

**IBFD's South African Chapter on:
Transfer Pricing and Dispute Resolution**

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	The right to claim privilege in respect of certain information is based in common law. In <i>Jeeva and Others v. Receiver of Revenue, Port Elizabeth and Others</i> , the Court confirmed that the right to keep professional communications between a legal advisor and client confidential has developed into a fundamental right. In accordance with the principle confirmed in <i>Jeeva</i> , where SARS requires the disclosure of information from the taxpayer or the taxpayer's advisors, they are entitled to refuse to disclose information protected by legal privilege.....	- 40 -
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1. INTRODUCTION

1.1 Transfer pricing documentation

1.1.1 Requirements and deadlines

Section 31 of the Income Tax Act, 1962 (ITA) contains the South African statutory transfer pricing rules. This section does not require any specific disclosure of transfer pricing arrangements. Therefore, the general rules in the ITA and in the Tax Administration Act, 2011 (TAA)¹ relating to disclosure of information apply.

The taxpayer is required to submit a tax return in such form and manner as required by the Commissioner for the South African Revenue Service (SARS).² Furthermore, the taxpayer is required to keep records, books of account or documents which enable the person to observe the requirements of the ITA, as specifically required under the ITA and which would enable SARS to be satisfied that the person has observed the requirements of the ITA³. The records, books of account and documents must at all reasonable times be available for inspection by a SARS official.⁴

SARS has wide powers to request and obtain information from taxpayers or any other person in order to assist SARS in the administration of the ITA. These powers are set out in Chapter 5 of the TAA:

- Part A: general rules for inspection, verification, audit and criminal investigation;
- Part B: powers of inspection, to request relevant material for audit or criminal investigation;

¹ The TAA came was promulgated on 4 July 2012 and came into effect on 1 October 2012.

² Sec. 66 ITA.

³ Sec. 29 TAA.

⁴ Sec. 31 of TAA.

- Part C: powers to request the taxpayer to attend an inquiry; and
- Part D: powers to search and seizure.

SARS has confirmed that a transfer pricing policy document needs to be prepared if the international transactions are 'substantial'. Practice Note 7, 'Determination of Taxable Income of Certain Persons from International Transactions: Transfer Pricing', issued on 6 August 1999, states that a transfer pricing policy document should include the following:

- a functional analysis identifying the relevant transactions in terms of Sec. 31 and setting out the nature and terms of these transactions (including prices) and the methods used to arrive at the terms and prices;
- copies of the international agreements with connected persons;⁵ and
- an economic analysis explaining which transfer method has been used for each relevant transaction and why the prices charged are considered to be of an arm's length nature.

In view of the uncertainty about the requirement to submit a transfer pricing policy document only when the international transactions are 'substantial', SARS issued an addendum to Practice Note 7 in 2005. Regarding the need for documentation, the addendum states the following:

10.2 The need for documentation

10.2.1 Although there is no explicit statutory requirement to prepare and maintain transfer pricing documentation, it is in the taxpayer's best interest to document how transfer prices have been determined, since adequate documentation is the best way

⁵ As defined in section 1 ITA. The concept is similar to the concept of a related party in the context of article 9 of the OECD Model Tax Convention on Income and on Capital (OECD Model).

to demonstrate that transfer prices are consistent with the arm's length principle, as required by Sec 31.

10.2.2 A taxpayer electing not to prepare transfer pricing documentation is at risk on two counts. Firstly, it is more likely that the Commissioner will examine a taxpayer's transfer pricing in detail if the taxpayer has not prepared proper documentation. Secondly, if the Commissioner, as a result of this examination, substitutes an alternative arm's length amount for the one adopted by the taxpayer, the lack of adequate documentation will make it difficult for the taxpayer to rebut that substitution, either directly to the Commissioner or in the Courts.

10.2.3 Also, if taxpayers have not maintained appropriate records, the process of checking compliance with the arm's length principle becomes far more difficult and the Commissioner's officials are forced to rely on less evidence on which to apply a method, thus requiring a greater degree of judgment.

10.2.4 In addition there are practical reasons why taxpayers would be well advised to keep contemporaneous (at or close to the time the transaction occurs) documentation. The income tax return for companies (IT 14) requires taxpayers to supply certain specific information regarding transactions entered into between connected persons. It is not possible for a taxpayer to comply with these requirements if the taxpayer has not addressed the question of whether its dealings comply with the arm's length principle.

10.2.5 Thus, if a taxpayer can demonstrate that it has developed a sound transfer pricing policy in terms of which transfer prices are determined in accordance with the arm's length principle by documenting the policies and procedures for determining those prices, the Commissioner is more likely to conclude that its

transfer pricing practices are acceptable and the risk of possible adjustments will be diminished.

10.2.6 On the other hand, preparing documentation is time-consuming and expensive. It will therefore not be expected of taxpayers to go to such lengths that the compliance costs related to the preparation of documentation are disproportionate to the nature, scope and complexity of the international agreements entered into by taxpayers with connected persons.

While there are no specific legislative requirements for contemporaneous documentation, it is in the taxpayer's interest to constantly document the basis for all transfer prices in order to enable the taxpayer to demonstrate that the transfer prices comply with the arm's length principle. There are no specific timing requirements relating to the disclosure of transfer pricing arrangements. The general rules relating to the submission of tax returns apply.

Under section 29 of the TAA, a person who is required to render a return must retain all records relevant to that return for a period of 5 years from the date of the submission of the return. Records include ledgers, cash books, journals, cheque books, bank statements, deposit slips, paid cheques, invoices and stock lists and all other books of account; and any electronic representations of information in any form, relating to any trade carried on by that person in which are recorded the details from which that person's returns for the assessment of taxes under the ITA were prepared. The records must be retained in such form as may be prescribed by SARS.

The guidelines of SARS, 'Quick Guide: How to complete your IT14 (2012)',⁶ under the heading 'International Related', ask the following questions:

⁶ See the SARS website, www.sars.gov.za.

- Did the company enter into any cross-border transactions under an international agreement⁷ as defined in section 31?
- Does the company have a transfer pricing policy document in support of the transfer pricing policy as applied to transactions as defined in section 31?

If the answer is 'yes' to either question, the following information must be furnished for each transaction:

- a copy of the agreement entered into; and
 - a copy of the transfer pricing policy document applicable to the current year, unless documentation has already been submitted in previous years and it applies to the current year's transactions.
- Did the company receive any financial assistance from a non-resident connected person or from an investor as defined in section 31(3) and Practice Note 2?⁸

If so, a schedule must be provided that details the reasons why it is considered that the provisions of section 31(3) and Practice Note 2 were adhered to.

- Has the company provided goods, services or anything of value (including transactions on capital account) to a non-resident connected person for less than arm's length consideration?⁹
- Has the company entered into a back-to-back arrangement with any other party which has resulted in an offshore connected person being granted financial assistance?

⁷ The definition of an "international agreement" in section 31 was deleted in 2007.

⁸ This question has been retained notwithstanding the deletion of section 31(3).

⁹ The concept of goods and services includes loans.

1.1.2

Applicable taxes, penalties, interest and other fees

The provisions of section 31 of the ITA apply to all taxes imposed under the ITA, notably normal income tax and capital gains tax.

If the taxpayer fails to pay any tax in full by the effective date, interest accrues on the amount of the outstanding balance of the tax debt.¹⁰ The prescribed rate of interest is determined by the Minister of Finance. As from 1 March 2011 this rate was 8.5% per annum.

A taxpayer may be liable to penalties on default if the taxpayer fails or neglects to furnish, file or submit any return or document or fails to furnish information or documents as and when required under the ITA.¹¹

The objective of the administrative non-compliance penalties is to ensure the widest possible compliance with the provisions of a tax act and to ensure the effective administration of the tax system; furthermore, to ensure that the penalties are imposed impartially, consistently and proportionally to the seriousness and duration of the non-compliance.¹²

If SARS is satisfied that the taxpayer failed to comply with an obligation imposed under a tax act and which is listed in a public notice issued by SARS, excluding non-compliance subject to the percentage based penalty imposed under Part C or the understatement penalty under Chapter 16, SARS must impose the appropriate penalty in accordance with the Table in section 211 of the TAA, as follows:

¹⁰ Chapter 12 TAA, sections 187-189.

¹¹ Chapter 15 TAA, which contains the Administrative Non-Compliance Penalties.

¹² Sec. 209 of the TAA.

Item:	Assessed loss or taxable income for preceding year (ZAR):	Penalty (ZAR:)
(i)	Assessed loss	250
(ii)	0 – 250 000	250
(iii)	250 001 – 500 000	500
(iv)	500 001 – 1 000 000	1 000
(v)	1 000 001 – 5 000 000	2 000
(vi)	5 000 001 – 10 000 000	4 000
(vii)	10 000 001 – 50 000 000	8 000
(viii)	Above 50 000 000	16 000

The amount of the penalty increases automatically by the same amount each month, or part thereof, that the person fails to remedy the non-compliance.

The following persons, except those falling under item (viii) of the Table or those that did not trade during the year of assessment, are treated as falling under item (vii) of the Table:

- (a) a company listed on a recognized stock exchange;
- (b) a company the gross receipts and accruals of which for the preceding year exceed ZAR 500 million;
- (c) a company that forms part of a group of companies, which group includes a company listed in the previous two categories; or
- (d) a person who is exempt from income tax under the ITA but is liable to tax under another tax act, whose gross receipts or accruals exceed ZAR 30 million.

The term 'group of companies' is defined¹³ as meaning two or more companies in which one company (referred to as the controlling group company) directly or indirectly holds shares

¹³ Sec. 1 ITA.

in at least one other company (referred to as the controlled group company), to the extent that:

- at least 70% of the equity shares of each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
- the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company.

If the income of a taxpayer, excluding the persons mentioned under subparagraph (a), (b) and (c.) above, is unknown or if that person was not a taxpayer in that year, SARS may impose a penalty in accordance with item (ii) in the column above or estimate the amount of taxable income based on available, relevant material and then impose a penalty in accordance with the table.¹⁴

A person who is regarded as a 'participant' in an illegitimate tax avoidance arrangement as determined in section 35 of the TAA, who fails to disclose the information in terms of a reportable arrangement as required under section 37 of the TAA, is liable to a penalty, for each month that the failure continues (up to 12 months) in the amount of (a) ZAR 50,000 in the case of a participant who is not the promoter or (b) ZAR 100,000 in the case of the promoter. The amount of the penalty is doubled if the amount of the anticipated tax benefit for the participant by reason of the arrangement exceeds ZAR 5,000,000 and is tripled if the benefit exceeds ZAR 10,000,000.¹⁵

If SARS is satisfied that an amount of tax was not paid as and when required under a tax act, SARS must, in addition to any other penalty or interest for which a person may be liable under

¹⁴ Sec. 211(4) TAA.

¹⁵ Sec. 212 TAA.

Chapter 15, impose a penalty equal to the percentage of the amount of unpaid tax as prescribed in the tax act.

Chapter 16 of the TAA provides for so-called 'understatement penalties'.

'Understatement' is defined to mean any prejudice to SARS or the fiscus in respect of the tax period as a result of:

- (a) a default in rendering a return;
- (b) an omission from a return;
- (c) an incorrect statement in a return; or
- (d) if no return is required, the failure to pay the correct amount of tax.

'Substantial understatement' is defined to mean a case where the prejudice to SARS or the fiscus exceeds the greater of 5% of the amount of tax properly chargeable or refundable under a tax act for the relevant period or ZAR 1,000,000.

In the event of an understatement by a taxpayer, the taxpayer is liable to the understatement penalty, in addition to the tax payable.¹⁶ The understatement penalty is determined by multiplying the percentage in accordance with the table in section 223 with the 'shortfall' outlined in section 222(3) and (4).

The shortfall is the sum of:

- (a) the difference between the amount of tax properly chargeable for the tax period and the amount of tax that would have been chargeable if the understatement would be accepted;
- (b) the difference between the amount properly refundable for the tax period and the amount that would have been refundable if the understatement would be accepted; and
- (c) the difference between the amount of an assessed loss or any other benefit to the taxpayer properly carried forward from

¹⁶ Sec. 222(1) TAA.

the tax period to a succeeding tax period and the amount that would have been carried forward if the understatement were accepted, multiplied by the rate of tax (which is defined to be the maximum rate applicable to the taxpayer, ignoring an assessed loss or any other benefit brought forward from a preceding tax period).¹⁷

The understatement penalty percentage table is as follows:

Item:	Behaviour:	Standard Case:	If obstructive, or if it is a 'repeat' case:	Voluntary disclosure after modification of audit:	Voluntary disclosure before modification of audit:
(i)	'Substantial understatement'	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	Gross Negligence	100%	125%	50%	5%
(v)	Intentional tax evasion	150%	200%	75%	10%

1.2 Local dispute procedure

Chapter 8 of the TAA provides the statutory framework for the assessment of tax returns submitted by the taxpayer. SARS is required to assess the relevant return and to give a notice of assessment to the

¹⁷Sec. 212 TAA.

taxpayer assessed.¹⁸ Where a taxpayer defaults in furnishing any return or information, or SARS is not satisfied with the return or information furnished, SARS is authorized to estimate the taxable income in relation to which the return or information is required.¹⁹ SARS is entitled to obtain a civil judgment against the taxpayer based on such an estimate of tax payable.²⁰ A court has recently criticized the application of such powers by SARS, describing them as 'draconian', and insisted that such an estimate be determined with great care by suitably qualified personnel, since it may otherwise be reduced to an arbitrary guesstimate with grave consequences for the taxpayer.²¹

If SARS is satisfied that an assessment does not reflect the correct application of a tax act, to the prejudice of SARS or the fiscus, SARS must make an additional assessment to correct the prejudice.²² SARS may not raise an additional assessment after the expiry of 3 years from the date of the original assessment in question, unless SARS is satisfied that the amount was not so assessed due to fraud or misrepresentation or non-disclosure of material facts.²³

Under certain circumstances, SARS may make a reduced assessment. This is the case in the following circumstances:

- (a) the taxpayer successfully disputed the assessment under Chapter 9 of the TAA;
- (b) it is necessary to give effect to a settlement under section 149 of the TAA;
- (c) it is necessary to give effect to a judgment pursuant to an appeal under Part E of Chapter 9 of the TAA and there is no right of further appeal; and

¹⁸ Sec. 222(3) TAA.

¹⁹ Secs. 91 and 96 TAA.

²⁰ Secs. 172 and 174 TAA.

²¹ See *Mokoena v. Commissioner for SARS*, unreported Case 05/20445, 31 August 2010, Gauteng High Court.

²² Sec. 92 TAA.

²³ Sec. 99 TAA.

(d) SARS is satisfied that there is an error in the assessment as a result of an undisputed error by SARS or by the taxpayer in a return.²⁴

A dispute arises when a taxpayer that is aggrieved by the assessment, the estimated assessment, the additional assessment or reduced assessment or a decision which ranks as an assessment, decides to raise objection.^{25 26}

The dispute procedures are set out in the following sections of the TAA:

- section 104: objection against assessment;
- section 106: decision on objection;
- section 107: appeals to tax court or tax board against assessment; and
- section 134: appeals against decisions of a tax court.

Furthermore, in terms of section 103 of the TAA the Minister of Finance may, after consultation with the Minister of Justice, by public notice make rules governing the procedures to lodge an objection and appeal against an assessment or decision by SARS and the conduct and hearing of an appeal before a tax board or tax court (the Dispute Rules).²⁷ The Dispute Rules may also provide the procedures for alternative dispute resolution.

If a taxpayer is aggrieved by an assessment may, prior to lodging an objection, to request SARS to provide reasons for the assessment required to enable the taxpayer to formulate an objection.²⁸ The taxpayer must request such reasons within 30 days after the date of the

²⁴ Sec. 93 TAA.

²⁵ Sec. 104 TAA.

²⁶ See B. Croome and L. Olivier, "Review of Assessments by the High Court", Tax Administration (Juta, 2010), chapter 12 (Dispute Resolution), at 247.

²⁷ The existing Dispute Rules were issued in terms of section 107 of the ITA. In terms of section 264 TAA, rules of court issued by the Minister under a tax act that are in force immediately before the commencement date of the TAA continue in force as if they were issued under section 103 of the TAA. With effect from 11 July 2014 a new set of tax dispute rules, promulgated in terms of section 103 of the TAA, took effect, replacing the tax dispute rules issued in terms of section 107 of the ITA, which were still in force in terms of section 264 of the TAA.

²⁸ Rule 6 Dispute Rules.

assessment. This 30 days can be extended by 45 days. SARS will first satisfy themselves whether adequate reasons were provided and have to advise the taxpayer within 30 days if adequate reasons were indeed provided, and if not has to provide such reasons within 45 days of the request. SARS' 45 days, given the circumstances, can be extended by another 45 days

The objection to an assessment (under section 104 of the TAA) must be submitted within 30 days of the assessment or within 30 days after SARS has provided the reasons for the assessment.²⁹ If the taxpayer fails to object within 30 days, it may request SARS to condone a late objection, which will be granted only if exceptional circumstances can be shown why the objection was late. SARS will then either allow the objection, which marks the end of the dispute, or disallow the objection.³⁰

In terms of section 164 of the TAA, the obligation to pay tax due under an assessment and the right of SARS to receive and recover the tax will not be suspended by an objection or appeal or pending the decision of a court of law pursuant to an appeal under section 133.

In terms of section 164(3), a senior SARS official may suspend payment of the disputed tax having regard to:

- (a) the compliance history of the taxpayer;
- (b) the amount of tax involved;
- (c) the risk of dissipation of assets by the taxpayer concerned during the period of suspension;
- (d) whether the taxpayer is able to provide adequate security for the payment of the amount involved;
- (e) whether payment of the amount involved would result in irreparable financial hardship to the taxpayer;
- (f) whether sequestration or liquidation proceedings are imminent;

²⁹ Rule 7 Dispute Rules.

³⁰ Sec. 104(4) of TAA and Rule 7 Dispute Rules.

- (g) whether fraud is involved in the origin of the dispute; or
- (h) whether the taxpayer has failed to furnish any information requested under the TAA for purposes of a decision under section 164(3).

In accordance with the judgment in *Mecash Trading Ltd v. Commissioner for SARS*,³¹ the Commissioner is required to exercise such discretion in a just and fair manner to comply with section 33 of the Constitution and the Promotion of Access to Information Act.³² The Court said the following:

The Act gives the Commissioner the discretion to suspend an obligation to pay. It contemplates, therefore that notwithstanding the 'pay now, argue later' rule, there will be circumstances in which it would be just for the Commissioner to suspend the obligation to make payment of the tax pending the determination of the appeal. What those circumstances are will depend on the facts of each particular case. The Commissioner must, however, be able to justify his decision as being rational. The action must also constitute 'just administrative action' as required by s 33 of the Constitution and be in compliance with any legislation governing the review of administrative action.

In terms of section 164(4), the Senior SARS official may deny a request in terms of subsection (3) or revoke a decision to suspend payment in terms of that subsection with immediate effect whenever he or she is satisfied that:

- (a) after the lodging of the objection, the objection or appeal is frivolous or vexatious;
- (b) the taxpayer is employing dilatory tactics in conducting the objection or appeal;
- (c) on further consideration of the factors contemplated in subsection (3), the suspension should not have been given; or

³¹ 2001 (1) SA 1109 (CC).

³² Act 2 of 2000.

(d) there is a material change in any of the factors described in subsection (3), upon which the decision to suspend the amount involved was based.

If SARS disallows the objection, the taxpayer may appeal against the disallowance, which appeal must be submitted to SARS within 30 days of the date of the SARS notice disallowing the objection. If the taxpayer fails to appeal within 30 days, it may request SARS to condone a late appeal, which will be granted only if exceptional circumstances can be shown why the objection was late.³³

The notice of appeal to the assessment allows the taxpayer a number of options. The first is to request SARS to resolve the dispute under the alternative dispute resolution procedure.³⁴ The prerogative to allow the alternative dispute resolution procedure rests with SARS.

A taxpayer who requests an ADR or agrees thereto, is regarded as having accepted the terms of ADR as set out in Rules 13 to 25.³⁵

The parties participate in the ADR with full reservation of rights in terms of the procedures referred to in the other parts of the Dispute Rules. Any representation made or documents submitted in the course of the ADR proceedings will be without prejudice.³⁶ SARS must establish a list of facilitators for ADR proceedings, which may include SARS officials or a person in good standing with appropriate experience. ADR proceeding can be without a facilitator, but where the parties agree to a facilitator the facilitator will must be appointed from the list.³⁷

During the proceedings contemplated in these rules, the taxpayer or its representative taxpayer may be accompanied by any representative of its choice and must be personally present unless the facilitator, in

³³ Sec. 104(3) TAA read with Rule 10 Dispute Rules.

³⁴ See Rule 13 Dispute Rules.

³⁵ See Appendix A.

³⁶ Rule 7(6)(b) Dispute Rules.

³⁷ See Rule 16(1),(2) and (3) Dispute Rules.

exceptional circumstances, allows the taxpayer or its representative taxpayer to be represented by a representative of its choice.³⁸

No person may, subject to some exceptions, subpoena any person involved in the alternative dispute resolution proceedings in whatever capacity to compel disclosure of any representation made or document tendered in the course of the proceedings; or subpoena the facilitator of the alternative dispute resolution proceedings to compel disclosure of any representation made or document tendered in the course of the proceedings.³⁹The taxpayer and SARS may agree at the commencement of the proceedings that the facilitator will make a recommendation at the end of the proceedings if no agreement or settlement can be reached by the parties, which recommendation would be admissible during subsequent proceedings, including court proceedings.⁴⁰

The alternative dispute resolution procedure has been supplemented by statutory confirmation of the ability of SARS to enter into settlements with the taxpayer. Part F of Chapter 9 of the TAA set out the parameters of such a settlement. 'Dispute' is defined as a disagreement on the interpretation of either the relevant facts involved or the law applicable thereto, or of both the facts and the law which arises pursuant to the issue of an assessment or the making of a decision.⁴¹ 'Settle' or 'settlement' is also defined to mean, after the lodging of an appeal under this Chapter, to resolve a dispute by compromising any disputed liability, otherwise than by way of either SARS or the person concerned accepting the other party's interpretation of the facts or the law applicable to those facts or of both the facts and the law.⁴²

³⁸ Rule 20(3) Dispute Rules.

³⁹ Rule 22(4) Dispute Rules.

⁴⁰ Rule 21(1) Dispute Rules.

⁴¹ Sec. 142 TAA.

⁴² Sec. 142 TAA.

Section 143(1) of the TAA sets out the duty of SARS, which is to assess and collect taxes, and not to forego any tax properly chargeable and payable. Section 143(2) concedes that the strictness and rigidity of this duty must be tempered where it would be to the best advantage of the state. Circumstances where it would be inappropriate and not to the best advantage of the state to settle a dispute, in the opinion of SARS, include the following:⁴³

- the action on the part of the person concerned which relates to the dispute, constitutes intentional tax evasion or fraud;
- the settlement would be contrary to the law or a clearly established practice of SARS generally prevailing on the matter, and no exceptional circumstances exist to justify a departure from the law or practice;
- it is in the public interest to have judicial clarification of the issue and the case is appropriate for this purpose;
- the pursuit of the matter through the courts will significantly promote compliance with the tax laws and the case is suitable for this purpose; or
- the person concerned has not complied with the provisions of a tax act and the non-compliance is of a serious nature.

Circumstances where it will be to the best advantage of the state to settle a dispute on a basis that is fair and equitable to both the taxpayer concerned and SARS, are considered in light of factors such as:⁴⁴

- whether that settlement would be in the interest of good management of the tax system, overall fairness and the best use of SARS resources;
- the cost of litigation in comparison to the possible benefits with reference to the prospects of success in court, the prospects for

⁴³ Sec. 145 TAA.

⁴⁴ Sec. 146 TAA.

collection of the amounts due and the costs associated with collection;

- whether there are any complex factual or quantum issues in contention or evidentiary difficulties which are sufficient to make the case problematic in outcome or unsuitable for resolution through the alternative dispute resolution procedures or the courts;
- whether a participant or a group of participants in a tax avoidance arrangement has accepted SARS' position in the dispute, in which case the settlement may be negotiated in an appropriate manner required to unwind existing structures and arrangements; or
- whether the settlement of the dispute will promote compliance with the tax laws by the taxpayer concerned, a group of taxpayers or a section of the public in a cost-effective way.

If the taxpayer or SARS decided not to route the matter via the alternative dispute resolution or if the alternative dispute resolution procedure failed, the appeal may be heard by the Tax Board or the Tax Court, depending on the amount involved.⁴⁵

The Tax Board may hear matters where the tax in dispute is less than ZAR 200,000, provided that a senior SARS official and the taxpayer agree to refer the matter to the Tax Board.⁴⁶ The Tax Board is chaired by an advocate or an attorney; if required by the Chairperson, a senior SARS official or the taxpayer, the Chairperson will be supported by an accountant or a representative of the commercial community.⁴⁷ If the taxpayer or SARS is dissatisfied with the Tax Board's decision, the taxpayer or SARS may, within 21 business days require that the appeal be referred to the Tax Court.⁴⁸

⁴⁵ Sec. 107 TAA read with Rule 25(3) Dispute Rules.

⁴⁶ Sec. 109(1) TAA read with Rules 26 - 30 Dispute Rules.

⁴⁷ Sec. 107 TAA read with Rule 25(3) Dispute Rules.

⁴⁸ Sec. 115 TAA.

The Tax Court is presided over by a judge or acting judge of the High Court, referred to as the President of the Tax Court, and will be supported by an accountant of not less than 10 years' standing and a representative of the commercial community.⁴⁹The Tax Court may hear any appeal, regardless of whether the appellant is resident or carries on business within the Tax Court's jurisdiction, or whether the dispute arose within that jurisdiction. The sittings of the Tax Court are not public and the Tax Court is entitled to exclude or withdraw from such sitting any or all persons whose attendance is not necessary for the hearing of the appeal under consideration.⁵⁰

Upon the hearing of any appeal, the decision of SARS will not be altered or reversed unless it is shown by the taxpayer that the decision is wrong.⁵¹

In the case of any assessment or decision under appeal, the Tax Court may:

- confirm the assessment;
- order that the assessment be altered; or
- refer the assessment back to SARS for further investigation and assessment.⁵²

Any altered assessment as a result of the referral back to SARS may be subject to objection and appeal.⁵³

In *Shell's Annandale Farm (Pty) Ltd v. Commissioner for SARS*,⁵⁴ Judge Dennis Davis held that the Tax Court was not the only competent authority to decide on tax issues. Where the question was simply one of law (i.e. the facts are not in dispute), the matter could be resolved by the High Court by way of a declaratory order.⁵⁵

⁴⁹ Sec. 118 TAA.

⁵⁰ Sec. 124 TAA.

⁵¹ Secs. 102 and 129 TAA.

⁵² Sec. 129(2) TAA.

⁵³ Sec. 129(4) TAA.

⁵⁴ 2000 (3) SA 564 (C).

⁵⁵ See the confirmation in *Grain SA v. Commissioner for SARS*, unreported Case 434/2010.

1.3 Availability of international procedures and relief from double taxation

International relief from double taxation is provided under the 75 income tax treaties concluded by South Africa.

Tax treaties are incorporated into the ITA under section 108. This section authorizes the national executive to enter into tax treaties with the governments of other countries. After approval by Parliament, the arrangements made will be notified by publication in the Official Gazette. The proclamation has the effect that the arrangements made in the treaty apply as if they were enacted into the ITA. The procedures relating to the collection and enforcement of tax under the ITA and the TAA thus also apply in the context of a tax treaty, unless the particular provisions of the tax treaty provide alternative procedures.

Although South African courts take judicial notice of international law, international treaties do not have a privileged status under South African law. This has been confirmed in several court cases.⁵⁶ Section 231 of the Constitution confirms that South Africa is bound by international agreements. However, where there is a potential conflict with national law provisions, the Constitution confirms that the treaty provisions do not have a privileged position.⁵⁷ The courts must attempt to give effect to international agreements by interpreting domestic law so as not to be in conflict with international treaty obligations. However, in principle, domestic law may be applied to override a treaty. This means that in case of a conflict between domestic law and treaty law, the courts are not obliged to apply the treaty.

⁵⁶ See *Pan American Airways*, 1965(3) SA 150(A) and *South Atlantic Islands Development Corporation Ltd v. Buchan*, 1971(1) SA 234(C). However, see the recent decision in *CSARS v. Tradehold Ltd* (2012) ZASCA 61, where the Court held that the provisions of the DTA must override conflicting provisions of the ITA.

⁵⁷ Sec. 233 of the Constitution.

Certain South African tax treaties provide that a resident of one of the contracting states may present its case to the competent authority of the state in which it is a resident if it is of the opinion that the action of one or both of those states result (or will result) in taxation not in accordance with the tax treaty. The competent authority must seek to resolve the case by mutual agreement with the competent authority of the other state, with a view to the avoidance of double taxation. The competent authorities may also consult each other to ensure the elimination of double taxation in cases not provided for within the tax treaty itself.

The provisions of the respective tax treaties usually stipulate a time limit within which the case must be presented to the competent authority – typically, within 3 years from the first notification of the action which resulted in taxation not in accordance with the tax treaties.

An objection under domestic law should be made within the proper time frame required under domestic law.⁵⁸

A refund claim must be submitted within 3 years after the date of the assessment by SARS or 5 years in the case of self-assessment.⁵⁹

1.4 Tax authorities

1.4.1 Organizational structure

The SARS transfer pricing department consists of a centralized transfer pricing team of 13 specialist auditors who work within the Large Business Centre of SARS and carry out all the transfer pricing audit work. The centralized transfer pricing team operates nationally. The head office of SARS is the competent

⁵⁸ See section 014 of the TAA, read with the rules promulgated in terms of section 103 TAA.

⁵⁹ See section 190 of the TAA and the decision in Income Tax Case 1544, 54 SATC 456 (T), regarding a refund of withholding tax claimed by a resident of the Netherlands under the tax treaty between South Africa and the Netherlands.

authority which takes the lead in mutual agreement procedures (MAPs), with technical support from the transfer pricing team.

1.4.2 Other relevant players

The other players within SARS are the various committees, for instance those dealing with requests by taxpayers to waive penalties, interest and additional tax, objections, settlements, appeals, etc. Alternative dispute resolution can be regarded as another internal 'player', as its procedures are facilitated by a SARS official or appointee.

The various courts dealing with tax matters (see analysis above) are external players.

1.4.3 Programmes to ensure consistent application of transfer pricing policies and penalties

By having a centralized transfer pricing team, SARS is able to ensure that a consistent approach is followed in the application of transfer pricing policies. The consistency of the application of penalties, interest, additional tax, objections and settlement is ensured by the various committees in charge thereof.

1.4.4 Downward transfer pricing adjustments

Section 31 of the ITA provides for the adjustment of the relevant price to reflect an arm's length price, which implies that it is possible that the price may be adjusted downwards. If the other contracting state under a tax treaty has made a transfer pricing adjustment based on the application of the arm's length principle, it should imply that the price should be adjusted accordingly for the South African taxpayer. Therefore, such a corresponding adjustment would be required under the provisions of section 31 if it can be shown that the adjusted price is determined at arm's length. However, in view of the wide range of potential prices which may be acceptable under the arm's length test, the pricing may differ and the adjustment may

thus cause double taxation. It may thus be necessary to revert to the provisions of an applicable tax treaty to avoid such double taxation.

In practice, few of the tax treaties concluded by South Africa provide for a corresponding adjustment procedure. However, most of the newly negotiated tax treaties contain provisions similar to those in article 9(2) of the OECD Model, which require such a corresponding adjustment. In such cases, SARS could be required to effect a downward adjustment of the relevant price to ensure a corresponding adjustment.

1.4.5

Contact information

SARS Large Business Centre

Transfer Pricing Unit

Private Bag x170

Rivonia, 2128

Telephone: +27 011 602 2000

Website: www.sars.gov.za

1.4.6

Profile and aggressiveness

In accordance with Practice Note 7, SARS applies transfer pricing guidelines which are in line with international standards, in particular the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TP Guidelines).

However, SARS has substantially increased its capacity to undertake transfer pricing audits (see below) and has become very active in this regard. The fact that a taxpayer is part of a multinational enterprise which applies consistent transfer pricing policies worldwide is not necessarily acceptable to SARS. SARS generally requires very specific confirmation of the

transfer pricing policies adopted by the local entity to ensure that they adhere to the arm's length principle.

2. AUDIT

2.1 Historical background

The transfer pricing team was set up approximately 5 years ago under the SARS Corporate Tax Centre as a result of an increase in transfer pricing matters. The transfer pricing team is comprised of individuals with a variety of backgrounds such as law, economics (accounting), consulting and litigation, although no economist is currently employed in this team.

Through the years there has been a global focus on transfer pricing, and SARS has engaged in discussions with various other tax authorities, such as the UK HMRC, the Australian ATO and the Fiscal Committee of the OECD, etc., on transfer pricing issues.

SARS has become focused on transfer pricing audits. The audit is detailed, and extensive information needs to be provided to the audit team. The audit team often requires employees of the company to be interviewed by members of the audit team with the objective to extract information from such personnel. Here the taxpayer should insist that the enquiry be restricted to the specific information required by SARS for purposes of the audit, as opposed to a general enquiry with no clear purpose, which could be time-consuming and costly to the taxpayer (see the limitation of the rights of SARS in this regard and the corresponding constitutional rights of the taxpayer, as outlined below). Furthermore, these enquiries may not take the form of a cross-examination as under formal court proceedings, unless the enquiry has been approved by a judge, as provided under section 74C (see below). Otherwise, the taxpayer is entitled to request SARS to pose its questions in writing and to be allowed sufficient time to respond

appropriately to the questions (see rights and obligations of the taxpayer below).

2.2 Primary current controversies

When transfer pricing rules were introduced in 1995, SARS concentrated on cross-border loans and the level of interest thereon, as this was an obvious risk from a transfer pricing (and thin capitalization) perspective. Furthermore, SARS concentrated on the supply of services and the use of intangibles, particularly in view of the erstwhile focus of the exchange control authorities on such supplies, which function was gradually transferred to SARS.

SARS is now applying the rules to a variety of issues and is becoming more experienced in sophisticated transfer pricing techniques.

Because of the concern of the exchange control authorities relating to the export of technology, SARS is particularly difficult about the pricing practices in this regard. Significant support is required to justify the royalties or transfer pricing involved.

2.3 Audit process and milestones

2.3.1 Authorities involved

The authority involved is SARS, in particular its Transfer Pricing Team.

2.3.2 Audit timeline

A risk assessment is performed before the transfer pricing audit is undertaken, and this will dictate the timeline. The average audit timeline is 18 to 36 months, depending on the complexity, difficulties and reasonable access to information from the party or parties involved.

2.3.3 Rights and obligations of taxpayer

The taxpayer has extensive obligations to report sufficient information to SARS to enable it to assess the income of the

taxpayer; furthermore, the taxpayer must pay its taxes due on time.⁶⁰

By contrast, while SARS has extensive powers to obtain information from a taxpayer⁶¹ and to force a taxpayer to pay taxes due following a rejection of an objection (see the analysis above), the taxpayer has certain procedural rights under the Constitution and related legislation to challenge fiscal legislation or the conduct of SARS and its officials.⁶² First, the taxpayer is entitled to access information held by SARS under section 32 of the Constitution as expanded by the Promotion of Access to Information Act.⁶³ Furthermore, the taxpayer is entitled to fair administrative action under section 33 of the Constitution as expanded by the Promotion of Administrative Justice Act⁶⁴(Promotion of Administrative Justice Act, PAJA) and to several other constitutional safeguards of its rights, such as the right to property and privacy.⁶⁵

In particular, under section 3 of the PAJA:

(1) Administrative action which materially and adversely affects the rights or legitimate expectations of any person must be procedurally fair.

(2)(a) A fair administrative procedure depends on the circumstances of each case.

⁶⁰ See chapters 4 and 5 TAA.

⁶¹ Chapter 5 TAA. It should be noted that the provisions under chapter 5 may contain conditions under which SARS must operate in its efforts to obtain information from a taxpayer, e.g. SARS may only request relevant material required for the purposes of the administration of a tax act and it is required to respect documents subject to legal privilege.

⁶² See the discussion of the procedural rights of taxpayers in B. Croome, *Taxpayers' Rights in South Africa* (Juta, 2010), Chap. 6, at 185. See also J. Silke, *Taxpayers and the Constitution: A Battle Already Lost*, *Acta Juridica* 'Revenue Law' (2002), at 334.

⁶³ Act 2 of 2000.

⁶⁴ Act 3 of 2000.

⁶⁵ Secs. 14 and 25 Constitution.

- (b) *In order to give effect to the right to procedurally fair administrative action, an administrator, subject to subsection (4), must give a person referred to in subsection (1):*
- (i) *adequate notice of the nature and purpose of the proposed administrative action;*
 - (ii) *a reasonable opportunity to make representations;*
 - (iii) *a clear statement of the administrative action;*
 - (iv) *adequate notice of any right of review or internal appeal, where applicable; and*
 - (v) *adequate notice of the right to request reasons in terms of section {5.}*

If the taxpayer is aggrieved by the actions of SARS on the basis that its rights have been prejudiced, it may institute proceedings in a court for the judicial review of the SARS action. Section 4 of the PAJA makes specific provision for judicial review of the actions of government officials. The following grounds for judicial review may be relevant in the context of an audit by SARS if:

- the relevant official acted under a delegation of power which was not authorized by the empowering provision or was biased or reasonably suspected of bias;
- a mandatory and material procedure or condition prescribed by an empowering provision was not complied with;
- the action was procedurally unfair;
- the action was materially influenced by an error of law;
- the action was taken:
 - for a reason not authorized by the empowering provision;
 - for an ulterior purpose or motive;

- because irrelevant considerations were taken into account or relevant considerations were not considered;
- because of the unauthorized or unwarranted dictates of another person or body;
- in bad faith; or
- arbitrarily or capriciously;
- the action itself contravenes a law or is not authorized by the empowering provision;
- the action itself is not rationally connected to:
 - the purpose for which it was taken;
 - the purpose of the empowering provision;
 - the information before the administrator; or
 - the reasons given for it by the administrator;
- the exercise of the power or the performance of the function authorized by the empowering provision, in pursuance of which the administrative action was purportedly taken, is so unreasonable that no reasonable person could have so exercised the power or performed the function; or
- the action is otherwise unconstitutional or unlawful.

SARS will typically raise queries regarding the transfer pricing policies of the taxpayer. SARS often sets unrealistic deadlines for the supply of such information. Furthermore, SARS often insists on meeting the taxpayer to orally question personnel on complex transfer pricing matters. Such action by SARS may constitute procedural unfairness or unreasonable administrative action, depending on the circumstances.⁶⁶ The oral interrogation of personnel could constitute a contravention of the requirements of Part C of Chapter 5 of the TAA, which requires

⁶⁶ See Croome and Olivier, *supra* n. 25, at 32.

a warrant from a judge, which may be issued only if certain conditions were met. This would imply non-compliance with a mandatory or material procedure or condition for the action taken.

A taxpayer is entitled to be informed of the reasons for an administrative decision by SARS.⁶⁷ Generally, SARS will issue a letter of findings before it issues an assessment, to ensure compliance with this requirement. However, the letter of findings is frequently not clear enough to explain the reasons for the proposed action, or SARS does not allow the taxpayer sufficient time to respond to such findings. This may again constitute unreasonable administrative action.

If a taxpayer feels that its rights under the PAJA have been violated by SARS, it may approach the court to review the decision made by SARS.⁶⁸

In *Deacon v. Controller of Customs and Excise*,⁶⁹ the Court emphasized that SARS must have regard to section 33 of the Constitution before it invokes the provisions of the Customs and Excise Act. The court insisted that SARS should conduct a full and proper hearing of all relevant facts and consider the principles of fairness, the rules of natural justice and the taxpayer's right to a hearing.⁷⁰

2.3.4 Rights and obligations of tax authorities

As indicated above, SARS has broad powers to obtain information from a taxpayer which is required for the purposes of the administration of the ITA and to collect taxes due under the ITA. SARS may require any person to furnish relevant

⁶⁷ Sec. 3(2)(v) PAJA; Rule 3 Dispute Rules.

⁶⁸ Croome and Olivier, *supra* n. 25, at 33.

⁶⁹ 61 SATC 275.

⁷⁰ *Id.* at 290; Croome and Olivier, *supra* n. 25, at 39. See also *Raymond Wong and Four Others v. Commissioner for SARS, JDR 0907 (T)*; *Degussa Africa (Pty) Ltd v. International Trade Administration Commission and Others* 69 SATC 146.

material (whether orally or in writing) required by SARS for the purpose of the administration of a tax act.⁷¹ However, these general powers are subject to the specific rules as set forth below.⁷²

Furthermore, SARS is obliged to respect the rights of the taxpayer and to ensure that its administrative actions are procedurally fair in accordance with the requirements of the PAJA and the Constitution.

2.3.5 Information used in tax audits

Information used in tax audits includes:

- financial statements;
- transfer pricing policy documents;
- publicly available information from commercial databases;
- discussions with the taxpayer about the relevant transactions and overall business; and
- tax returns.

2.3.6 Confidentiality of information

Every person employed by SARS in carrying out the provisions of the ITA must preserve secrecy for matters that may come to that person's knowledge in the performance of that person's duties. Such persons are not entitled to communicate any such matter to any person who is not a SARS official.⁷³

There are a number of exceptions to this general rule where the information may be disclosed e.g. the information may be disclosed to the South African Police Service or the National Prosecuting Authority if the information relates to and constitutes material information for the proving of a tax offence; if another act requires disclosure notwithstanding the secrecy provisions of a tax act; disclosure to the exchange control

⁷¹ Sec. 46(1) TAA.

⁷² Secs. 40-66 TAA.

⁷³ Sec. 67 TAA.

authorities if required to administer the exchange control rules; disclosure to the Financial Intelligence Centre, to allow it to perform its duties, inter alia, to counter money laundering; if a judge orders such disclosure of information which may reveal evidence in a case where the court may impose a sentence of imprisonment exceeding 5 years or an imminent and serious public safety risk, etc.⁷⁴

2.3.7 Right of access to information

The following provisions of the TAA may be used by SARS to obtain information required to administer a tax act:

- Part A of Chapter 5: sections 40-44: general rules for inspection, verification, audit and criminal investigation;
- Part B of Chapter 5: sections 45-49: Inspection, request for relevant material, audit and criminal investigation;
- Part C of Chapter 5: sections 50-58: Inquiries; and
- Part D of Chapter 5: sections 59-66: Search and seizure.

In terms of section 3 of the TAA, the 'administration of a tax act' is defined to mean, inter alia:

- to obtain full information in relation to anything that may effect the liability of a person for tax, a taxable event or the obligation of a person to comply with a tax act;
- to ascertain whether a person has filed a correct return, information or documents in compliance with a tax act;
- to investigate whether an offence has been committed in terms of a tax act and whether to lay criminal charges; and
- to enforce of any of SARS' powers and duties under a tax act to ensure that an obligation imposed by or under a tax act is complied with.

The provisions under Chapter 5 of the TAA provide SARS with extensive powers to obtain the required information from a

⁷⁴ Secs. 67, 68, 69, 70 and 71 TAA.

taxpayer. However, as indicated above, these administrative powers must be exercised within the framework of the protections afforded a taxpayer under the Constitution, the PAJA and other relevant administrative rules and procedures.⁷⁵

In terms of section 29 of the TAA, a person must keep the records, books of account or documents that enable the person to observe the requirements of a tax act, se specifically required under a tax act and enable SARS to be satisfied that the person has observed these requirements. Section 31 of the TAA provides that the records, books of account and documents referred to in section 29 must at all reasonable times be available for inspection by a SARS official in South Africa for the purpose of determining compliance by the taxpayer or an inspection, audit or investigation under Chapter 5.

Section 40 of the TAA provides that SARS may select a person for inspection, verification or audit on the basis of any consideration relevant for the proper administration of a tax act, including on a random or a risk assessment basis.

If at any time before or during the course of an audit it appears that a person may have committed a serious tax offence, the investigation of the offence must be referred to a senior SARS official responsible for criminal investigations for a decision as to whether a criminal investigation should be pursued.⁷⁶

In terms of section 45, a SARS official, who is properly authorized by a senior SARS official may, for purposes of the administration of a tax act, arrive at premises without prior notice if the SARS official has reasonable belief that a trade is carried on at the premises to conduct an inspection to determine only (a) the identity of the person occupying the premises; (b)

⁷⁵ See section {2.3.3.}

⁷⁶ Sec. 43 TAA. A "tax offence" is defined to mean an offence in terms of a tax act involving fraud on SARS relating to the administration of a tax act.

whether the person occupying the premises is registered for tax; and (c) whether the person is complying with the obligations to retain records. However, the official is not allowed to enter any dwelling house or domestic premises (except any part thereof as may be occupied or used for the purposes of trade) without the consent of the occupant. The taxpayer is entitled to demand the authorization letter from the official who wishes to exercise his or her power under this section.

SARS may, for the purposes of the administration of a tax act in relation to a taxpayer, require the taxpayer or any other person to submit relevant material (whether orally or in writing), as SARS may require.⁷⁷ A request by SARS for relevant material from a person other than the taxpayer is limited to the records maintained or should be reasonably maintained by the person in relation to the taxpayer.

A senior SARS official may, by notice, require a person, whether or not chargeable to tax, to attend in person at the time and place designated in the notice for purposes of being interviewed by a SARS official concerning the tax affairs of the person if the interview is intended to clarify issues of concern to SARS to render further verification or audit unnecessary and is not for a criminal investigation.⁷⁸

An authorized SARS official may require a person, with prior notice of at least 10 business days, to make available at the person's premises specified in the notice relevant material that the official may require to audit or criminally investigate in connection with the administration of a tax act.⁷⁹ The person on whose premises an audit or criminal investigation is carried out, must provide such reasonable assistance as is required by SARS,

⁷⁷ Sec. 46 TAA.

⁷⁸ Sec. 47 TAA.

⁷⁹ Sec. 48 TAA.

including making appropriate facilities available, answering questions relating to the audit or investigation and submitting relevant material as required.⁸⁰

A senior SARS official may authorize a person to conduct an inquiry for the purposes of the administration of a tax act,⁸¹ which could include the cross-examination of the taxpayer and any witnesses, provided that the strict requirements under sections 50-58 TAA are complied with. In such a case, a senior SARS official must apply to a judge to designate a person to be the presiding officer, and the judge must be satisfied that there are reasonable grounds to believe that:

- there has been non-compliance by any person with regard to that person's obligations under a tax act or a tax offence has been committed by any person;
- relevant material is likely to be revealed which may afford proof of such non-compliance or the committing of such offence.

A judge may issue a warrant to SARS authorizing an officer named therein, without previous notice and at any time, to enter any premises to search for relevant material that may assist in the determination of the taxable income of the person.⁸²

However, a judge must be satisfied that:

- there has been non-compliance by any person with its obligations under a tax act; or an offence under the ITA has been committed by any person; and
- relevant material is likely to be found on the premises specified in the application which may afford proof of such non-compliance or the committing of such offence.

⁸⁰ Sec. 49 TAA.

⁸¹ Sec. 50 TAA.

⁸² Sec. 60 TAA.

The SARS official must conduct the search with strict regard for decency and order, and may search a person if the official is of the same gender as the person being searched.⁸³

A senior SARS official may conduct a search without a warrant if the official is satisfied, on reasonable grounds, that there may be an imminent removal or destruction of relevant material likely to be found at the premises, if SARS applied for a search warrant, it would be granted and the delay in obtaining a warrant would defeat the object of the search and seizure.⁸⁴

If SARS wishes to seize relevant material that may be subject to legal privilege, SARS must either arrange for an independent attorney to accompany the SARS official or SARS must seal the material and make arrangements for an independent attorney to make a determination whether the legal privilege applied.⁸⁵

Therefore, despite the wide powers granted to SARS under these provisions, there are strict procedures which SARS must follow.

2.3.8

Penalties

SARS is entitled to impose administrative penalties if a taxpayer fails to comply with any procedural or administrative action or duty imposed or requested under the ITA.⁸⁶ In terms of section 211 of the TAA, the penalty will be determined according to the taxpayer's taxable income. For example, if the taxable income of the taxpayer is between ZAR 10 million and ZAR 50 million, the penalty could be ZAR 8,000 per month until the taxpayer complies.

⁸³ Sec. 61 TAA

⁸⁴ Sec. 63 TAA.

⁸⁵ Sec. 64 TAA.

⁸⁶ Section 210 of the TAA and see the table above.

2.3.9

Access to foreign-based information

Most South African tax treaties contain exchange-of-information provisions. Generally, these provisions allow SARS to approach the competent authority of the other state with a request for information about the tax affairs of a taxpayer who is a resident of that other state.

If no tax treaty is applicable or the applicable tax treaty does not contain an exchange-of-information provision and the foreign based taxpayer refuses to disclose the required information, SARS could estimate the tax liability of the taxpayer and issue a corresponding assessment.⁸⁷

2.3.10

Burden of proof

Section 102 TAA provides that the taxpayer bears the burden of proof:

- (a) that an amount, transaction, event or item is exempt or otherwise not taxable
- (b) that an amount or item is deductible or may be set-off
- (c) the rate of tax applicable to a transaction, event, item or class of taxpayer
- (d) that an amount qualifies as a reduction of tax payable
- (e) that a valuation is correct or
- (f) whether a decision that is subject to objection or appeal under a tax act is incorrect.

The burden of proving whether an estimate under section 95 of the TAA is reasonable, or the facts on which SARS based the imposition of an understatement penalty under Chapter 16 of the TAA, is upon SARS.⁸⁸

2.3.11

Statute of limitations

SARS may not raise an additional assessment after the expiration of 3 years after the date of the assessment of an

⁸⁷ Sec. 95 TAA.

⁸⁸ Sec. 102(2) TAA.

original assessment by SARS; in the case of self-assessment for which a return is required, 5 years after the date of assessment by way of self-assessment by the taxpayer or, if no return is received, by SARS; in the case of self-assessment where no return is required, after the expiration of 5 years from the date of the last payment of tax for the tax period or the effective date, if no payment was made in respect of the tax for the tax period.

In the case of:

- (i) an additional assessment if the, (aa) amount which should have been assessed to tax under the preceding assessment was, in accordance with the practice generally prevailing at the date of assessment, not assessed to tax; or (bb) full amount of tax which should have been assessed under the preceding assessment was, in accordance with the practice, not assessed;
- (ii) a reduced assessment, if the preceding assessment was made in accordance with the practice generally prevailing at the date of that assessment; or
- (iii) a tax for which no return is required, if the payment was made in accordance with the practice generally prevailing at the date of that payment; or; in respect of a dispute that has been resolved under Chapter 9.⁸⁹

The 3-year limit does not apply in the case of assessment by SARS if said amount was not assessed for tax due to fraud, misrepresentation or non-disclosure of material facts; in the case of self-assessment, the fact that the full amount of tax chargeable was not assessed, was due to (i) fraud; (ii) intentional or negligent misrepresentation; (iii) intentional or negligent non-disclosure of material facts; or (iv) the failure to submit a return or, if no return is required, the failure to make the required

⁸⁹ Sec. 79(1), proviso (i)(aa) ITA.

payment of tax; SARS and the taxpayer so agree prior to the expiry of the limitations period; or it is necessary to give effect to (i) the resolution of a dispute under Chapter 9; or (ii) a judgment pursuant to an appeal under Part E of Chapter 9 and there is no right of further appeal.

2.3.12

Information requests

This will normally be done by sending letters to the taxpayer, requesting the production of information or documentation relating to the transfer pricing issue. SARS does not have a standard list of documents that are required for transfer pricing disputes, and follows the OECD TP Guidelines in this regard.

2.3.13

Solicitor-client privilege

The right to claim privilege in respect of certain information is based in common law.⁹⁰ In *Jeeva and Others v. Receiver of Revenue, Port Elizabeth and Others*,⁹¹ the Court confirmed that the right to keep professional communications between a legal advisor and client confidential has developed into a fundamental right. In accordance with the principle confirmed in *Jeeva*, where SARS requires the disclosure of information from the taxpayer or the taxpayer's advisors, they are entitled to refuse to disclose information protected by legal privilege.⁹²

Schwikkard summarizes the requirements for the claim to privilege as follows:⁹³

'Before legal privilege can be claimed, the communication in question must have been made to a legal advisor acting in a professional capacity, in confidence, for purpose of pending litigation or for the purpose of obtaining professional advice. The client must claim the

⁹⁰ See *Taxpayers' Rights in South Africa*, supra n. 56, at 174; D.T. Zeffertt and A.P. Paizes, *The South African Law of Evidence* (2nd ed.) (Butterworths, 2009), chapter 17.

⁹¹ 1995 (2)SA 433 (SE).

⁹² See *Taxpayers' Rights in South Africa*, supra n. 56, at 175.

⁹³ See P.J. Schwikkard et al., *Principles of Evidence* (3rd ed.) (Juta, 2009), chapter 10, at 147.

privilege. And the lawyer can claim the privilege on behalf of his client once the latter has made an informed decision.'

The taxpayer cannot secure the benefits of privilege by merely handing over internally generated correspondence and documents to its legal advisor, which documents are required by SARS under the ITA. Furthermore, once SARS has commenced an audit of the taxpayer's returns, the taxpayer may not refuse to make documents and information available to SARS by handing those documents and information over to an attorney.⁹⁴

Where a taxpayer seeks tax advice from any person other than a lawyer, privilege does not protect such advice.⁹⁵

2.3.14

Recommendations for taxpayers during tax audits

The taxpayer is entitled to insist that SARS abide by the procedural requirements of Chapter 5 of the TAA for any enquiries for information relating to transfer pricing issues.⁹⁶ In particular, SARS must give the taxpayer reasonable notice of any request for information, and is not entitled, except in specific circumstances, to simply appear at the taxpayer's premises and insist on cooperation from the taxpayer, unless the SARS officer has the required authorization or a warrant from a judge as required under the provisions of Chapter 5 of the TAA. SARS is not entitled to seize any documents which are subject to legal privilege, even if the SARS official has a warrant for the obtaining of information. As indicated above, the SARS official may seal relevant material in respect of which legal privilege is claimed and deliver the material to an independent attorney, who must determine whether such material enjoys legal

⁹⁴ See Taxpayer's Rights in South Africa, *supra* n. 56, at 176.

⁹⁵ *Id.* at 177.

⁹⁶ See section {2.3.7.}

privilege. The taxpayer is entitled to insist on representation by its attorney in any such enquiries by SARS.

3. APPEALS AND LITIGATION

3.1 Historical statistics

To date, no transfer pricing case has been taken to court, and all disputes have been settled by negotiation.

3.2 Appeals and litigation process

Following the notice of appeal, the two most important documents in the dispute process are:

- under Rule 10, a statement of grounds of assessment, provided by SARS to the taxpayer; and
- under Rule 11, a statement of grounds of appeal, subsequently provided by the taxpayer to SARS.

The SARS statement of grounds of assessment must set out a clear and concise statement of the grounds upon which the taxpayer's objection is disallowed, as well as the material facts and legal grounds upon which SARS relies for such disallowance.

The taxpayer's grounds of appeal must set out a clear and concise statement of the grounds upon which the taxpayer appeals, stating the material facts and legal grounds upon which the taxpayer relies and the facts and legal grounds alleged in the SARS statement of grounds of assessment which are admitted or denied. The issues in any appeal to the Tax Court will be those defined in the statement of the grounds of assessment read with the statement of grounds of appeal. The parties may agree to amend the various statements of grounds, but upon failure to reach an agreement the Tax Court may, upon application of notice, grant leave to amend the various statements of grounds. The matter will then go through a process of discovery of evidence to be used, notice of expert witnesses, a pre-trial conference,

the production of a dossier by SARS and the production of various bundles by SARS or the taxpayer.

The Tax Court does not normally make orders for costs, but may do so if it finds that SARS was unreasonable or the grounds of the taxpayer were frivolous. A dispute is first heard in the Tax Court. The aggrieved party has an automatic right of appeal to the High Court, which will be presided over by three judges. The party aggrieved by the judgement of the High Court may, upon application for leave to appeal, take the matter to the Supreme Court of Appeal, normally presided over by five judges.

The party aggrieved by the decision of the Tax Court may, upon the granting of an application for leave to appeal, appeal directly to the Supreme Court of Appeal. The aggrieved party may even approach the Constitutional Court if it is of the opinion that its constitutional rights have been prejudiced.

3.3 Advantages and disadvantages

The advantage of the appeals and litigation process is that the process is fair and well established, and the rule of law will apply to decide the matter. However, the cost of litigation is very high and is often a significant barrier to the taxpayer.

4. MUTUAL AGREEMENT PROCEDURE UNDER TAX TREATIES AND ARBITRATION

4.1 Historical statistics

According to SARS, there are several MAP cases which are currently pending relating to transfer pricing. However, there are no existing MAP precedents on transfer pricing.

4.2 Mutual agreement procedure

The ITA does not contain specific arbitration procedures dealing with transfer pricing or MAPs in the context of a tax treaty.

If a taxpayer wishes to institute a MAP procedure, it should approach SARS and request it to initiate the procedures with the tax authorities of the other contracting state.

5. ADVANCE PRICING AGREEMENTS

Because it is not possible to obtain an advance tax ruling on transfer pricing matters (under section 76G(1)(a)(iii) of the ITA), advance pricing agreements are not available in South Africa.

6. RECOMMENDATIONS

The transfer pricing rules applicable under section 31 of the ITA are based on the arm's length principle. SARS acknowledges the OECD TP Guidelines in the application of the transfer pricing rules. Therefore, the rules accord with transfer pricing rules applied internationally. This provides certainty in the application of the rules.

SARS has wide powers to obtain information from a taxpayer about transfer pricing practices, and uses such powers extensively to police perceived transfer price manipulation.

It is important for taxpayers to know their rights in case of a dispute with SARS on the application of the transfer pricing rules. The taxpayer should insist that SARS comply with the specific requirements of the TAA before information is obtained from the taxpayer. Furthermore, SARS is required to comply with the Constitution and the PAJA, which require fair and reasonable administration of the provisions of the ITA.

Should the dispute not be resolved under the various settlement procedures provided in the TAA, the taxpayer may appeal to the courts to have the matter resolved by a judge. The judicial process is expensive and time-

consuming. However, in view of the power of SARS to impose up to 200% in understatement penalties plus interest, it may well be crucial for the taxpayer to resort to litigation to resolve the dispute.