



TRANSFER PRICING: *ADDENDUM* TO SARS PRACTICE NOTE 7 DATED 6 AUGUST 1999: SUBMISSION OF TRANSFER PRICING POLICY DOCUMENT

It has been brought to SARS' attention that taxpayers are being advised that they must submit a copy of their transfer pricing policy document with their annual return of income. Where taxpayers have not prepared such a policy document, they are advised that they are obliged to draft one for submission with their return to prevent a material non-disclosure that is an offence and will result in the return remaining open indefinitely for revision by SARS.

SARS wishes to clarify its position on this matter and provide taxpayers with some guidance on how to approach it. SARS Practice Note 7 dated 6 August 1999 dealing with transfer pricing states the following in paragraph 10.2:

“10.2 The need for documentation

- 10.2.1 Although there is no explicit statutory requirement to prepare and maintain transfer pricing documentation, it is in the taxpayer's best interest to document how transfer prices have been determined, since adequate documentation is the best way to demonstrate that transfer prices are consistent with the arm's length principle, as required by section 31.
- 10.2.2 A taxpayer electing not to prepare transfer pricing documentation is at risk on two counts. Firstly, it is more likely that the Commissioner will examine a taxpayer's transfer pricing in detail if the taxpayer has not prepared proper documentation. Secondly, if the Commissioner, as a result of this examination, substitutes an alternative arm's length amount for the one adopted by the taxpayer, the lack of adequate documentation will make it difficult for the taxpayer to rebut that substitution, either directly to the Commissioner or in the Courts.
- 10.2.3 Also, if taxpayers have not maintained appropriate records, the process of checking compliance with the arm's length principle becomes far more difficult and the Commissioner's officials are forced to rely on less evidence on which to apply a method, thus requiring a greater degree of judgment.
- 10.2.4 In addition there are practical reasons why taxpayers would be well advised to keep contemporaneous (at or close to the time the transaction occurs) documentation. The income tax return for companies (IT 14) requires taxpayers to supply certain specific

information regarding transactions entered into between connected persons. It is not possible for a taxpayer to comply with these requirements if the taxpayer has not addressed the question of whether its dealings comply with the arm's length principle.

10.2.5 Thus, if a taxpayer can demonstrate that it has developed a sound transfer pricing policy in terms of which transfer prices are determined in accordance with the arm's length principle by documenting the policies and procedures for determining those prices, the Commissioner is more likely to conclude that its transfer pricing practices are acceptable and the risk of possible adjustments will be diminished.

10.2.6 On the other hand, preparing documentation is time-consuming and expensive. It will therefore not be expected of taxpayers to go to such lengths that the compliance costs related to the preparation of documentation are disproportionate to the nature, scope and complexity of the international agreements entered into by taxpayers with connected persons.”

SARS hereby confirms that its policy remains that there is no statutory requirement that taxpayers compile a formal transfer pricing policy document. The requirement for submission of a formal transfer pricing policy document in terms of the annual return of income must, therefore, be read as a requirement to submit such a policy document where a taxpayer has in fact already compiled one. In the event that a taxpayer has not compiled such a policy document it is sufficient to formally confirm that one has not been compiled.

As stated in the Practice Note SARS acknowledges that the preparation of transfer pricing documentation is time-consuming and expensive. The important general rule is that it is not expected of taxpayers to go to such lengths that the compliance costs related to the preparation of documentation are disproportionate to the nature, scope and complexity of the international agreements entered into between the taxpayers and connected persons.

Furthermore, where a taxpayer has provided full details of the international agreements that it has entered into with connected parties, the absence of formal transfer pricing documentation will not be regarded as non-disclosure. Taxpayers choosing not to prepare documentation must, however, realise that they are at risk and that it may be more difficult to discharge the onus of proving that an arm's length price has been established.

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