Tax developments in South Africa

John Stanley and Cicelia Potgieter of Deloitte & Touche outline some recent changes in taxation in South Africa.

Transfer pricing

Transfer pricing legislation was introduced in South Africa in 1995, mainly due to relaxation of exchange controls and the country's re-emergence into international trading when sanctions ended. Since then, the South African Revenue Services (SARS) has not really policed compliance, but is starting to focus more of its resources on legislation and a practice note was issued in August 1999. Taxpayers who ignore transfer pricing arrangements could risk significant tax adjustments.

SARS is also in the process of establishing a transfer pricing investigation unit to police compliance. Taxpayers who ignore it may soon find themselves faced not only with further income tax, but also penalties (up to 200% of under-paid taxes) and interest. On top of this, a company is potentially exposed to Secondary Tax on Companies, currently at a rate of 12.5%.

The Income Tax Act does not impose specific penalties for non-arm's length pricing principles. Due to the subjective nature of transfer pricing adjustments, general penalty provisions could be too harsh. Other countries have introduced specific penalty provisions to address the subjectivity of the adjustments.

The acceptable methods are: comparable uncontrolled price, resale price, cost plus, profit split and transactional net margin method. The method that is finally used, should be the one with the most reliable results and that requires the least and most reliable adjustments. The aim should be for consistent application worldwide. When different methods are applied from country to country or the application of the methods differs significantly, a multinational may be at risk of double taxation. SARS, in line with the OECD guidelines, prefers the transactional methods over the profit methods and, as a general rule, prefers the comparable uncontrolled price method.

Taxpayers are being urged to prepare contemporaneous documentation to support transfer prices. The practice note will be applied retrospectively and SARS will expect documentation in respect of all transactions entered into from July 1995. For future transactions, documentation should be prepared no later than the date of submission of a tax return affected by these transactions.

A good introduction

The practice note is a good introduction to transfer pricing. Other countries started with broad introductory guidelines followed by specific ones. South African taxpayers will have to see whether SARS will issue further practice notes on topics such as the application of transfer pricing, financial services, intra-group services, intangibles and documentation. ■

John Stanley is a partner in the tax division at Deloitte & Touche.

Cicelia Potgieter is a senior manager in the tax division at Deloitte & Touche.

Tax treaties signed

During 1999 tax treaties were signed with the following:

- Australia
- Italy
- Namibia (re-negotiated)
- Pakistan
- Slovak Republic
- Tunisia.

Treaty provisions will apply to South Africa, from 1 January, 2000. ■

Foreign tax credits

When taxpayers are liable to taxation in South Africa and a foreign country on income derived from a source outside South Africa, they are entitled to a rebate, or credit, equal to the foreign taxes paid.

The Income Tax Act has been amended to clarify that such a credit is also available when the income relating to services rendered outside South Africa is deemed to accrue to taxpayers from a source within South Africa, which income would therefore be subject to tax in South Africa. ■

Foreign investment income

Where a South African resident holds more than 50% of the rights to participate in the capital or profits, or exercises more than 50% of the votes or control, of a foreign company, that foreign company will constitute a controlled foreign entity (CFE) of the South African resident. Any annuity, interest, rental or royalty income earned by the CFE will be subject to South African tax in the hands of the South African resident in proportion to its participation rights, subject to a number of exemptions. One such exemption is where the foreign tax paid or payable is more than 85% of the South African tax payable. A recent change to the Income Tax Act now makes it clear that the 85% will be determined on the basis of the amount of any taxes paid or payable without any right of recovery by any person. The change was effected to counter a loophole in situations where a country's tax legislation allowed for a refund of the foreign tax paid. ■