



Tax Alert

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Let's talk

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SARS issuing transfer pricing information-requests on cross-border loans

In brief

SARS has started issuing information-request letters in relation to cross-border intercompany loans which are potentially subject to SA's transfer pricing rules. Taxpayers should therefore ensure that the necessary documentation and evidence are in place to support the arm's length nature of such loans.

In detail

Background

Section 31 of SA's Income Tax Act sets out the arm's length requirements for "*affected transactions*" which includes (amongst other things) financial assistance between SA tax residents and foreign connected persons or associated enterprises.

SARS relies largely on the OECD Transfer Pricing Guidance (with some interesting exceptions) in assessing the application of, and adherence to, the arm's length principle. On 17 January 2023, SARS finally published its Interpretation Note 127: *Determination of the Taxable Income of Certain Persons from International Transactions: Intra-Group Loans* ("**IN127**") which provides guidance on SARS' application of the arm's length principle in the context of the pricing of cross-border intercompany loans.

IN127

IN127 indicates that SARS will consider a transaction to be non-arm's length if, amongst other factors, some or all of the following circumstances exist:

- the taxpayer is thinly capitalised (the amount of debt is excessive); and
- the repayment terms, interest rate, currency of the loan, or other terms are not what would have been entered into or agreed to between independent parties.

Therefore, the pricing of cross-border intercompany loans includes a consideration of both the amount of debt and the cost of the debt.

SARS' request for information

Examples of information that SARS is requesting include:

- Group policies regarding the intercompany loans
- Clarification of the nature of the loan
- Copies of written agreements covering the loan
- Detailed explanations of the terms and conditions of the loan (e.g. maturing date, capital and interest repayments, covenants and securities)
- Deal summaries and amendments covering the entire duration of the loan
- Information regarding how the loan amount was extended and arrived at
- Explanation of the purpose of the loan
- Confirmation on how the loan was actually utilised (e.g. to fund capital assets, working capital)
- Minutes of meetings regarding obtaining or use of the loan
- Loan amortisation schedule and borrowing summary
- South African Reserve Bank submissions, approvals and reporting of the loan
- Proof of ongoing monitoring and periodic review of the loan
- Evidence of how the borrower considered the ability to service the debt and maintain funds needed to meet the operational requirements

- Processes to ensure availability of funds to repay the principal amount of the loan and interest, providing collateral, monitoring and fulfilling of any other obligations
- How the creditworthiness of the borrower was assessed and monitored during the term of the loan
- Comparability/benchmarking studies
- Details of any security or related transactions

Our recommendation

Taxpayers should ensure that all the necessary information is in place to evidence the arm's length nature of loans subject to the arm's length requirements in section 31.

Whilst IN127 summarises SARS' view on how cross-border intra-group loans should be priced for TP purposes, taxpayers are also reminded of the TP documentation and filing requirements set out in various other SARS publications.



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