Transfer pricing – Consequence of year end adjustments

As all multinational groups of companies should be aware transfer pricing is a significant tax issue when operating cross border in multiple tax jurisdictions.

Transfer pricing legislation exists in most established tax regimes and is becoming more and more prevalent in countries previously considered less tax sophisticated.

In the context of South Africa, transfer pricing legislation has been present in the Income Tax Act, 1962 (the Act) for a number of years and was significantly revised in 2012 to better align with the Transfer Pricing Guidelines issued by The Organisation for Economic Cooperation and Development (OECD).

The transfer pricing legislation is set out in section 31 of the Act and is aimed specifically at cross border transactions. The principles set out in section 31 require that the terms and conditions of any cross border transaction, between connected persons as defined, must be conducted as if these transactions were between independent persons dealing at arm's length.

This principle, on the face of it, would appear to be a simple one to apply, but when considering cross border transactions between connected group companies, this is often not the case.

The South African Revenue Service (SARS) has over the past

number of years developed a transfer pricing division, which although still relatively small, is highly skilled. SARS has made it clear that non-compliance in this area of tax law is one which they are looking to target.

International groups very often apply transactional profits methods, as set out by the OECD, when applying their transfer pricing policies.

Often the effect of the application of these methods is that as a group, late transfer pricing adjustments are raised to ensure that the profits of individual group companies fit within certain defined profit levels which have been set out in the group's transfer pricing policies.

Although these methods are recognised by the OECD, what very often is overlooked by companies are the potential impacts of these late transfer pricing adjustments on customs duties and import value-added taxation (VAT).

When companies import product into South Africa, this product goes through a customs clearing process which involves the determination of customs duty payable and a deemed VAT amount which must be paid by the importer of record before the product can clear through customs.

These values are generally based on the invoice value as issued by the supplier of the product.

If these values are subsequently adjusted, in the form of year end transfer pricing adjustments, this would indicate that both customs and VAT have been determined and paid on the incorrect values attributable to the product concerned.
By raising these late transfer pricing adjustments companies are not only exposing themselves to additional customs duties and VAT but also to potential penalties and interest as a result of underpaying taxes due.

With the on-going additional disclosures being required in

corporate taxation returns and the improving ability of SARS to assimilate and analyse this information, international groups should avoid late transfer pricing adjustments, particularly where these affect the values of products which have already been supplied.

Any late transfer pricing adjustments should clearly be disclosed to SARS.

RSMSA
ITA: section 31
OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations