Transfer pricing in South Africa: overview
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TRANSFER PRICING: GENERAL OVERVIEW

1. What are the main characteristics of transfer pricing law and policy in your jurisdiction?

South Africa's transfer pricing rules are based on the Organisation for Economic Co-operation and Development’s arm’s length standard. The rules require a legal connection between the parties to the transaction and although the definition of a connected party is complex, for companies it can be summarised as including members of a group where the common shareholding is more than 50%, and companies which own a shareholding of at least 20% in a company in which no other holder of shares holds the majority voting rights in the company.

The legislation permits re-characterisation of a transaction where any of the terms and conditions differ from those found between unrelated parties. The legislation is a self-assessment provision, in that the taxpayer must file a return based on the transaction being in accordance with the arm’s length principle. If the taxpayer is party to a transaction that is not priced on an arm’s length basis, the taxpayer must adjust the pricing to an arm’s length amount when filing the return (primary adjustment).

A transfer pricing primary adjustment attracts a secondary adjustment in the form of a deemed dividend in its current form (in specie) in the case of a company, which is equal to the primary adjustment and subject to dividends withholding tax at a rate of 20%. In the case of a person other than a company, the secondary adjustment is subject to donations tax of 20%.

There are no specific transfer pricing penalties at present, but general administrative and understatement penalties can apply.

2. What have been the main developments of significance for transfer pricing law and practice in your jurisdiction in the past 12 months?

South Africa has adopted certain of the minimum standards proposed under the Organisation for Economic Co-operation and Development’s (OECD) base erosion and profit shifting (BEPS) recommendations. Section 29 of the Tax Administration Act No 28 of 2011 (TAA) has been extended to include document retention requirements for transfer pricing. These are onerous and go beyond the requirements proposed by the OECD under Action 13 relating to master file and local file requirements. There is also a particular section of the annual tax return which requires specific transfer pricing disclosure, mostly relating to financial data on transactions.

In addition to the documentation retention provision, the South African Revenue Service (SARS) has also recently issued transfer pricing documentation requirements as part of its implementation of the mini mum standard requirement under BEPS. These requirements are in line with Action 13 recommendations and involve the completion of the Country-by-Country reporting template (CBR) and the Master File and Local File documents.

The transfer pricing documentation requirements apply to taxpayers that have aggregated connected party transactions of a value of ZAR100 million or more. If this threshold is met, documentation should be completed for all transactions of ZAR5 million or more.

The CBCR reports must be completed by parent companies of groups that have consolidated turnover of ZAR10 billion or more.

SARS has also recently extended the administrative penalty under section 21D of the TAA for non-compliance relating to the submission of the CBCR, Master File and Local File.

TRANSFER PRICING LEGISLATION

Federal or national legislation

3. What is the main federal (national) legislation regulating transfer pricing in your jurisdiction?

Primary legislation

The main transfer pricing provisions in South Africa are:

• Section 1 of the Income Tax Act no 58 of 1962 (ITA), which defines “connected person”. A “connected person” in relation to a company can be either another company within a group or a person subject to certain specified percentages of equity shares and voting rights indicating an economically significant interest in that company (see Question 1).

• Section 31(1) of the ITA defines an “affected transaction” as one that is direct or indirect, entered into or effected between connected persons, and any term or condition which is not at arm’s length.

• Section 31(2) of the ITA, which provides for the primary adjustment (see Question 1).

• Section 31(3) of the ITA, which states that the primary adjustment gives rise to a secondary adjustment in the form of a deemed dividend consisting of a distribution of an asset in specie in the case of a company or a deemed donation in the case of a person other than a company.

• Section 64E of the ITA, which imposes a 20% dividends tax charge on the affected transaction in the case of a company.

• Section 64 of the ITA which imposes a 20% donations tax charge on the affected transaction in the case of a person other than a company.

Secondary legislation

In addition to the ITA, the Tax Administration Act No 28 of 2011 (TAA) governs the manner in which the ITA is administered. Relevant sections specific to transfer pricing are:

• Section 25 of the TAA, requiring the completion of country-by-country reports.

• Section 29 of the TAA, requiring the retention of transfer pricing documentation.
• Part A of Chapter 16 of the TAA (sections 221 to 224), in relation to the imposition of understatement penalties.
• Section 210 of the TAA imposing an administrative penalty for non-compliance relating to submission of the CBCR, Master and Local Files.

State or local transfer pricing legislation

4. What additional regional (local state) legislation and revenue authorities are relevant to transfer pricing in your jurisdiction?

Legislation
Other than that referred to in Question 3, there is no additional local legislation pertaining to transfer pricing in South Africa.

Revenue authorities
The South African Revenue Service is the taxing authority for South Africa and operates on a national basis.

International transfer pricing treaties and agreements

5. What are the main international treaties and agreements that apply in your jurisdiction?

South Africa has a broad network of tax treaties. These largely follow the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention, although there are some treaties that include elements of the UN Model Tax Convention.

South Africa is a party to a number of tax treaties with both developed countries within the OECD and neighbouring countries across the African continent. In total South Africa has entered into 82 treaties of which three are awaiting ratification. A further 22 are in the process of negotiation and renegotiation.

6. What impact do international treaties and agreements have in your jurisdiction?

The treaties referred to in Question 5 largely follow the OECD Model Tax Convention and provide for relief from double taxation, both juridical and economic, by assigning taxing rights either to South Africa or to the other country party to the treaty.

In addition, South Africa has also signed the OECD Multilateral Competent Authority Agreement on the Exchange of Country by Country Reports and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). South Africa has provisionally indicated that 76 of its tax treaties will be covered tax agreements for purposes of the MLI. South Africa has provisionally opted in to apply the majority of the MLI provisions subject to a provisional list of reservations and notifications (MLI positions). South Africa’s final MLI positions will be provided upon the deposit of its instrument of ratification, acceptance or approval of the MLI.

TRANSFER PRICING POLICY

7. What is the overall national transfer pricing policy in your jurisdiction?

South Africa is closely following developments at the Organisation for Economic Co-operation and Development (OECD) relating to base erosion and profit shifting (BEPS) and those impacting transfer pricing. It has first-world transfer pricing legislation in place and extensive double tax treaties which adopt the arm’s length standard for determining the taxable profit allocation between South Africa and its treaty parties in respect of transactions entered into between members of multinational enterprises.

South Africa endorses the OECD guidance on transfer pricing and is adopting much of the revised guidance recommendations on BEPS, notably the proposed changes to documentation requirements.

South Africa has issued the following legislative public notices under the TAA relating to transfer pricing documentation:
• Related to section 29, the requirement for South African taxpayers to retain transfer pricing records. This was issued on 28 October 2016 and applies to years of assessment starting on or after 1 October 2016.
• Related to section 25, rules relating to the completion of country-by-country (CbC) reports for multinational enterprise groups were published on 20 October 2017 for reporting fiscal years commencing on or after 1 January 2016 in relation to reporting entities that are residents and residents that are constituent entities, and for financial years commencing on or after 1 October 2016 in relation to residents where the aggregate of such residents’ potentially affected transactions for the year of assessment, without offsetting any potentially affected transactions against one another, exceeds or is reasonably expected to exceed ZAR100 million. In such cases, documentation should be prepared to support all transactions with a value of ZAR5 million or more.

Under section 29 of the TAA, a South African corporate taxpayer must retain documents and records of account relating to its transfer pricing if the aggregate of its related party transactions (excluding any set-off or netting) totals ZAR100 million or more. Detailed records must be kept for all transactions valued at ZAR5 million or more.

In addition, South Africa has adopted the OECD recommendations for completion of CbC reports which will be shared with other signatory countries by automatic exchange. The final regulations relating to country-by-country reporting standards (CbC Regulations) were published by the South African Minister of Finance in the Government Gazette (Regulation No. R.1598 published in Government Gazette No. 40510) on 23 December 2016 for purposes of paragraph (b) of the definition of “international tax standard” in section 1 of the TAA (promulgated under section 257) and apply to all reporting fiscal years of Multi National Entity (MNE) groups starting on or after 1 January 2016.

South Africa has also adopted the OECD’s guidance on keeping master file and local country file documentation which is set out in the Business Requirements Specification (BRS): Country-by-Country and Financial Data Reporting.

The following persons are required to report:
• The Ultimate Parent Entity (UPE), resident in South Africa, of a Multi-National Entity (MNE) group with a total consolidated group revenue of ZAR10 billion or more during the Fiscal Year immediately preceding the Reporting Fiscal Year, as reflected in its Consolidated Financial Statements for such preceding Fiscal Year, is required to file a CbC Report (CbC01), master file and local file;
• Any MNE with potentially affected transactions for the year of assessment, without offsetting any potentially affected transactions against one another, that exceed or are reasonably expected to exceed ZAR100 million, is required to file a local file and may also be required to file a master file (but not necessarily a CbC01).

The UPE or other MNE must submit the required information as stipulated in the Business Requirements Specification (BRS): Country-by-Country and Financial Data Reporting.

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8. What are the main transfer pricing methodologies that are used to determine an arm’s length price in your jurisdiction?

In implementing its transfer pricing rules, South Africa adopts all five methods recognised by the Organisation for Economic Co-operation and Development (OECD). These are:

- The transaction-based methods:
  - comparable uncontrolled price method;
  - resale price method;
  - cost plus method;

- The profit-based methods:
  - profit split method;
  - transactional net margin method.

There is no hierarchy of methods and South Africa recognises the most appropriate method approach endorsed by the OECD.

9. To what extent, if any, does your jurisdiction follow the OECD transfer pricing guidelines?

South Africa endorses and largely follows the guidance provided by the Organisation for Economic Co-operation and Development (OECD). With the proposed changes to these guidelines as recommended under the base erosion and profit shifting (BEPS) actions, there may be certain areas where South Africa does not wholly adopt this guidance. For example, the authors expect that there may be some resistance to accepting the recommended approach for the treatment of low value-adding services which is a proposed change to Chapter VII of the guidelines.

Currently, other than the developments indicated earlier relating to the changes under the Tax Administration Act, No 28 of 2011 (TAA), South Africa’s transfer pricing guidance is contained in Practice Note 7 to the Income Tax Act which dates back to 1999. There have been several key legislative changes which impact the relevance of this practice note, notably around certain key definitions. The documentation guidance has also been superseded by section 29 of the TAA (see Question 7). However certain aspects of the practice note can provide some additional guidance. For example, the practice note states that “The OECD Guidelines should be followed in the absence of specific guidance in terms of this Practice Note, the provisions of section 31 or the tax treaties entered into by South Africa” (paragraph 3.2.3, Practice Note, 7 August 1999).

South Africa also relies on its transfer pricing provisions for the purposes of addressing thin capitalisation. There is currently no final interpretation or guidance on what is acceptable from SARS in this context, placing a significant burden on taxpayers, although a draft interpretation note on thin capitalisation was issued in 2013. This issue has been considered by the Davis Tax Committee (DTC), a committee appointed by the Minister of Finance to consider improvements to South Africa’s tax policies, particularly in light of the OECD BEPS reports. The DTC recommends that a “safe harbour” with a fixed rate be introduced in section 31 or finalised guidance be published to provide local taxpayers and non-residents funding South African entities with more certainty as to acceptable levels of debt. Any such guidance should be consistent with the OECD recommendations.

The DTC also recommends simplification of the rules and introducing ways to reduce the compliance costs for taxpayers with a low risk of BEPS through interest deductions. These could be by introducing a safe harbour with a fixed debt-equity ratio or threshold based on a loan value or other measure.

The proposed discussion document referred to in the 2018 Budget Review on the tax treatment of excessive debt financing is expected to incorporate the OECD and DTC recommendations on transfer pricing rules applicable to interest deductions.

10. Is it possible to obtain any clearances or advance pricing agreements from the revenue authorities in respect of transactions?

Clearances
South Africa has an advance ruling programme that, in certain circumstances, enables taxpayers to seek interpretation on the application of the Income Tax Act, 1962 to proposed transactions or arrangements. Interpretation is provided through a “binding ruling”. However, the provisions that permit a taxpayer to seek a binding ruling specifically exclude situations that relate to the pricing of a transaction. Therefore, there is no opportunity to obtain a binding ruling on a transfer pricing matter.

Advance pricing agreements
South Africa does not have an advance pricing programme in place. At the time of writing there is also no intention on the part of the South African Revenue Service to introduce an advance pricing agreement programme.

11. Where the revenue authorities make a transfer pricing adjustment, what is the effect of that adjustment on the other party to the transaction?

A primary transfer pricing adjustment (see Question 1) gives rise to a secondary adjustment in the form of a deemed dividend in specie which is subject to dividends withholding tax at 20% in the case of companies, or a deemed donation which is subject to donations tax at 20% in the case of persons other than companies (see Question 3). This tax is payable by the South African taxpayer, however, and is not the liability of the foreign recipient of the deemed dividend.
There is debate with the tax authorities and consequently uncertainty whether the dividends withholding tax would be subject to treaty reduction under Article 10 of the relevant treaties (see Question 9). Domestic legislation does allow for this even though the liability is that of the local taxpayer and not the non-resident, provided certain criteria are met. Whether or not these criteria are met depends on the interpretation given to certain domestic tax provisions as well as on the wording of the specific tax treaty that might potentially apply.

12. What are the reporting and other administrative obligations that apply to help the authorities evaluate transfer prices?

South Africa has adopted the base erosion and profit shifting Action 13 on country-by-country reporting which will provide the South African Revenue Service (SARS) with information on the activities and profitability of companies within a multinational group. These reports, including those provided to SARS under the automatic exchange of reports, will provide significant source of information to enable SARS to carry out risk assessments. SARS has also indicated it will be prepared to share the completed Master File with other jurisdictions if requested.

In addition, the annual income tax return has gradually changed over the last few years to require more detailed and granular information from corporate taxpayers relating to their inter-company transactions. These disclosures are used by SARS to assess possible areas of risk.

Finally, SARS has a standard transfer pricing questionnaire which is issued to taxpayers and which requests additional information relating to the taxpayer’s transfer pricing practices. This often includes a request from SARS for transfer pricing documentation from the taxpayer.

TRANSFER PRICING COURTS AND DISPUTE RESOLUTION

13. What are the relevant national courts and what dispute resolution mechanisms exist for transfer pricing issues in your jurisdiction?

The dispute resolution process is a tiered process that is designed to give the taxpayer opportunity to present additional information. Once an audit is concluded, the South African Revenue Service (SARS) will normally issue a “letter of findings” which proposes the adjustments it intends to make and the basis for each adjustment. The taxpayer is given the opportunity to respond and provide additional information, clarification and an opposing view. SARS will consider the merits of the response and then either issue an assessment or confirm satisfaction with any rebuttal. The letter of findings also provides the taxpayer with an opportunity to explain itself and provide evidence of extenuating circumstances justifying the non-imposition of penalties and interest on any additional tax that may be due as a result of a proposed adjustment.

Once an assessment is issued, the taxpayer can object to the assessment and state its grounds for objecting. SARS will consider the objection and can either allow, partially allow or disallow the objection. As part of this process, the taxpayer can request reasons for the basis of the assessment, if SARS’s grounds for raising the assessment are unclear.

Assuming that an objection is disallowed, the taxpayer can appeal this decision to the Tax Court. The taxpayer can also request that the alternative dispute resolution (ADR) process be considered. The taxpayer can also make an objection to the competent authority to invoke the mutual agreement procedure (MAP) under the relevant treaty. If either ADR or the competent authority route is chosen, the appeal process will be halted pending the outcome.

The ADR process involves the taxpayer and SARS discussing the merits of the case and putting forward their respective arguments in front of an independent person. This person is a SARS official but is independent from the audit. The independent person can make recommendations to SARS following the ADR, after which SARS may or may not accept the taxpayer’s arguments in whole or in part.

The competent authority route involves invoking the MAP process between the two affected revenue authorities. This is a closed discussion and the taxpayer cannot make any additional representations during the process.

If the appeal continues, the matter will be heard in the Tax Court. The ruling of the judge in the Tax Court can be appealed to the Supreme Court. The procedures for dealing with dispute resolution are contained in Chapter 9 of the Tax Administration Act 2011.

International courts and transfer pricing dispute resolution

14. What international dispute resolution methods are available in your jurisdiction, and which are preferred for transfer pricing issues?

The only international dispute resolution available is appeal to the competent authority to invoke the mutual agreement process under the relevant double tax treaty.

TRANSFER PRICING CASE LAW

15. What are the most significant case law developments on transfer pricing in your jurisdiction?

There have been no significant transfer pricing cases published in South Africa at the time of writing. There has been a recent Tax Court case which considered supply chain transactions, but this largely focused on the doctrine of substance over form as opposed to transfer pricing.

TRANSFER PRICING ADJUSTMENTS

16. Where the revenue authorities make an adjustment of transfer prices for tax purposes, can any other penalties also be imposed in addition to that adjustment?

There are no specific transfer pricing penalties relating to transfer pricing adjustments. Adjustment made under the transfer pricing rules can attract penalties for understatement of tax and penalties for underpayment of tax. These are general penalties imposed under the Tax Administration Act 2011.

Legislative amendments in 2016 have changed the definition of an understatement to encompass any additional tax arising from an adjustment made by SARS under any general anti-avoidance provision. It is arguable whether the transfer pricing rules constitute a general anti-avoidance provision and this remains untested at the time of writing. If SARS successfully argue that the transfer pricing rules are an anti-avoidance provision, a penalty equivalent to 75% of the additional tax due will be imposed on a transfer pricing adjustment.

As indicated in Question 2 there are specific administrative penalties for non-compliance relating to the completion and submission of the CBCR, Master File and Local File.

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17. Are there any current trends, developments or reform proposals that have or will affect the area of transfer pricing in your jurisdiction?

There have been several recent developments associated with transfer pricing in South Africa, largely in the context of South Africa having adopted certain base erosion and profit shifting recommendations.

The requirement for retention of transfer pricing documentation was introduced in October 2016 and applies to years of assessment starting on or after that month. Taxpayers that fall within the threshold limits must keep certain documentation relating to the transactions they enter into with connected persons. In addition, in December 2016, South Africa legislated regulations for country-by-country reporting and on 20 October 2017 rules were introduced regarding the completion of country-by-country reports. Furthermore, South Africa has also adopted the OECD’s guidance on keeping master file and local country file documentation which is set out in the Business Requirements Specification (BRS): Country-by-Country and Financial Data Reporting.

Subsequently, the Davis Tax Committee (DTC): Second Interim Report on Base Erosion and Profit Shifting (BEPS) in South Africa on Action 4: Limit base erosion via interest deductions and other financial payments, considered the tax treatment of excessive debt financing against South Africa’s existing transfer pricing rules and BEPS and made various recommendations in this regard. Following this, it was proposed in the 2018 Budget Review that a discussion document will be published addressing the tax treatment of excessive debt finance, which is expected to incorporate the OECD and DTC recommendations.

18. What have been the main national and international trends affecting tax enforcement and anti-avoidance practice in your jurisdiction in the past 12 months?

In recent years, multinational companies that avoid or evade tax by shifting taxable income to low-tax regimes or tax havens have come under the global spotlight.

South Africa has been proactive in taking policy action in this area and has joined the Group of Twenty (G20) and the OECD to examine base erosion and profit shifting.

South Africa has also taken the following steps:

- Improving the quality of information that corporates are required to provide to the South African Revenue Authority (SARS) for SARS to identify aggressive or abusive tax planning schemes.
- Taking action on transfer pricing. SARS will soon have access to country-by-country information on all large multinationals operating in South Africa.
- Enhancing rules on foreign companies controlled by a South Africa resident to ensure that a portion of the profits earned by a South Africa-owned subsidiary, operating in another country, is taxed in South Africa if no meaningful economic activity took place in the other country.
- Introducing rules that limit excessive interest deductions.

19. How does your jurisdiction make the distinction between abusive tax avoidance and legitimate tax planning?

In South Africa, to determine whether a taxpayer has engaged in legitimate tax planning, a distinction is made between:

- Tax evasion;
- “Impermissible” tax avoidance; and
- Legitimate tax planning or “tax mitigation”.

In adopting the Organisation for Economic Co-operation and Development’s (OECD) definition of tax evasion, South Africa defines tax evasion as encompassing “illegal arrangements through or by means of which liability to tax is hidden or ignored”. This encompasses arrangements in which the taxpayer pays less tax than he or she is legally obligated to pay by deliberately hiding income or information from the tax authorities.

The term “impermissible tax avoidance” is described as an artificial or contrived arrangement with little or no actual economic impact upon the taxpayer, that is usually designed to manipulate or exploit perceived loopholes in the tax laws to achieve results that conflict with or defeat the intention of the legislature.

Legitimate tax planning has been described as a situation in which the taxpayer has arranged his or her affairs in a legal manner, either reducing their income or ensuring that there is no income on which tax is payable and genuinely suffering the economic consequences that the legislature intended to be suffered by taking advantage of a fiscally attractive option. A taxpayer is not barred from entering into a bona fide transaction which, when carried out, has the effect of avoiding or reducing liability to tax, provided that there is no provision in the law that prevents the avoidance or the reduction of tax.

20. Do the revenue authorities in your jurisdiction offer any guidance on the distinction between legitimate tax planning mechanisms and abusive or aggressive tax avoidance?

South Africa has had a general anti avoidance rule (GAAR) in its income legislation for many years. The South African Revenue Service (SARS) published a Discussion Paper on Tax Avoidance and Section 103 of the ITA in November 2005, discussing issues of tax evasion and impermissible tax avoidance, and how best to address them. SARS also published an interim response in March 2006, taking into account the comments received on the discussion paper. South Africa introduced the current version of its GAAR in 2006, after these publications.

Tax anti-avoidance provisions

21. Can you identify any direct or indirect impact in your jurisdiction of the OECD or other recent international initiatives to combat abusive tax avoidance?

International initiatives have had an impact on South African general anti-avoidance legislation and tax rules. In the 2005 discussion paper on tax avoidance (see Question 20), the South African Revenue Authority provided an overview of the recent experiences with, and responses to, abusive tax avoidance schemes and impermissible tax avoidance in six different countries, namely, Australia, Canada, New Zealand, Spain, the UK, and the US. South Africa’s current GAAR was drafted against the backdrop of international experience in this area.
22. Does your jurisdiction have GAAR designed to prevent or reduce abusive tax avoidance?

South Africa’s general anti-avoidance rule (GAAR) is contained in sections 80A to 80L of the Income Tax Act no 58 of 1962 (ITA) and applies to any arrangement entered into on or after 2 November 2006.

In general, the South African Revenue Authority’s Commissioner can apply the GAAR to a transaction if four requirements are met:

- There must be an arrangement.
- The arrangement must result in a tax benefit.
- The arrangement must lack commercial substance and:
  - be carried out by means or in a manner that would not normally be employed for bona fide business purposes, other than obtaining a tax benefit;
  - create rights or obligations that would not normally be created between persons dealing at arm’s length; or
  - result directly or indirectly in the misuse or abuse of the provisions of the ITA; and.
- The arrangement’s sole or main purpose must be to obtain a tax benefit.

An arrangement having these characteristics is an "impermissible avoidance arrangement". The Commissioner has explicit authority to determine the tax consequences of any impermissible avoidance arrangement for any party by, among other things, “disregarding, combining, or re-characterising any steps in or parts of the impermissible avoidance arrangement”. The Commissioner can also apply the GAAR either to an impermissible avoidance arrangement as a whole or to any step in or part of such an arrangement.

23. What are the legislative provisions that are designed to reinforce GAAR and any other abusive tax avoidance provisions?

In addition to the general anti-avoidance rule (GAAR), the Income Tax Act no 58 of 1962 (ITA) also contains a large number of specific anti-avoidance provisions. In the context of companies, some of the most significant of these include:

- The definition of "connected person" contained in section 1, which provides a limitation on the quantum of deductions or allowances in respect of certain second-hand assets acquired from connected persons.
- Sections 7(5) and (6), which deem donors to be liable to tax on income received by or accrued to trustees or to the trust’s beneficiaries as a result of any donation, settlement or other disposition.
- Section 7(8), which provides that donors who cede or otherwise make over to other persons their right to receive income from certain assets are in certain circumstances liable to tax on the income ceded or made over.
- Section 7(9), which provides that where an asset has been disposed of for a consideration less than its market value, the amount by which the market value exceeds the consideration will be deemed to be a donation.
- Section 7C, which gives rise to a deemed donation in circumstances where no or low interest-bearing loans are advanced to a trust or its underlying company by a connected person.
- Sections 8A and 8C, which contain specific anti-avoidance provisions aimed at share incentive schemes.
- Section 8E, which deems dividends on hybrid “equity instruments”, as defined, to be income.
- Section 8EA, which deems dividends on “third-party backed shares”, as defined, to be income.
- Section 8F, which denies a deduction in respect of any amount paid or payable by an issuer under a “hybrid debt instrument” as defined, and reclassifies such interest as a deemed dividend in specie.
- Section 8FA which applies to “hybrid interest”, and if applicable, denies an interest deduction and reclassifies such interest as a deemed dividend in specie.
- South Africa’s controlled foreign company rules in section 9D, which includes as income in the hands of a resident who holds participation rights in a controlled foreign company, a notional amount of the foreign company’s net income, unless certain exemptions apply.
- Section 24J, which deems interest to have accrued or to have been incurred on a yield to maturity basis, to prevent schemes designed to avoid tax.
- Section 25B(2A), which includes an amount in income where residents acquire a vested right to an amount representing the capital of a non-resident trust.
- Section 31, which provides transfer pricing rules to counter abusive practices.
- The value-shifting arrangements contained in paragraph 11(1)(g) of the Eighth Schedule to the ITA and dealing with capital gains tax (CGT). Value shifting involves the effective transfer of value from one entity to another without constituting an ordinary disposal for CGT purposes. The mischief that the anti-avoidance provisions contained in the Eighth Schedule are aimed at combating is the situation where entities manipulate the value of assets to obtain a CGT benefit.
- Paragraph 16 of the Eighth Schedule to the ITA, which provides for certain capital losses to be disregarded where they arise from intangible assets acquired before 1 October 2001 from a connected person or as part of a business. The mischief that paragraph 16 is aimed at combating is the abuse of the valuation of intangible assets on the acquisition of a business.
- Paragraph 19 and 43A of the Eighth Schedule to the ITA, which deals with extraordinary dividends and losses from dividend stripping.
- Paragraph 38 of the Eighth Schedule to the ITA, which deals with donation or disposals to connected persons and which are not priced on an arm’s length basis. This paragraph applies deemed market value treatment to both purchaser and seller.
- Paragraph 39 of the Eighth Schedule to the ITA which “clogs” capital gains tax losses derived from disposals between connected persons.
- Paragraph 56, which disregards capital losses linked to the disposal of debts owed by connected persons.
- Part X of the Eighth Schedule which is the CGT equivalent to sections 7(5) and 7(8) to the ITA.
24. Identify and discuss any case law of interest concerning GAAR and any other cases dealing with abusive tax avoidance in your jurisdiction.

Current case law relevant to abusive tax avoidance

There have been no important cases dealing with the application of the current GAAR contained in sections 80A to 80L of the ITA. However, there were several cases that dealt with the earlier versions of the GAAR, which have assisted in the interpretation of certain terms of the new GAAR.

A recent focus of the South African tax authorities has been “sham transactions” and there is substantial case law in South Africa around the substance-over-form doctrine.

In Commissioner of Customs and Excise v Randles Bros & Hudson Ltd 1941 AD 369 the court held that a simulated or disguised transaction was “a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, between them, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside the prohibition or not subject to the tax”. The court also said that provided the court found that there was an unexpressed agreement or tacit understanding between the parties, the transaction could be interpreted in accordance with what is found to be the real agreement.

‘These cases have included Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR 1996 (2) SA 942 (A), 58 SATC 229 and Commissioner for the South African Revenue Service v NWK Ltd [2011] 2 SA 67 (SCA) 73 SATC 55.

In cases before the NWK case, the courts had made it clear that to find that there was simulation, the court needed to be satisfied that there was a real intention definitely ascertainable which differed from the simulated intention. It was stated in the seminal case of Zandberg v Van Zyl, 190 AD 302 that “if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be”. However, in the more recent NWK case, Lewis JA re-visited the established test of whether or not the parties to a contract intended it to have effect according to its tenor and stated: “In my view, the test to determine simulation cannot simply be whether there is an intention to give effect to a contract in accordance with its terms. The test should go further and require an examination of the commercial sense of the transaction of its real substance and purpose. If the purpose of the transaction is only to achieve an object that allows the evasion of tax or of a peremptory law, then it will be regarded as simulated”.

The extract from Lewis JA’s judgment suggested to some that even an honest transaction can be deemed simulated and fraudulent simply because it is motivated by a desire to avoid tax.

Fortunately, the uncertainty created by the NWK judgment has been clearly resolved in the subsequent Supreme Court of Appeal decisions of both:

- Roschcon (Pty) Ltd v Anchor Body Builders CC(49/13) [2014] ZASCA 40.
- CSARS v Bosch and another 77 SATC 61.

The Roschcon case confirmed again that a transaction cannot be said to be simulated or disguised if the parties genuinely intend to give effect to the transaction in accordance with the provisions of their agreement. Therefore, while clarifying that a transaction undertaken to improve tax efficiencies is not in itself simulated, the court noted that elements of a transaction may be simulated if they are totally artificial and self-cancelling. That is, if they have no commercial purpose other than tax evasion and are included solely to disguise the nature of the true, underlying transaction.

The Roschcon approach was further reinforced in the Bosch case, where the court held, “…Simulation is a question of the genuineness of the transaction under consideration. If it is genuine then it is not simulated, and if it is simulated then it is a dishonest transaction, whatever the motives of those who concluded the transaction. The true position is that the court examines the transaction as a whole, including all surrounding circumstances, any unusual features of the transaction and the manner in which the parties intend to implement it, before determining in any particular case whether a transaction is simulated”. The court went on to emphasise that there is nothing impermissible about arranging one’s affairs to minimise one’s tax liability, and the tax authorities were free to legislate to close any perceived loopholes.

However, in the recent Tax Court case of X (Pty) Ltd v Commissioner for the South African Revenue Services (IT 13065/13) it was suggested that an arrangement could be genuine but still vulnerable to a substance over form challenge. This finding has been extremely controversial as it represents a radical departure from very long-established doctrine of what constitutes a simulated transaction. It is anticipated that it is likely to be overturned on appeal.

TAX AVOIDANCE PENALTIES
Civil and administrative penalties for abusive tax avoidance

25. What civil and administrative penalties can be imposed in abusive tax avoidance cases in your jurisdiction?

There is an understatement penalty regime contained in the Tax Administration Act 2011, which provides a structured approach of taxpayer behaviour categories when imposing penalties. The highest penalties imposed under this regime are:

- For a “standard case” of intentional tax evasion, 150% of the tax due.
- For an “obstructive” or “repeat case”, 200% of the tax due.

An amendment to the tax law in 2016 introduced “impermissible avoidance arrangement” (which includes an arrangement dealt with in terms of sections 80A to 80L of the Income Tax Act 1962) as a new category of behaviour subject to understatement penalties. Understatement penalties imposed under this category are charged at:

- For a standard case, 75% of the tax due.
- For an obstructive or repeat case, 100% of the tax due.

This new provision came into effect on 1 March 2017.

Criminal penalties for abusive tax avoidance

26. What criminal penalties can be imposed in abusive tax avoidance cases in your jurisdiction?

Section 235 of the Tax Administration Act 2011 (TAA) provides that it is a criminal offence for a person, with the intent to evade tax or assist another person to evade tax or obtain an undue refund, to:

- Make a false statement in a return or document, or sign a return or document containing a false statement, without reasonable grounds for believing the statement to be true.
- Give a false answer to a request for information from the South African Revenue Service (SARS).
• Prepare, maintain or authorise the preparation or maintenance of false books of account or other records, or falsify or authorise the falsification of books of account or other records.
• Make use of, or authorise the use of, fraud or contrivance.
• Make any false statement for the purpose of obtaining any refund of, or exemption from, tax.

A senior SARS official can lay a complaint with the South African Police Service or the National Prosecuting Authority regarding an offence under section 235 of the TAA. If prosecuted and convicted, a person may be fined, or imprisoned for a period not exceeding five years.

**TAX AVOIDANCE DEVELOPMENTS AND REFORM**

27. Are there any current trends, developments or reform proposals that have or will affect the area of tax avoidance in your jurisdiction?

South Africa, like many other countries, faces the problem of some taxpayers hoping to exploit gaps in international tax rules to artificially shift profits and avoid paying tax. To combat these avoidance measures, the South African government is likely to continue to propose amendments to improve transfer-pricing documentation and reporting.

South Africa already has a variety of sophisticated anti-avoidance measures in its legislation. There are no tax avoidance measures recommended by the OECD which are not already found in some form in South African tax legislation. In addition, the Davis Tax Committee’s final report on BEPS provided recommendations to the Minister of Finance on how South Africa can incorporate the OECD’s minimum standards, best practice guidelines, and international standards on BEPS into its international tax framework. The report addresses each of the 15 BEPS action plan items and provides concrete next steps accounting for South African international tax policy. An ongoing review of these measures and their scope and impact is very likely, given the South African Revenue Authority’s ongoing need to meet its fiscal targets, the continued work of the Davis Tax Committee and the adoption by South Africa of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting.

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**THE REGULATORY AUTHORITIES**

**South African Revenue Service (SARS), general**
T +27 11 602 2093 or 0800 00 7277 (inside South Africa) F (Check regional numbers) E (Check regional contact centres)
W www.sars.gov.za

**South African Revenue Service (SARS), head office**
T +27 12 422 4000 W www.sars.gov.za Outline structure. SARS is South Africa's tax collecting authority. Established in terms of the South African Revenue Service Act 34 of 1997 as an autonomous agency, it is responsible for administering the South African tax system and customs service.
Responsibilities. Tax administration and revenue collection.
Procedure for obtaining documents. Please refer to website.

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**ONLINE RESOURCES**

**Davis Tax Committee**
W www.taxcom.org.za/ Description. Government-appointed committee with the objective to assess South Africa’s tax policy framework and its role in supporting the objectives of inclusive growth, employment, development and fiscal sustainability.
**Practical Law Contributor profiles**

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