

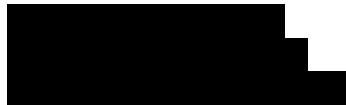
Ref # 628820

Submission File

7 September 2017

South African Revenue Service
Private Bag X923
Pretoria
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BY E-MAIL:



Dear Sir/Madam

**SAICA SUBMISSION ON THE INCOME TAX RETURN DISCLOSURES RELATED
TRANSFER PRICING ISSUES**

1. We herewith present our comments on behalf of the South African Institute of Chartered Accounts (SAICA) Transfer Pricing Committee, a subcommittee of the SAICA National Tax Committee on the annual Income Tax Return (ITR14) disclosures, more specifically how it impacts on transfer pricing (ITR14 Transfer Pricing submission).
2. The ITR14 Transfer Pricing submission transpires from an initiative to engage more effectively with the South African Revenue Service (SARS) as agreed during the meeting held on 13 April 2017 on transfer pricing matters. Given the future update of the ITR14, SARS requested SAICA to submit proposals/guidance as to how certain transfer pricing matters should be treated, which SARS will consider during the update procedure of the ITR14.

OBESREVATIONS

3. We herewith address the specific enquiries relating to questions in the ITR14 that generally must be responded to where a company entered into an "affected transaction", as set out in section 31(1)(a) of the Income Tax Act No 58 of 1962 (the Act):

Specify the items to be included in the financial assistance to fixed capital ratio

4. The response to the mandatory question relating to the financial assistance to fixed capital ratio is only relevant if the financial assistance was received by a taxpayer (i.e. greater than zero rand).

5. Submission: It is submitted that a taxpayer should therefore not be required to respond to this question where financial assistance is only outbound, or alternatively it should be clarified by SARS that it is acceptable for the taxpayer to include a “0”.

6. In addition, it is currently and technically not possible to reflect negative ratios. However, in practice, these may come up.

7. Submission: It is proposed that the system be updated to allow for negative ratios to be inserted, or, alternatively, to provide guidance recommending that a negative ratio be reflected in the return by entering a large amount, for example 999999999.

The term “financial assistance” or “debt”

8. Page 132 of the SARS Comprehensive Guide to the ITR14 (ITR14 Guide) provides some guidance on what constitutes “financial assistance” or “debt”, stating that:

“The debt is the debt determined in terms of International Financial Reporting Standards (“IFRS”) during the year of assessment. Debt for purposes of arm’s length testing will therefore include, for example straightforward loans, advances and debts and items that are economically equivalent to debt such as finance leases, certain structured derivative financial instruments and components of hybrid instruments.”

9. It is unclear whether the debt is limited to long term debt or also includes short term debt relating to ordinary trading activities, such as trade payable, bank overdraft, tax payable, deferred tax liabilities and ordinary short term liabilities from financial exchange contracts. The uncertainty arises considering that not all structured derivatives financial instruments are included in the examples.

10. Submission: Clarity needs to be provided on whether or not short term liabilities should be included as part of debt.

11. It is proposed that the ITR14 Guide clarifies that debt should include short term debt, but should exclude items relating to ordinary trading activities such as trade payable, bank overdraft, tax payable, deferred tax liabilities, as well as ordinary short term liabilities from financial exchange contracts, unless interest accrues on such liabilities such as the bank overdraft.

12. Furthermore, as stated in the draft interpretation note on thin capitalisation, the amounts as at year end, and not the average of the debt over the financial year, should be used.

Specify the items to be included in the debt in relation to earnings, before interest, taxes, depreciation, and amortisation (EBITDA) ratio

13. The debt in relation to EBITDA ratio must only be completed by a taxpayer if the value of in the field of “interest paid/payable” exceeds R0 during the year of assessment.

The term “interest”

14. The ITR14 Guide notes on page 133 that “interest paid” must include:



“interest, dividends and other charges paid and accrued on all items treated as debt in terms of IFRS. Items that are economically equivalent to debt such as finance leases, certain structured derivative financial instruments and components of hybrid instruments should also be taken into account.”

15. It is uncertain whether the costs indirectly relating to the debt such as raising fees, facilitation fees and guarantee fees would also be considered to be “interest paid”.

16. Submission: In order to provide taxpayers with a minimum level of clarity SARS should provide guidance on whether or not indirect costs such as raising fees, facilitation fees and guarantee fees would also be considered to be “interest paid or payable”.

Specify the financial items to be included in the EBITDA to finance cost ratio

17. Similar to the EBITDA/Debt ratio, a taxpayer will only be required to populate the EBITDA to finance cost ratio if the company incurred finance charges or interest during the year of assessment.

The term “finance cost”

18. As noted above, guidance is provided in the ITR14 Guide with respect to the term “interest paid”, but the term “finance cost” is not defined.
19. It is unclear whether “interest paid” and “finance costs” are similar and the terms merely utilised interchangeably or not.
20. Similarly to the problem statement stated above relating to “interest paid”, it is questionable whether indirect costs relating to the debt such as raising fees, facilitation fees and guarantee fees should be considered to constitute “finance cost”.

21. Submission: Clarity needs to be provided on whether or not indirect costs such as raising fees, facilitation fees and guarantee fees would also be considered to be “finance cost”.

Specify the financial items to be included in the debt in relation to total tangible assets ratio

The term “tangible assets”.

22. The term “tangible assets” is not a defined term, which raises the question if it will include inventory and capital work-in-progress.

23. Submission: A clear definition of the term tangible assets needs to be provided.

Does the company have transfer pricing documentation that supports the pricing policy applied to each transaction between the company and the foreign connected person during the year of assessment as being at arm’s length

24. On the face of it, this question covers every cross-border related party transaction regardless of materiality. Concern still remains that the response to this question may

be distorted where there is a once-off immaterial transaction or immaterial transactions that are not covered in the transfer pricing documentation.

25. As it is very costly and administratively burdensome to identify and support each and every (immaterial valued transaction) cross-border connected party transaction, some taxpayers may answer “no” to the question “does the company have transfer pricing documentation that supports the pricing policy applied to each transaction”, as it would not have prepared a transfer pricing document for a transaction that is e.g. valued at R10 million. This would give SARS a wrong impression that no transfer pricing document has been prepared, whereas documentation is in place for the material transactions.

26. Submission: It is proposed that the ITR14 Guide is updated to include thresholds aligned to the thresholds stated in Notice 1334 containing the transfer pricing documentation retention requirements published in terms section 29 of the Tax Administration Act, No 28 of 2011 (TAA).

27. Thus, a minimum threshold regarding when a taxpayer needs to respond to this question, e.g. if the aggregate of all potentially affected transactions without set offs, exceeds or is likely to exceed R100 million, and that the question only applies to potentially affected transactions where the relevant amount exceeds R5 million.

Did the company transact with a connected person that is a tax resident in a country jurisdiction that has a corporate tax rate that is less than 18% or is a tax haven

28. The terms corporate tax rate can be limited as not all taxes on income may be regarded as corporate tax rate and may inadvertently exclude jurisdictions with taxes on income higher than the 18% corporate tax rate.

29. Submission: The following question is proposed instead of the current question in the ITR14: “Did the company transact with a connected person that is a tax resident in a country/jurisdiction that has a tax rate on income that is less than 18%?”

Is the “tested party”, of the transaction operation, scheme, agreement or understanding, a tax resident outside South Africa

30. The term “tested party” is not defined in the ITR14 Guide.
31. The Notice 1334 containing the transfer pricing documents retention requirements published in terms of the TAA defines “tested party” as:

“the party to a potentially affected transaction that has been selected for the application of a transfer pricing method.”

32. Submission: It is proposed that the tested party definition contained in Notice 1334 be included in the ITR14 Guide or a reference to Notice 1334 be included in the ITR14 Guide.



Did the company, on or after 1990, transfer, alienate or dispose of any South African developed (or previously South African registered) Intellectual Property to any non-resident connected person or any foreign branch of a South African resident?

33. The period required to test this question is exceptionally long. Taxpayers may not always have information dated back as far as 1990, which may lead to incorrect responses to this question.

34. Submission: It is proposed that the test to this question be limited to the year of assessment to which the tax return relates to or at most cover not more than 3 years prior to the year of assessment to which the tax return relates.

Transfer pricing received/receivable and paid/payable section

35. It is difficult for taxpayers in the services industry with cross-border related party services transactions to complete these sections as there is not a line item that accommodates main business service income received/receivable (i.e. other than admin, management, secretarial fees). The taxpayer either needs to reflect the service income under “sale of goods” or “other income received”. Guidance is requested from SARS on where SARS recommends the main business service income should be reflected/inserted.

Historic submission relating to ITR14 transfer pricing challenges, dated 25 September 2015

36. During September 2015, SAICA did provide a submission to SARS to address ITR14 transfer pricing challenges and proposed certain amendments to improve the ITR14.

37. Submission: Given the relevance of the historic submission dated 25 September 2015, SAICA has attached it again, as it coincide with some of the issues raised in the current submission and reconfirm the challenges raised historically.

CONCLUSION

38. We would like to thank SARS for the opportunity to provide constructive comments in relation to the transfer pricing disclosures in the ITR14. SAICA believes that a collaborative approach is best suited in seeking actual solutions to complex problems.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

Christian Wiesener

Madelein Grobler

**CHAIRMAN: SAICA Transfer Pricing
Sub-Committee**

SAICA PROJECT MANAGER: Taxation

The South African Institute of Chartered Accountants