Proposed Model for Establishing an Advance Pricing Agreement Programme in South Africa and Release of Draft Legislation

Income Tax
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1. Purpose

This document seeks to provide a high-level model and draft legislative framework for an advance pricing agreement (APA) unit and associated processes at SARS and the introduction of an APA programme in South Africa.

2. Background

In keeping with international developments and the recommendations of the Davis Tax Committee, the establishment of an APA programme has been a key aspect of SARS’s strategic objective of providing clarity and certainty for taxpayers of their obligations. The establishment of an APA programme has, accordingly, been taken up in SARS’s annual performance plans and will also support SARS’s other strategic objectives such as making it easy for taxpayers to comply, while building public trust and confidence in the tax administration system.

A draft public discussion paper on the introduction of an APA programme was released for public comment towards the end of 2020. Although responses were limited, on the whole the discussion paper was met with support for the introduction of an APA programme. Constructive comments and suggestions were submitted, which have been incorporated into the SARS thinking and development of the SARS APA model.

3. Discussion

Whilst challenging, the necessity of establishing an APA unit is foundational in advancing the SARS strategic agenda and restoring the organisation to world class status. The chief impediment in establishing a workable APA programme in South Africa relates to the scarcity of transfer pricing expertise in the country, which will require resources and time to develop at SARS. The establishment of an APA unit cannot be done in isolation from the concurrent development and expansion of capacity in the existing transfer pricing unit. Although the APA unit will require independence from the transfer pricing unit, it is envisaged that in the APA unit’s early stages of development the relationship between the units will be relatively fluid, necessitating the exchange of expertise and personnel between the units.

Although SARS is fairly advanced in developing a model as to how it envisages the development of an APA programme, some aspects have not yet been finalised. In an effort to further develop and refine the model, a pilot APA project is planned for as soon as possible after the legislative framework has been put in place. The APA pilot will only accept bilateral APA applications and should allow the SARS APA unit to learn from other jurisdictions and expand capacity in the APA space before SARS introduces the full APA programme or expands the programme to include multilateral APA applications.

It is also hoped that the feedback received after the release of the proposed model will enable further streamlining of the model and, to this end, draft legislation capturing the essential features of the model is also being released. Various aspects relating to the mechanics, processes, timeframes, eligibility criteria and scope of what will be ruled and agreed upon in advance will be subject to promulgation in the Gazette. This is important as it provides a level of flexibility, particularly as these criteria are likely to be different at the pilot and final rollout stages.

With this in mind, a high level proposed model is set out below.
4. Proposed process model

The envisaged high-level process flow through the various stages is as follows:

4.1. APA Pre-application (entry point for all new applications – outbound & inbound): includes a request for an APA pre-application consultation; payment of the pre-application consultation fee; initial screening; pre-application consultation; initial indication of quantum of cost recovery fees; and the decision by SARS as to whether or not an APA application may be made.

4.2. APA Application (entry point for extensions, amendments & re-negotiations): includes the submission of the formal APA application; payment of the application fee; and initial screening of the APA application to determine the completeness and acceptability of the application.

4.3. APA Processing: includes allocation of the case to an APA team; comprehensive examination and analysis of the application; engagement with the applicant (as required) on any relevant aspect (including fees); regular progress reports and fee invoices; establishing and approval of the SARS position and parameters for negotiation with foreign tax authority; and drafting of a preliminary advance pricing agreement.

4.4. APA Negotiations: includes negotiations with the foreign tax authority in order to reach agreement in respect of the preliminary advance pricing agreement (including amendments where required); sending the preliminary advance pricing agreement and invoices to the applicant; allowing input by the applicant in respect of the agreed preliminary advance pricing agreement (including allowing amendments where in scope); and the decision by applicant whether or not to proceed to signature.

4.5. APA Finalisation: includes payment of any outstanding fees based on invoices (whether proceeding or not); signature by applicant of the final preliminary advance pricing agreement; signature by SARS of the preliminary advance pricing agreement; signature by the foreign tax authority of the preliminary advance pricing agreement; and dissemination of signed APA agreement to all relevant parties.

4.6. APA Implementation & Monitoring: APA holder implements APA and submits an APA compliance report after the end of each period; APA unit conducts a compliance review and, if necessary, audit after receipt of the compliance report; APA holder to correct any non-compliance; APA unit to initiate amendment / termination procedures (whichever is relevant) in case of continued non-compliance or fraud / misrepresentation.

4.7. APA Termination / Amendment / Extension: includes the APA amendment and re-negotiation process (necessitated by changes in law, or initiated by APA holder when there is a change in circumstances); the APA termination process (necessitated by fraud, misrepresentation, non-compliance, unwillingness by APA holder to amend APA when law changes, or the APA reaches the end of its term); and the APA extension process (initiated by the APA holder) with the necessary fees based on invoices.
Aspects of the administration of the APA programme that will be managed by way of public notice in the Gazette by the Commissioner include the following:

- Any other relevant factors to be considered in determining the most appropriate transfer pricing method (definition of “most appropriate transfer pricing method” in section 1);
- The parameters within which the competent authority of South Africa may enter into an advance pricing agreement with an applicant (section 90C);
- Which persons are eligible to apply to SARS for an advance pricing agreement (section 90D);
- The quantum of the relevant fees, which constitute the following:
  - Pre-application consultation fee [section 90E(1)(a)];
  - Application fee [section 90E(1)(b)];
  - Cost recovery fees [section 90E(1)(c)];
  - Any fees associated with the maintenance or extension of an existing agreement [section 90E(1)(d)];
- The minimum value of affected transactions in order to qualify for the APA process [section 90J(1)]; and
- Procedures and guidelines for the implementation and operation of the APA process (section 90Q)

5. **Way forward**

It is hoped that the release of the model and draft of the APA legislation will not only lay the groundwork for the APA programme, but will facilitate comprehensive engagement from all affected parties.

Please forward written comments to SARS at acollins@sars.gov.za by close of business on 31 January 2022.
Annexure – Draft legislation

CHAPTER 7 OF THE TAX ADMINISTRATION ACT

Part A
ADVANCE RULINGS

Part B
ADVANCE PRICING AGREEMENTS

90A. Definitions.—In this Chapter, unless the context indicates otherwise, the following terms, if in single quotation marks, have the following meanings—

‘advance pricing agreement’ means an agreement for a defined period of time between an applicant, the competent authority of South Africa and the competent authority of another country, which has an agreement for the avoidance of double taxation with South Africa, regarding the advance pricing arrangement of an affected transaction between and among associated enterprises and connected persons in relation to the applicant;

‘advance pricing agreement application’ means a request by a person to SARS in the prescribed form and manner for an advance pricing agreement and includes supporting documents and additional information required by SARS to consider entering into an advance pricing agreement with the person;

‘advance pricing arrangement’ is an arrangement that determines the most appropriate transfer pricing method, the arm’s length transfer price, the arm’s length allocation and, where necessary, the compensating adjustments in respect of an affected transaction over a defined period of time;

‘affected transaction’ means an “affected transaction” as defined in section 31 of the Income Tax Act;

‘agreement for the avoidance of double taxation’ means an agreement that is effected under section 108 of the Income Tax Act that contains an Article similar to Article 9 of the Model Tax Convention on Income and on Capital of the OECD;

‘applicant’ means a person who submits an advance pricing agreement application to SARS;

‘arm’s length allocation’ means an allocation in an affected transaction that would have been the allocation if the participants had been dealing at arm’s length with each other;

‘arm’s length transfer price’ means a transfer price in respect of an affected transaction that would have been the price in respect of the transaction if the participants in the transaction had been dealing at arm’s length with each other;

‘associated enterprise’ means an “associated enterprise” as defined in section 31 of the Income Tax Act;

‘compensating adjustment’ is an application of the most appropriate transfer pricing method, as agreed to in an advance pricing agreement, to an affected transaction and the attribution of the income from the affected transaction to be taxed in one or more countries;

‘competent authority’ is an official in a country who is authorised by the government of the country to enter into and administer an agreement for the avoidance of double taxation with another country;

‘connected person’ is a “connected person” as defined in section 31 of the Income Tax Act;

‘country of residence’ is the country in which a person is considered to be a resident according to income tax legislation after the application of an agreement for the avoidance of double taxation;

‘critical assumptions’ means the fundamental factors that are necessary for each party to an advance pricing agreement to remain bound by the advance pricing agreement;
‘most appropriate transfer pricing method’ means a transfer pricing method, having regard to the nature of an affected transaction performed between and among associated enterprises and connected persons, and such other relevant factors prescribed by the Commissioner in a public notice, that forms the basis for establishing an arm’s length transfer price or arm’s length allocation in terms of section 31 of the Income Tax Act and an agreement for the avoidance of double taxation for the affected transaction;

‘transfer price’ means the price at which connected persons or associated enterprises trade a service, tangible property or intangible property with and among each other across international borders in an affected transaction;

‘transfer pricing method’ means any of the transfer pricing methods referred to in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations;

90B. Purpose—To promote tax certainty in respect of affected transactions that will prevent or minimise double taxation and associated dispute resolution procedures.

90C. Scope—The competent authority of South Africa may enter into an advance pricing agreement with an applicant after consulting with the competent authority of the country, which will be party to the agreement, within the parameters prescribed by the Commissioner in a public notice.

90D. Persons eligible to apply.—The Commissioner must issue a public notice to determine which persons are eligible to apply to SARS for an advance pricing agreement.

90E. Fees for advance pricing agreements.—(1) In order to defray the cost of the advance pricing agreement system, the Commissioner may by public notice prescribe fees payable by an applicant including—

   (a) a pre-application consultation fee;
   (b) an application fee;
   (c) a cost recovery fee for processing an application; and
   (d) any fees associated with the maintenance or extension of an existing agreement.

(2) An applicant must pay the fees in subsection (1) based on an invoice issued by SARS.

(3) SARS may retain the fees in subsection (1), or a portion thereof, if it rejects an application or terminates an agreement.

(4) If there is more than one prospective applicant or applicant in respect of an advance pricing agreement, SARS may, upon written request and by agreement among the prospective applicants or applicants, impose the fees in subsection (1) on one of the prospective applicants or applicants.

(5) The fees imposed under this section constitute fees imposed by SARS in terms of section 5(1)(h) of the SARS Act and constitute funds of SARS within the meaning of section 24 of that Act.

90F. Pre-application consultation.—(1) A prospective applicant must together with proof of payment of the prescribed fee in section 90E(1)(a) request in the prescribed form and manner a pre-application consultation meeting.

(2) SARS must arrange a pre-application consultation meeting with the prospective applicant within 60 days of receipt of the request in subsection (1).

(3) The pre-application consultation meeting must, among other things—

   (a) discuss the scope of the advance pricing agreement;
   (b) identify the parties that will be involved in the advance pricing agreement, their organisational structures and the relationship between the parties;
   (c) discuss the most recent annual financial statements of the prospective applicant;
(d) discuss the suitability of the affected transactions to form part of the advance pricing agreement;

(e) discuss the most appropriate transfer pricing method to apply to each affected transaction;

(f) discuss the arm’s length allocation, arm’s length transfer price and compensating adjustments, where necessary, in respect of each affected transaction;

(g) discuss in which country the arm’s length allocations and compensating adjustments, where necessary, should be taxed;

(h) discuss the legislation in a tax Act that may be applicable;

(i) discuss the provisions in the relevant agreement for the avoidance of double taxation that may be applicable;

(j) discuss if the prospective applicant, associated enterprise or connected person has consulted with the competent authority in the country who may be party to the advance pricing agreement as a prerequisite to determine if the competent authority will support the agreement;

(k) discuss the duration of the advance pricing agreement, which may not exceed five years;

(l) estimate the time required to finalise the advance pricing agreement;

(m) discuss the applicable fees in section 90E;

(n) determine any further information that may be required from the prospective applicant.

(4) SARS must notify the prospective applicant within 90 days from the last pre-application consultation meeting if the prospective applicant may submit an advance pricing application.

90G. Application for an advance pricing agreement.—(1) A prospective applicant that chooses to submit an advance pricing agreement application after receiving notification from SARS under section 90F(4) must do so within 60 days from receipt of the notification.

(2) An application may not be made in respect of a tax period that:

(a) ended before the date on which the application is submitted;

(b) is due to end within 180 days from the date on which the application is submitted; or

(c) is subject to inspection, verification or audit under Chapter 5.

(3) If there is more than one applicant in respect of an advance pricing agreement, the applicants must join their applications into a joint application and designate one representative for the applicants.

(4) An application must be in the prescribed form and manner and must include the following—

(a) the name, reference number or proof of identity, e-mail address, postal address, physical address, telephone number and country of residence of the applicant;

(b) a list of persons that will be party to the advance pricing agreement and their e-mail addresses, postal addresses, physical addresses and telephone numbers;

(c) the organisational structure of the applicant in relation to associated enterprises and connected persons and their organisational structures;

(d) the most recent annual financial statements of the applicant;
(e) the primary business activities of the applicant, the affected transactions that will be covered by the agreement, a quantification of the affected transactions, the associated enterprises and connected persons that are party to the affected transactions and their countries of residence, the most appropriate transfer pricing method for each affected transaction, the critical assumptions that should apply to the affected transactions, the arm’s length allocations and compensating adjustments, where necessary, in respect of the affected transactions;

(f) any views the competent authority in the country that will be party to the proposed advance pricing agreement being sought has expressed;

(g) the applicable legislation in a tax Act and an interpretation thereof;

(h) the applicable provisions in the relevant agreement for the avoidance of double taxation and an interpretation thereof;

(i) the expected duration of the advance pricing agreement but not exceeding five years;

(5) SARS may at any time require the application to be supplemented by further information.

(j) the proposed advance pricing agreement;

(k) confirmation that the applicant is tax compliant to the extent referred to in section 256(3); and

(l) confirmation that the prescribed fee in section 90E(1)(b) has been paid.

90H. Amendments to an application.—(1) An applicant may request in writing for an amendment to an application within 30 days from submitting an application to SARS.

(2) SARS may allow the amendment to the application if the amendment does not have the effect of altering the nature of the application that was originally filed.

(3) The amendment will be considered only if the applicant agrees and pays any additional cost recovery fee in terms of section 90E(1)(c) and invoiced in terms of section 90E(2).

90I. Withdrawing an application.—(1) An applicant may withdraw an application within 30 days from submitting an application.

(2) The withdrawal does not absolve an applicant from the liability for any fees that are due and payable in terms of section 90E.

90J. Rejection of an application—(1) SARS may reject an application if the application does not meet the requirements of this Part including—

(a) the value of the affected transactions is less than an amount prescribed by the Commissioner by public notice;

(b) the proposed advance pricing agreement would not ensure that there is alignment between true economic activity and profit outcomes in South Africa;

(c) the application requires SARS to consider the legal form of a transaction without taking the substance of the transaction into account;

(d) the affected transactions appear to lack commercial substance or are entered into primarily to avoid tax;

(e) the application involves the interpretation or application of a general or specific anti-avoidance provision or doctrine;

(f) the application is in respect of an issue that is the same as or substantially similar to an issue that is—

(i) currently before SARS in relation to an audit, investigation or other proceeding involving the applicant, an associated enterprise or a connected person in relation to the applicant;
(ii) the subject of a ‘binding general ruling’ as defined in section 75 or proposed amendments to a tax Act that have been published; or

(iii) subject to dispute resolution under Chapter 9;

(g) the application is submitted for academic purposes;

(h) the application is in respect of a frivolous or vexatious issue;

(i) the applicant fails or refuses to provide additional information requested by SARS with regard to the application;

(j) the applicant requests changes to a preliminary advance pricing agreement in section 90K(5) that are not acceptable to SARS; or

(k) the applicant does not pay the prescribed fees in section 90E.

90K. Processing an application.—(1) SARS must process an application after accepting the application in a notice that must set out the terms and conditions under which the application will be considered.

(2) SARS must inform the applicant of the progress it has made in processing the application at 90-day intervals and must issue invoices for purposes of section 90E(2).

(3) Based on the information provided in the accepted application, SARS must prepare a preliminary advance pricing agreement that includes the following—

(a) the names, e-mail addresses, postal addresses, physical addresses, and countries of residence of the parties to the advance pricing agreement;

(b) the type of advance pricing agreement being entered into;

(c) a definition of each of the key terms in the advance pricing agreement;

(d) the affected transactions;

(e) the applicable accounting standards on which the applicant's financial statements are based;

(f) critical assumptions;

(g) the most appropriate transfer pricing method to be applied to affected transactions;

(h) the arm's length allocation, arm's length transfer price or compensating adjustment, where necessary;

(i) the basis of the arm's length allocation, arm's length transfer price or compensating adjustment, where necessary;

(j) in which country the proportionate income from an affected transaction should be taxed and a quantification thereof;

(k) the duration of the advance pricing agreement which must not exceed five years.

(4) After reaching agreement with the competent authority in the country that will be party to the agreement, SARS must send the preliminary advance pricing agreement reflecting such agreement to the applicant to accept, reject or suggest changes within 60 days of being sent.

(5) SARS may make changes to a preliminary advance pricing agreement, as required by the applicant, if the requested changes fall within the scope of the application for the advance pricing agreement.

(6) Subsection (4) will apply with the necessary changes if subsection (5) is applicable.

90L. Finalisation of an advance pricing agreement.—(1) If an applicant accepts a preliminary advance pricing agreement, the applicant must sign the agreement and return it to SARS.

(2) At least two senior SARS officials and the competent authority of South Africa must sign the preliminary advance pricing agreement after subsection (1) has been complied with.
(3) The competent authority of the country that will be party to the agreement must sign the preliminary advance pricing agreement after subsections (1) and (2) have been complied with.

(4) An advance pricing agreement will only come into effect after subsections (1), (2), and (3) have been complied with.

(5) SARS must send the advance pricing agreement to the applicant and the competent authority of the country that is party to the agreement.

90M. **Compliance report.**—(1) An applicant must submit a compliance report to SARS within 60 days from the end of a tax period that falls within the duration of an advance pricing agreement or from the date on which an advance pricing agreement is terminated.

(2) The compliance report must be in the prescribed form and manner and include the following in respect of the latest tax period—

   (a) the applicant's affected transactions;
   
   (b) confirmation that the circumstances in the advance pricing agreement application have not changed subsequent to submitting the application;
   
   (c) a demonstration of compliance with the terms and conditions of the advance pricing agreement; and
   
   (d) confirmation that the critical assumptions in the advance pricing agreement have been complied with.

90N. **Extension of an advance pricing agreement.**—(1) An applicant may request SARS to extend an advance pricing agreement not less than 60 days before the date on which the agreement is due to expire.

(2) Where the facts and circumstances have not changed materially from the advance pricing agreement application, SARS may grant the extension for a defined period that does not exceed three years.

(3) For subsection (2) to apply, the applicant must make a declaration in the prescribed form and manner that includes the following—

   (a) there have been no material changes in the facts and circumstances underlying the advance pricing agreement that is due to expire and the critical assumptions remain valid and relevant; and
   
   (b) all terms and conditions of the existing advance pricing agreement have been complied with.

(4) The applicant must inform SARS of any changes that need to be taken into account in the extended advance pricing agreement such as—

   (a) updated studies, analyses, and supporting documents;
   
   (b) changes that have occurred in the facts, circumstances, or critical assumptions underlying the advance pricing agreement; or
   
   (c) subsequent economic, technical, product, or industry developments that were not taken into account in the existing advance pricing agreement.

(5) Sections 90G, 90H, 90I, 90J, 90K, and 90L will apply with the necessary changes for the extension of an advance pricing agreement.

(6) SARS may reject a request to extend an advance pricing agreement and may direct the applicant to submit a new application under section 90G.

90O. **Termination of an advance pricing agreement.**—(1) A party to an advance pricing agreement may choose to terminate the agreement by informing the other parties to the agreement of the reasons for the termination.
(2) SARS may terminate an advance pricing agreement retrospectively if—

(a) the applicant has not yet commenced the affected transaction or has not yet incurred significant costs in respect of the transaction;

(b) a person other than the applicant will suffer a significant tax disadvantage if the agreement is not withdrawn or modified retrospectively and the applicant will suffer comparatively less if the agreement is withdrawn or modified retrospectively;

(c) the effect of the agreement will materially erode the tax base of South Africa and it is in the public interest to withdraw or modify the agreement retrospectively;

(d) an affected transaction was carried out in a materially different manner from that disclosed in the application;

(e) there is a breach of any of the critical assumptions or any condition on which the agreement is based

(f) the applicant failed to comply with the terms and conditions of the agreement; or

(g) there is fraud, misrepresentation or non-disclosure of a material fact by the applicant.

(3) An advance pricing agreement will be terminated if—

(a) there is an amendment to the legislation on which the agreement is based in which case the agreement will cease to be effective from the date of the amendment unless the general interpretation upon which the advance pricing agreement was based is unaffected by the amendment (or SARS issues a notice to the contrary);

(b) a court overturns or modifies an interpretation of the legislation on which the agreement is based in which case the agreement will cease to be effective from the date of judgment unless—

(i) the decision is under appeal;

(ii) the decision is fact-specific and the general interpretation upon which the agreement was based is unaffected; or

(iii) the reference to the interpretation upon which the agreement was based was *obiter dicta*;

(c) there is a change to the agreement for the avoidance of double taxation on which the agreement is based unless the general interpretation upon which the agreement was based is unaffected by the change (or SARS issues a notice to the contrary).

(4) Any party to an advance pricing agreement must inform other parties to the agreement within 30 days of becoming aware of a condition in subsection (2) or subsection (3) that will result in the termination of the agreement.

(5) SARS must inform all parties to an advance pricing agreement of the effective date from which the agreement has been terminated.

90P. Record retention.—(1) In addition to obligations under a tax Act, an applicant must maintain books of account, records or documents that will enable SARS to determine the extent of the applicant’s compliance with the advance pricing agreement.

(2) Information requested by SARS with regard to compliance with this Part must be made available to SARS within 30 days of receipt of the written request.

(3) If additional time is required to submit the information requested in subsection (2), SARS may grant one extension not exceeding 30 days.

90Q. Procedures and guidelines.—The Commissioner may by public notice specify procedures and guidelines for the implementation and operation of the advance pricing agreement system.