

Tax Alert

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Let's talk

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SARS' draft guidance on transfer pricing of cross-border intra-group loans

In brief

On 11 February 2022, SARS issued a draft Interpretation Note (IN) on the application of the arm's length principle in the context of the pricing of intra-group loans for public comment. Feedback on the content of the IN is due by 29 April 2022.

In detail

Background

Companies are generally funded by either debt or equity.

When a non-resident related party funds a South African tax resident company (directly/indirectly) with interest-bearing debt, this could lead to erosion of the tax base through excessive interest deductions for income tax purposes by the SA company (commonly referred to as thin capitalisation).

To prevent this abuse, SA tax legislation (section 31) provides that taxpayers must determine the acceptable amount of debt by applying arm's length principles. Accordingly, both the amount of the debt and the cost of the debt have to be considered.

The IN aims to provide guidance on the application of the arm's length principle, as well as the consequences should the debt funding arrangement not meet the requirements.

Arm's length principle

The IN details the applicable legislation and provides SARS' view on the application thereof to specific factual circumstances.

It addresses inter alia the use of credit ratings and bank opinions and opines on the methodology to determine risk-free and risk-adjusted rates of return.

The tax consequences for a taxpayer who fails to meet the arm's length standard are also summarised (i.e. the primary and secondary adjustments).

Permanent establishments (PE)

SARS will apply consistent principles for situations involving PE's. The PE will be viewed as a separate enterprise, subject to the application of the arm's length principle, but notional charges will not be permitted.

Other

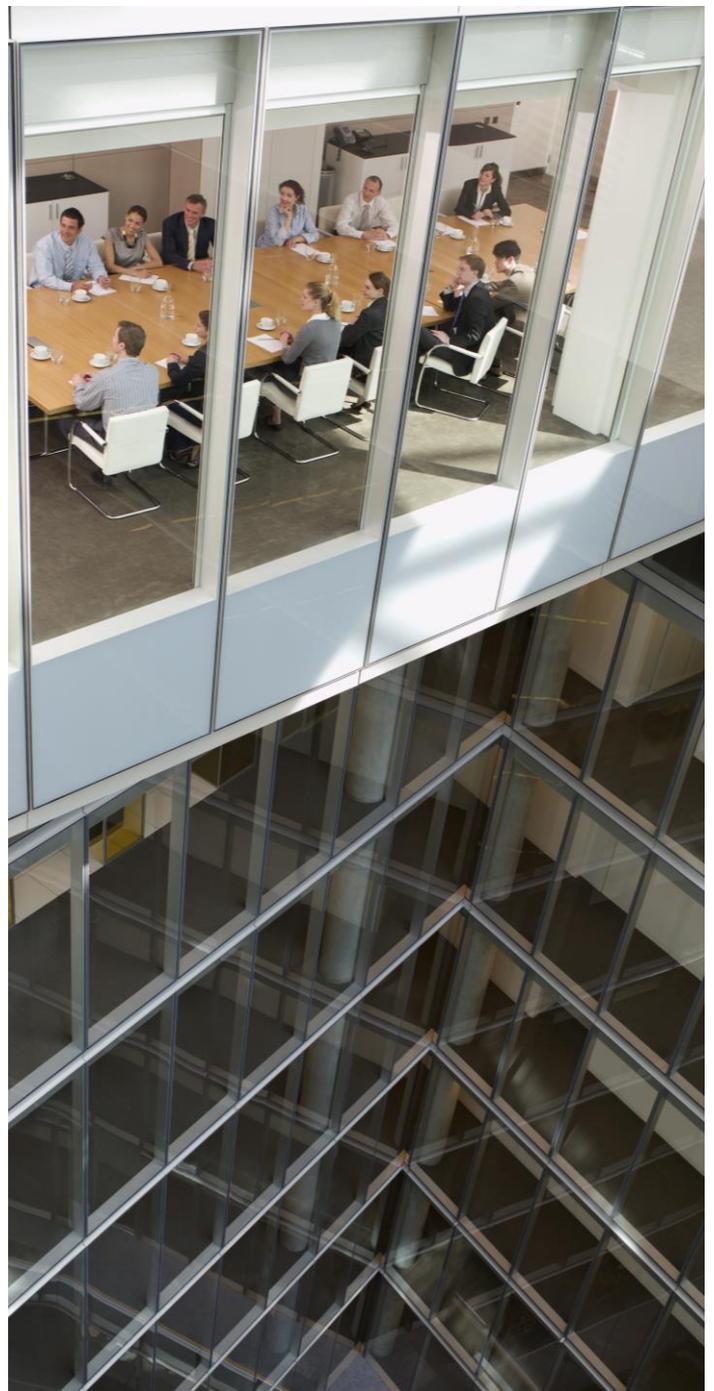
- Advance pricing agreements: The IN notes that SARS is considering the use of APA's in future, in which case a taxpayer and SARS may reach an advance agreement on intra-group cross-border debt that would meet the arm's length requirements.
- Interaction of section 31 with sections 23M and 23N: SARS opines that section 31 applies prior to considering the impact, if any, of section 23M and section 23N.
- SARS confirms that the withholding tax on interest calculation will not be effected by any transfer pricing adjustments.
- The IN would be applicable from years of assessment commencing on or after 1 April 2012.

It is important to note that an IN is simply SARS' view of the legislation, and may not necessarily be a correct interpretation. There are a number of issues in the IN that are, from our view concerning to taxpayers. PwC will be addressing a number of these concerns in a detailed submission to the National Treasury.

Due date

Comments on the IN are due by 29 April 2022.

Should you wish to give input in our submission, please contact one of the people noted above.



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