Transfer Pricing – Income Tax Act 58 of 1962 Section 31 further analysis

The provisions of Section 31 of the Income Tax Act No. 58 1962 (the Act) have been revised. Section 31 was introduced in 1995 to grant the Commissioner power to adjust tax calculations where a taxpayer was involved in cross-border transactions not at arm’s length. The old section 31 provided that the Commissioner could adjust the consideration in respect of the transaction to reflect an arm’s length price for the goods or services. This meant that taxpayers were not obliged to make the adjustments on their tax returns for transactions even if such transactions were not conducted on an arm’s length basis. Taxpayers could therefore file tax returns with excessive deductions, and then sit and wait and hope for the best – which would be that the Commissioner did not pick up these excessive deductions.

It has long been acknowledged by international bodies such as the OECD that transfer pricing is a complex technical issue and that it requires highly trained staff and specialist skills. In order to deal with these inherent complexities the UK Tax Administration has made use of various specialists such as industry experts, specialist economists and the UK’s Government Actuary Department. In South Africa, however, while external experts have been used to support the preparation of transfer pricing cases and give evidence in court, SARS has also found that industry experts can sometimes be reluctant to assist tax authorities, especially if these experts are anticipating other work elsewhere in their area of expertise.

It, therefore, did not come as a surprise that National Treasury decided to amend Section 31 of the Act. The amended section applies to all years of assessment commencing on or
after 1 April 2012. Section 31 now requires taxpayers to determine whether the terms and conditions of any transaction meeting part (a) of the definition of an “affected transaction” differ from the terms and conditions that would have existed should the parties have been independent persons dealing at arm’s length. Should a difference occur or a tax benefit result to one of the parties, the taxpayer is required to calculate their taxable income based on the arm’s length terms and conditions of the affected transaction.

With the amendment to Section 31, the costs of hiring experts to benchmark the terms and conditions of the affected transaction are borne by the taxpayer.

To ensure that the Tax Authorities have the necessary expertise to audit transfer pricing transactions, SARS recently acquired the expertise of a senior transfer pricing specialist from the UK. Seconded by HMRC, he has assisted in identifying a range of transfer pricing products to build transfer pricing capability in the African Tax Administration Forum (ATAF) member countries.

ATAF has made it clear that they intend to develop a register of resources and that this will involve countries with expertise in a particular aspect of transfer pricing agreeing to offer in-depth support to other partner countries in the developing world. As South Africa is part of ATAF, it is clear that when it comes to transfer pricing it is not business as usual.

Taxpayers that are part of or have relationships with multi-national companies can expect additional audits from SARS despite having been audited in the past. With all the powers that have been afforded to SARS now, thanks to the Tax Administration Act No. 28 of 2011, taxpayers who have transactions that are not deemed to be at arm’s length could be exposed to the risk of tax penalties and interest.
Taxpayers will now have to be pro-active and re-look at their cross-border transactions with multi-national companies. For those that have not yet been exposed, there is scope for voluntary disclosure and the waiver of penalties and interest. Once caught and exposed it could be too late! It remains to be seen as to how many will be prepared to take this risk.

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