The Department of Trade and Industry has raised the possibility of, amongst others, providing for the (optional) inclusion of stakeholder representation on the board of directors, and increasing creditors and employees’ access to information, particularly to policies and decisions that will affect their interests (see J Pretorius ‘The Future of South African Company Law?’ (2004) 12 The Quarterly Law Review for People in Business 70).

4 Conclusion

Government has the right to create legislative compulsion for transformation to take place in the South African economy as a result of it being the franchisor of companies and of it providing the institutional infrastructure necessary for companies to be brought into existence. Further, as Government is one of the stakeholders in companies, it has the right to exert its influence over the affairs of companies as do the other stakeholders. One of the means by which Government seeks to exercise this right is through the use of legislation.

Resolving Transfer-pricing Disputes: Are ‘Advance Pricing Agreements’ the Way Forward for South Africa?

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1 Introduction and Statement of the Problem

Adam Smith in his famous work The Wealth of Nations (1776) pointed out that the subjects of every state ought to contribute towards the support of the government in proportion to the revenue which they respectively enjoy under the protection of the state. However, the tax (contribution) which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment and the amount to be paid, ought to be clear and plain to the contributor (see AS Silke Tax Avoidance and Tax Evasion within the Framework of the South African Income Tax Legislation with specific reference to the Effect on the Fiscus and to Current Anomalies and Inequalities (1958) at 561; Keith Huxham & Phillip Haupt Notes on South African Income Tax (2005) at 2). This is necessary so that the taxpayer knows the tax consequences of any given transaction in advance. Tax planning and budgeting would be an impossibility if the parameters within which the Fiscus operates were not clearly defined.

Tax certainty is a principle that is upheld in South African tax legislation. The degree of certainty required is achieved by formulating rules which clearly indicate the methods and manner in which tax is to be collected by South

When uncertainties and disputes arise between a taxpayer and SARS about the tax consequences of a given transaction, SARS responds by providing its views on the issue or by issuing a specific ruling that relates to the specific set of circumstances. However, SARS views and rulings do not have any statutory basis and are not binding on either SARS or taxpayers (SARS Discussion Paper on a Proposed System for Advance Tax Rulings (2003) at 4). When taxpayers approach SARS for guidance on the interpretation of a specific provision of the Income Tax Act 58 of 1962 (‘the Act’), SARS responds by developing and formulating interpretation notes, guides and brochures (SARS Discussion Paper op cit at 4). SARS has also come up with practice notes that are helpful in resolving disputes. Unfortunately, SARS practice notes are not law and this limits their application as authority in a court of law.

One of the areas of our tax legislation that has been lacking in certainty and for which SARS has formulated a practice note, is ‘transfer pricing’, a concept employed to describe a method used by taxpayers to avoid paying the taxes of a given country. In order to prevent transfer pricing, most countries, including South Africa, use the arm’s-length principle to curb the depletion of their tax base. Internationally, the application of this principle entails making use of certain methods so as to arrive at an arm’s-length price. In South Africa, the working of these methods is set out in SARS Practice Note 7: Determination of Taxable Income of Certain Persons from International Taxation: Transfer Pricing (6 Aug 1999). Despite this Practice Note, choosing the right method to apply in a given situation does not always give satisfactory results. This often causes uncertainties for taxpayers about the tax consequences of their business transactions and often disputes arise between SARS and the taxpayers concerned.

In order to ensure certainty for taxpayers in applying the methods used to arrive at an arm’s-length price, jurisdictions such as the United Kingdom and the United States of America, make use of ‘Advance Pricing Agreements’ (‘APAs’) that have proved helpful in resolving transfer-pricing disputes. However, APAs are not in use in South Africa and SARS has declared that APAs will not be made available to South African taxpayers in the foreseeable future but gave no reasons for this stance (SARS Practice Note 7 op cit in par 6.2; see also David Clegg *Income Tax in South Africa* (May 2005) in par 24.12.1; Lynette Olivier, Emil Brincker & Michael Honiball *International Tax: A South African Perspective* 2 ed (2004) at 245).

In this analysis, transfer pricing is defined and the reasons why disputes arise in the application of the arm’s-length method are set out. Considerations for and against the introduction of APAs in South Africa are analysed and recommendations made for SARS to reconsider its stance on the introduction of APAs in South Africa.
2 ‘Transfer pricing’ Defined

Transfer pricing is a term employed to describe the means by which related or connected entities, such as subsidiaries in a multinational group of companies, manipulate the prices at which they transfer goods or services between each other. Transfer pricing is also described as the systematic manipulation of prices in order to reduce or increase profits artificially or to cause losses and avoid taxes in a specific country (see The Second Interim Report of the Commission of Inquiry into Certain Tax Structures of South Africa: Thin Capitalisation Rules (1995) in par 1.3b; see also Brian J Arnold & Michael J McIntyre International Tax Primer (2002) at 53; Nathan Boldman ‘International Tax Avoidance’ (1981) 35 Bulletin for International Fiscal Documentation 443; Allan Stoud & Collin Masters Transfer Pricing (1991) at 10; Julian Ware & Paul Roper Offshore Insight (2001) at 178).


3 Curbing Transfer Pricing

In South Africa, transfer pricing is countered by making use of the arm’s-length principle which is set out in s 31(2) of the Income Tax Act. This provides that

‘where any goods or services are supplied or acquired in terms of an international agreement and the acquirer is a connected person in relation to the supplier; whereby goods or services are supplied or acquired at a price which is either less than the price which such goods or services might have been expected to fetch if the parties to the transactions had been independent persons dealing at arm’s length (such price being the arm’s length price); or greater than the arm’s length price, then for purposes of this act in relation to either the acquirer or supplier, the commissioner may, in the determination of the taxable income of either the acquirer or suppliers, adjust the consideration in respect of the transaction to reflect an arm’s length price for the goods or services.’

Basically, the section permits the Commissioner of SARS to adjust the consideration for goods or services supplied in terms of an international agreement if the actual price paid is either more or less than the price – the arm’s-length price – that would have been paid on the open market under conditions which would have existed between unconnected persons in
comparable circumstances (see SARS Practice Note 7 op cit in par 2.7; see also Susan C Borkowski ‘Transfer Pricing Documentation and Penalties: How Much is Enough?’ (2003) 26 International Tax J at 3; Van Blerck op cit at 45).

The wording of this section falls in line with the international practice of curbing transfer pricing. For instance, art 9 of the OECD Model Tax Convention provides that when conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

4 Determining an Arm’s-length Price

Determining an arm’s-length price is not easy. Often disputes arise between taxpayers and SARS over the determination of such price. To resolve these disputes, SARS applies certain methods set out in its Practice Note 7. These methods are applied internationally and are recognised by OECD Guidelines (see SARS Practice Note 7 op cit in par 9.1.2-3; see also Report of the OECD Committee on Fiscal Affairs ‘Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators’ Sept 1994 Intertax in par 86; Alwyn de Koker Silke on South African Income Tax vol 3 (2003) at 17.59).

The methods are divided into two categories. First there are the traditional transactional methods which include the comparable uncontrolled-price method, the resale-price method and the cost-price method. Then there are the profit-based methods which include the transactional net-margin method and the profit-split method (see OECD ‘Transfer Pricing Guidelines’ op cit in par 87; see also Jon E Bischel & Robert Feinschreiber Fundamentals of International Taxation 2 ed (1985) at 231). The operation of these methods is described briefly below and the reasons why disputes arise in their application are also set out.

5 Methods Employed to Arrive at an Arm’s-length Price and the Difficulties in Their Application

Under the ‘comparable uncontrolled-price’ method, a direct comparison is drawn between the price charged for a specific product in a controlled transaction and the price charged for a closely comparable product in an uncontrolled transaction where the circumstances are comparable (see OECD ‘Transfer Pricing Guidelines’ op cit in par 92; see also Guillermo Campos ‘Transfer Pricing of Major Trading Nations May (1996) 50 Bulletin for International Fiscal Documentation 217). The ‘comparable uncontrolled price’ is the most preferred method because it is the most direct and reliable way to apply the arm’s-length principle (Hay, Horner & Owens op cit at 432 in par 64).

However, the problem with this method is that it depends on finding a
transaction between independent enterprises which is similar to a controlled transaction and has no differences that could have a material effect on the final price. This is not possible in normal business transactions as usually there are differences in aspects such as the quantity and quality of the products sold or in the market levels, and in the amounts and types of intangible property involved. Disputes that arise in the application of this method are sometimes resolved by making reasonable adjustments between controlled and uncontrolled transactions (see OECD ‘Transfer Pricing Guidelines’ op cit in par 94; see also Hay, Horner & Owens op cit at 432 in par 65; SARS Practice Note 7 op cit in par 9.4.2; Miesel, Higinbotham & Chun op cit at 6).

In situations where comparable transactions may not be easily found, the ‘resale-price’ method is used. This method considers the price at which a product which has been purchased from a connected enterprise is resold to an independent enterprise. The resale price is then reduced by an appropriate gross margin that covers the reseller’s operating costs so as to provide an appropriate profit, having taken into consideration the functions performed, assets used and risks assumed by the reseller. The balance is then regarded as the arm’s-length price. The resale-price method is most appropriate where the reseller does not add significant value to the product (see SARS Practice Note 7 op cit in par 9.5.1; see also Campos op cit at 217; Hay, Horner & Owens op cit at 432 in par 66; OECD ‘Transfer Pricing Guidelines’ op cit at 340 in par 107; Miesel, Higinbotham & Chun op cit at 9).

The problem with the resale-price method is that it depends on the ability to compare the cost structure and functions performed by the enterprises involved. However, in real life, these usually differ from enterprise to enterprise. To resolve any disputes that might occur, adjustments have to be made to ensure that the same type of costs are compared (see OECD ‘Transfer Pricing Guidelines’ op cit in par 107; SARS Practice Note 7 op cit in par 9.5.1-3).

Then there is the ‘cost-plus’ method which requires an estimation of an arm’s-length price by adding an appropriate mark-up to the costs incurred by the supplier of goods or services in a controlled transaction. The mark-up would, for instance, cover an appropriate profit of the supplier, in the light of the functions performed, assets employed and risks assumed. This method is most suitable when services are provided or where semi-finished goods are sold between connected parties that have concluded long-term buy and supply arrangements. The mark-up is determined by comparing it to the mark-up earned by a similar independent supplier in an uncontrolled transaction that bears similar risks and employs similar assets to those of the taxpayer (see OECD ‘Transfer Pricing Guidelines’ op cit at 343 in par 119; SARS Practice Note 7 op cit in par 9.6.3).

The problem with the cost-plus method is that, like the resale-price method, it also depends on the similarity of the functions performed by and the cost structure of the entities being compared. However, there may be circumstances where there is no discernable link between the level of costs incurred and the market price. To prevent any disputes that might arise, appropriate adjustments
have to be made to ensure that the same types of costs are included for the comparison (see SARS Practice Note 7 op cit in par 9.6.3; OECD ‘Transfer Pricing Guidelines’ op cit at 343 in par 119).

Since the above transaction-based methods are influenced by the characteristics of particular transactions (eg, the functions performed, cost structures, assets employed and risks assumed), the OECD developed other profit-based methods that are supposedly less adversely affected by the characteristics of the transactions concerned. These are the ‘transactional net-margin method’ and the ‘profit-split’ method.

Under the ‘transactional net-margin method’, the net profit margin that a taxpayer realises from a controlled transaction is examined relative to an appropriate base of, for example, costs, sales or assets. A profit-level indicator of an enterprise in a controlled transaction is then determined and this is then compared to the profit-level indicators of comparable independent parties (see SARS Practice Note 7 op cit in par 9.7.1; see also Campos op cit at 218). The problem of relying on this method is that the controlled enterprise and the uncontrolled enterprise involved in the comparison would need to be structurally similar, which is not usually the case in practice. Often, the net margin of a taxpayer can be affected by other factors that do not necessarily have an influence on price or gross margins (SARS Practice Note 7 op cit in par 9.7.2.).

Under the ‘profit-split’ method, the combined profit of the connected parties is split between them. This is achieved by approximating the profit that would have been anticipated had agreement been made at arm’s length. This method is usually applied where transactions are so interrelated that they cannot be evaluated separately. The practical problem in applying this method is that it relies on the ability to access world-wide group data, which may be difficult to obtain (see SARS Practice Note 7 op cit in par 9.8.1-3; OECD ‘Transfer Pricing Guidelines’ op cit at 346 in par 131; see also Campos op cit at 217; Hay, Horner & Owens op cit at 435 in par 82).

In general, all the methods that may be employed to arrive at an arm’s-length price are based on measuring a multinational enterprise’s pricing strategies against a benchmark of the pricing strategies of independent entities in uncontrolled transactions. The most appropriate of these methods is used depending on the facts and circumstances of each case and the availability of reliable information (SARS Practice Note 7 op cit at 14 in par 9.2.1-3). In applying any of these methods, a four-step approach developed by the Australian Tax Office is applied by SARS (see Annexure A of SARS Practice Note 7). This approach requires, firstly, an understanding of the cross-border dealings between connected persons in the context of the taxpayer’s business and then assessing the risk; secondly, selecting the appropriate transfer-pricing method; thirdly, applying the selected method; and finally calculating the arm’s-length price in accordance with the selected method.

Generally all the methods are based on the concept of comparing the prices and margins achieved by connected persons in their dealings, to those achieved
by independent entities for the same or similar dealings. The problem with this is that for such comparisons to be useful, the economically relevant characteristics of the situations being compared must in fact be highly comparable. As observed earlier, this is not always possible in normal business transactions. Usually comparable adjustments can be made for objective differences in the functions performed or in contractual obligations, but this is not easy when it comes to differences in the efficiency or effectiveness of these functions. Also, in unique situations involving intangibles, it is not practical to apply methods based on a high degree of comparability (see Miesel, Higinbotham & Chun op cit at 6; SARS Practice Note 7 op cit in par 8.1.1-6; OECD ‘Transfer Pricing Guidelines’ op cit at 326).

The other problem of applying the various methods is that they require that use be made of the ‘separate-entity’ approach in order to arrive at a comparable price. However, connected parties (e.g., multinational group of companies) are integrated enterprises dealing in highly specialised goods, in intangibles, and in the provision of specialised services. It is through integration that such enterprises achieve economies of scale in aspects such as transaction costs, risk management, brand development, and logistics. These measures of integration cannot be duplicated in the context of independent transactions conducted by two non-integrated businesses performing the same or similar functions and selling the same or similar products. Thus, applying the arm’s-length standard by breaking a multinational into separate parts generally produces a number of problems depending on the level of integration (see OECD ‘Transfer Pricing Guidelines’ op cit at 324 in par 26; Miesel, Higinbotham & Chun op cit at 2; Hay, Horner & Owens op cit at 428 in par 36).

The directions for applying the above methods that are given by SARS in Practice Note 7 have been criticised as a cause of disputes as they deviate from the OECD Guidelines. It is contended that according to the SARS Guidelines, when applying all the transfer-pricing methods (except the ‘comparable uncontrolled-price’ method) a range of arm’s-length transfer prices have to be considered; SARS elects the mid-point in the range of those prices as the arm’s-length price (see Olivier, Brincker & Honiball op cit at 240). The problem with this approach is that determining where within that range the relevant price falls, depends solely on the facts and circumstances of the particular case. This may result in SARS electing the mid-point range in the absence of persuasive evidence for the selection of a particular point in that range. Choosing a mid-point in this way is contradictory to the arm’s-length principle (see Olivier, Brincker & Honiball op cit at 240).

Another controversy surrounding Practice Note 7 is that SARS recommends that taxpayers should arrive at arm’s-length prices by applying more than one method. This conveys the notion that to convince the Commissioner that transfer prices are set at arm’s length, a taxpayer’s pricing practices may be more credible if they are supported by more than one method. According to the OECD Guidelines, applying more than one method creates undue burdens on the taxpayers. The OECD recommends that the use of multiple methods
is only required in the event of very complex transactions and so the use of multiple methods should be considered the exception rather than the rule (see Olivier, Brincker & Honiball op cit at 240). SARS Practice Note 7 recognises the importance of the OECD Guidelines on transfer pricing and states that they should be followed in the absence of specific guidelines to the contrary in s 31 or in any double-taxation agreement entered into by South Africa.

The difficulty of applying SARS Practice Notes is that they are not law. Practice Note 7 specifically states in par 3.1 that it was drafted as a practical guide and is not intended to be prescriptive or exhaustive. In terms of s 108 of the Income Tax Act, read together with s 232 of the Constitution of South Africa, 1996, when a double-taxation agreement is concluded and published in the Government Gazette, it becomes part of the law of South Africa. That implies that international principles applied in such an agreement that may comply with the OECD Guidelines will be in conflict with SARS Practice Note 7. This conflict is bound to cause disputes between taxpayers and SARS as the former will be uncertain as to which of the two views they should rely on.

Disputes between taxpayers and tax authorities are further augmented by the fact that applying the above methods places an administrative burden on taxpayers who are required to submit various documents required by SARS. Failure to maintain pertinent documentation that stand the scrutiny of the tax administrators may cause disputes with the tax authorities. Often taxpayers fail to comply with SARS requirements due to the difficulties of having to obtain adequate information to evaluate uncontrolled transactions and to compare them to the business activities of controlled transactions. Sometimes the information that is accessible may be incomplete and difficult to interpret; some information may not be easily obtainable because of confidentiality concerns, geographical reasons; or it may simply not exist (see SARS Practice Note 7 op cit in par 10.3 read in conjunction with SARS form IT 14 Corporate Income Tax Return (2001); OECD ‘Transfer Pricing Guidelines’ op cit at 325 in pars 28-9).

6 The International Response to the Difficulties of Applying the Arm’s-length Principle

Although on the whole the arm’s-length principle and the methods used to arrive at an arm’s-length price have been found to work effectively in many cases, there are a number of significant cases in which it is difficult and complicated to come up with satisfactory results that are acceptable to both taxpayers and their taxing authorities. Member countries of the OECD are of the view that despite these problems, the arm’s-length principle is sound in theory since it provides the closest approximation of the workings of the open market in cases where goods and services are transferred between associated enterprises (OECD ‘Transfer Pricing Guidelines’ op cit at 325 in pars 30-1; see also Hay, Horner & Owens op cit at 428 in par 38).

Even if the arm’s-length principle may not be straightforward to apply
in practice, it generally produces appropriate results acceptable to tax administrators. A move away from this principle would destabilise international consensus and substantially increase the risk of double taxation. Many countries that apply the principle have now gathered experience that has produced a level of understanding among the business community and tax administrators. This shared understanding is of great practical value in achieving the objectives of securing the appropriate tax base in each jurisdiction. The OECD is thus of the view that this experience should be drawn on to elaborate the arm’s-length principle further, to refine its operations, and to improve it so as to be able to stand the challenges faced in international trade (OECD ‘Transfer Pricing Guidelines’ op cit at 325 in pars 30-1).

In an endeavor to resolve transfer-pricing disputes and uncertainties, a number of countries (mentioned below) have introduced ‘advance pricing agreements’ (defined below) as a means of enhancing the effectiveness of the methods that are employed to arrive at an arm’s-length price.

7 ‘Advance Pricing Agreements’ Defined

An ‘advance pricing agreement’ (‘APA’) is a binding, written contract between a taxpayer and the revenue authority. Sometimes a foreign revenue authority may be included as a party to the agreement. In that case it is referred to as a bilateral APA and may be used in curbing double taxation of income (see Marc M Levey, Steve C Wrappe & Kerwin Chung ‘The Future of Transfer-Pricing Disputes: All Roads Lead to Competent Authority’ (1998) 27 Tax Management International J 379; see also Yitzhak Hadari ‘Resolution of International Transfer-Pricing Disputes’ (1998) 46 Canadian Tax J 47).

In an APA the parties agree on the best transfer-pricing method for determining the arm’s-length price. According to par 234 of the OECD ‘Transfer Pricing Guidelines’, APAs open up a possibility for enterprises to obtain approval in advance by the tax authorities of the pricing method to be applied in controlled transactions (see H Sugishita ‘Comments Concerning the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators’ Jul 1995 Intertax 299; Chris Rolfe & Andrew Casley ‘Towards Reconciliation in Transfer Pricing’ 1996 Corporate Finance 37).

Apart from agreeing on the best pricing method, the taxpayer and the tax authority could also agree on other pricing principles based on an appropriate set of criteria. Such criteria could include an agreement on how to come up with an arm’s-length range of results, comparable and appropriate adjustments, and the proper application of the chosen arm’s-length method to the taxpayer’s particular facts and circumstances (see Sven-Olof Lodin ‘Is the American Approach Fair? – Some Critical Views on the Transfer Pricing Issues’ May 1995 Intertax 243; Thomas C Pearson & Dennis R Schmidt ‘Transfer Pricing Tax Concerns for Global Financial Companies’ (1998) 76 Taxes at 25).

For an APA to be concluded, a taxpayer would have to disclose to the tax authorities fully all the facts of the relevant business or industry it is involved in and the relevant tax authorities have a duty not to disclose the trade secrets
of the taxpayer concerned (Olivier, Brincker & Honiball op cit at 245). Once an APA is finalised and executed by the parties, it satisfies the arm’s-length standard provided the taxpayer complies with its terms. The duration of an APA is for a fixed number of years, usually from three to five years, and is renewable. An APA may sometimes be retrospective, especially where the negotiation process has been lengthy (see Levey, Wrappe & Chung op cit at 3).

8 Advantages of Using APAs and Examples of their Use in Other Jurisdictions

The use of the APA ensures transfer-pricing certainty and prevents the taxpayer having to incur penalties where the requirements of the relevant tax authority have not been complied with. As stated above, certainty is one of the canons of a good tax system as it ensures that tax rules are clear and simple so that businesses can anticipate the tax consequences of the transactions they enter into (see Hammond Suddards e-Commerce: A Guide to the Law of Electronic Business (1999) at 256). In the case of transfer pricing, APAs are one of the means that can be used to ensure certainty.

Apart from the certainty that APAs bring, APAs also help to accelerate the procedure of arriving at arm’s-length prices as long drawn-out audits, queries and controversies which often result in extremely expensive transfer-pricing disputes, can be avoided (Federal Tax Conference Discussion Paper ‘The Real World of Transfer Pricing Today’ (1999) 77 Taxes 175; see also Hadari op cit at 45; Olivier, Brincker & Honiball op cit at 245).

APAs were first introduced in the United States of America in 1991. After their initial success, bilateral and multilateral APAs were implemented with America’s major trading partners in 1994. APAs are now quite popular in nations such as the United Kingdom, Australia, Canada, Germany, Japan, Spain, Korea and New Zealand, where a considerable number of taxpayers are participating in APAs more frequently (Federal Tax Conference Paper op cit at 175; see also Lodin op cit at 243; Rolfe & Casley op cit at 37; Campos op cit at 214; Deloris R Wright ‘Transfer Pricing in the United States: Recent Events and Expectations for the Future’ (2001) 55 Bulletin for International Fiscal Documentation 421; Helmut Becker ‘The Future of Transfer Pricing’ (1996) 50 Bulletin for International Fiscal Documentation 536; Klaus Vogel Interpretation of Tax Law and Treaties and Transfer Pricing in Japan and Germany (1998) at 205-20).

In the United Kingdom, APAs have been given statutory force and the tax administration has statutory power to enter into APAs in order to resolve transfer-pricing issues and disputes. Guidance on APA procedures is set out in the United Kingdom Inland Revenue Statement of Practice. The Inland Revenue Guidance Notes on procedures for bilateral APAs draw on the experience of concluding APAs with treaty partners. For instance, the United Kingdom APA procedures are very similar to those applied in America (see generally ss 85-87 of the UK Finance Act 1999 (c 16); UK Inland Revenue Advance Pricing Agreements SP 3/99 (31 Aug 1999); see also Hugh J Ault

It has been observed that the major reason why the number of countries offering APAs has increased, particularly among OECD member countries, is that less manpower is generally required on the part of the tax authorities in negotiating and monitoring the compliance with an APA than conducting a fully-fledged audit of a transfer-pricing issue. This has allowed tax authorities to better utilise their scarce resources in other areas of tax administration (see Campos op cit at 214).

9 Criticisms against the Use of APAs

Although APAs are now widely used internationally, they have been criticised for not providing the answer to resolving all transfer-pricing problems faced by all taxpayers. It has been observed that APAs are advantageous in accelerating the dispute-resolution process if the taxpayer’s transfer-pricing issues are already subject to re-examination by the revenue authorities. For a taxpayer who still stands a good chance of avoiding transfer-pricing examination in the absence of an APA, the APA may not be necessary. It is thus argued that an APA is justified only if there is a special need for certainty and the taxpayer seeks an APA in order to resolve what has proved to be a particularly difficult issue (see the Federal Tax Conference Paper op cit at 175).

It has also been argued that introducing APAs is not magically going to make difficult issues go away. APA negotiations can be quite contentious just as any negotiations in which issues are difficult and participants have very different interests. APAs have also been regarded to be most useful when they involve relatively straight-forward issues like those involving tangible property, services and routine intangibles, but not so helpful in resolving difficult issues like those involving high value intangibles (ibid).

The other criticism against APAs is that unless they are given statutory power, as in the United Kingdom, the agreement itself is beyond the control of the courts and cannot be legally objected to. The APA is a negotiation process and not a ruling procedure. APAs are often developed in private negotiations with a limited number of enterprises. This may have the negative effect of affecting subsequent parties that had no opportunity to gain insight into the process so as influence the guiding agreement. An even more serious problem is that the APA procedure may result in tax considerations rather than business reasons influencing transfer-pricing principles. This is because the advantages of getting APA may overshadow the advantages of basing transactions on purely business reasons (see Lodin op cit at 243).

Paragraph 235 of the OECD ‘Transfer Pricing Guidelines’ suggests that in general great care must be taken if the APA goes beyond the setting of the most appropriate methodology. This is because in an APA, the specific conclusions that may be arrived at often rely on predictions about future events. The reliability of a prediction depends on the critical assumptions on which it is
based and these may differ from the facts and circumstances in each actual case. The OECD suggests that it is better to rely on the appropriateness of a method rather than on unpredictable and unreliable future events (Shugishita op cit at 107; see also Frances M Horner ‘International Co-operation and Understanding: What’s New about the OECD’s Transfer Pricing Guidelines’ (1996) 50 University of Miami LR 593).

Since APAs are entered into for a fixed number of years, it has been argued that this may be disadvantageous to the taxpayer if the period is too long. The reason is that in the course of time the taxpayer may lose flexibility in making business decisions (Vogel op cit at 215). APAs have also been criticised for being complex to apply and for requiring the employment of specialised personnel. For this reason, in emerging markets, APAs are likely to be adopted at a much slower pace since it is difficult and costly to hire and retain specialised professionals (see the Federal Tax Conference Paper op cit at 175; see also Hadari op cit at 176-7; Campos op cit at 214). For instance, it has been observed that the unavailability of APAs in South Africa is presumably because of a lack of administrative capacity within SARS (see Olivier, Brincker & Honiball op cit at 245).

10 SARS Position in respect of the Introduction of APAs in South Africa

As observed earlier, APAs are not employed in South Africa and SARS provides no reasons why they are not availed to South African taxpayers. However, it is worth observing that the Minister of Finance announced in the 2003 Budget Review that SARS was actively reviewing the possibility of introducing an advance tax-ruling system which would give certainty to taxpayers about the tax treatment of their business transactions. In 2003, SARS released a Discussion Paper on advance tax rulings with the hope of providing a process of consultation between SARS, taxpayers and various stakeholders with an opportunity to comment on the design of a system that ensures tax certainty before the actual legislation is introduced (SARS Discussion Paper op cit at 4). An advance tax-ruling system would not only ensure certainty but would also promote self-assessment and good relations between tax authorities and taxpayers, ensure greater consistency in the application of the law, minimize controversy and litigation, and also achieve a more coordinated system (ibid).

In conformity with the SARS Discussion Paper, the Explanatory Memorandum of the Second Revenue Laws Amendment Bill 25 of 2004 set out a structure of the types of ruling that would be covered. As a result, s 12 of the Second Revenue Laws Amendment Act 34 of 2004 was enacted. It inserted Part IA in Chapter III of the Income Tax Act. Section 76 of this Act sets out the details of the working of the advance tax rulings. However, it is worth observing that s 76G(1)(a)(iii) specifically provides that the Commissioner of SARS may not accept any application from a taxpayer for an advance tax ruling in respect to the pricing of goods or services supplied by or rendered to
a connected person in relation to the applicant or to a class member in the case of an application for a binding class ruling. This in essence rules out any form of advance tax ruling (such as APAs) in respect of transfer pricing.

11 Recommendations and Concluding Remarks

Despite the fact that it appears that South African legislation does not provide for APAs, the certainty that APAs could offer taxpayers and tax authorities cannot be underestimated (see Rolfe & Casley op cit at 39). Although SARS gives no reasons why they are not available to South African taxpayers, it may be assumed that the reasons are in part based on the criticisms against APAs pointed out earlier. In this author’s view, the advantages of APAs outweigh the criticisms and although APAs may not resolve all transfer-pricing problems, in some situations they might be the most feasible approach to resolving transfer-pricing disputes.

It is recommended that SARS should not indefinitely postpone the introduction of APAs in South Africa on account of its alleged administrative incapacity to deal with them. Rather, South Africa should consider investing in training personnel to learn how the APA process works. This will require SARS to recruit a team with specialised tax expertise and skills. To ensure proper delivery of service, it is suggested that APAs should be introduced on a limited scale initially to cater for situations involving relatively straightforward issues such as those involving tangible property, services and routine intangibles. As administrative capacity builds up, APAs may be employed to deal with more complex situations. In the long run, the training of personnel would save on administrative costs since the time spent on transfer-pricing procedures and the numerous queries and controversies will be shortened as personnel will only have to deal with those controversial disputes for which APAs are not used. This will further help in promoting taxpayer confidence in the administration of the tax system and also foster a good working relationship between taxpayers and tax authorities (see the SARS Discussion Paper op cit at 20).

There is clear evidence of the success of APAs elsewhere. In America, for instance, it has been remarked that the APA process is maturing, that the time required to complete an APA is shorter than ever before, and that the APA office is growing and gaining knowledge and experience needed to make the process more efficient (see Wright op cit at 442). If APAs are introduced in South Africa, we shall have the advantage of learning from the experience of other countries in dealing with them.

The countries that have introduced APAs are amongst South Africa’s major trading partners. The introduction of APAs will be advantageous for South Africa as it will align it with the trend in international taxation practices being used by major developed countries. Evidence in America indicates that APAs are predominantly used by foreign-owned companies (either subsidiaries or branches) and the financial service industry (ibid). If South Africa introduces APAs, this would enhance foreign investment and economic growth as foreign investors, with either subsidiaries or branches here, would find it appealing to
deal with a country where inevitable transfer-pricing disputes may be resolved easily (see Rolfe & Casley op cit at 39).

However, it is worth pointing out that, the introduction of APAs will require that care be taken so as to give due cognisance to South Africa’s unique economic condition, being a country with a mixture of developed and developing elements in its economy (SARS Discussion Paper op cit at 7). The developing aspect should, however, not be an excuse for not introducing trends in international practices – such as APAs – on account of the costs that could be involved. As South Africa is steadily becoming an economic force to be reckoned with, both regionally and internationally, national legislation and policy as regards matters of taxation that affect international trade and investment, should lean more towards encouraging the emergence of a developed economy. The introduction of APAs is one of the steps that may be taken in this regard.

It is accordingly recommended that as 76D of the Part IA in Chapter III of the Income Tax Act provides that the Commissioner of SARS may make an advance tax ruling on any provision of the Act, SARS should reconsider its stance and permit taxpayers to apply for advance tax rulings in the form of APAs in respect of transfer pricing.

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**Broad-based Black Economic Empowerment: Some Challenges in Measuring Ownership of Companies**

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**1 Introduction**

The Broad-Based Black Economic Empowerment Act 53 of 2003 was assented to by the President in January 2004. Although other legislative efforts, such as the Employment Equity Act 55 of 1998, the Preferential Procurement Policy Framework Act 5 of 2000, and the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000 contributed to redressing the imbalances of the past, they were not directly aimed at broad-based participation in the economy by black people. The objective of the Broad-Based Black Economic Empowerment Act (‘the Act’) is to facilitate black economic empowerment (‘BEE’) by increasing participation in the economy by all black people – including women, workers, youth, people with disabilities and people living in rural areas – through diverse but integrated socio-economic strategies (see ss 1 and 2).

This analysis will give a brief overview of the Act. It will comment on