SAIT | Summit Place Business Park | Building 3, Ground Floor
221 Garsfontein Road | Menlyn | South Africa | 0081

www.thesait.org.za

31 August 2023

To: The National Treasury
240 Madiba Street
PRETORIA
0001

The South African Revenue Service
Lehae La SARS
299 Bronkhorst Street
Nieuw Muckleneuk
Pretoria
0181

Via email: National Treasury (2023AnnexCProp@treasury.gov.za)
SARS (acollins@sars.gov.za)

RE: DRAFT TAX ADMINSTRATION LAWS AMENDMENT BILL, 2023: TRANSFER PRICING CONSIDERATIONS

Dear Colleagues,

We attach the comments from the SAIT Transfer Pricing Working Group committee (**the WG**) on the proposals contained in the draft Tax Administration Laws Amendment Bill, 2023 (**DTALAB**), as it pertains specifically to the Advanced Pricing Agreement Program.

We value the opportunity to participate in the legislative process and would welcome further engagement where appropriate.

Please do not hesitate to contact us should you need further information.

Yours sincerely,

SAIT Transfer Pricing Working Group Committee

All references to the legislation are to the Income Tax Act, No. 58 of 1962 (the Act), the Tax Administration Act, No. 28 of 2011 (the TAA) and proposals contained in the draft Tax Administration Laws Amendment Bill, 2023 (DTALAB).

1. Advanced Pricing Agreement Program

[Applicable provisions: Part IA of Chapter III of the Act]

1.1. Government proposal

1.1.1. The government is proposing the amendment of the Act by the insertion after Part I of Chapter III of Part IA as relating to advance pricing agreements (**APAs**).

1.2. WG introductory comments

1.2.1. At the outset, the WG welcomes the proposal to introduce an APA pilot program and is pleased regarding the progress that has been made in this regard.

1.2.2. The WG supports the speedy implementation of an APA program as we are of the view that the speedy implementation thereof will promote a cooperative relationship between taxpayers and tax authorities, resulting in both parties reaching agreements that will facilitate international trade and reduce trade uncertainty.

1.2.3. Notwithstanding the above, we have reviewed of the proposed amendments and submit the following commentary hereon.

1.3. WG response

1.3.1. SARS capacity and technical transfer pricing (TP) knowledge

1.3.1.1. To our knowledge and based on interactions that this WG has had with SARS/Competent Authority, it appears that there are a limited number of professionals that are well versed in TP at the SARS/Competent Authority. It is our understanding that the APA program, at this stage, will only be launched as a limited bilateral program that would include "complex" TP transactions (which are yet to be defined).

1.3.1.2. We are concerned that should there be a large uptake in this program, based on our understanding of the current capacity, SARS/Competent Authority may not have sufficient technically skilled staff to manage the program.

1.3.1.3. For the successful implementation of this program, we recommend that additional, technically competent resources be allocated/recruited hereto. This in our view, will inspire confidence in applicants and result in the success of the program.

1.3.1.4. Additionally, section 76L(2) requires that "***<u>at least two</u>*** *SARS officials delegated to do so and the 'competent authority' of the Republic to sign off the preliminary 'advance pricing agreement'"* after the requirements in 76L(1) have been complied with.

1.3.1.5. To the extent that the current team that engages taxpayers and corresponding Competent Authorities regarding mutual agreement procedures (MAPs) is the same/ similar team that is envisaged to oversee the APA program, we are concerned that the SARS capacity constraints and the abovementioned requirement outlined in section 76L(2) could be an impediment to the speedy conclusion of APAs.

1.3.2. Narrow application of the APA program to Bilateral APAs ("BAPA")

1.3.2.1. The proposed legislation appears to be limited to BAPA's and it typically only works where the Double Tax Avoidance Agreements ("DTAs" or tax treaties) provide for such procedures and if the Contracting State (the other country) also has APA regulations in place. In our view, this restricts the jurisdictions with which BAPAs can be entered into, especially for South African based headquartered companies having a presence in Africa. We presume that developed countries (i.e., US, UK etc.) may wish to enter into these BAPAs with South Africa. However, a substantial amount of trade occurs or potentially will occur on the African continent – which in itself does not have adequate APA rules and mechanisms. We are concerned that the narrow application of BAPAs limits the certainty for African based large businesses.

1.3.2.2. We appreciate that the BAPA program may assist SARS/the Competent Authority in upskilling the staff with the required administrative and technical skills, however, traditionally, obtaining BAPAs have been a lengthy process from a taxpayers' perspective in terms of time and investment and it must be borne in mind that in accordance with international trends, unilateral APAs are more favorable. Unilateral APAs provide key advantages to both parties (i.e., the revenue authority and the taxpayer). Over and above their ease of implementation, unilateral APAs are far less complex and less time consuming because another corresponding Competent Authority is not involved. Further, the experience gained on unilateral APAs could serve well in negotiating BAPAs.

1.3.2.3. From a tax practitioner and industry point of view, unilateral APAs are generally favored, for *inter alia* the reasons outlined above. Therefore, in order to make the APA program attractive, we recommend that consideration be given to the introduction of unilateral APAs in addition to the BAPAs as soon as possible, ideally from the outset but we do take note of SARS/Competent Authority's capacity constraints.

1.3.3. Definitions

1.3.3.1. The definitions of the various terms in the proposed insertion make the legislation very complex and are in many instances not aligned to international definitions. For instance, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 (OECD Guidelines) define an APA as:

"An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments hereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period

of time.".

1.3.3.2. Although, many countries do have their own set of definitions, based on domestic and internationally accepted principles, the goal most importantly is to avoid double taxation in advance, and is negotiated in a cooperative setting between the taxpayers and the revenue authorities. The DTALAB proposal currently concentrates more on "allocation of taxing rights and the allocation of profits" and seems in general written with a MAP mindset as opposed to a pure APA mindset.

1.3.3.3. The terms read harmoniously seem to suggest that the South African APAs wish to concentrate more on "allocation of taxing rights and the allocation of profits" rather than focusing on "*an appropriate set of criteria (e.g., method, comparable and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time"* – which is in accordance with the OECD Pricing Guidelines for Multinational Enterprises and Tax administrations 2022.

1.3.3.4. We are concerned that this misalignment of definitions with those set out in the OECD TP Guidelines and/or internationally accepted principles, may discourage corresponding jurisdictions from entering into BAPAs with South Africa. Therefore, we recommend that the definitions contained in the proposed insertion be aligned with international definitions.

1.3.3.5. For example, the term '**adjustment**' is defined as "an application of the most appropriate 'transfer pricing method' to an 'affected transaction', *as agreed to in an 'advance pricing agreement', to attribute the profit from the 'affected transaction' to an 'affected party' to determine the taxable income of the 'affected party'*; [Own emphasis]

1.3.3.6. The WG is concerned by this proposed approach because the primary focus of APAs is not solely related to the allocation of taxing rights or profits. As opposed to focusing solely on profits, we recommend the use of words such as "income" because due regard should be given to the possibility of losses being made by companies that wish to enter an APA. We present the following examples below of instances where losses may be incurred:

1.3.3.6.1. Startup companies or "Greenfield projects" that may want certainty on the TP model, may still have losses in the initial years of trade; and

1.3.3.6.2. When performing a residual profit split – there may be no profit for an entity that is part of an APA.

1.3.3.7. Additionally, the term adjustment, which is also required to be elaborated upon in the application requires determination of the "taxable income" of the affected party. This is not the purpose of an APA and it should be limited to "pricing" of a cross border intragroup transaction. The discussion on allocation of taxing rights and the calculation of taxable income based on the group structure, PE, POEM, etc. are typically part of the critical assumptions and not the main subject matter of the APA.

1.3.3.8. We would welcome the publication of a public notice/ practical regulations to

assist taxpayers to fully understand this complex set of legislative proposed insertions. We also recommend that SARS consider simplifying the legislation – which is currently complex in nature and consider rather putting the complexity in the regulations as opposed to in the legislation itself.

1.3.4. "Affected transaction"

1.3.4.1. The term "affected transaction" per the DTALAB proposal is confusing when comparing to the definition contained in section 31(1) of the Act. Additionally, the term "potentially affected transaction" has been in use for a few years now. The terminology should be clarified and consistently applied.

1.3.4.2. We recommend that SARS refer to section 31(1) definition and then include in the Act the potentially affected transaction terminology. This should then be applied to the Act and TAA, accordingly.

1.3.5. Timelines

1.3.5.1. The timelines provided are confusing in terms of the event from which the clock starts for each phase.

1.3.5.2. The 90 days' timeline to submit an application after the outcome of the pre-consultation meeting as communicated is too ambitious. A substantial amount of work needs to be done to prepare the application after guidance has been provided in the pre-consultation. The requirement to submit an APA application within 90 days is too short a period particularly in the context of large organisations where any such application will need to be reviewed by multiple people often in multiple jurisdictions.

1.3.5.3. Further, details are often not thrashed out for the pre-consultation until such time that the taxpayer has certainty whether or not the matter/application will be accepted into the program (this is all the more reason that SARS should clarify what is intended by the term "complex" transactions and provide examples of what type of transactions or situations they envisage will be accepted into the program). It seems that the current timelines envisage that taxpayers would, at pre-application stage, have all the requisite information on hand.

1.3.5.4. In our experience, circa 10 months' worth of time typically lapses from the time that the pre-consultation application is submitted until the outcome of pre-consultation is communicated to the taxpayer and then the taxpayer begins with the process of the application.

1.3.5.5. There is also no defined timeline in terms of which the negotiation will take place. Once that has been concluded, the taxpayer has 60 days to accept or reject the outcome.

1.3.5.6. According to OECD recommended best practice, APAs should ideally be concluded end-to end within 30 months, with this time being reduced to 24 months at the stage that Competent Authorities become more mature in their implementation of APA programs. Due regard should be given hereto.

1.3.5.7. Another matter is that during the time that it takes to finalise an APA, the very subject matter of an APA may become the subject of a TP audit (in respect of the same taxpayer). We thus request that guidance be provided as to what would happen where a TP audit is initiated and the subject underpinning the audit is the subject matter of an APA.

1.3.5.8. We propose that a mechanism be put in place to inform the existing audit team that the matter is under discussion in an APA; and further that any audit findings be in placed in abeyance until such stage that the APA is finalised.

1.3.5.9. We again refer to the requirement that the Commissioner must notify the prospective 'applicant' ***within 90 days from the last pre-application consultation meeting if the prospective 'applicant' may submit an 'advance pricing agreement application'.*** It is unclear which pre-application meeting is being referred to. We request that clarification be provided.

1.3.5.10. We are also concerned regarding the fact that the proposed 90 days' timeline appears to be binding on the foreign revenue authorities herein. Due regard must be had for the fact that the time within which foreign Competent Authorities may/ may not provide feedback is something outside of the control of the SARS /Competent Authority. On the basis that one cannot control how quickly the corresponding foreign authority will revert, we recommend that this timeline be amended so as not to create false expectations.

1.3.5.11. In conclusion and in essence, the APA process envisages significant taxpayer Competent Authority interaction and we propose that the timelines realistically reflect this.

1.3.6. Years of assessment

1.3.6.1. We understand that the APA can be agreed for a period up to five years going forward. We copy the relevant section below:

76L(5) The 'advance pricing agreement' will be applicable for up to a maximum of five consecutive years of assessment commencing on the day after the end of the year of assessment in which the associated 'advance pricing agreement application' is received by the Commissioner.

1.3.6.2. Section 76L also seems to provide for retrospective application (i.e., roll-back) of 3 years (however this is not worded very clearly). A taxpayer is allowed to apply for an APA in respect of a matter that is not subject to dispute under Chapter 9 of the TAA (i.e., not objected to).

1.3.6.3. In a scenario where the APA is still being negotiated, guidance should be provided on what would happen where an assessment for a previous period is issued which is contrary to the position in the APA being negotiated and an adjustment for a transaction is made.

1.3.6.4. We also recommend that ethical barriers ("Chinese walls") be put in place between the SARS' audit team and the Competent Authority so as not to

prejudice the taxpayer at the point that a TP dispute potentially occurs. As mentioned in the preceding section, a public notice to this effect would need to clarify the process to be followed regarding audits conducted on matters that are subject matter of the APA.

1.3.7. Finalisation of the APA

1.3.7.1. Based on the draft legislation, it appears that a taxpayer will not have the opportunity to comment on the draft APA before it is finalised. This is different to what was included in the previous draft. We suggest that consideration should be given to affording taxpayers the opportunity to review the APA prior to finalisation and to provide input if there are any incorrect facts, statements or the other matters in the APA.

1.3.8. Termination of APA after the fact

1.3.8.1. It is not clear how SARS can cancel contracts retrospectively under Section 76O(3). We submit that adequate consultation should be had with taxpayers and more guidelines should be provided to this effect stipulating whether an opportunity will be granted to the taxpayer to discuss SARS' decision for termination.

1.3.8.2. Whilst we understand that there are standard procedures that would warrant the termination of an APA such as for example, a change in taxpayer circumstances, the taxpayer becoming non-compliant. We request clarification on any additional circumstances where the SARS can cancel an APA.

1.3.8.3. We further request that consideration be given regarding taxpayer remedial action before the cancellation or termination of an APA happens. This should be stated in appropriate guidance such as regulations/ public notices/ guidelines.

1.3.8.4. Essentially, our view is that SARS' powers with regards to the termination of an APA are too wide. We request that this section be clarified in its entirety.

1.3.9. Uncertainty regarding the initial application

1.3.9.1. APAs bring out an inherit level of uncertainty. At the stage of the initial application, taxpayers are informed at the pre-filing meeting whether they can proceed with the APA.

1.3.9.2. We recommend that the pre-application process should be a "light touch" process- to establish whether SARS has appetite to entertain the application. It should only be following this that the taxpayer should be required to provide additional information relating to the subject matter of the APA, which is often an extensive, expensive exercise.

1.3.10. Compliance report

1.3.10.1. Section 76M(2) refers to the information that is required to be included into the compliance report.

1.3.10.2. We request clarification on whether this compliance report will take the form of a separate return and who will be mandated to review/ audit this compliance report.

1.3.10.3. We presume that regulations will be released to this effect as the program is rolled out and we are of the view that clarification regarding the compliance report will provide taxpayers with certainty in this regard.

1.3.11. Record retention

1.3.11.1. The record retention requirements that are incumbent upon taxpayers as outlined in section 76P are, in our view, very broad.

1.3.11.2. We request that guidance be provided as to what encompasses "*information that will enable the Commissioner to determine if the applicant is complying with the agreement.*"

1.3.11.3. We further request that guidance be given as to what constitutes a "*reasonable period"* within which to provide the "information" to the Commissioner.

1.3.12. Extension of an advance pricing agreement

1.3.12.1. Section 76N speaks of "extension" of an APA. Internationally, the term "Renewal" is generally used.

1.3.12.2. We recommend that the language be aligned to international legislation. Additionally, the number of renewals permitted should be clearly stipulated.

Concluding comments:

Considering the above comments, currently, it appears that the proposed legislation in the DTLAB is in between tax regulations and tax administrative procedures, which are not complete in either sense. In our view, further refinements would be required before the draft is finalised, for smooth running of the program and to encourage participation from taxpayers. Further guidance on the rules should also elaborate clearly on what ongoing compliance will be required; who this compliance is required to be submitted to; who can sign off on this compliance, etc.

On an overall basis, the proposed insertion of rules relating to the APA program are welcome and will no doubt provide some framework of certainty for taxpayers. We hope that the commentary and recommendations that we have provided will assist with the implementation of this APA program in a simplified way and make the program attractive for taxpayers to engage with SARS.

End.