

**PROVISION OF THE FINANCIAL ASSISTANCE BENCHMARKING TOOL FOR  
TRANSFER PRICING**

**BUSINESS REQUIREMENTS SPECIFICATION**

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## SARS RFP 08/2020

## Business Requirements Specification

## PROCUREMENT OF A TRANSFER PRICING BENCHMARKING TOOL

This document forms part of the RFP 08/2020 pack. The document sets out the business requirements that SARS has for Credit rating tool for transfer pricing purposes.

## 1. USAGE OF TERMS IN THIS DOCUMENT

## 1.1 GLOSSARY TABLE

TERM	DESCRIPTION
<b>Affected transaction</b>	Is defined in section 31(1) and includes any transaction, operation, scheme, agreement or understanding which has been directly or indirectly entered into or effected between or for the benefit of either or both a resident and a non-resident which are connected persons in respect to each other and where any of the term or condition agreed upon are different from any term or condition that would have existed had those persons been independent persons dealing at arm's length.
<b>BEPS</b>	Base Erosion and Profit Shifting
<b>BEPS Action plans</b>	Base Erosion and Profit Shifting Actions 1 to 15
<b>Bidder/Tenderer/Supplier</b>	A person or company responding to this RFP
<b>Connected person</b>	A person as defined in terms of section 1 of the ITA
<b>CPM</b>	Cost Plus Method
<b>CUP</b>	Comparable Uncontrolled Price Method
<b>ITA</b>	Income Tax Act 58 of 1962, as amended
<b>Material deviation</b>	A deviation which, in SARS' opinion, would <ol style="list-style-type: none"> <li>1. Detrimentially affect the scope, quality, or performance of the services identified in the RFP;</li> <li>2. Change SARS or the Bidder's risks and responsibilities under the RFP, or;</li> </ol>

	Affect the competitive position of other Bidders presenting responsive tenders, if it was to be rectified.
<b>MAP</b>	Mutual Agreement Procedure
<b>MNE</b>	Multinational Entities
<b>NACE</b>	Nomenclature of Economic Activities
<b>OECD</b>	Organisation for Economic Cooperation and Development
<b>PLI</b>	Profit level indicator
<b>Reporting</b>	This involves reporting on all the data relating to traceability events, fiscal marking, markings applied at licensed facilities, tax stamp management, etc. that may be required by SARS. The specific reporting requirements and authorisations to other parties must be defined by SARS.
<b>Responsive tender</b>	A response that conforms to all the terms, conditions, and specifications of the tender documents without material deviation or qualification.
<b>RPM</b>	Resale price Method
<b>SARS</b>	South African Revenue Service
<b>Secure</b>	Ability of a solution to resist to virtual or physical, internal or external attacks
<b>SIC</b>	The Standard Industrial Classification
<b>Solution Provider</b>	A third-party organisation external to SARS, which is engaged by SARS to design, build, implement, manage and support the transfer pricing tool/database solution
<b>The Solution</b>	Refers to the transfer pricing tool/database that will be used by SARS to conduct comparability studies to enable SARS to effect transfer pricing adjustments in terms of section 31 of the ITA
<b>TNMM</b>	Transactional Net Margin Method
<b>TPSM</b>	Residual Profit Split Method

## 1.2 DIRECTORY REQUIREMENTS

Bidders are advised to read the business requirements as set out in this document with care. Where SARS has specified a mandatory requirement, (i.e. where the business requirement, by the context; present verbs such as 'must'; 'will'; 'shall' etc.; or explicit instruction indicates that it is mandatory) the Bidder must build and price its solution

accordingly. If a proposal fails to meet or does not address a mandatory requirement, the proposal may, at SARS's discretion, be disqualified at any stage of the evaluation process as being non-responsive.

Directory requirements (i.e. where the business requirement, by the context; present verbs such as 'May; 'should; 'can' etc.; or explicit instructions indicate that it is directory) are requirements that SARS does not regard as mandatory.

### 1.3 MANDATORY AND DIRECTORY REQUIREMENTS

The Bidder must be affiliated with nationally recognized statistical rating organization (NRSRO) and submit the certification thereto.

The credit rating tool would need to allow for a peer analysis of the rated South African company across industries as well as similarly credit rated companies.

The Bidder must be able to perform a credit rating on a selected company and provide appropriate arm's length interest rates.

The database of the bidder must reflect full company names and financial information (including financial statement and balance sheets) and allow a taxpayer to be tested against independent companies in the sector and with the same or similar credit rating.

## 2. BACKGROUND

The term transfer pricing describes the process by which entities set the prices at which they transfer goods or services between each other.

The transfer prices adopted by a multinational have a direct bearing on the proportional profit it derives in each country in which it operates. If a non-arm's value (inadequate or excessive consideration) is paid for the transfer of goods or services between the members of a multinational, the income calculated for each of those members will be inconsistent with their relative economic contributions. This distortion will impact on the tax revenues of the relevant tax jurisdictions in which they operate.

Since South Africa's re-emergence in the international market, there has been a marked expansion of international trade and commerce, with wide-ranging changes in volume and complexity. An increasing proportion of this international activity is carried on between members of multinationals. As the globalisation of business activity continues to accelerate, protecting the South African tax base is vital to South Africa's wealth and development.

Exchange controls have historically provided some protection against the more significant manipulation of transfer prices to transfer profits to lower tax jurisdictions. In anticipation

of the relaxation of exchange controls and the envisaged adverse effect on the South African tax base, section 31 was introduced into the Act in 1995.

Section 31 enables the Commissioner to adjust the consideration in respect of a supply or acquisition of goods or services in terms of an international agreement between connected persons.

The Commissioner may adjust the consideration, for tax purposes, if the actual price is either less or greater than the price that would have been set if the supply or acquisition of goods or services had occurred between independent parties on an arm's length basis. The Commissioner may use the amount so determined, in the determination of the taxable income of either of the parties to the transaction.

Section 31, therefore, provides a mechanism by which the Commissioner adopts the internationally accepted "arm's length principle" for taxation purposes as the basis for ensuring that the South African fiscus receives its fair share of tax. This is achieved by adjusting the consideration in the determination of taxable income based on the conditions, which would have existed between unconnected persons under comparable circumstances.

Transfer pricing is a legitimate and necessary feature of the commercial activities of multinational enterprises. However, where the transfer prices between the associated enterprises do not accord with internationally applicable norms, they can distort the allocation of profit among the countries in which a multinational enterprise operates. When transfer pricing artificially shifts profits out of a country it, primarily, denies the country essential tax revenue. Such profit shifting can also have much wider implications: tax avoidance by high-profile corporate taxpayers will be perceived as "unfair" by citizens and may undermine the legitimacy and credibility of the wider tax system, thus discouraging compliance by all taxpayers. These are issues faced by developing and developed countries alike.

Most double tax treaties also incorporate the arm's length principle as the basis for allocating profits (and thus taxes) between associated enterprises. The arm's length principle provides broad parity of tax treatment for transactions between associated enterprises and those between independent enterprises. Implementation of the principle is intended to create equality of treatment between members of a group of companies (which may gain tax advantages through non-arm's length transfer pricing) and independent enterprises. It also provides an objective standard that attempts to replicate market results. By helping to level the playing field, and by virtue of the fact that it represents an international standard, the arm's length principle helps reduce distortions to international trade and investment.

In enforcing the arm's length principle, many Tax Administrations report uncertainties and difficulties in conducting comparability analyses. A key issue raised by developing countries, in particular, is the scarcity in some parts of the world of the financial data

necessary to carry out a comparability analysis (i.e. benchmarking study). Such issues can affect taxpayers and tax administrations alike. Tax Administrations may face difficulties in implementing their rules, which, in turn, will affect their tax revenues.

In many developing countries, challenges to obtaining information are not limited to specific, highly complex transactions: they may exist in all industries. For many resource-rich developing countries, a lack of data on the pricing of certain commodities is of particular concern.

In order to determine if a transaction between associated entities is at arm's length, a benchmark study would need to be conducted using a reliable comparable database.

A common concern of developing economies in the implementation of transfer pricing regimes relates to difficulties in accessing information on "comparables": data on transactions between independent parties used in the application of the arm's length principle.

Benchmarking studies are the critical part of any transfer pricing analysis contained in a compliance or policy document and are mainly used to test the arm's length nature of the connected party transactions.

The purpose of benchmarking studies is to determine the general conditions surrounding the transactions conducted by third parties on a given market. Such studies help elicit a range of values, i.e. the so-called arm's length range. Statistically, the arm's length range is typically defined within the boundaries of a lower quartile and upper quartile and is the range of values of price or profit attached to the comparable transactions between comparable unrelated parties.

When a transfer price determined by a taxpayer for a transaction under review (or the profitability derived by taxpayer from such transaction) is not found in the applicable arm's length range, SARS will determine the arm's length price or margin with reference to such an arm's length range, derived through conducting a benchmarking study on a database containing relevant and reliable independent comparable data.

Managing transfer pricing risk remains critical in an increasingly aggressive environment. SARS has continued to focus on transfer pricing and is currently involved in several major audits that could lead to substantial adjustments. The tool is at the centre of auditing and raising transfer pricing tax assessment. Put simply, a comprehensive Transfer Pricing tax audit is not possible without a benchmarking study or tool.

An effectively resourced Transfer Pricing Unit is thus integral in order to ensure a successful and sustained tax compliance focus. Transfer pricing is one of the key areas of focus, particularly after the BEPS Action plan and the impact that BEPS has on developing countries. BEPS is a major significance for developing countries due to the heavy reliance on corporate income tax, particularly from multinational entities. In order to ensure that SARS issues accurate and defensible Transfer Pricing assessments, it is critical that these assessments are based on external comparable that are derived from a well-established, comprehensive and reputable database.

Based on the SARS strategy, the objectives for Bidders is to provide SARS with:

- A complete solution which can provide reliable comparable data;
- Software used locally and internationally by tax administrations, multilateral organisations such as the OECD and multinational companies;
- Produce benchmark studies that can be defended in court or during litigation and audits;
- A database that encompasses all industry types on a global basis;
- Public and private company data, which include updated financial information;
- Industry wide searches;
- Comprehensive corporate structures which will assist in determining independence of the companies;
- Comprehensive and reliable data for pricing intra group financial assistance, which should include credit ratings, financing terms, currencies, interest rates, collateral and repayment terms.

The tool will significantly improve the capacity of SARS in:

- Revenue collection
- Improving the reliability of the adjustments raised

### **3. GENERAL REQUIREMENTS FOR THE SERVICES**

#### **3.1 SOLUTION DESIGN OVERVIEW**

It is envisaged that following award of the tender and subsequent contract, a detailed design phase will be undertaken to define specific business requirements and functional specifications based on the appointed Bidder's proposed solution. The solution design described in this document is meant as a guide for potential Bidders to understand SARS general and technical requirements and prepare their responses accordingly. The solution design considers SARS current Transfer pricing situation, the associated risks and SARS strategic direction to mitigate such risks.

#### **3.2 SCOPE OF SOLUTION DESIGN:**

The scope of the software/database required is to consider the funding structure of South African taxpayers, in particular the arm's length nature of funding provided by offshore-related parties to a South African related party in terms of the quantum of the loan, as well as the appropriate arm's length interest rate.

In particular, the transfer pricing benchmark tool would be required to determine the standalone credit rating of a South African company and the group credit rating to assess implicit support. Based on this, SARS would be able to determine the arm's length debt capacity of the South African company and appropriate interest rate applicable to related party debt.

#### 4. TECHNICAL SPECIFICATIONS AND REQUIREMENTS

This section provides a detailed description of the functionality and features required from the bidder. It is expected that the solution provider will use this detail as a guide when preparing their responses and ensure that all required features and functionality are elaborated upon in such responses. The solution provider proposal must maintain the structure and should be grouped under the following main headings so evaluators can trace requirements back to proposed functionality:

Technical Specification – Solution Components	
4.1	<b>End to end solution:</b> means that the provider of an application program, software and system will supply all the software as well as hardware requirements of the customer such that no other vendor is involved to meet the needs.
4.2	<b>Data Comparability Factors and Database filter options:</b> refers to factors that render companies comparable in how they conduct their business, provide services or use intangible assets.
4.3	<b>Size of the database:</b> refers to the total number of companies on the database and total number of agreements on the database.
4.4	<b>Quantitative and Qualitative screening:</b> Qualitative screening refers to observation to gather non-numerical data. Quantitative screening refers to information about quantities; that is, information that can be measured and written down with numbers.
4.5	<b>SIC and NACE codes:</b> refers to industry classification codes, SIC refers to Standard Industrial Classification Code designed by the US government to classify industries. NACE refers to Nomenclature of Economic Activities, the European statistical classification of economic activities.
4.6	<b>Final Report on all search criteria or search steps followed:</b> refers to a report, which details the entire search criterion that we applied when performing the benchmark study.
4.7	<b>Data Management and Interfacing:</b> Refers to the receipt, storing, processing, analysis and reporting of the data that is generated by the transfer-pricing tool
4.8	<b>Training and Service Support and Maintenance:</b> Refers to the training, service, support that the solution provider will provide SARS.
4.9	<b>Additional requirements:</b> Refers to the service provider demonstrating their capabilities.

##### 4.1 END TO END SOLUTION

#### TECHNICAL REQUIREMENTS

The following table presents detailed requirements for solution providers related to the packed solution. These represent the minimum set of requirements, details of which will be further discussed and elaborated upon during contracting and solution designing phase following appointment of a successful solution provider.

- The solution should be managed and handled by only one vendor, working from beginning to completion, without the direct involvement of any other third party.
- A single solution provider should provide the whole package.
- The solution should include quantum and pricing based information on financial assistance, which:
  - Should enable benchmark studies to be conducted on affected transactions.
  - Pre-recorded detailed presentation of how the system operates, functions, works and its output;
  - Print screens of the proposed solution that demonstrate the functionality of the system;
  - Provide the Business Profile that describes the service offerings, years of experience of each resource and capability to deliver and support the Solution to SARS;
  - Three (3) contactable references of companies where similar services were provided recently (within the last 5 years);
  - Provide a summary of the information contained on the database specifically for South African companies or companies in emerging economies as well as information on the number of independent companies on the database, and broad geographic locations of said companies. (e.g. Middle East and Africa). This would provide clarity on whether the South African tested party could accurately be tested against independent companies in the same or similar geographic market.
  - Implementation plan indicating the time frames for implementing and customizing the Solution to SARS unique requirements;
  - The nature of support (e.g. telephonic, email etc.) and whether there is local support available.

## 4.2 DATA COMPARABILITY FACTORS

### Data Comparability Factors and Filters

- Comparability analyses is an important element in the implementation of the arm's length principle, requiring a comparison of the conditions in transactions between cross-border connected parties ("controlled transactions") with the conditions in comparable transactions between independent parties ("comparable uncontrolled transactions" or "comparable").
- Comparability factors for financial assistance (including loans, guarantees etc.) should take into account (this is not an exhaustive list):
  - Lender's name;
  - Borrower's name;
  - Transaction type (loans, bonds, etc.);
  - Transaction description;
  - Industry in which the borrow operates;
  - Location where the borrower is based;
  - Borrower's credit rating;
  - Amount of the financial assistance;
  - Base currency applicable;
  - Term of the agreement;
  - Maturity date;
  - Interest rate types;
  - Base rate margin;
  - Other margins;
  - Facility fee rate;
  - Collateral or security;
  - Repayment option;
  - Repayment terms; and
  - Late payment interest.

## 4.3 SIZE OF THE DATABASE

### TECHNICAL REQUIREMENTS

The following refers to the total number of companies on the database and total number of agreements on the database details of which will be further discussed and elaborated upon during contracting phase following appointment of a successful solution provider.

1. The solution/database should have as a minimum at least 1 000 000 companies and a minimum of, 3000 loan agreements and all major commodity indexes and market prices.

#### 4.4. QUANTITATIVE AND QUALITATIVE SCREENING

##### TECHNICAL REQUIREMENTS

Qualitative screening refers to observation to gather non-numerical data. Quantitative screening refers to information about quantities; that is, information that can be measured and written down with numbers, details of which will be further discussed and elaborated upon during contracting phase following appointment of a successful solution provider.

The solution/database should be able to produce the following:

##### Quantitative screening:

Financial statements prepared in accordance with IFRS or local GAAP  
Consolidated and Unconsolidated accounts  
Operating profit margins, Return of assets, Return on equity, Solvency ratios,  
EBIT margin, EBITDA margin, operational ratios, net asset turnover, Liquidity ratios etc.

#### 4.5 SIC AND NACE CODES

##### TECHNICAL REQUIREMENTS

The following refers to industry classification codes

1. The solution should cover a broad spectrum of industries classified using US SIC codes, NACE codes or NAIC 2017 codes.

#### 4.6 FINAL REPORT ON ALL SEARCH CRITERIA OR SEARCH STEPS FOLLOWED

##### TECHNICAL REQUIREMENTS

The below presents the detailed requirements for the solution provider around central enforcement and reporting:

The solution/database should provide a comprehensive report-detailing showing all the comparable companies selected. The report can be either in excel or word format or in a format that is compatible with SARS systems.

SARS should be able to rely on the report when raising assessments on taxpayers.

#### 4.7 DATA MANAGEMENT AND INTERFACING

##### TECHNICAL REQUIREMENTS

The solution provider will be responsible for creating a data management capability. This will include the ability to receive, store, process, report and make available all solution data. The table below presents the detailed requirements related to the data management capability.

- This should be an administrative process that includes acquiring, validating, storing, protecting, and processing required data to ensure the accessibility, reliability, and timeliness of the data for its users.
- The capability should include detailed documentation of all the searches performed.

#### 4.8 TRAINING AND SERVICE SUPPORT AND MAINTENANCE

##### REQUIREMENTS

The solution provider will be responsible for providing the necessary training to operate the solution.

- The solution provider should be available for to provide training on how to operate the solution.
- The solution provider should be able to assist at any given moment should the users require any assistance.
- Where there are any changes to the solution, the solution provider should provide training to equip the users on those changes.
- The solution provider must provide the following related to security:
  - Information Security Governance
    - The solution provider must confirm if they conform to King 1/2/3/4 reports on governance.

- The solution provider must provide an overview of information security policy, standards and process (SOP) implementation.
  - The solution provider must confirm if information security awareness is performed.
  - The solution provider must confirm audit, risk assessment and vulnerability assessment processes. This includes confirmation that SARS can perform audits/assessment at any time.
- Information Security
- The solution provider must provide an overview of logical access control measures.
  - The solution provider must provide an overview of data protection measures.
  - The solution provider must provide an overview of technical support, problem-, change management processes, including patch management.
  - The solution provider must provide an overview of malicious code (viruses, malware, ransomware etc.) measures.
  - The solution provider must provide an overview of network security measures.
  - The solution provider must provide an overview of application security measures.
  - The solution provider must provide an overview of back up, disaster recovery and business continuity measures.
  - The solution provider must provide an overview of IT asset management, including compliance to license agreements.

#### 4.9 ADDITIONAL REQUIREMENTS

##### Demonstrated Capacity

The solution provider must demonstrate to SARS their ability to deliver on the required technical criteria (as stipulated in this document)

- Screenshots should be provided with the initial submissions to SARS. If required the solutions provider may be requested to provide additional demonstrations. This may include:
- Physical presentation to a panel of evaluators; and/or
- Live video conferencing showing a facility where the solution has been implemented successfully