africa.

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### 3. Discussing the key elements of BEPS Action 13<sup>7</sup>

In order for us to understand how South Africa implemented Action 13, we first need to understand the content of BEPS Action 13. Therefore, this chapter illustrates the transfer pricing guidelines within BEPS Action 13. This chapter includes a detailed discussion on the guidance set out in BEPS Action 13 in terms of documentation design with added focus on the Master file, Local file and CbCR. The guidelines for the design of each document will be discussed as well as the relevance of each point in the guidelines.

#### 3.1. Introduction

Among the 15 Action Points addressed in the BEPS Action Plan is Action 13. Action 13 provides guidance on transfer pricing documentation and CbCR. Action 13 provides one of the bigger challenges to taxpayers in terms of transparency and disclosure. In addition, several other Action Points build on the disclosure requirements set out in Action 13.

The purpose of this Action Point is to re-examine transfer pricing documentation by developing rules to enhance transparency, including a requirement that multinational entities provide information to all governments in all countries in which it operates in. The information to be provided to the Local governments includes the allocation of income, the level of economic activity taking place in that jurisdiction, and taxes paid amongst countries in accordance with a standardised template.

As a result, Action 13 details a new standardised three-tiered approach to transfer pricing documentation which is made up as follows:



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<sup>7</sup> OECD, 2015b. *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project*. Paris: OECD. Available from: <http://dx.doi.org/10.1787/9789264241480-en> [accessed 09 January 2019]

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These three documentation tiers require taxpayers to articulate consistent transfer pricing positions with regards to its related party transactions and will provide tax authorities with useful information to assess transfer pricing risks.

In addition, Action 13 will enable tax authorities to decide on where audit resources can most effectively be utilised, and, in the event that audit queries are raised, provide information to commence and target audit enquiries. By ensuring a consistent approach to transfer pricing documentation across countries, and by limiting the need for multiple filings of CbCR through making use of information exchange among tax authorities, MNEs will also benefit from a more limited compliance burden.

In addition, Action 13 can help MNEs in identifying risks and inconsistencies in its current transfer pricing models and can assist the MNEs in building more sustainable and robust transfer models in the future.

Each component of the three-tiered approach will be discussed in further detail in the following paragraphs.

### **3.2. Master file**

The Master file requirements aim to provide an overview of the MNE group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity in order to assist tax authorities in evaluating whether significant transfer pricing risks are present within the MNE group.

In general, the Master file is intended to provide a high-level overview of the MNE group in order to position the MNE group's transfer pricing practices in a global economic, legal, financial and tax context.

The Master file also includes lists of important intercompany services agreements as well as a description of the relevant intangibles within the MNE group. The appropriate level of detail should be produced in the Master file as the objective of the Master file to provide tax authorities with a high-level overview of the MNE's global operations and policies. As per Action 13, the Master file should contain the following information in addition to the above:

- a) the MNE group's organisational structure;
- b) a description of the MNE's business or businesses;
- c) the MNE's intangibles;
- d) the MNE's intercompany financial activities; and
- e) the MNE's financial and tax positions.

For purposes of producing the Master file, information is considered important if its omission would affect the reliability of the transfer pricing outcomes.

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### **3.3. Local File**

In contrast to the Master file, which provides a high-level overview as described above, the Local file provides more detailed information relating to specific intercompany transactions affecting the local entity. The information required in the Local file supports the Master file and helps to ensure that the taxpayer has complied with the arm's-length principle in respect of intercompany, cross-border transactions.

The Local file focuses on information relevant to the transfer pricing analysis related to transactions taking place between a Local country affiliate and associated enterprises in different countries and which are material in the context of the Local country's tax system.

The Local file replaces the traditional transfer pricing documents from the past in the sense that it simplifies the documentation design by setting out the chapters in a clear and logical manner, whereas in the past, no clear guidance was given in respect of the design of traditional transfer pricing documentation which could have resulted in inconsistent and inefficient documentation.

As per Action 13, the following information should be included in a Local file:

- Local entity overview including:
  - A description of the management structure and organisation chart of the local entity. In addition, a description of the reporting lines and the country or countries in which such individuals maintain their principal offices should also be included;
  - A detailed description of the business activities and business strategy pursued by the Local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity; and
  - Key competitors.
  
- Controlled transactions (cross-border, intercompany transactions)
  - A description of each material controlled transaction and the context in which such transaction takes place;
  - The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity broken down by tax jurisdiction of the foreign payer or recipient;
  - An identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them;
  - Copies of all material intercompany agreements concluded by the Local entity;

- A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years;<sup>8</sup>
- An indication of the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method;
- An indication of which associated enterprise is selected as the tested party, if applicable, and an explanation of the reasons for this selection;
- A summary of the important assumptions made in applying the transfer pricing methodology;
- If relevant, an explanation of the reasons for performing a multi-year analysis.
- A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information;
- A description of any comparability adjustments performed, and an indication of whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both;
- A description of the reasons for concluding that relevant transactions were priced on an arm's-length basis based on the application of the selected transfer pricing method.
- A summary of financial information used in applying the transfer pricing methodology; and
- A copy of existing unilateral and bilateral/multilateral Advanced Pricing Agreements ("APA") and other tax rulings to which the Local tax jurisdiction is not a party and which are related to controlled transactions described above.

Where a requirement of the Local file can be fully satisfied by a specific cross-reference to information contained in the Master file, such a cross-reference should suffice.

### **3.4. CbCR**

The CbCR requires an aggregate of the worldwide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the MNE group operates. The CbCR also requires a listing of all the companies within the MNE group for which financial information is reported, including the tax jurisdiction of incorporation, where different from the tax jurisdiction of residence, as well as the nature of the main business activities carried out by that group company.

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<sup>8</sup> This point overlaps with Action 10 whereby an emphasis on the value creation of the transaction is analysed and a two sided approach is adopted in which the functions of the taxpayer and relevant associated entity is analysed to ensure that the value creation is in line with the economic substance of the transactions.

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The CbCR will be helpful for high-level transfer pricing risk assessment purposes. It may also be used by tax authorities in evaluating other BEPS related risks and where appropriate for economic and statistical analysis.

However, the information in the CbCR should not be used as a replacement for a detailed transfer pricing analysis of individual cross-border related party transactions and prices should still be based and tested with a full functional analysis and a full comparability analysis.

The CbCR may be used for high-level transfer pricing risk assessment purposes, and may also be used by tax authorities in evaluating other BEPS related risks and where appropriate, for economic and statistical analysis. It should not be used by tax authorities to propose transfer pricing adjustments based on a global apportionment of income.

The information in the CbCR on its own does not provide conclusive evidence that the transfer pricing methodology are incorrect or are not appropriate. Furthermore, the CbCR should not be used by tax authorities to propose transfer pricing adjustments.

### ***3.4.1. CbCR Threshold***

Based on the guidance provided in Action13, it is recommended that all MNE groups should file the CbCR each year however, MNE group's with an annual consolidated group revenue in the prior financial year of more than EUR 750 million (or the equivalent amount in local currency) are required to file the CbCR on an annual basis.

### ***3.4.2. CbCR Template***

The CbCR template as per Action 13 includes three Tables which should be populated by the MNE group entity if it meets the CbCR threshold as described above. The main purpose of the three separate Tables is to understand the financial position of each entity within the MNE group as well as the functional profile of each entity.

The information required under each Table is summarised below.

#### ***3.4.2.1. Table 1***

Table 1 of the CbCR requires the MNE group to provide information relating to each group company's financial position as well as the number of employees in each entity. Table 1 provides an overview of the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the MNE group operates.

The information required in Table 1 of the CbCR can be summarised as follows:

| Tax jurisdiction | Revenues        |               |       | Profit (loss) before income tax | Income tax paid (on cash basis) | Income taxes accrued – current year | Stated capital | Accumulated earnings | Number of full time employees | Tangible Assets (other than cash and cash equivalents) |
|------------------|-----------------|---------------|-------|---------------------------------|---------------------------------|-------------------------------------|----------------|----------------------|-------------------------------|--|
|                  | Unrelated party | Related party | Other |                                 |                                 |                                     |                |                      |                               |  |
|                  |                 |               |       |                                 |                                 |                                     |                |                      |                               |  |
|                  |                 |               |       |                                 |                                 |                                     |                |                      |                               |  |

**Challenges faced with CbCR Table 1**

Various challenges arise from Table 1 of the CbCR. As the CbCR is a risk profiling tool, it should be completed as accurately as possible. In practice, certain guidelines have been derived from completing Table 1 of the CbCR to ensure that the correct information is included under each heading. The guidance on the various aspects of the columns of the CbCR is discussed in the following paragraphs:

*Revenues*

The following line items in the income statement of each company within the group should be considered for the purposes of completing the “Revenue” columns in the CbCR:

- Net sales from inventories, properties, services, royalties, interest, premiums and other amounts.
- The sale of fixed assets, sale of scrap and interest on investments, among others.
- The revenue figures should exclude payments received that are treated as dividends.

*Profit or loss before income taxes*

The “Profit or loss before income taxes” column should include extraordinary income and expense items from the income statements.

*Income tax paid on a cash basis*

The “Income tax paid on a cash basis” column should include income tax and withholding taxes paid in actual year and should also include payments made in the current year that relate to prior years. Any income tax refunds should be set off.

*Income taxes accrued - Current year*

The “Income taxes accrued – Current year” column should include the sum of accrued current tax expense on taxable profits or losses for the year. The column should only reflect operations in the current year and should not include deferred taxes or provisions for uncertain tax liabilities.

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### *Stated capital*

The “Stated capital” column should be made up of the sum of share capital, share premium and other capital reserves, excluding retained earnings.

In the case of PEs, the CbCR is still required to be completed. However, the “Stated capital” column will not be completed as the PE is not a separate legal entity. The treatment and definition of a PE is detailed in Action 7.

### *Accumulated earnings*

The “Accumulated earnings” column should include the sum of total accumulated earnings as of the end of the year as per the balance sheet of each group company.

Where there are any accounting adjustments that could impact accumulated earnings, a note should be included in Table 3.

### *Number of full-time employees*

The number of full time employees in each company within the group should be made up of 'full time equivalents' employees and should include independent contractors. This may be reported on any basis, as long as it is consistent across countries.

### *Tangible assets (other than cash and cash equivalents)*

The “Tangible assets” column should include the net book value of tangible assets which includes inventory. This column should exclude trade receivables, prepayments and operating leases, but include capital leases.

### *Functional currency of the CbCR*

All amounts provided in the CbCR should be reported in one and the same currency, being the currency of the Reporting MNE. If the annual financial statements are used as the source for the CbCR, all amounts should be translated to the stated functional currency of the Reporting MNE at the average exchange rate for the year stated which will be stated and referenced in the additional information section included in Table 3 of the CbCR.

#### **3.4.2.2. Table 2**

Table 2 of the CbCR requires the MNE group to classify the business activities of each of the companies within the MNE group. It is vital that the group company's activities are mapped out correctly.

The information required in Table 2 of the CbCR can be summarised as follows:

| Tax jurisdiction | Constituent entities resident in the tax jurisdiction | Jurisdiction of incorporation, if different from tax jurisdiction of residence | Main business activity(ies) |   |                           |                             |                                  |  |  |                        |                              |           |  |         |       |  |  |
|------------------|---|--|-----------------------------|---|---------------------------|-----------------------------|----------------------------------|--|--|------------------------|------------------------------|-----------|--|---------|-------|--|--|
|                  |   |  | Research and Development    | Holding or Managing intellectual property | Purchasing or Procurement | Manufacturing or Production | Sales, Marketing or Distribution | Administrative, Management or Support Services | Provision of Services to unrelated parties | Internal Group Finance | Regulated Financial Services | Insurance | Holding shares or other equity instruments | Dormant | Other |  |  |
|                  |   |  |                             |   |                           |                             |                                  |  |  |                        |                              |           |  |         |       |  |  |

**3.4.2.3. Table 3**

Table 3 of the CbCR allows the MNE group to include any further brief information or explanation that it considers necessary or that would facilitate the understanding of the compulsory information provided in the CbCR.

**3.5. The Multilateral Competent Authority Agreement<sup>9</sup>**

The Multilateral Competent Authority Agreement (“MCAA”) is a multilateral framework agreement that provides a standardised and efficient mechanism to facilitate the automatic exchange of information in accordance with the Standard for Automatic Exchange of Financial Information in Tax Matters (“the Standard”). It avoids the need for several bilateral agreements to be concluded between jurisdictions and plays a vital role in the sharing of CbCR between jurisdictions.

Its design as a framework agreement means the MCAA always ensures each signatory has ultimate control over exactly which exchange relationships it enters into and that each signatory’s standards on confidentiality and data protection always apply.

The MCAA framework agreement was signed in Berlin on 29 October 2014 and since then, 61 jurisdictions have signed a multilateral competent authority agreement to automatically exchange information based on Article 6 of the Multilateral Convention. The Multilateral Convention implements a series of tax treaty measures to update international tax rules and lessen the opportunity for tax avoidance by multinational enterprises.<sup>10</sup>

<sup>9</sup> OECD, n.d. *What is the Multilateral Competent Authority Agreement*, viewed 26 February 2019. Available at: <http://www.oecd.org/tax/transparency/technical-assistance/aeoi/whatisthemultilateralcompetentauthorityagreement.htm> [accessed: 26 February 2019]

<sup>10</sup> OECD, n.d. *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*. Available at: <http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> [accessed: 26 February 2019]

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The significance of the MCAA framework agreement was demonstrated by the participation of 39 ministers in the signing ceremony in Berlin and the signing ceremony held in margins of the OECD Ministerial meeting ("MCM") in Paris in June 2015.

The competent authority agreement is a multilateral framework agreement, with the subsequent bilateral exchanges coming into effect between those signatories that file the subsequent notifications under Section 7 of the agreement.

The agreement specifies the details of what information will be exchanged and when, as set out in the Exchange of information.

The agreement consists of eight sections:

- *Section 1* contains the definitions of the terms used in the agreement.
- *Section 2* sets out the information to be automatically exchanged.
- *Section 3* sets out the timing and method of the automatic exchange of information.
- *Section 4* outlines how the parties to the agreement will work together to ensure compliance with the agreement.
- *Section 5* sets out provisions to ensure confidentiality and the safeguarding of the data.
- *Section 6* sets out the process to consult on ensuring the smooth operation of the agreement and to amend the agreement.
- *Section 7* sets out the subsequent notifications required under the agreement and how the agreement is then subsequently brought into effect.
- *Section 8* sets out the role of the Secretariat.

### **3.5.1. Multilateral Competent Authority Agreement on the Exchange of CbC Reports<sup>11</sup>**

The Multilateral Competent Authority Agreement on the Exchange of CbC Reports (the "CbC MCAA") has been developed and sits alongside the MCAA. In addition, two further model competent authority agreements have been developed for exchanges of CbCR, one for exchanges under Double Tax Conventions and one for exchanges under Tax Information Exchange Agreements.

The purpose of the CbC MCAA is to set out rules and procedures as which will be necessary for jurisdictions which are signatories of the MCAA and are implementing BEPS Action 13 to automatically exchange CbCR prepared by the Reporting MNE.

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<sup>11</sup> OECD, n.d. *Automatic Exchange: Country-by-Country reporting*. Available at: <http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/country-by-country-reporting.htm> [accessed: 26 February 2019]

## **4. Transfer Pricing in South Africa**

The purpose of this chapter is to discuss the development of South Africa's transfer pricing documentation requirements. This chapter will focus on past transfer pricing documentation requirements and how they have evolved into the current documentation requirements which include both the approach to documentation design as per BEPS Action 13 as well as SARS' own transfer pricing documentation retention requirements.

### **4.1. General overview of the transfer pricing landscape in South Africa**

#### **4.1.1. Existence of Transfer Pricing Laws/Guidelines<sup>12</sup>**

Section 31 of the Act contains the main legislative provisions relating to the South African transfer pricing rules. The current, revised, version of section 31 of the Act was introduced by the Taxation Laws Amendment Act, 2011 with effect from 1 April 2012, and is applicable in respect of years of assessment commencing on or after that date ("South African transfer pricing rules").

The South African transfer pricing rules will apply, broadly speaking, to any transaction, operation, scheme, agreement or understanding where:

- a) that transaction constitutes an "affected transaction" as defined; and
- b) results or will result in any tax benefit being derived by a person that is a party to the affected transaction.

The term "affected transaction" is defined in section 31(1) and includes, inter alia, any transaction, operation, scheme, agreement or understanding which has been directly or indirectly entered into or effected between or for the benefit of either or both, inter alia, a resident and a non-resident which are connected persons in respect to each other and where any of the terms or conditions agreed upon are not of an arm's-length nature.

In these circumstances section 31(2) places an obligation on each party to the affected transaction which derives a tax benefit, to calculate its taxable income or tax payable as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed, had those persons been independent persons dealing at arm's-length.

Essentially, the burden of proof is thus placed on the taxpayer to show that he has entered into the transaction, operation, scheme, agreement or understanding with connected persons on the terms and conditions that would have existed had the persons been independent persons dealing at arm's-length.

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<sup>12</sup> Lexis Nexis Editorial Staff, 2018. *Professional Tax Handbook Volume 1*. Johannesburg: Lexis Nexis

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Section 31(3) of the Act further provides for a secondary adjustment on the basis that any “adjustment amount” (in other words, the difference between the tax payable calculated in accordance with the provisions of section 31(2) and otherwise) will, with effect from 1 January 2015, in the case of an affected transaction between a resident company and inter alia, any other person that is not a resident, be deemed to be a dividend in specie paid by the resident company to that other person.

The deemed dividend in specie will be deemed to have been declared and paid on the last day of a period of six months following the end of the year of assessment in which the adjustment is made.

In terms of section 64EA of the Act, a company that is a resident that declares and pays a dividend that consists of a distribution of an asset in specie is liable for dividends tax in respect of that dividend. Dividends tax is calculated at 20% of the amount of any dividend paid (increased from 15% for any dividend paid on or after 22 February 2017), but might be reduced by the applicable double taxation agreement entered into between South Africa and the jurisdiction where the non-resident is resident for tax purposes if the non-resident would have been entitled to a reduction in the rate had it been liable for the dividends tax and provided certain documentation requirements are met.

#### ***4.1.2. South Africa’s Status with regards to the OECD Guidelines***

Although South Africa is not a member country of the OECD, it was awarded OECD observer status in 2004 and is also a member of the OECD BEPS Committee. South Africa closely follows the guidance contained in the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“OECD Guidelines”) in respect of transfer pricing matters in the absence of specific South African guidance.

In this regard, it has been acknowledged by SARS that the OECD Guidelines are an important document that reflect unanimous agreement amongst the member countries, reached after an extensive process of consultation with industry and tax practitioners in many countries and, as the OECD Guidelines are also followed by many countries that are not OECD members, they have effectively become a globally accepted standard.

SARS also endorses the standard OECD transfer pricing methods, including the traditional transaction methods, such as the Comparable Uncontrolled Price (“CUP”) method, the resale price method and the cost plus method, as well as the transactional profit methods, such as the Transactional Net Margin Method (“TNMM”) and profit split method.

#### ***4.1.3. Thin capitalisation***

With the introduction of the current transfer pricing rules, the issue of thin capitalisation has also become part of the general transfer pricing mandate, which is in alignment with the view of the OECD. On this basis, the South African transfer pricing rules require that the arm’s-length principle be applied to financial assistance in the same way as it is applied to any other transaction, operation, scheme, agreement or understanding.

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In practice, in the context of financial assistance, this will result in a taxpayer having to determine, inter alia, what amounts it would have been able to borrow in the open market (that is, its lending capacity), on what overall terms and conditions and at what price.

Additionally, section 23M of the Act contains a “fixed-ratio” rule as contemplated in the Final report on BEPS Action 4 “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments”. In terms of section 23M, net interest expenses in respect of certain inward loans may be disallowed as a deduction to the extent that they exceed a specified percentage of a resident taxpayer’s Earnings before Interest, Tax, Depreciation and Amortisation (“EBITDA”).<sup>13</sup>

#### **4.1.3.1. Draft Interpretation note on Thin Capitalisation<sup>14</sup>**

SARS issued a Draft Interpretation Note, Determination of the Taxable Income of certain persons from international transactions: Thin Capitalisation, which has never been finalised. In this regard, it should be noted that SARS’ interpretation notes are not law, but provide insight into the prevailing practice of SARS and guidelines on SARS’ view on the interpretation and application of the provisions of the tax acts.

SARS indicated in their Draft Interpretation Note that, that in order to consider what is an appropriate amount of debt for thin capitalisation purposes and in applying the arm’s-length principle to funding arrangements, a taxpayer should consider the transaction from both the lender’s perspective and the borrower’s perspective.

That is, in determining the arm’s-length amount of debt from the lender’s perspective, whether the amount borrowed could have been borrowed at arm’s-length (that is, what a lender would have been prepared to lend and therefore what a borrower could have borrowed) and from the borrower’s perspective, whether the amount would have been borrowed at arm’s-length (that is, what a borrower acting in the best interest of its business would have borrowed). In addition, the taxpayer needs to consider whether the interest rate is an arm’s-length interest rate.

The draft Interpretation Note specifies the following:

- SARS should consider transactions in which the Debt: EBITDA ratio of the SA taxpayer exceeds 3:1 to be of greater risk. The ratio is not a safe harbour, this ratio is merely indicative of the level of risk set by SARS for the purpose of selecting cases for audit.
- An interest rate not exceeding the weighted average of the Johannesburg Interbank Average Rate (“JIBAR”) plus 2% may be paid on financial assistance.

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<sup>13</sup> IBID, Page 19

<sup>14</sup> South African Revenue Services, 2012, *Draft Interpretation Note on the Determination of the Taxable Income of Certain Persons from International Transactions: Thin Capitalisation*. South Africa: SARS

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#### **4.1.4. Transfer Pricing Scrutiny**

In line with most other jurisdictions, SARS has substantially increased its focus on transfer pricing as one of the main sources of income in fighting its increasing budget deficit.

In recent years, the main focus has been scrutinizing so-called high-risk transactions, in particular in the mining and resources sectors.

In addition, benchmarking studies<sup>15</sup> are not necessarily accepted at face value by SARS, and the validity of the assumptions underlying a benchmark may be called into question.

#### **4.1.5. Definition of Related Party**

Related parties are defined as “connected persons” for South African tax and transfer pricing purposes. The definition of a “connected person” is contained in section 1 of the Act.

In terms of the general definitions in the Act, a connected person with regard to a company is any other company which would be part of the same group of companies as that company, if the following threshold of “at least 70 per cent of the equity shares in” is replaced by “more than 50 per cent of the equity shares or voting rights in”.

In addition, any company that individually or jointly with any connected person in relation to itself, directly or indirectly holds at least 20 per cent of a company’s share capital or voting rights is also considered a connected person to such company, as long as no shareholder holds the majority voting rights in the company. In respect of transactions involving intellectual property or financial assistance, the above qualification “as long as no shareholder holds the majority of the voting rights in the company” falls away, therefore a 20 per cent shareholding is sufficient to constitute connected persons for transactions involving intellectual property or financial assistance, independent of whether any other shareholder holds the majority of voting rights in the company or not.<sup>16</sup>

A connected person relationship between two companies may also exist where a connected person in relation to one company (or a connected person in relation to such person) manages or controls the other company.

The connected person definition is extensive and requires careful consideration. Structures involving trusts are especially likely to include connected persons.

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<sup>15</sup> Benchmarking studies identify an arm’s-length range of prices and operating profits and/or testing the appropriateness of a transfer pricing policy

<sup>16</sup> IBID, Page 19

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#### **4.1.5.1. Potential amendments**

During the 2019 South African Budget Speech presented by the Minister of Finance on 20 February 2019, suggested changes were discussed with regards to the “connected persons” definition in terms of Section 31 of the Act.

It was proposed that the scope of application of the rules be reviewed with a view to determining whether their application should instead be based on the concept of “associated enterprises” as defined in Article 9 of the OECD Model Tax Convention. This definition is also that proposed by the OECD in its 2011 paper “Transfer Pricing Legislation – A Suggested Approach”.

#### **4.1.6. Transfer Pricing Penalties<sup>17</sup>**

In addition to the primary and secondary adjustment, where the application of non-arm's-length terms has resulted in any prejudice to SARS, the taxpayer may be liable for understatement penalties in terms of section 222 of the Tax Administration Act, 28 of 2011 (“TAA”).

Understatement penalties are determined as a percentage of the difference between the understated amount of tax and the amount that should properly have been chargeable to tax. The percentage depends on the “behaviour” involved in the understatement and ranges between 10 percent, for a first case of “substantial understatement” to 200 percent for a repeat case of “intentional tax evasion”.

In terms of sections 89*bis* and 89*quat* of the Act, interest is payable on underpaid amounts of tax at a rate which is prescribed from time to time.

#### **4.1.7. The Arm's-length Principle<sup>18</sup>**

The arm's-length principle is the international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. Under this principle, the conditions made or imposed between two associated enterprises in their commercial or financial relations should not differ from those that would be made between independent enterprises engaging in similar transactions under similar circumstances. The OECD member countries have agreed that when the transfer pricing arrangements between associated enterprises do not reflect the arm's-length principle, the taxable profits of the associated enterprises may be adjusted as appropriate.

#### **4.1.8. Transfer Pricing Methods**

As mentioned before, SARS generally follows the guidance of the OECD Transfer Pricing Guidelines. Accordingly, all transfer pricing methods accepted by the OECD in the OECD Guidelines are accepted by SARS, including the CUP method, the resale price method, the cost plus method, the profit split method and the TNMM.

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<sup>17</sup> IBID, Page 19

<sup>18</sup> OECD, 2017. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*. Paris: OECD

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Each of the transfer pricing methods accepted by SARS are briefly described below<sup>19</sup>:

### ***The CUP method***

The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction under comparable circumstances. For the purposes of the CUP method, an uncontrolled transaction is considered to be comparable to a controlled transaction if reasonably accurate adjustments can be made to eliminate the effects of any material differences between the controlled and uncontrolled transactions. The extent and reliability of any such adjustments will affect the relative reliability of the analysis under the CUP method. The difficulties that arise in attempting to make reasonably accurate adjustments should not routinely preclude the possible application of the CUP method.

As a general rule, the most reliable method will be the one that requires fewer and more reliable adjustments to be made. Taxpayers will not be required to undertake an intricate analysis of all the methodologies, but should have a sound basis for using the selected methodology.

### ***Resale Price Method***

The resale price method evaluates the arm's-length character of a controlled transaction by reference to the gross profit margin realised in comparable uncontrolled transactions. It is most useful where it is applied to operations that do not add significant value to the goods or services in which they deal for example, distributors.

### ***Cost Plus Method***

The cost plus method evaluates a controlled transaction by reference to the mark up realised in comparable uncontrolled transactions. It is most useful where semi-finished goods are sold between related parties; where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements; or where the controlled transaction is the provision of services.

### ***Profit Split Method***

Where transactions are very interrelated, it might be that they cannot be evaluated on a separate basis and therefore a one sided approach may not be available. This may be the case where two or more parties are effectively engaged in a composite business or where each holds intangibles (or makes unique contributions) which cannot reliably be priced in a different way.

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<sup>19</sup> OECD, 2017. *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, Para. 2.1 – 2.155.*  
Paris: OECD

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**TNMM**

The TNMM examines the net profit relative to an appropriate base (for example, costs, sales and assets) that a taxpayer realises from a controlled transaction or group of transactions in relation to the net profit realised from comparable uncontrolled transactions. Net margins are less affected by transactional differences than is the case with price, as used in the CUP method, and also may be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins. Because differences in the functions performed between enterprises are often reflected in variations in operating expenses, enterprises may have a wide range of gross profit margins but still earn broadly similar levels of net profit. Differences in accounting principles and treatment also play a role in this.

In order to be applied reliably, the TNMM must be applied in a manner consistent with the manner in which the resale price or cost plus method is applied.

**4.1.9. Comparability<sup>20</sup>**

Application of the arm's-length principle is generally based upon a comparison of the economically relevant characteristics of a controlled transaction with the economically relevant characteristics of transactions between independent enterprises. In order for a controlled transaction to satisfy the arm's-length principle, it must be sufficiently comparable to an uncontrolled transaction.

If material differences exist between the controlled and uncontrolled transactions that would affect the transfer pricing analysis, reasonable adjustments must be made to eliminate the effect of such differences on the price or margin achieved in respect of such transactions. If adjustments cannot be made to take account of such differences, then the controlled and uncontrolled transactions are not sufficiently comparable under the arm's-length principle.

In order to establish the degree of actual comparability and then to make appropriate adjustments to establish arm's-length conditions, it is necessary to compare the controlled and uncontrolled transactions based on five comparability factors set out in the OECD Guidelines.

These factors include the characteristics of the property or services transferred; the functions performed by the parties (taking into account assets used and risks assumed); the contractual terms; the relevant economic circumstances; and the business strategies pursued by the parties. The extent to which each of these factors matters in establishing comparability will vary from case to case.

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<sup>20</sup> South African Revenue Services, 1999. *Practice Note 7: Section 31 Of The Income Tax Act, 1962 (The Act): Determination Of The Taxable Income Of Certain Persons From International Transactions : Transfer Pricing*, SARS, South Africa

Information on South African companies is only readily available in the form of published financial accounts of public companies. More detailed information on public companies and information on private companies is generally not publicly available. South African comparables are consequently not easily available.

Accordingly, SARS has stated in Practice Note 7 that it accepts the use of foreign financial databases but may require that adjustments to the data are carried through for use in the South African market. SARS currently uses Bureau Van Dijk's AMADEUS and Orbis Databases to conduct comparable studies. While in the past SARS was relying heavily on European companies for comparability, its approach has recently been widened to include other geographic areas, depending on the specific circumstances of the transaction and the industry in which the tested party<sup>21</sup> operates.

#### **4.2. Impact of Action 13 on Documentation and Disclosure Requirements**

Transfer pricing documentation and disclosure requirements in South Africa have evolved over the years, below is a summary of the evolution of transfer pricing documentation in South Africa:

##### **1999: Practice Note 7 ("PN7") Four step approach<sup>22</sup>**

This approach included the following steps:

**Step 1:** Understand the cross-border dealings between connected persons in the context of the business;

**Step 2:** Select the appropriate transfer pricing method;

**Step 3:** Apply the transfer pricing method; and

**Step 4:** Calculate the arm's-length price in accordance with the selected method.

##### **2010: OECD Nine step approach<sup>23</sup>**

On 22 July 2010, the OECD approved the final revisions to Chapter I-III of the OECD Guidelines. One of the most noteworthy changes was the inclusion of a nine step process which served as an example as to how the recommendations of the new OECD Guidelines could be applied in practice.

<sup>21</sup> A tested party is the entity whose profit margin is compared with that of the comparables in order to determine the arm's-length price of a transaction.

<sup>22</sup> SA Institute of Tax Practitioners, edited by Juta's Statutes Editors, 2010. *SAIT Tax Legislation Compendium, Second Edition 2010*

<sup>23</sup> Organisation for Economic Co-operation and Development (OECD), 2010. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration*. Paris: OECD.

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Although the OECD Guidelines recognised that following these 9 steps would not necessarily lead to an arm's-length result, and conversely, that not following the 9 step process did not preclude an arm's-length result, the OECD explicitly mentioned that there needed to be a process that is reliable and transparent (a process which a tax auditor can examine, follow and test where necessary).

The nine step approach was a more comprehensive approach to transfer pricing documentation than PN7's four step approach. This approach included the following steps:

**Step 1:** Determine years to be covered – which determines the fiscal years to be covered in the transfer pricing documentation;

**Step 2:** Broad-based analysis of the taxpayer's circumstances - An "essential step" this is analysis of factors relevant to the taxpayer or the environment in which the controlled transactions take place;

**Step 3:** Review of the controlled transactions and choice of tested party - This includes functional analysis in order to apply subsequent steps and identify relevant comparability factors;

**Step 4:** Review of existing internal comparables – This consists of a review of any internal comparable data which may be "more complete" than external data and be "more direct and closer" to the transactions;

**Step 5:** Determine available sources of information on external comparables - If needed, sources of external comparable data and their likely reliability should be considered before choosing a method;

**Step 6:** Select most appropriate transfer pricing method and relevant financial indicator -This involves choosing both the method and the relevant financial indicators that need to be considered when applying it;

**Step 7:** Identify potential third party comparables - This includes identifying the characteristics that will determine what is comparable and applying these to select the data to use;

**Step 8:** Determine and make comparability adjustments where appropriate - If adjustments are required to improve reliability of the comparable data, then these should be identified and made; and

**Step 9:** Interpret data collected, determine arm's-length range and conclude - The final step involves applying the most reliable comparables to the method selected and determining the arm's-length remuneration.

#### ***2014/ 2015: OECD Master file, Local file and CbC reporting***

These developments were dealt with under chapter 3 of the report. In the paragraphs below, these developments are dealt with from a South African perspective.

#### 4.2.1. Level of Documentation in a post BEPS environment

South Africa has committed itself to introducing transfer pricing documentation requirements in line with the three-tiered approach as suggested by the OECD as described in chapter 3.

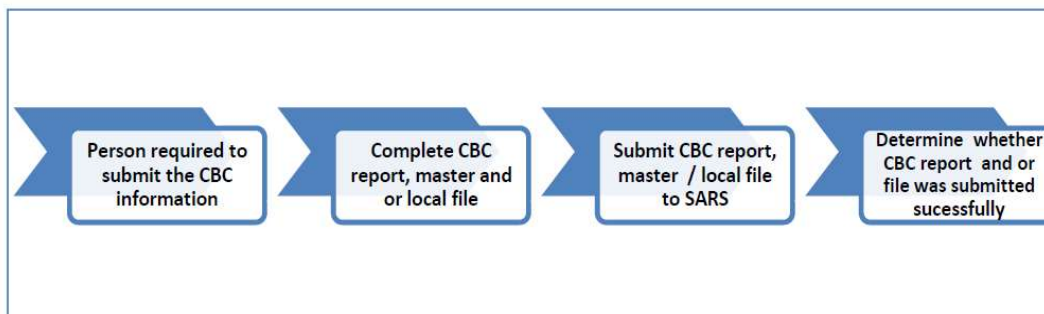
The requirements for CbCR were finalised on 23 December 2016 while the Master file and Local country file requirements were finalised on 20 October 2017 in Public Notice 1117 of 20 October 2017 (“GN 1117”).

##### 4.2.1.1. CbC returns

On 23 December 2016, the Minister of Finance issued regulations governing CbC reporting which closely follow the implementation package in Annex IV to Chapter V of the OECD Guidelines. The main requirements in respect of CbCR may be summarised as follows:

- MNE Groups with consolidated group revenue of less than R10 billion (equivalent to EUR 750 million when the regulations were issued, however it is currently less than EUR 750 million) are not required to file CbC returns.
- CbC returns are to be submitted within 12 months of the last day of the reporting fiscal year. The notice applies in respect of Reporting Fiscal Years commencing on or after 1 January 2016, and the first returns will therefore be due by 31 December 2017.
- South Africa signed the MCAA (including the CbC MCAA), as detailed in section 3.5 of this research report, in September 2017 which has enabled the country to exchange and share CbC reports with other countries who have also signed the MCAA.

The following diagram depicts the process for companies which are required to submit CbCR returns<sup>24</sup>:



<sup>24</sup> South African Revenue Services, 2018, *How To Complete And Submit Your Country By Country Information Revision 4*, SARS, South Africa

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#### **4.2.1.2. Master file and Local file returns<sup>25</sup>**

On 20 October 2017, the Minister of Finance issued regulations governing transfer pricing documentation. In terms of GN1117 certain taxpayers are required to submit transfer pricing returns to SARS. The form and content of the returns are specified in the External Business Requirements Specification: CbC and Financial Data Reporting, and correspond to the Master file, Local file and CbC report.

The Public Notice refers to two sets of companies which should comply with its requirements and guidelines namely Category 1 and Category 2 companies. The two Categories can be described as follows:

- *Category 1:* MNE Groups that are required to submit CbCR; and
- *Category 2:* Persons who are not required to submit CbCR but have “potentially affected transactions” (essentially cross-border transactions with connected persons) for the year of assessment that exceeds or is reasonably expected to exceed R100 million in aggregate value. Potentially affected transactions includes cross border intercompany transactions but excluding any transaction, operation, scheme, agreement or understanding contemplated in section 31(5), 31(6) or 31(7). Potentially affected transactions also include dividends paid / received, the coupon paid / received on preference shares and finance charges flowing from any transaction, operation, scheme, agreement or understanding, directly or indirectly entered into or effected between or for the benefit of either or both a person that is a resident; and any other person that is not a resident.<sup>26</sup>

The key requirements in terms of the Public Notice are as follows<sup>27</sup>:

- Companies included under either of the categories described above, are required to submit a return in the form and containing the information specified in the Business Requirement Standard: CbC and Financial Data Reporting (“BRS”) in relation to the Master file and Local file.
- The BRS incorporates the Master file and Local templates from Annexes I and II of Chapter V of the OECD Guidelines. In respect of the Master file, the BRS notes that the information required in terms of Annex I represents a minimum requirement for the Master file. No set format exists for the presentation of the Master file information.

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<sup>25</sup> South African Revenue Services, 2017, *Public Notice 1117 of 20 October 2017: Return to be submitted by persons in terms of Section 25 of the Tax Administration Act, 2011 (Act No. 28 of 2011)*. SARS, South Africa

<sup>26</sup> IBID, Page 28

<sup>27</sup> IBID, Page 28

- The BRS notes however that, given this flexibility, MNEs are encouraged to prepare the Master file as a “real-life summary”, depicting the overall transfer pricing policy and supply chain for each of their businesses in such a manner that any person reading the document may understand the intercompany pricing policies adopted. The BRS does not provide any guidance in respect of the Local file contents beyond that contained in Annex II to Chapter V.
- The Master file and Local file are to be submitted electronically via the South African Revenue Service (“SARS”) e-filing system. MNEs are therefore able to prepare the Master file and Local file returns in a form which they choose, and upload those documents to the system.
- The Master file and Local file returns are to be submitted within 12 months of the last day of the year of assessment. The submission deadline therefore coincides with that for the corporate tax return.

The Public Notice applies to the following companies in respect of commencement dates<sup>28</sup>:

- In respect of Category 1 companies, the Public Notice applies from financial years commencing on or after 1 January 2016, and first in respect of financial years commencing on or after 1 January 2016, and the first returns were due by 31 December 2017. This is applicable to the CbCR as well as the Master file and Local file.
- In respect of Category 2 companies, the Public Notice applies from financial years commencing on or after 1 October 2016, first returns were submitted by 30 September 2018.

#### **4.2.1.3. Record Keeping**

In addition to the submission of transfer pricing returns, as described in the previous paragraph, taxpayers whose potentially affected transactions, for a year of assessment commencing on or after 1 October 2016, exceed, or are reasonably expected to exceed R100 million in aggregate, are required to keep the records specified in terms of Public Notice 1334 of 28 October 2016 (“GN 1334”). These records are not intended to be submitted as a matter of course but are required to be retained in case of audit, according to the requirements of section 29 of the TAA.

In particular, all taxpayers which meet the R100 million threshold are required to keep specified information regarding their structure and operations. Additionally, such taxpayers are required to keep certain transaction-specific records in respect of any potentially affected transaction that exceeds, or is reasonably expected to exceed, R5 million in value.<sup>29</sup>

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<sup>28</sup> IBID, Page 28

<sup>29</sup> South African Revenue Services, 2016, *Public Notice 1334 of 28 October 2016: Duty to keep the records, books of account or documents in terms of Section 29 of the Tax Administration Act, 2011 (Act No. 28 of 2011)*SARS, South Africa

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Taxpayers which do not meet the R100 million threshold are nevertheless recommended to keep such records as will allow them to ensure, and allow SARS to be satisfied, that their potentially affected transactions were concluded at arm's-length.

#### *Requirements in terms of Income Tax Return*<sup>30</sup>

The ITR14 corporate income tax return requires the disclosure of certain transfer pricing related information. In particular, taxpayers are required to disclose whether they have entered into any potentially affected transactions during the year of assessment. Taxpayers which have entered into such transactions are further required to answer whether they have prepared documentation which supports the arm's-length nature of such transactions.

According to the SARS Comprehensive Guide to the Income Tax Return for Companies, taxpayers which answer this question is "yes", must have such documentation available for immediate submission to SARS, if requested.

The information to be retained as part of the record keeping requirements include the following:

#### **Structural and operational documents**<sup>31</sup>

- A description of the person's ownership structure, with details of shares or ownership interest in excess of 10 per cent held by the person or therein by other persons as well as a description of all foreign connected persons with which that person is transacting and the details of the nature of the connection;
- Name, principal office, legal form and tax residence of connected persons which a potentially affected transaction has been entered into by the person ;
- Business operation summary including:
  - An organogram showing the title and location of the senior management team members;
  - Major economic and legal issues affecting the profitability of the person and the industry;
  - A description of any business restructurings or intangibles transfers that the person has been affected by or involved in;
  - The person's market share within the industry, analysis of relevant market competition environment and key competitors;
  - Key value drivers identified by available industry research findings or reports; and
  - Industry policy, incentives or restrictions affecting the persons business.

#### **Documentation for each controlled transaction**

The following must be kept in respect of any potentially affected transaction that exceeds or is reasonably expected to exceed R5 million:

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<sup>30</sup> IBID

<sup>31</sup> IBID, Page 30

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- The nature and terms (including transfer pricing policy) of the potentially affected transactions entered into by the person with each connected person;
  - Copies of any contracts or agreements related to the potentially affected transactions entered into by the person with each connected person, if such contracts or agreements were prepared in the ordinary course of business;
  - Any other governance and regulatory documents, such as complete board minutes and South African Reserve Bank applications and approvals, relevant to the potentially affected transactions;
  - An indication of which party to the potentially affected transaction is the tested party, if applicable, and an explanation of the reasons for the party's selection;
  - With respect to the tested party—
    - a detailed allocation of revenues, costs, expenses and profits between its connected person transactions and independent person transactions, including records of the application of the transfer pricing policy and documents showing how the financial data used in applying the transfer pricing method reconciles to the annual financial statements; or
    - If the financial data for the purposes of subparagraph (i) cannot be directly allocated, an explanation supporting the allocation rationale and documentation that demonstrates how the allocation was carried out;
  - Where a tested party is tax resident outside of South Africa, such documents as evidence the functional and risk classification of the tested party;
  - A description of the functions performed, risks assumed and assets employed by the person and the connected persons involved in the potentially affected transaction;
  - A description of the intangible assets involved in the potentially affected transaction, and their influence on the functional and risk classification of the tested party;
  - Operational flows including information flow, product flow, and cash flow of the potentially affected transactions;
  - The comparable data and methods considered and used for determining the arm's-length return and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the potentially affected transactions, including:
    - (i) A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises, if any, relied on in the analysis, including a description of the comparable search methodology;
    - (ii) Summary schedules of relevant financial data for any other comparables used in the analysis and the sources from which the data was obtained;
    - (iii) If relevant, an explanation of the reasons for performing a multi-year analysis;
    - (iv) Any comparability adjustments made and the reasons for making such adjustments;

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- The assumptions, strategies, policies and price negotiations, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the potentially affected transactions;
  - Details of the adjustments, if any, made to transfer prices to align them with the arm's-length return determined under section 31(2) of the Income Tax Act and consequent adjustment made to the total income or expenses for tax purposes; and
  - Copies of existing unilateral, bilateral and multilateral APAs and other tax rulings to which SARS is not a party and which are related to the potentially affected transactions.

#### **General financial assistance transactions**

- A summary of financial forecasts which are contemporaneous with the financial assistance transactions in question, projected as far as is meaningful in relation to the period of the funding transactions, including a clear picture of the expected levels of interest cover, gearing or other relevant measures over the forecast period; and
- An analysis of the financial strategy of the business, including how capital is allocated and the relationship between capital and cash flows from operations and any changes relating to the financial assistance transactions and details regarding principal cash flows and the sources of repayment of debt.

#### **Financial assistance transaction which are longer than 12 months**

- A description of the funding structure which has been or is in the process of being put in place, including the dates of transactions, a clear statement of the source of the funds (immediate and ultimate), reasons for obtaining the funds, how the funds were or will be applied (the purpose of the financial assistance) and the repayment terms;
- A group structure covering all relevant companies and clearly setting out any changes to the structure taking place over the course of the financial assistance transactions; and
- Copies of the financial statements and management accounts prepared most recently before the point in time the financial assistance is obtained and after the financial assistance has been granted.

Most of the record keeping requirements overlap with the Master file and Local file requirements as per Action 13 of the OECD. This makes it more efficient for clients as the information required to be submitted as part of the Master file and Local file will assist in collating and retaining documentations required by SARS.

There are a few key areas where the record keeping requirements differ from the Master file and Local file requirements. Further documentation is required to be retained by a person, which is not specified in Action 13.

These additional requirements (key differences) are as follows:

- Operational flows including information flow, product flow, and cash flow of the potentially affected transactions;
- Where a tested party is tax resident outside the Republic, such documents as evidence the functional and risk classification of the tested party;
- The requirement to segment the tested party's income statement; and
- Copies of existing unilateral, bilateral and multilateral advance pricing agreements and other tax rulings to which SARS is not a party and which are related to the potentially affected transactions.

As a result of these differences it is highly recommended that MNE's should adapt their Master file and Local files to cater for the Record-Keeping requirements which would ensure that it complies with all South African transfer pricing documentation requirements.

#### ***4.2.1.4. Penalties for failure to submit CbCR, Master file and Local Files***

The definition of "International Tax Standard" has been amended in section 1 of the TAA to include the CbCR standard of Multinational Enterprises.

All the South African reporting MNE groups that must file the CbC report must also submit a Master and/or Local file to SARS when required in terms of section 25 of the TAA.

Administrative non-compliance penalties comprise fixed amount penalties as well as percentage-based penalties as per sections 210(1) and 211 of the TAA . The penalty amount that will be charged depends on a taxpayer's taxable income and can range from R250 up to R16 000 a month for each month that the non-compliance continues.

#### ***4.2.1.5. Language for Documentation***

Transfer pricing documentation should be drafted in the Commissioner's functional language, which is English, even though, in theory, all 11 official languages of South Africa are accepted.

### ***4.2.1. Tax Return Disclosures***

The ITR14 corporate tax return requires disclosure of whether the taxpayer has entered into any "potentially affected transactions" (in other words, the cross-border, related party transactions, regardless of whether the terms thereof are arm's-length) during the year of assessment.

Where potentially affected transactions have been entered into, the taxpayer is required to disclose the value of such transactions in respect of various payment categories (royalties, commissions, service fees etc.), on a jurisdiction by jurisdiction basis, for the 5 most valuable jurisdictions in each category.

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### **4.2.2. The APA Program**

The APA program allows the taxpayer and the tax authority to avoid future transfer pricing disputes by entering into a prospective agreement, generally covering at least five tax years, regarding the taxpayer's transfer prices.

South Africa does not provide for Advance Pricing Agreements (APA). Although taxpayers may make an application for an Advance Tax Ruling (“ATR”) from SARS to confirm the tax treatment of a proposed transaction where uncertainty as to the tax treatment thereof exists, transfer pricing related transactions are specifically excluded in terms of the “No Rulings List” published by SARS in Public Notice 748 of 24 June 2016.

## **5. Interpretation of BEPS Action 13 by members of the BRICS nations**

To perform a comparative analysis on how various countries have applied BEPS Action 13 to their legislation and adapted their documentation rules to align to Action 13, countries which are a part of/ or members of a similar bloc were selected. For the purposes of comparing South African transfer pricing documentation requirements, transfer pricing rules in countries that are members of BRICS have been included in the comparison below.

### **5.1.1. BRICS**

BRICS is the acronym for an association of five major emerging national economies namely: Brazil, Russia, India, China and South Africa. The grouping was originally known as “BRIC” before the inclusion of South Africa in 2010.

The five BRICS countries represent over 3 billion people, or 42% of the world population; as all five members are in the top 25 of the world by population, and four are in the top 10. The five nations have a combined nominal GDP which is equivalent to approximately 20% of the gross world product.<sup>32</sup>

The paragraphs below detail how the transfer pricing documentation of the BRICS countries have evolved in a post-BEPS environment.

### **5.1.2. Interpretation and Analysis of Action 13**

The purpose of the following four chapters is to investigate Brazil’s approach to the transfer pricing documentation guidelines as per BEPS Action 13. The research investigates three issues as they are the most relevant for purposes of this research.

Firstly, this research looks at each country’s current legislations and practices and the legal compliance of transfer pricing documentation.

Secondly, an analysis of how each country has aligned its legislation and practices to BEPS Action 13 will be performed.

Thirdly, this research analyses how each country deals with taxpayers’ non-compliance with the updated documentation requirements. The chapter will end with a comparison between the approaches followed by South Africa and the respective countries.

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<sup>32</sup> South African Government, n.d. *BRICS (Brazil, Russia, India, China, South Africa)*. Available from [www.gov.za/about-government/brics-brazil-russia-india-china-south-africa-1](http://www.gov.za/about-government/brics-brazil-russia-india-china-south-africa-1) [accessed: 06 February 2019]

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## **6. Interpretation of BEPS Action 13 by Brazil**

### **6.1.1. Introduction**

Brazil is the fifth largest country in the world by area. It is also one of the most populous countries in the world with a population exceeding 209 million people. Only China, India, the United States of America and Indonesia have bigger populations.

Brazil is divided into 27 federal units or states, including Brasilia as its capital. The official language of Brazil is Portuguese, and the currency is the Brazilian Real (“BRL”)<sup>33</sup>.

The Brazilian economy is considered large by almost any standard. Brazil is the ninth largest economy in the world in terms of gross domestic product (“GDP”) derived from purchasing power parity (“PPP”) calculations.

### **6.1.2. Transfer Pricing documentation prior to BEPS**

The Brazilian transfer pricing rules are applicable to the import and export transactions of goods, services, and licenses between related parties (the legislation provides an extensive list of the parties considered as ‘related’ for transfer pricing purposes). Under these rules, the pricing policies determined between related parties will be acceptable for Brazilian tax purposes, if it is in accordance with one of the transfer pricing methods established by the legislation.<sup>34</sup>

The transfer pricing methods established under Brazilian legislation are as follows<sup>35</sup>:

- Comparable independent price method;
- Resale price minus gross profit method;
- Production cost-plus profit method;
- Quotation price on import method;
- Export sales price method;
- Resale price method;
- Purchase or production cost method; and

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<sup>33</sup> EUR 1 = BRL 4.31 as at 8 March 2019

<sup>34</sup> PwC, 2018. *PwC Worldwide Tax Summaries – Brazil*. Available at: <http://taxsummaries.pwc.com/ID/Brazil-Corporate-Group-taxation> [accessed: 05 February 2019]

<sup>35</sup> Ernst & Young, 2018. *EY Worldwide Transfer Pricing Reference Guide – Brazil*. Available at: <https://www.ey.com/gl/en/services/tax/international-tax/transfer-pricing-and-tax-effective-supply-chain-management/2017-2018-ey-worldwide-transfer-pricing-reference-guide-brazil> [accessed: 05 February 2019]

- Quotation price on export method.

There are no “profit” based methods such as the TNMM method which are accepted by the Brazilian tax authorities.

None of the above methods can be seen as the best approach, therefore taxpayers can choose the most suitable method for each transaction (goods, services, or license) on an annual basis, except in cases involving listed commodities. Furthermore, all transactions with tax havens and those subject to advantageous tax regimes are subject to transfer pricing rules, whether involving related parties or not.

Transfer pricing documentation has to be prepared annually under Local country regulations. A detailed analysis must be prepared for all intercompany transactions (goods, services, rights, interest in loan).

This analysis includes a full functional analysis of each intercompany transaction. The functional analysis includes describing the functions performed under each transaction, the risks assumed by all parties involved in the transaction as well as the assets used in each transaction. This analysis is then supported with a benchmarking study that analyses independent transactions and concludes whether the pricing policy applied in these transactions satisfy the arm’s-length principle.

### ***6.1.3. Transfer Pricing documentation in a Post-BEPS environment***

Over the years, the Brazilian tax authorities slowly implemented rules that are coherent with the BEPS Action Plan initiative. Because of this, tax authorities are already vigilant in their tax audits.

#### ***6.1.3.1. Master file and Local file requirements<sup>36</sup>***

With regards to the Master file and Local file requirements, the Brazilian tax authorities have not implemented any rules and regulations regarding this topic. Nevertheless, transfer pricing documentation in respect of intercompany transactions, as described above, should still be kept on hand.

#### ***6.1.3.2. CbCR Requirements<sup>37</sup>***

Brazil has rules that impose and enforce CbC requirements on MNE Groups who’s reporting MNE is resident for tax purposes in Brazil. The first filing obligation for a CbC report in Brazil commenced in respect of fiscal years commencing on or after 1 January 2016.

Brazil meets all the terms of reference relating to the domestic legal and administrative framework, with the exception of the annual consolidated revenue threshold calculation rule in respect of MNE Groups whose Ultimate Parent Entity is located in a jurisdiction other than Brazil which may deviate from the guidance issued by the OECD and could lead to Local filing requirements which are inconsistent with Action 13.

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<sup>36</sup> IBID, Page 36

<sup>37</sup> IBID, Page 36

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Brazil has primary law in place for implementing the BEPS Action 13 minimum standard which consists on a general legal basis for the establishment of any new filing obligations and secondary law establishing the necessary requirements, including the filing and reporting obligations. Guidance addressing the main topics related to the filing and reporting obligations has also been published.

In addition, Brazil has also published guidance which provides further explanations to taxpayers with respect to CbCR, and which includes the provisions contained in the OECD's Guidance on the Implementation of CbCR translated into Portuguese.

According to Brazil's secondary law, the filing of a CbC report is not requested with respect to MNE Groups with annual consolidated group revenue in the preceding fiscal year which is lower than BRL 2,260 billion if the Ultimate Parent Entity is resident in Brazil for tax purposes, or lower than EUR 750 million or an equivalent amount converted in the Local currency of the jurisdiction of residence of the final controller, as reflected in their Consolidated Financial Statements.

Brazil signed the MCAA (including the CbC MCAA), as detailed in section 3.5 of this research report, in September 2018 which has enabled the country to exchange and share CbC reports with other countries who have also signed the MCAA.

#### **6.1.4. Interest and penalties<sup>38</sup>**

The consequences of failure to meet submission dates or provide incorrect disclosures with regards to the CbCR rules can be significant. Transactions and financial operations that are not fully reported in the CbCR give rise to a penalty of up to 3% of the underlying value of the transactions.

In addition to these penalties, general tax penalties are also applicable. The amount of the penalty may be up to 20% of the omitted tax (or 0.33% per day) if the taxpayer pays the related taxes late but before an audit. Meanwhile, if the tax authority assesses the taxpayer as part of a transfer pricing audit, the applicable penalties may range from 75% to 225% of the omitted taxes.

#### **6.1.5. Conclusion**

The CbCR requirements implemented by the Brazilian tax authorities is in line with SARS' requirements where the threshold for submitting CbCR is below the EUR 750 million group operating revenue threshold proposed in Action 13.

With regards to transfer pricing documentation, Brazil has not implemented Action 13's Master file and Local file requirements into their legislation which means that their documentation design is not on par with the global standard. Furthermore, when compared to SARS' level of documentation design and retention requirements, there is room for enhancing its transfer pricing documentation requirements.

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<sup>38</sup> IBID, Page 36

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## **7. Interpretation of BEPS Action 13 by Russia**

### **7.1.1. Introduction**

Russia is the largest country in the world by territory, covering more than a ninth of the earth's land mass. Russia's capital is Moscow and official language is Russian<sup>39</sup>. The functional currency in Russia is the Ruble ("RUB").<sup>40</sup>

Russia has an upper-middle income mixed economy with an extensive reserve of natural resources, particularly oil and natural gas. Oil, natural gas, metals, and timber account for more than 80% of Russian exports abroad.

The economic development of the country has been uneven geographically with the Moscow region contributing a very large share of the country's GDP.<sup>41</sup>

### **7.1.2. Transfer Pricing documentation prior to BEPS<sup>42</sup>**

Russia is not a member of the OECD, therefore Russia is not legally obliged to follow OECD documents. Nevertheless, the OECD Guidelines are used by the Russian tax authorities as reference when preparing transfer pricing documentation. Generally, the OECD's transfer pricing principles are the basis for the Russian transfer pricing legislation, with a number of differences. The legislation establishes criteria for related parties and controlled transactions, transfer pricing methods for determining arm's-length prices/profitability, a list of permitted information sources, and compliance requirements.

Under the Russian transfer pricing rules, the following parties are recognised as being related parties (connected persons):

- Entities where one party (the party and its related parties) has more than a 25% direct or indirect participation in these entities;
- Entities where (i) more than 50% of the directors of these companies are the same individuals, or (ii) not less than 50% of the directors are appointed/chosen by the same individual; or
- Entities where the same individual/entity acts as the sole executive body, and on the basis of some other criteria.

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<sup>39</sup> PwC, 2018. *PwC Worldwide Tax Summaries – Russia*. Available at: <http://taxsummaries.pwc.com/ID/Russian-Federation-Overview> [accessed: 05 February 2019]

<sup>40</sup> EUR 1 =RUB 74.57 as at 9 March 2019

<sup>41</sup> Wikipedia, 2018. *Russia Economy*. Available from: <https://en.wikipedia.org/wiki/Russia#Economy> [accessed: 05 February 2019]

<sup>42</sup> PwC, 2018. *PwC Worldwide Tax Summaries – Russia*. Available at: <http://taxsummaries.pwc.com/ID/Russian-Federation-Corporate-Group-taxation> [accessed: 05 February 2019]

Transfer pricing documentation should be prepared on an annual basis for the following transactions:

- Cross-border transactions between related parties;
- Cross-border transactions between unrelated parties concerning sale of commodities or in case a party to transactions is located in a low-tax jurisdiction: threshold of RUB 60 million; and
- Domestic transactions between related parties. These transactions between Russian tax residents are subject to transfer pricing only if the annual income on the transactions between such parties exceeds RUB 1 billion and if certain additional criteria are met.

The Russian tax authorities may request transfer pricing documentation during a transfer pricing audit, but not earlier than by 1 June of the calendar year following the year in which the transactions took place. Taxpayers will be required to present transfer pricing documentation within 30 working days of receiving a tax authority's request. Therefore it is recommended that Russian companies that meet any of the above requirements should prepare contemporaneous documentation to avoid failing to meet any deadlines for submissions.

### ***7.1.3. Transfer Pricing documentation in a Post-BEPS environment***

#### ***7.1.3.1. Master file and Local file requirements***

##### ***7.1.3.1.1. Master file***

The Russian tax authorities have adopted Action 13's Master file and Local file documentation design guidelines.

A Master file is required for entities with consolidated group revenues greater than RUB 50 billion if the parent company of the group is the Russian resident; or Local threshold in respective foreign jurisdiction (in case the foreign resident's parent entity has relevant regulations on the CbCR threshold in its jurisdiction).

The Master file should be drafted for fiscal years beginning on or after 1 January 2017. The Master file must be provided if required by the tax authorities within three months from the date of the request. The tax authorities may request the Master file not earlier than 12 months and not later than 36 months from the last day of the reporting fiscal year.<sup>43</sup>

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<sup>43</sup> KPMG, 2018. *BEPS Action 13: Country Implementation Summary*. Available at: <https://home.kpmg/content/dam/kpmg/xx/pdf/2018/10/tnf-beps-action-13-october16-2018.pdf> [accessed: 05 February 2019]

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#### **7.1.3.1.2. Local File**

Elements of Action 13's Local file requirements have been included in the current transfer pricing documentation design in Russia. The updated Local file is applicable for fiscal years beginning on or after 1 January 2018.

The Local file will be prepared at the request of the tax authorities on or after 31 December of the year following the fiscal year and it should be filed within 30 days after receipt of a request.<sup>44</sup>

#### **7.1.3.2. CbCR Requirements**

Russia has introduced a domestic legal and administrative framework which imposes a CbCR obligation on ultimate parent entities of MNE Groups above a certain threshold of revenue.

In respect of the CbCR requirements, the Russian legislation states that the CbC filing requirement is not applicable for a Russian MNE group if the consolidated group revenue is less than RUB 50 billion (Russian roubles) in the immediately preceding fiscal year.

The first filing obligation for a CbC report in Russia commences in respect of financial years beginning on 1 January 2017 or thereafter, with a voluntary filing mechanism is allowed for financial years beginning from 1 January 2016. The CbCR must be filed within 12 months of the last day of the reporting fiscal year of the MNE Group.<sup>45</sup>

Russia signed the MCAA (including the CbC MCAA), as detailed in paragraph 3.5 of this report, in September 2018 which has enabled the country to exchange and share CbC reports with other countries who have also signed the MCAA.

#### **7.1.4. Interest and penalties**

Transfer pricing audits will be performed by a special unit of the tax authorities. Local authorities are entitled to check notification forms correctness and notify the tax authorities if additional controllable transactions are identified.

In terms of submitting a Master file, penalties may only apply for a late submission or non-submission of the file, and there is no penalty protection as such.

For a Local file, penalty protection is available, provided that all Local documentation requirements are met, including Russian translation, Local comparability analysis and financial analysis of a Local tested party.<sup>46</sup>

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<sup>44</sup> IBID, Page 40

<sup>45</sup> IBID, Page 40

<sup>46</sup> IBID, Page 40

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### **7.1.5. Conclusion**

The CbCR guidance under Russian legislation does not create any issues for MNE Groups whose Ultimate Parent Entity is a tax resident in Russia, however they may be incompatible with the guidance on currency fluctuations for MNE Groups whose Ultimate Parent Entity is located in another jurisdiction.

This will be the case if Local filing requirements were applied in respect of a group company (which is a Russian tax resident) of an MNE Group which does not reach the threshold as determined in the jurisdiction of the Ultimate Parent Entity of such Group.

In relation to South African documentation design requirements, the Russian requirements are highly comparable in nature. The key differences are the following:

- South Africa does not consider related party domestic transactions as part of its transfer pricing scope. The focus is only on cross border transactions, whereas Russia has a domestic transfer pricing regime.
- South African transfer pricing documents also require additional information to be retained should SARS request it. This level of detail is not apparent in the Russian transfer pricing legislation as only Action 13's three-tiered approach is applied.

## **8. Interpretation of BEPS Action 13 by India**

### **8.1.1. Introduction**

India is a country located in South East Asia and is the seventh-largest country by geographical area, the second-most populous country with over 1.25 billion people, and the most populous democracy in the world. The country is surrounded by the Indian Ocean to the south, the Arabian Sea to the southwest, and the Bay of Bengal to the southeast. It shares land borders with Pakistan to the west; Bhutan, the People's Republic of China, and Nepal to the northeast; and Bangladesh and Myanmar to the east. India is divided into 29 states and seven union territories, with New Delhi as the capital. The official languages of India are Hindi and English, and the currency is the Indian rupee ("INR")<sup>47</sup>.

India gained independence from the British Empire in 1947, and is developing into an open-market economy. Economic liberalisation, including reduced controls on foreign trade and investment, began in the early 1990s and has assisted in the acceleration the country's growth rate.

Over the seven decades since independence, the country has achieved self-sufficiency in terms of food and grains. India is now a net exporter of food. Life expectancy has more than doubled, literacy rates have quadrupled, health conditions have improved, and a sizeable middle class has emerged. India is now home to globally recognised companies in pharmaceuticals, automobiles, steel, and information and space technologies.<sup>48</sup>

### **8.1.2. Transfer pricing documentation prior to BEPS**

Prior to the revised documentation guidelines introduced in Action 13, the Indian tax authorities maintained existing requirements on the documentation to be submitted for transfer pricing purposes.

The documents to be maintained and submitted to the tax authorities include the following:

Transfer pricing documentation requirements are provided under Section 92D of the Act and Rule 10D of the Rules. The categories of documentation required are:

- An ownership structure of the resident company;
- Overview of the MNE group;
- Business description and strategies;
- Nature and terms (including prices) of the related party cross border transactions;

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<sup>47</sup> EUR 1 = INR 78.61 as at 9 March 2019

<sup>48</sup> PwC, 2018. *PwC Worldwide Tax Summaries – India*. Available at: <http://taxsummaries.pwc.com/ID/India-Overview#> [accessed: 06 February 2019]

- Description of functions performed, risks assumed and assets employed for each of the cross border transactions identified;
- Record of any financial estimates;
- Record of uncontrolled transaction with third parties and a comparability evaluation;
- Description of transfer pricing methods considered;
- Reasons for rejection of alternative transfer pricing methods;
- Details of transfer pricing adjustments, if any were effected during the financial year; and
- Any other information or data relating to the associated enterprise that may be relevant for determining the arm's-length price.

#### **8.1.2.1. Domestic transfer pricing**

Domestic transfer pricing is applicable for transactions which include intercompany transfers of goods or services of profit-linked, tax-eligible units; transactions of profit-linked, tax-holiday-eligible units with other parties; and any other transaction for which an entity may be notified by the tax authorities. By extending transfer pricing provisions to specified domestic transactions, the pricing of these transactions need to be determined with regard to the arm's-length principle using methods prescribed under Indian transfer pricing regulations applicable to cross border transactions.<sup>49</sup>

### **8.1.3. Transfer pricing documentation in a post-BEPS environment<sup>50</sup>**

#### **8.1.3.1. Master file and Local file requirements**

##### *Master file*

Master file requirements as per Action 13 of the BEPS Action Plan apply to a group company if the consolidated turnover of the international group exceeds INR 5 billion and either of the following:

- The aggregate value of international transactions exceeds INR 500 million during the reporting year; or
- The aggregate value of international transactions pertaining to the purchase, sale, transfer, lease or use of intangible property exceeds INR 100 million during the reporting year, as per books of accounts.

<sup>49</sup> Ernst and Young, 2018. *EY Worldwide Transfer Pricing Reference Guide – India*. Available at: <https://www.ey.com/gl/en/services/tax/international-tax/transfer-pricing-and-tax-effective-supply-chain-management/2017-2018-ey-worldwide-transfer-pricing-reference-guide-india> [accessed: 06 February 2019]

<sup>50</sup> IBID, Page 43

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The following additional information is required to be included in the Master file which deviates from Action 13 requirements.

The additional information is as follows:

- Maintenance of a list of all the entities of the international group, along with their addresses.
- A description of the functions performed, assets employed and risks assumed by the group companies of the international group that contribute at least 10% of the revenues or assets or profits of the group.
- A list of all the entities of the international group engaged in the development and management of intangibles, along with their addresses.
- A detailed description of the financing arrangements of the international group, including the names and addresses of the top 10 unrelated lenders.
- In a number of instances, the Final Rules require a “detailed description”, instead of a “general description” mentioned in the Action 13 report, particularly with respect to transfer pricing policies relating to research and development, intellectual property, intragroup services and financing arrangements.

#### *Local file*

The Local file is to be maintained if the aggregate value of all intercompany transactions during the relevant financial year exceeds INR 10 million and/or specified domestic transactions during the relevant financial year exceed INR 200 million.

Transfer pricing documentation has to be prepared annually, as per the Indian transfer pricing regulations. Full transfer pricing documentation, including an update of the functional analysis and an updated economic analysis using the latest available data, must be maintained.<sup>51</sup>

#### **8.1.3.2. CbCR**

If the total consolidated group revenue, as reflected in the consolidated financial statement for the preceding accounting year, exceeds INR55 billion, the ultimate parent entity will be required to complete and submit CbCR.<sup>52</sup>

India signed the MCAA (including the CbC MCAA), as detailed in section 3.5 of this research report, in September 2017 which has enabled the country to exchange and share CbC reports with other countries who have also signed the MCAA.

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<sup>51</sup> IBID, Page 43

<sup>52</sup> IBID, Page 43

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### **8.1.4. Interest and penalties**

The interest and penalties applicable for not maintaining a Master file and Local file when required to do so, may include a penalty of 2% of the transaction value. This penalty is also applicable for failing to report an affected transaction, or maintaining inaccurate information with regards to the transaction.

For a failure to provide any information or documents requested by the tax officer, a penalty of 2% of the transaction value may be levied.

#### **8.1.4.1. CbCR penalties<sup>53</sup>**

For non-filing of a CbC report by an Indian resident parent company or alternate resident company the following penalties apply:

- A penalty of INR 5,000 per day for up to one month;
- A penalty of INR 15,000 per day beyond one month; and
- A penalty of INR 50,000 per day for continuing to default after being served notice.

If the information requested by the Indian tax authority is not provided within the given time limit, a penalty of INR5,000 per day up to service of penalty order and INR50,000 per day for default beyond the date of service of penalty order.

In addition, if any inaccurate details or non-filing of a corrected report is provided within 15 days, a penalty of INR500,000 is applicable.

### **8.1.5. Conclusion**

India's transfer pricing documentation regime differs from South Africa's own transfer pricing rules as India also requires transfer pricing documentation for domestic intercompany transactions.

The main reason for this is that India levies various surcharges and different tax rates for domestic and international companies and domestic transfer pricing mitigates the risk of shifting profits to companies which have lower tax rates within a group due to its structuring.

In terms of the Action 13 requirements, India's CbCR implementation is in line with the OECD guidance however, the threshold for submitting CbCR is much higher in India, therefore less MNEs will meet the CbCR requirements. South Africa's CbCR threshold is slightly lower than the OECD's EUR 750 million threshold, potentially including more MNEs being subject to CbCR.

In terms of the Master file and Local file documents, India includes a threshold for submitting these documents which is also adopted by South Africa. The thresholds aim to include a high level of detail for material cross border transactions as well as a section which provides for domestic transactions.

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<sup>53</sup> IBID, Page 43

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Overall, India has implemented the recommended three-tiered approach included in Action 13 of the BEPS Action Plan, and like South Africa, the transfer pricing documentation rules are more aligned to the global standard.

## **9. Interpretation of BEPS Action 13 by China**

### **9.1.1. Introduction**

China is the most highly populated country in the world, with over 1.3 billion people. Located in East Asia along the coastline of the Pacific Ocean, China is one of the largest countries in the world by land area. The capital of China is Beijing, and the official language is Mandarin Chinese.

The official currency of China is the yuan (“CNY”)<sup>54</sup>, and it is held in a floating exchange-rate system. It used to be managed primarily against the United States Dollar (“USD”).

China's growth comes from both huge state investments in infrastructure and heavy industries as well as private sector expansion in light industries. Exports had been China's major economic driver, but since the 2008 global financial crisis, which seriously affected the international markets of China export products, the Chinese government shifted the focus to stimulate investment and consumption in domestic markets.<sup>55</sup>

### **9.1.2. Transfer pricing documentation prior to BEPS**

All enterprises are required to enter into transactions with related parties on an arm's-length basis. The Chinese tax authorities are allowed to make adjustments to transactions between related parties that are not conducted at arm's-length and result in the reduction of taxable income of the enterprise or its related parties using the appropriate methods that are consistent with the arm's-length principle.

The accepted methods in China are as follows:

- Comparable uncontrolled price method;
- Resale price method;
- Cost plus method;
- TNMM;
- Profit split method; and
- Other methods (for example, the cost approach, market approach, income approach).

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<sup>54</sup> EUR 1 = CNY 7.55 as at 9 March 2019

<sup>55</sup> PwC, 2018. *PwC Worldwide Tax Summaries – China*. Available at: <http://taxsummaries.pwc.com/ID/Peoples-Republic-of-China-Overview> [accessed: 06 February 2019]

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### **9.1.3. Transfer pricing documentation in a post-BEPS environment<sup>56</sup>**

#### **9.1.3.1. Master file and Local file requirements**

##### *9.1.3.1.1. Master file requirements*

China has followed Action 13 of the BEPS Action Plan very closely with respect to the Master file which is governed by guidance, namely China's State Administration of Taxation (SAT) issued SAT Bulletin [2016] ("B42"), which was released by the Chinese tax authorities on 29 June 2016.

According to B42, Chinese subsidiaries will be required to maintain a Master file, translated into Chinese, if the subsidiary's related party transactions exceed CNY 1 billion in aggregate or if the headquarters already prepares a Master file for another jurisdiction.

The contents of the Master file under B42 requirements are mostly the same as under the OECD guidance, except for a few differences as described below:

- Additional detail should be provided on the types of business restructurings that need to be disclosed, including any transfers of functions, risks or assets within the group, as well as changes in business legal forms, share acquisitions, asset acquisitions and mergers;
- Clarification is made that, among tax rulings that need to be listed and briefly described, bilateral APAs are included; and
- Clarity on which entity (usually the ultimate parent entity) of the group will file the CbCR on behalf of the group.

Overall, it is not necessary for the MNE drafting the group Master file to make significant changes to the document to comply with Chinese requirements, however it will be prudent for the group to perform a high-level assessment on whether the Master file fully complies with Chinese documentation requirements.

The Chinese subsidiary must have a copy of the group's Master file within 12 months of the ultimate parent company's financial year-end. Accordingly, Chinese requirements are unlikely to put pressure on the group's timeline for preparing the Master file. It should be noted, however, that Chinese Local files must be completed by June 30 of the year following the Chinese subsidiary's tax year (which is always the calendar year).

Therefore, it is advisable for company within the MNE responsible for preparing the Local file to ensure that Chinese Local files are consistent with the requirements of the Master file as per B42.

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<sup>56</sup> Ernst and Young, 2016. *China's New Transfer Pricing Compliance Requirements: Impact on Foreign Headquarters*. Available at: <http://www.ey.com/Publication/vwLUAssets/EY-china-tp-alert-satissues-> [accessed: 06 February 2019]

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#### 9.1.3.1.2. Local file requirements

The Local file from a Chinese perspective follows the approach as per Action 13, however the Chinese tax authorities have included more extensive requirements for the Local file which are included under B42. As a result, headquarters management and tax personnel will have to make decisions about what information should be shared with Chinese tax staff and how it should be presented in the Local file.

A Chinese subsidiary is required to submit a Local file if its related party transactions during the year meet any of the following conditions:

- Annual related party transactions that involves physical goods that exceed CNY 200 million;
- Annual related party transactions that involves the transfer of financial assets or rights to intangibles that exceed CNY 100 million; or
- Annual related party transactions of other types such as related party service transaction, royalties for use of intangibles, related party financing transactions, in aggregate exceed CNY 40 million.

The additional requirements included in B42 requires a company to perform a value chain analysis within the Local file. Various aspects of the MNE's value chain would be included in the Master file however, for Chinese purposes, a value chain analysis should be conducted and tailored to the operations of the Chinese subsidiary.

B42 includes points to be included by the Chinese subsidiary in determining the value chain of the entity. These points are as follows:

- Whether the Chinese subsidiary is involved in a single value chain or should multiple value chains be discussed.
- Whether additional disclosure is necessary because the Chinese subsidiary is involved in operations that are not considered material for Master file purposes.
- Whether the value chain discussed in the Local file could be narrower than that in the Master file because the Chinese subsidiary is not involved in all of the group's lines of business.
- The extent of research and development or intangible licensing operations relate to the value chain/ chains.

In addition to the above, B42 also includes the requirement to provide the most recent financial statements of all participants in the value chain. From the inclusion of the financial statements of each of the participants in the value chain, the Chinese subsidiary is required to disclose the profit allocation throughout the value chain in line with each company involved in the value chain. This requirement overlaps with the CbCR requirement whereby the profitability of all entities within the MNE is disclosed.

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This requirement focuses on the profitability of the company included in the value chain rather than the aggregate profitability of the country as is disclosed in the CbCR.

The final requirement set out in B42 that differs from the OECD's standard requirements is the requirement to discuss any location specific factors, such as location savings, and perform an analysis on whether they have an impact on transfer pricing.

#### **9.1.3.2. CbCR requirements**

China follows Action 13 of the OECD in terms of transfer pricing documentation. On a more global basis, along with all other countries within BRICS, China has also implemented CbCR.

MNEs with revenues in excess of CNY 5.5 billion must file a CbCR with their annual tax return at the end of May each year. The CbCR requirement is applicable to financial years commencing in 2016 and after.

Chinese companies do not have to notify Chinese tax authorities on whether its group will file a CBCR and which group entity will file it.

China signed the MCAA (including the CbC MCAA), as detailed in section 3.5 of this research report, in September 2018 which has enabled the country to exchange and share CbC reports with other countries who have also signed the MCAA.

#### **9.1.4. Interest and penalties**

General penalties applicable to tax record maintenance and tax filing requirements also apply to transfer pricing documentation. Under Article 62 of the Tax Collection and Administration Law, taxpayers who do not meet tax filing obligations may be fined between CNY 2,000 and CNY 10,000. This would apply to failure to file transfer pricing disclosure forms with the annual tax return.

Under Article 60 of the Tax Collection and Administration Law, taxpayers failing to maintain accounting books and other relevant information or failing to provide such information to tax authorities upon request, may be fined between CNY 2,000 and CNY 10,000. This would apply to failure to maintain or provide contemporaneous documentation.<sup>57</sup>

#### **9.1.5. Conclusion**

China's transfer pricing documentation regime is similar to that of South Africa's whereby Action 13's three-tiered approach to documentation is applied. Nevertheless, the two countries have additional documentation requirements. In South Africa's case, additional documentation relating to the transfer pricing Local file is required to be retained by taxpayers.

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<sup>57</sup> Ernst and Young, 2018. *EY Worldwide Transfer Pricing Reference Guide – China*. Available at: <https://www.ey.com/ql/en/services/tax/international-tax/transfer-pricing-and-tax-effective-supply-chain-management/2017-2018-ey-worldwide-transfer-pricing-reference-guide-china> [accessed: 06 February 2019]

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China also requires a value chain analysis to be performed as well as the disclosure of the profitability of each participant in the value chain. This differs from South Africa's rules as South Africa relies on the MCAA for access to the MNE's CbCR and therefore does not require other jurisdictions' profitability included in the Local file unless the tested party of the transaction is not a South African resident company.

Therefore in preparing transfer pricing Local files for Chinese subsidiaries, additional thought must be given to how certain sensitive information will be presented in the Chinese Local files as these requirements are uncommon globally. It is highly recommended to get an early start on developing approaches and analyses for compliance with this requirement.

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## **10. Conclusion**

### **10.1. South Africa's Approach to the BEPS Action Plan**

The BEPS Action Plan consists of 15 Action Points with the objective of minimising or eliminating transactions that erode or decrease a MNE's tax base by routing its profits from high tax jurisdictions to low tax jurisdictions. The overriding concept of the BEPS Action Plan is that all taxable profits should be taxed once.

South Africa has committed itself to introducing transfer pricing documentation requirements in line with the three-tiered approach as suggested by the OECD as described in chapter 3 of this research report. The requirements for CbCR were finalised on 23 December 2016 while the Master file and Local country file requirements were finalised on 20 October 2017.

#### **10.1.1. CbC returns**

On 23 December 2016, the South African Minister of Finance issued regulations governing CbC reporting which closely follow the implementation package in Annex IV to Chapter V of the OECD Guidelines. The main requirements in respect of CbCR may be summarised as follows:

- MNE Groups with consolidated group revenue of less than R 10 billion are not required to file CbC returns.
- CbC returns are to be submitted within 12 months of the last day of the reporting fiscal year. The notice applies in respect of Reporting Fiscal Years commencing on or after 1 January 2016, and the first returns were therefore due by 31 December 2017.

#### **10.1.2. Master file and Local file returns<sup>58</sup>**

On 20 October 2017, the South African Minister of Finance issued regulations governing transfer pricing documentation. In terms of GN 1117, certain taxpayers are required to submit transfer pricing returns to SARS. The form and content of the returns are specified in the External BRS: CbC and Financial Data Reporting, and correspond to the Master file, Local file and CbC report.

The Public Notice refers to two sets of companies which should comply with its requirements and guidelines namely Category 1 and Category 2 companies.

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<sup>58</sup> South African Revenue Services, 2017, Public Notice 1117 of 20 October 2017, *Return to be submitted by persons in terms of Section 25 of the Tax Administration Act, 2011 (Act No. 28 of 2011)*. South Africa: SARS

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## **10.2. South Africa in Comparison to Other Countries on Action 13 Implementation**

For the purposes of comparing South African transfer pricing documentation requirements, transfer pricing rules in countries that are members of BRICS have been included in the comparison below.

### **10.2.1. Brazil**

The CbCR requirements implemented by the Brazilian tax authorities is in line with South Africa's requirements where the threshold for submitting CbCR is below the EUR 750 million group operating revenue threshold proposed in Action 13.

With regards to transfer pricing documentation, Brazil has not implemented Action 13's Master file and Local file requirements into their legislation which means that their documentation design is not on par with the global standard. Furthermore, when compared to South Africa's level of documentation design and retention requirements, there is room for enhancing its transfer pricing documentation requirements.

### **10.2.2. Russia**

The CbCR guidance under Russian legislation does not create any issues for MNE Groups whose Ultimate Parent Entity is a tax resident in Russia, however they may be incompatible with the guidance on currency fluctuations for MNE Groups whose Ultimate Parent Entity is located in another jurisdiction.

This will be the case if Local filing requirements were applied in respect of a group company (which is a Russian tax resident) of a MNE Group which does not reach the threshold as determined in the jurisdiction of the Ultimate Parent Entity of such Group.

In comparison to South African documentation design requirements, the Russian requirements are highly comparable in nature. The key differences are the following:

- South Africa does not consider related party domestic transactions as part of its transfer pricing scope. The focus is only on cross border transactions, whereas Russia has a domestic transfer pricing regime.
- South African transfer pricing documents also require additional information to be retained should SARS request it. This level of detail is not apparent in the Russian transfer pricing legislation as only Action 13's three-tiered approach is applied.

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### **10.2.3. India**

India's transfer pricing documentation regime differs from South Africa's own transfer pricing rules as India also requires transfer pricing documentation for domestic intercompany transactions. The main reason for this is that India levies various surcharges and different tax rates for domestic and international companies and domestic transfer pricing mitigates the risk of shifting profits to companies which have lower tax rates within a group due to its structuring.

In terms of the Action 13 requirements, India's CbCR implementation is in line with the OECD guidance however, the threshold for submitting CbCR is much higher in India, therefore less MNEs may fall into the CbCR requirements. South Africa's CbCR threshold is slightly lower than the OECD's EUR 750 million threshold, potentially including more MNEs being subject to CbCR

In terms of the Master file and Local file documents, India includes a threshold for submitting these documents which is also adopted by South Africa. The thresholds aim to include a high level of detail for material cross border transactions as well as a section which provides for domestic transactions.

Overall, India has implemented the recommended three-tiered approach included in Action 13 of the BEPS Action Plan, and like South Africa, the transfer pricing documentation rules are more aligned to the global standard.

### **10.2.4. China**

China's transfer pricing documentation regime is similar to that of South Africa's whereby the three-tiered approach to documentation is applied. Nevertheless, the two countries have additional documentation requirements. In South Africa's case, additional documentation relating to the transfer pricing Local file is required to be retained by taxpayers. The documentation builds on Action 13's requirements but additional documentation is also required.

China on the other hand required a value chain analysis to be performed as well as disclosing the profitability of each participant in the value chain. This differs from South Africa's rules as South Africa relies on the MCAA for access to the MNE's CbCR and therefore does not require other jurisdictions profitability included in the Local file unless the tested party of the transaction is not a South African resident company.

Therefore, in preparing transfer pricing Local files for Chinese subsidiaries, additional thought must be given to how certain sensitive information will be presented in the Chinese Local files as these requirements are uncommon globally. It is highly recommended to get an early start on developing approaches and analyses for compliance with this requirement.

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### **10.2.5. Final words**

South Africa's transfer pricing documentation requirements are on par, or sometimes exceeds the requirements of countries operating in a similar bloc, namely BRICS. The additional documentation retention requirements implemented by SARS requires companies that fall either in Category 1 or Category 2 to submit or retain an extensive amount of detailed information.

This allows SARS to monitor and ensure that cross-border intercompany transactions which are material in value are documented and arrived at accurately. It also allows SARS to have full visibility on the relevant transactions taking place within a group and whether the transfer pricing policies have been arrived at an arm's-length basis.

Therefore, companies should monitor their transfer pricing arrangements closely to ensure that they are in line with the requirements set out in OECD's BEPS Action Plan as well as South Africa's own specific documentation requirements.

Companies that do not meet the thresholds set out by SARS, should perform an analysis on an annual basis to ensure that they comply with all transfer pricing documentation requirements should they meet the thresholds going forward.

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