Implementation of advanced pricing agreements by the South Africa Revenue Service: a critical review

By

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Abstract

Transfer pricing may be described as the process by which related entities set prices at which they transfer goods or services between each other. Multinational entities (MNEs), by virtue of its global presence, are subject to different tax laws of different countries. Accordingly, MNEs can potentially set transfer prices that would result in more profit being earned in lower taxing jurisdictions rather than in countries with higher tax rates. As a result the tax base of higher taxing jurisdictions is eroded by virtue of MNE’s transfer pricing policies. The Organisation for Economic Cooperation and Development (OECD) noted that the erosion of a country’s tax base is a global issue faced by many tax authorities.

In order to be transfer pricing compliant, MNEs need to ensure that their intercompany transactions are conducted at an arm’s length basis. As per the OECD Transfer Pricing Guidelines, the arm’s length principle is defined as:

“the international transfer pricing standard that OECD member countries have agreed [and that] should be used for tax purposes by MNE groups and tax administrations.”

The establishment of an arm’s length price by an MNE can differ to the price set by a tax authority for the MNE’s intercompany transactions. As a result of the uncertainty endured by MNEs, there has been a number of transfer pricing disputes between tax authorities and taxpayers.

In order to minimise transfer pricing disputes, the OECD has recognised the need for transparent, efficient and consistent discussions between taxpayers and tax authorities. Advanced pricing agreements (APAs), as per the OECD Transfer Pricing Guidelines, is a tool that attempts to prevent disputes from arising by proactively determining the criteria for applying the arm’s length principle to intercompany transactions.

In June 2017, South Africa adopted a preliminary position towards implementing measures to make cross-border dispute resolution between taxpayers and tax authorities more effective through the Multilateral Convention to Implement Tax-treaty Related Measures to Prevent BEPS (MLI). Although South Africa has shown its commitment to the OECD through signing the MLI, the South African Revenue Service (SARS) has seemingly excluded transfer pricing matters from the advanced tax ruling system. Accordingly, there is no APA program in place within the South African fiscal system. There is also very little explanation offered by SARS for not implementing an APA system.

This study argues that taxpayers and the tax revenue authorities have different views on the arm’s length principle. SARS and South African taxpayers are no different and may very well face such challenges. In light of such challenges, this study investigates whether SARS and the taxpayer may
find relief with the implementation of an APA program. It is suggested that through the use of APAs, the arm’s length principle will be pre-determined and agreed by the parties. This will ultimately create certainty for many taxpayers, i.e. investors, due to the predictability of the transfer prices. In addition this study recommends introducing an APA program through an amendment of the current advance tax ruling legislation in order to open the ambit so as to include transfer pricing matters. Thereafter, SARS would need to introduce an APA program under Article 25(3) of South African tax treaties, through the publication of a guide on APAs like the way it was done for the MAP.
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# Glossary of Terms and Abbreviations

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<td>ADR</td>
<td>Alternate dispute resolution</td>
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<td>APA(s)</td>
<td>Advanced Pricing Arrangement(s)</td>
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<td>APMA</td>
<td>Advance Pricing and Mutual Agreement</td>
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<td>ATO</td>
<td>Australian Tax Office</td>
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<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
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<td>Bulletin 64</td>
<td>SAT Bulletin [2016] No. 64</td>
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<td>CBDT</td>
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<td>CFC</td>
<td>Chevron Texaco Funding Corporation</td>
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<td>Chevron Australia</td>
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<td>CTFC</td>
<td>Chevron Texaco Funding Corporation</td>
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<td>DTA</td>
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<td>Income Tax Act</td>
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<td>ITAA</td>
<td>Part IVA of the Income Tax Assessment Act 1936, Australia</td>
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<td>MAP</td>
<td>Mutual Agreement Procedure</td>
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<td>MLI</td>
<td>Multilateral Convention to Implement Tax-Treaty Related Measures to Prevent BEPS</td>
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<td>MNE(s)</td>
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<td>PSLA 2015/4</td>
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<td>SARS</td>
<td>South African Revenue Service</td>
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<td>SAT</td>
<td>Chinese State Administration of Tax</td>
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<td>United Nations TP Guidelines</td>
<td>The United Nations Practical Manual on Transfer Pricing for Developing Countries</td>
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<td>U US</td>
<td>United States of America</td>
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<td>USD</td>
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1 Chapter One: Introduction

The OECD is an international body that was established in 1961 with the aim of promoting economic policies that are designed to:

“(a) Achieve the highest sustainable economic growth and employment, and a rising standard of living in member countries; while maintaining financial stability, and thus to contribute to the development of the world economy;
(b) Contribute to sound economic expansion in member, as well as non-member countries, in the process of economic development; and;
(c) Contribute to the expansion of world trade on a multilateral, non-discriminatory basis, in accordance with international obligations.”

The main purpose of the OECD was to highlight economic challenges and to promote policies, in an attempt to resolve these issues. One of the key concerns that the OECD was cognisant of, is profit shifting activities by MNEs, and the resultant erosion of a country’s tax base. As a result, the OECD took a decision to conduct a study into Base Erosion and Profit Shifting (BEPS). According to the OECD, BEPS activities are defined as:

“The use of legal arrangements that make profits disappear for tax purposes, or to allow profits to be artificially shifted to low or to no-tax locations, where the business has little or no economic activity.”

One of the abusive tax practices noted by the OECD takes place within the area of transfer pricing. Transfer pricing may be described as ‘the process by which related entities [within a multinational group] set prices at which they transfer goods or services between each other.’

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MNEs, by virtue of their global presence, are subject to different tax laws within different countries. Accordingly, MNEs can potentially set transfer prices that would result in more profit being earned in jurisdictions with a low tax rate, than in countries with higher tax rates. As a result, the tax base of the jurisdiction with the higher tax rate is eroded by the MNE’s transfer pricing policies.

In 1995, the OECD published its first version of the ‘OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations’ (OECD TP Guidelines). The guidance put forward in the OECD TP Guidelines focuses largely around the concept of the arm’s length principle. As per the OECD TP Guidelines, the arm’s length principle is defined as:

“The international transfer pricing standard that OECD member countries have agreed, [and that] should be used for tax purposes by MNE groups and tax administrations.”

With rising concerns on international transactions, on structures and on transfer pricing arrangements, the OECD conducted further studies into BEPS activities. In February 2013, the OECD, in collaboration with the G20 countries, issued a report, entitled Addressing Base Erosion and Profit Shifting, followed by 15 Action Plans. The Action Plans include an extensive expansion of the OECD TP Guidelines, which created a proposed enhanced compliance framework for transfer pricing documentation. In order to reflect and clarify the positions put forward by the BEPS Action Plans, the OECD updated the OECD TP Guidelines once more, with the latest version having been released in 2017.

In the light of the Action Plans and the enhanced documentation framework, many MNEs now face increasing documentation and compliance requirements. More importantly, MNEs are required to consider and to understand the impact of intragroup transactions, together with transfer pricing in their organisation, in order to ensure that their dealings are at arm’s length. For this reason, organisations are found to be upgrading transfer pricing processes, formalising procedures and increasing documentation levels, to manage and to reduce transfer pricing risks. However, these endeavours are often found to be costly, complex and difficult to accomplish with a hundred percent certainty.


MNEs are often uncertain on whether their transfer pricing policies will be accepted by tax authorities.\(^8\) Thus, many MNEs have been levied with heavy transfer pricing adjustments, which ultimately leads to double taxation, despite the MNEs’ efforts to correct its transfer pricing.

In the case of *Chevron Australia Holdings (Pty) Ltd versus Commissioner of Taxation\(^9\)* (the Chevron case) is a prime example of different perspectives put forward by the tax authorities and the taxpayer, on the settlement of an arm’s length price. The Chevron case dealt with an intercompany loan agreement between Chevron Australia Holdings (Pty) Ltd (Chevron Australia) and Chevron Texaco Funding Corporation (CTFC).\(^10\) The issue at hand was whether the interest paid by Chevron Australia to CTFC was excessive, in relation to the arm’s length price for borrowing.

The court considered the meaning of ‘arm’s length consideration’ and used a hypothetical argument in favour of the Australian Tax Office (ATO). The court held that in a hypothetical circumstance, Chevron’s parent company would naturally provide security in the form of parent guarantees that would result in a significant reduction of the interest rate payable by the related party borrower. Accordingly, the transfer pricing assessment put forward by the ATO was upheld by the court. The Chevron case is a precise representation of the difficulties faced by many other MNEs and tax authorities on the conclusion of an arm’s length price, for intercompany transactions.

Action Plan 14 of the BEPS project aims to address the risks of unintended double taxation and uncertainty, by advocating for dispute resolution mechanisms through the Mutual Agreement Procedure (MAP). The OECD has put forward peer-based monitoring recommendations, in order to make the MAP effective and robust. In addition, many countries have opted to implement mandatory binding arbitration in their bilateral tax treaties, as a mechanism to guarantee that treaty-related disputes would be resolved within a specified timeframe.

Further to Action Plan 14, the OECD recognised the need for creating a tool that would allow the taxpayer and revenue authorities to swiftly enjoy the treaty-based recommendations and engage in a resolute manner. Accordingly, and in line with Action Plan 15, various OECD member countries developed the Multilateral Convention to Implement Tax-treaty Related Measures to Prevent BEPS (MLI), and the OECD released the text in November 2016.\(^11\)

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9 *Chevron Australia Holdings (Pty) Ltd versus Commissioner of Taxation [2017] FCAFC 62.*

10 This entity is a subsidiary of Chevron resident in the United States.

Article 16 of the MLI addresses dispute resolution mechanisms. More specifically, Article 16 also aims to encourage countries to resolve tax disputes through MAP, as outlined in Article 25(1) to (3) of the OECD Model Tax Convention\(^{12}\) on Income and on Capital (OECD Model Tax Convention).\(^{13}\)

The OECD’s work, insofar as BEPS is concerned, is admirable. However, there are various challenges from a practical point of view. For instance, although MAP can be used to deal with transfer pricing adjustments, it is done so on a reactive rather than a proactive basis. In other words, the revenue authority in a Contracting State would have had to impose an adjustment first, which would lead to double taxation, and then the taxpayer would have had to put in a request for correction. Only if the taxpayer is unsuccessful in its request for correction, may the taxpayer approach the revenue authority in the resident state for assistance. By this time, the taxpayer would have exhausted a great deal of resources, i.e. time and money. Therefore, the MAP mechanism is regarded as time consuming and costly.

Given that some of the OECD’s recommendations are impractical from a MAP perspective, there are various other proactive recommendations that can be considered, to deal with these challenges. The OECD TP Guidelines have highlighted the use of tools that require proactive engagement between taxpayers and tax authorities – an example of such a tool is known as APAs.

1.1. Background on APAs

The concept of APAs is believed to date back to the nineties. The Internal Revenue Service (IRS) in the United States issued a binding APA for the first time in 1991.\(^ {14}\) At that time, companies such as Apple Computer Inc., Matsushita, Sumitomo Bank Capital Markets, General Motors and Barclays Bank requested an early application of the APA.\(^ {15}\)

Following on the IRS’s initiative, many countries such as India and Australia, then began to introduce APA practices, with the intention of protecting the tax base of the country, by imbedding certainty for taxpayers.

In October 1999, the OECD introduced guidance\(^ {16}\) on APAs, via an annex to the OECD TP Guidelines. As per the OECD, an APA is:

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15 Ibid.
“An administrative approach that attempts to prevent transfer pricing disputes from arising, by determining criteria for applying the arm’s length principle to transactions, in advance of those transactions taking place.”

It is clear from the OECD’s definition that the intention of an APA is to provide certainty through proactive engagement between taxpayers and tax authorities. The United Nations Department of Economic and Social Affairs’ practical manual (UN Practice Manual) follows the OECD in its definition of an APA, but also adds that APAs are purposeful to cross border transactions:

“To a great extent, APAs have reduced transfer pricing adjustment risks for multinationals, especially under bilateral APAs involving two countries, and therefore the number of applications for APAs has reached almost the number of adjustment cases in some developed countries.”

In order to document the process for conducting an APA, the tax authority must issue regulations. These regulations are generally consistent with the guidance offered in the OECD TP Guidelines.

The OECD TP Guidelines refer to various types of APAs. Bilateral APAs involve the competent authorities of two tax administrations under the tenets of a treaty. A number of bilateral mutual APAs are referred to as multilateral APAs. The annex to the TP Guidelines contains a recommendation that APAs should be concluded on a bilateral or on a multilateral basis, between competent authorities, through the MAP of the relevant treaty.

There are various features of an APA programme that make it workable. The regulations that breathe life into an APA state that an APA should be “accessible, fair and informative”. Ideally, there should also be a skilled team of resources to handle APAs. These skills should go beyond the task of simply collecting revenues on behalf of the State. In addition to resources and regulations, Mulachella puts forward the following features of an APA programme:

19 OECD, Guidelines for Conducting APAs under the MAP (see Chapter 1, footnote 16)
20 Ibid at paragraph 5.
21 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 69. (see Chapter 1, footnote 14)
22 Ibid.
“Funding: the funding in particular for bilateral and multilateral APAs can be costly, and the source is commonly from the state budget or to be borne by the applicant.

Feature: each country has their specific requirements for APAs, which contain broad accessibility to the APA, and any facility and limitation. The features are mostly aligned with each of the applicants’ domestic laws; and

Treaty access: this includes the taxpayer’s eligibility and the availability of corresponding adjustments and dispute resolution mechanisms.”

The main purpose of an APA is to provide clarity and to gauge certainty for all parties involved. As with any programme, there may be disadvantages with APAs which will be discussed in later chapters. However, the primary expectation of an APA is more than clear. A more detailed review of the various APA structures and the benefits and the contents of an APA will be discussed in the following chapter.

1.2. South Africa’s Position on APAs

Section 31 of the Income Tax Act 58 of 1962 (Income Tax Act) is the formal transfer pricing legislation for South Africa, and it came into effect on 1 July 1995. Section 25 of the Tax Administration Act No. 28 of 2011 (Tax Administration Act), as amended, read with Section 31 of the Income Tax Act provides for a three-tiered documented approach for transfer pricing as well. In line with the legislation, SARS, published Practice Note 7 on 6 August 1999, in order to provide guidance on how Section 31 should be interpreted.

Although the Income Tax Act does not specifically provide for the application of the OECD TP Guidelines, Practice Note 7 includes the principles set out by the OECD. The arm’s length principle is the fundamental concept that underpins the South African transfer pricing legislation.

It must be noted that South Africa is not formally a member of the OECD, therefore the findings of the OECD are not legally binding on South Africa. However, South Africa has been an active participant in many OECD projects by applying certain principles and implementing the guidance

23 Ibid.
offered under the BEPS project. An example of South Africa’s initiatives to impose the OECD recommendations, is the signing of the MLI.

SARS, through signing the MLI in June 2017, adopted a preliminary position towards implementing measures to make cross-border dispute resolution between taxpayers and tax authorities more effective.

During July 2018, SARS also released detailed guidance on MAP procedures. SARS has advocated that the MAP will allow taxpayers to request assistance on topics such as transfer pricing adjustment requests, the attribution of profits of a permanent establishment, dual residence of individuals and persons other than individuals, withholding tax levied beyond what is permitted by the applicable Double Tax Agreement (DTA), and any other case in which a person considers that the taxation is not in accordance with the applicable DTA.

Although South Africa has shown its commitment to the OECD through signing the MLI and adopting MAP, SARS has seemingly excluded transfer pricing matters from the advanced tax ruling system. Accordingly, there is currently no APA programme in place within the South African fiscal system.

SARS currently has a tiered dispute resolution process for transfer pricing issues. This process is kick started when SARS issues a letter of findings wherein it explains the adjustments being made. Once the taxpayer responds, SARS will either confirm or rebut the taxpayer’s position. The final outcome of this process can also be appealed to the Tax Court. Taxpayers also have the option of using MAP or an alternative dispute resolution process.

The Davis Tax Committee has conducted various studies into the application of the BEPS project to the South African regulatory environment. Amongst the other key findings, the Davis Tax Committee has repeatedly noted the resource incapacity within the SARS transfer pricing unit. This issue could perhaps be the main motivation for the lack of an APA programme in South Africa.

Be that as it may, there are various reasons for implementing an APA programme in South Africa. Given that South Africa is a developing country, much economic growth is expected to flow in, in order to maintain the fiscus. Accordingly, foreign investment needs to be attractive from a tax perspective. Swift dispute resolution mechanisms, such as APAs, allow MNEs to conduct their affairs in a manner that is consistent with the rulings from tax authorities.


Moreover, South African taxpayers and SARS will face a great deal of difficulty in resolving transfer pricing disputes in the absence of an efficient and robust programme. In the light of such challenges, SARS and the taxpayer may find a suitable alternative for compliance with the implementation of an APA programme. Through the use of APAs, the arm’s length principle will be pre-determined and agreed by the parties. This will ultimately create certainty for taxpayer and foreign investors at large, who wish to deal proactively with their tax arrangements.

1.3. Objective and research problem

In light of the theory discussed thus far, this study aims to investigate whether or not SARS should introduce an APA programme in South Africa by, inter alia, analysing the advantages and disadvantages of such a programme. If it is found that there is merit in such an endeavour, this study will also seek to propose the form that the APA programme should then take. This study is influenced by the guidance offered in the OECD TP Guidelines with regard to the policy and the administrative aspects of applying APA policies.

1.4. Research method

In order to conduct and apply the research to this study, a critical research method will be used. This methodology will be combined with an interpretative approach where required. The research methodology mentioned herein will be utilised in a manner to reflect the history and background of APAs, current global trends on APAs and South Africa’s current position on the implementation of an APA program. The data will then be critically analysed and interpreted so as to formulate an argument in favour of an APA program in South Africa.

The type of data required for this study are OECD reports, tax journal articles, media articles, international tax books, case reports as well as South African and global regulations. The necessary data will be collected via online databases such as, but not limited to, the IBFD, LexisNexis library and OECD library.

1.5. Structure of dissertation

This study is comprised of six chapters. Chapter one provides an overview of the study and sets out the background of APAs from an international and local perspective. Chapter one also establishes the research question and structure of the study.

Chapter two delves into the details of the APA process and discusses the advantages and disadvantages of the APA programme. Chapter two also includes an overview on the APA process in China and India. This chapter looks at the challenges faced by tax authorities in China and India respectively and the manner in which these problems were overcome. China and India are part of
the BRICS countries together with South Africa. These countries were chosen as they have introduced APA programmes which could serve as examples for South Africa.

Following from Chapter two, Chapter Three takes a global view on countries that have implemented APA programmes both formally and informally. This section will also look at the form in which the APA programme has taken, i.e. through MAP or formal regulations.

Chapter Four discusses the Chevron case in detail. The Chevron case is a recent dispute that deals extensively with transfer pricing matters. The case is relevant for the study as it is used to prove how an APA programme could have been used to avert the litigation. The issues and grounds for the judgement are discussed in this chapter.

Chapter Five is the basis for the argument put forward in support of an APA programme in South Africa, as well as showing the advantages that both taxpayers and SARS will derive from such a programme.

Lastly, this study will conclude with a recommendation of the form and the shape that the APA programme within South Africa should take. It will take a look at the current legislation as well as the steps that should be taken to ensure a swift introduction of an APA programme in South Africa.

1.6. **Scope and limitations**

This study has chosen to use China and India as a point of reference for APAs. Apart from both these countries being regarded as developing countries and members of BRICS, the reason for this selection stems from the wide APA network that both these countries currently have in place. Both tax administrations in these countries have dealt extensively with the challenges that come out of an APA programme and seem to have overcome them. This provides a good example for South Africa.

The area that has not been covered in this study is the process and potential challenges of revoking legislation in South Africa that does not support APAs. This study rather focuses on whether or not there is merit in introducing an APA program and the manner in which SARS can overcome any current challenges to achieve this. In addition, this study discusses the Chevron case that took place on 23 October 2015 before the Federal Court of Australia in detail, however there is no examination of the appeal case\(^\text{28}\) thereafter.

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\(^{28}\) The appeal case went before The Federal Court of Australia on 27 February-2 March, 14 March 2017. Chevron lost the appeal case.
Chapter Two: APA process and its operation in China and India

As tax authorities are becoming more aware of transfer pricing practices, there is a sharper focus on MNEs and their compliance from an international tax perspective. MNEs are facing a greater deal of scrutiny on their trading activities within the global marketplace. As a result, tax authorities critically analyse transfer pricing models and request transfer pricing adjustments, should they find any inconsistencies.

From the moment a tax authority presents its findings to the taxpayer on its transfer pricing adjustment, the taxpayer finds itself in a lengthy and drawn out administrative process to resolve any unjustified findings. Accordingly, there is a need for a streamlined process that involves proactive engagement by both the tax authority and the taxpayer, whereby both parties reach a consensus on the transfer pricing policy that is to be implemented by the taxpayer.

As mentioned before, the OECD has advocated for the use of APAs as a means of proactively achieving clarity on transfer pricing policies; thereby reducing the number of transfer pricing disputes that arise.

“The objectives of an APA process are to facilitate principled, practical and co-operative negotiations, to resolve transfer pricing issues expeditiously and prospectively, to use the resources of the taxpayer and the tax administration more efficiently, and to provide a measure of predictability for the taxpayer.”

Many tax authorities around the world have accepted the OECD’s recommendation and have introduced APA programmes, in an effort to confirm the criteria of, inter alia, the arm’s length principle; with regard to the taxpayer’s economic policies. Accordingly, APA programmes, especially bilateral APAs, have claimed merit in reducing transfer pricing adjustment risks for many MNEs.

This chapter aims to analyse the details of the APA process and discusses the advantages and disadvantages of the APA programme. Thereafter there will be an overview of the APA process in

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29 OECD, 2017. *OECD TP Guidelines - Annex II to Chapter IV. Advance Pricing Arrangements*. Section A.3 at paragraph 9. (See Chapter 1, footnote 6)
30 UN, 2017. *UN Practical Manual*. Page 375 at paragraph B.8.10.1. (see Chapter 1, footnote 18)
China and India. The challenges faced by tax authorities in China and India respectively will be discussed as well as the manner in which these problems were overcome.

2.1. The APA Process

International organisations such as the United Nations, OECD and the European Union have offered guidance on the process to conclude APAs. There are generally four steps that need to be followed, and these include pre-filing discussions, formal filing of the APA application, analysis, evaluation by the tax authority and lastly, the negotiation and the agreement by both parties.

The pre-filing discussion is an important feature of the APA process. It allows the taxpayer and the tax authority to expedite the process, in order to assess whether there is merit in taking the APA process further. During this process, both the taxpayer and the tax authority can request information so that each party can consider the risks and the benefits, prior to entering into an APA. It must be noted that the outcome of the pre-filing discussion is not binding on either party. Notwithstanding the outcome, the tax authority is required to provide a report on whether it rejects the taxpayer’s request, or if the filing is feasible, should the pre-filing discussion be a mandatory meeting.

As mentioned above, the taxpayer will only be allowed to file an APA when the tax authority approves the merit of the application, subsequent to the pre-filing discussion. Once the green light is received, the taxpayer will proceed to file a formal APA application, together with the requisite documentation and information. The information required by a formal APA application generally consists of a covering letter, an executive summary of the transactions, the company background, an industry analysis, a functional analysis and an economic analysis. The Annex to chapter IV of the OECD TP Guidelines, together with the European Union APA Guidelines, is more prescriptive on the type of documentation that should accompany an APA application.

The tax authority on behalf of the taxpayer, will engage the other tax authority so that both competent authorities may engage in the analysis and the evaluation process. It is important to note that the process from here on, does not include the taxpayer’s direct involvement in the negotiations.

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31 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 71. (see Chapter 1, footnote 14)
32 Ibid.
33 Ibid.
34 Ibid.
During the competent authorities’ deliberation over the application, it might make requests for additional information or for conduct interviews at the taxpayer’s business premises. The OECD even recommends the use of third party independent experts to gain a full understanding of the case, on the taxpayer’s behalf.

Mulachella summarises this phase as follows:

“At this stage, each relevant tax authority may prepare its position paper by examining the comparable analysis, the methodology applied, the critical assumptions and the conduct independent reviews and evaluations.”

It is important that the taxpayer supports the competent authorities by timeously responding to information requests, in order for the process to remain efficient.

The negotiation and the agreement phase generally serves as a platform for the competent authorities to discuss the issues that have emerged from the analysis phase. An action and a time plan is also prepared at this stage of the process. In order to be efficient, competent authorities may prepare a report detailing their position and they will then hold a meeting, either by way of conference calls or face to face discussions, to elaborate on their findings.

It is interesting to note that although the taxpayer cannot participate directly, the competent authorities may allow the taxpayer to present its case as part of the MAP process. Once a decision is reached by the competent authorities, there will be a resolution in the form of a MAP document and this document will provide the necessary certainty and assurance that the related party transaction will be priced as agreed.

2.2. Critiques of the APA Programme

There are many pros and cons of any economic framework. However, the need for an APA programme and the advantages thereof far exceed any pitfalls that may arise. The United Nations Practical Manual on Transfer Pricing for Developing Countries (United Nations TP Guidelines) has noted a key advantage of the APA system:

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36 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 72. (see Chapter 1, footnote 14)
37 OECD, Guidelines for Conducting APAs under the MAP. Section D.2.1 at paragraph 55. (see Chapter 1, footnote 16)
38 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 72. (see Chapter 1, footnote 14)
39 Ibid.
40 Ibid at page 73.
41 Ibid.
42 Ibid.
43 UN, 2017. UN Practical Manual. Page 375 at paragraph B.8.10.1. (see Chapter 1, footnote 18)
"One of the key advantages of adopting an APA system is that uncertainty can be eliminated through the enhancement of the predictability of the taxation of international transactions. Developing countries thus have a good opportunity to obtain access to the existing documentation which is relevant to their local operations."\(^{44}\)

Another advantage of an APA system for tax authorities is the ability to gather data on MNEs voluntarily. Given that the availability of economic data for MNEs is scarce in developing countries, the APA programme can be used as an administrative tool by tax authorities, to gather such information. During the consultation process, tax authorities can take the opportunity of learning about the MNE’s business strategies and more broadly, the challenges that MNEs face in the industry within which they operate. With more in-depth knowledge of the industry and factors that affect trading, tax authorities will be able to make informed decisions with regard to the adjustments it makes for audit purposes.

A necessary component of introducing an APA programme is having sufficient skilled resources. The OECD TP Guidelines makes it pertinently clear that dedicated and skilled people are needed to make an APA programme functional.\(^{45}\)

"Tax authorities are encouraged, where possible, to devote sufficient resources and skilled personnel to the process to ensure that cases are settled promptly and efficiently."\(^{46}\)

This might be a challenge for certain tax authorities and could perhaps be the reason that they opt not to implement APA programmes. However, there is also the option of hiring third party independent experts, with specific economic or industry experience who can assist on an ad hoc basis. Tax authorities could employ such experts to train staff members and explicitly use the trained staff for APA matters only.

Another obstacle for tax authorities who wish to implement an APA programme is financial resources.\(^{47}\) The APA process can become costly when the preferred method of communication is through face to face meetings.\(^{48}\) These types of meetings can escalate travel and accommodation costs, and this begs the question as to who will bear the burden of these costs? Naturally, the costs

\(^{44}\) Ibid at paragraph B.8.10.2.
\(^{45}\) OECD, 2017. OECD TP Guidelines - Annex II to Chapter IV. Advance Pricing Arrangements. Section D.1 at paragraph 53. (See Chapter 1, footnote 6)
\(^{46}\) Ibid.
\(^{47}\) Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 74. (see Chapter 1, footnote 14)
\(^{48}\) Ibid.
should be funded by the country’s revenue budget. However, many countries face more pressing economic challenges, such as education and basic housing for the less fortunate members of society. Accordingly, it is recommended that costs should be kept to a minimum unless it is necessary to incur an expense for the benefit of the taxpayer. In addition, any out of pocket costs that are incurred during the APA process, such as travel and accommodation costs, should be borne by the taxpayer.\(^\text{49}\) Notwithstanding the burden of costs on the taxpayer, the tax authority still has the responsibility of ensuring that the future benefit for the taxpayer should outweigh the fee.\(^\text{50}\)

An APA programme is definitely a worthy mechanism for developing a non-adversarial platform for taxpayers and tax administrations, with room for consultation, mitigation of costs for transfer pricing examinations and disclosure of information, in order for tax administrations to understand complex international transactions taken-on by multinationals.\(^\text{51}\)

### 2.3. APAs in China

An example of a tax authority who has successfully introduced the APA system in its regulations is the Chinese State Administration of Tax (SAT). In 1998, APAs were introduced as one of the “other” transfer pricing adjustment methods.\(^\text{52}\) In 2002, the APA program was established formally through Article 53 of The Implementation Rules of the Tax Collection and Administration Law of the People’s Republic of China. Through such a publication, APAs were removed from the ambit of transfer pricing methods and formed as a separate program. More detailed rules around the negotiation and conclusion procedures, requirements, follow up, execution and monitoring, as well as guidance on APA administration was published by the SAT in 2004.\(^\text{53}\)

Although there were a number of attempts by local Chinese tax authorities to conclude APAs, it was that APAs lacked proper functional and risk analyses. Despite SAT’s effort to formalise rules around APAs, the main challenge at this time was the absence of standardized and clearly defined implementation guidance and highly simplistic APA articles.\(^\text{54}\) For this reason, local Chinese tax authorities adopted varied practices when concluding APAs.

In order to curb this challenge, SAT has since required local tax authorities to submit draft unilateral agreements to SAT for review and approval prior to concluding the APA process. In addition, local tax authorities are also required to promote the use of APAs and have to strictly adhere to regulations

\(^\text{49}\) Ibid.  
\(^\text{50}\) Ibid.  
\(^\text{51}\) UN, 2017. UN Practical Manual. Page 375 at paragraph B.8.10.2. (see Chapter 1, footnote 18)  
\(^\text{54}\) Ibid.
of the APA programme as set out by SAT. As a result, local tax authorities in China have since
achieved a level of uniformity and have successfully concluded many APAs since 1998.

In pursuit of further efficiencies, SAT issued SAT Bulletin [2016] No. 6455 (Bulletin 64) in 2016, which
speaks to the administration of APAs. In line with Bulletin 64, the taxpayer must ensure that its
related party transactions amount to at least RMB forty million over a three year period. This
amount must be calculated in order to total RMB forty million prior to the year that the SAT accepts
the MNE’s notice of intent to enter an APA. The APA process entails a pre-filing meeting, intent for
APA, analyses and evaluation, formal filing, negotiations signing, and monitoring and execution.

The key steps in the APA process are to analyse and to evaluate the operations of the business, as
well as the related party transactions. During this step, the tax authority invokes the arm’s length
principle as a basis for the transfer pricing policy. The tax authority also has the option of conducting
on site functional and risk interviews. This allows the tax authority to understand the transaction
flows, so that it may conclude an appropriate transfer pricing policy. This assists the tax authority
with the decision of whether to accept the formal filing of the APA or not.

Bulletin 64 contains key changes to the previous set of rules contained in Article 48 of Chapter 6 of
Circular 2. The introduction of the three year period enables the SAT to focus on MNEs who have
ongoing operations and an array of related party transactions. The new rules also allow the SAT to
reject APA applications for MNEs that fail to submit annual related party disclosure forms according
to the relevant regulations.

Although the SAT has introduced its APA regulations recently, China has always been regarded as
an active participant in the international tax reform process. Since the issuance of its first APA rule
in 1998, up until 2017, China has signed fifty-one bilateral APAs and had made forty-three transfer
pricing corresponding adjustments by the end of 2015. In addition, SAT eliminated international
double taxation exposures of RMB 18.7 billion for MNEs during the period 2011 to 2015. It was
apparent from the applications that the industry which APAs appealed to the most was the

55 China’s State Administration of Taxation, 2016. SAT Bulletin [2016] No. 64. 18 October 2016.
56 Deloitte Tohmatsu Tax Co., 2016. SAT issued new rules to improve administration of advance pricing agreements, Deloitte, October
2016 Tax Analysis. Available: https://www2.deloitte.com/content/dam/Deloitte/jp/Documents/tax/jp-it-tax-analysis-china-
57 Ibid.
58 Ibid.
59 Ibid.
60 Ibid.
61 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 76. (see Chapter 1,
footnote 14)
62 Ibid.
manufacturing sector. In addition, it surfaced that the transactional net margin method was the most preferred method for testing transfer pricing transactions.63

The Tokyo based financial services firm, Deloitte, has expressed that the Chinese Tax Authorities have gained a great deal of experience from handling APAs during recent years. This has allowed the Chinese Tax Authority to apply higher standards to the reviewing and the concluding of APAs.

2.4. APAs in India

Another administration that is a prime example of being an APA programme leader is the Central Board of Direct Taxes (CBDT) in India. Having introduced APA provisions in its legislation in 2012, the CBDT received more than eight hundred applications for APAs.

Approximately 85% of the applications were for unilateral APAs between a taxpayer and the CBDT.64 As at 31 March 2018, there were one hundred and ninety-nine unilateral and twenty bilateral APAs that were concluded.65 It was apparent from the applications that the industry which APAs appealed to the most was the information technology industry.66 In addition, it surfaced that the transactional net margin method was the most preferred method for testing transfer pricing transactions.67

Since the inception of the APA programme, the Indian Tax Authorities have faced difficulty in dealing with the influx of applications for APAs. It took the CBDT as long as thirty-nine months to grant APAs. However, the CBDT has recently proved to be more efficient and robust in dealing with applications from taxpayers. During the period 2016 to 2017, the Indian Tax Authority steadily reduced the timeframes for both unilateral and bilateral APAs.68

The achievement of India’s APA reduced timelines could be attributable to a number of factors, ranging from the availability of regulations to the government’s support of the APA programme.69 However, one of the key factors that makes the APA programme a successful endeavour is the highly skilled officers of the CBDT who are enthusiastic on furthering the objective of understanding the industry.70 Their complete dedication to the programme itself ensures timeous dealings with

64 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 76. (see Chapter 1, footnote 14)
67 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 77. (see Chapter 1, footnote 14)
68 Ibid.
69 Ibid.
70 Ibid.
applications and taxpayers. The CBDT now considers the work of individuals within the APA department as productive as opposed to working in audit and litigation processes:

“While taxpayers have managed to get certainty over transfer pricing issues for five or nine years (depending upon whether rollback provisions are applicable to an agreement), the Government has been able to divert resources away from the audit and litigation processes to more productive work.”

Based on this statement, one can gather that challenges such as resourcing and skills for the establishment of an APA programme can be overcome with proper planning. Overall, the CBDT sees a great deal of benefit in the establishment of an APA programme in India. The CBDT has advocated as follows in support of APAs:

“The Indian APA programme is poised to move ahead quicker than it has done so far. The Government is aware of the benefits of the programme and how it is helping in creating a conducive environment for global corporate giants to do business in India. In view of this, the Government is committed to strengthen the programme by providing it with adequate human and physical resources. All this augurs well for both the taxpayers and the tax administration.”

The CBDT has attracted positive attention for making the APA programme a more efficient process. However, the reasons underpinning the success of the programme has been critiqued as naïve. According to author Goel, who writes for the Kluwer International Tax Blog, the uncertainty resulting from the OECD’s ongoing work with BEPS has led many taxpayers to actively seek APAs. Therefore, the number of APA applications that the CBDT receives has increased over the years. In addition to this, there has been an introduction of the US-India APA program. Indian taxpayers with operations in the US are now able to secure bilateral APAs which has led to a further influx of APA applications for the CBDT. Goel warns against the impression that the influx of APA applications is due to the CBDT’s efficiencies as this is not the case.

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71 Ibid.
73 Ibid.
75 Ibid.
76 Ibid.
In addition to the misconception offered by Goel, there are also a few challenges with the Indian APA programme that was highlighted:

“There is little transparency in the APA process and companies do not want to run the risk of getting entangled in the bureaucratic processes. Further, there is significant delay in concluding APAs and that certainly is a disincentive to many. The APA filing fees are exorbitant and no step has been taken to rationalize the fees to ensure a level-playing field.”\(^77\)

Although the CBDT has made an effort to improve the time in which an APA is concluded, Goel puts forward that the time in which it takes the CBDT to conclude an APA is still an issue:

“The recent APA statistics published by the CBDT show that it takes an average time of nearly four years to conclude a bilateral APA. The CBDT last week announced that it has signed a total of 24 APAs in the last years. This means that over 150 applications are pending as on date. This is a big cause for concern among companies. Given the lack of transparency in the APA program, what causes the delay is not clearly known. However, the delay is attributable to either the applicant in submitting documentation or otherwise dilly-dallying around, or to the CBDT in processing the application and preparing or approving what is called an ‘APA Position Paper’, or to the foreign tax authority in prolonging bilateral negotiations.”\(^78\)

According to Goel, there are solutions that could be utilised to overcome the current efficiency challenges faced by the CBDT. The issue of staffing resources needs to be looked at. The CBDT needs more personnel at the Commissioner-level to ensure that the APA process reaches its conclusion quickly and more effectively.\(^79\)

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\(^77\) Ibid.  
\(^78\) Ibid.  
\(^79\) Ibid.
Goel recommends that the pre-filing meeting is merely optional and is not necessary for the APA process. The CBDT routinely requests the pre-filing meeting and perhaps the elimination of this requirement, where it is not necessary, will save the taxpayer and the CBDT time.\textsuperscript{80}

From a planning perspective, it may be worthy for the CBDT to create a timeline in which it sets the amount of time required for each stage of the APA process. In this way, the taxpayer and the CBDT will be held accountable should there be any delays in the process. If there is a commitment to conclude an APA application within a set amount of time, this might attract more taxpayers to use the APA route.\textsuperscript{81}

Lastly Goel submits there needs to be an IT infrastructure component to the process. The introduction of an e-service filing of APA-related documentation will greatly increase the speed, ease and efficiency of the APA process.\textsuperscript{82}

Whilst the recommendations from Goel are worthy of consideration, there is an element of reasonability that must be borne in mind. The issue of increased personnel will always be an ongoing challenge for the CBDT. The more APA applications it receives, the more likely it is that there will be delays in the process and the CBDT will always need more staff to meet the demand. The issue herein is more towards the level of expertise needed from personnel. APA applications aren’t purely administrative in nature. The consideration of APA applications requires an economic and legal background from each employee. Should the availability of such skills be high, then the CBDT can easily procure the personnel it needs.

On the issue of setting a specific timeline for the conclusion of the APA process, such timeframes will be difficult to cement for every APA application as each related party transaction is different. Therefore there might be the case where special expertise may be required for more complex transactions and the CBDT or the taxpayer will need time to source such resources. Accordingly Goel’s suggestion of abiding to hard and fast timelines may be overly optimistic.

Despite the criticisms of the APA process in India, it appears that the first prize was the seriousness with which the Indian Tax Authority has taken on dispute resolution. Furthermore, they do not rely on APA programmes alone for the reduction of disputes on transfer pricing issues. The CBDT has also incorporated the BEPS Action Plans into its domestic regulations and has specifically, introduced the rollback provision with the requirements of transfer pricing documentation in July 2014.\textsuperscript{83} The rollback feature is applicable for a maximum of four years prior to the first year of the

\textsuperscript{80} Ibid.
\textsuperscript{81} Ibid.
\textsuperscript{82} Ibid.
APA period. Therefore a taxpayer enjoys a level of certainty with regard to its transfer pricing for a maximum of nine years if the rollback feature was utilised. In addition, the Indian Tax Authority has also introduced MAP procedures that taxpayers can take advantage of. All these efforts of the CBDT allow taxpayers to gain more certainty around transfer pricing issues, which in turn, reduces the number of transfer pricing disputes that the courts have to deal with on a daily basis.

Apart from following the objectives of the OECD, the Indian government has established a domestic dispute resolution system with an appeal process, and further escalation to the Tax Tribunal, High Court and the Supreme Court. Furthermore, the Indian government, under the existing provisions of the Income Tax Act, formed an alternative dispute mechanism; the Dispute Resolution Panel, to resolve disputes relating to transfer pricing in international transactions.

2.5. APAs in the United States of America (United States)

Although not a developing country like South Africa, it is interesting to note how the United States has responded to the APA guidance in the OECD TP Guidelines. The United States introduced its APA programme in 1991. The Internal Revenue Service has executed more than one thousand six hundred APAs since then. For the sake of efficiency, the Internal Revenue Service opted to combine the APA and the MAP offices, which culminated in the Advance Pricing and Mutual Agreement (APMA) unit.

The challenges faced by the United States subsequent to implementation of its APA programme is no different to that of China or India. One of the difficulties that the United States had was around resource constraints in staff and funding for travel. Inevitably the lack of key personnel and funding meant that applications for APAs could not be dealt with timeously:

“Perhaps, there is no area more sensitive or crucial to the success and utility of the APA programs as its funding. APAs are particularly fact intensive and contain issues that are difficult to resolve, requiring the dedication of a knowledgeable and talented staff. Chronic short – staffing, along with inquiries and lawsuits that have siphoned the APA Program’s resources, has plagued the APA Program in recent years. Timeliness goals and case currency are simply

84 Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 78. (see Chapter 1, footnote 14)
85 Ibid.
86 Ibid.
not possible without a string and well-staffed APA Program. We recommend that the APA Program be fully staffed to meet its timeliness goals and be provided additional staff to respond to the government inquiries and lawsuits into its activities.\(^{88}\)

Having taken note of the staffing issues, the Internal Revenue Service employed a highly skilled labour force to deal with transfer pricing dispute resolutions.\(^{89}\) Currently the United States has signed 1713 APAs into effect.\(^{90}\)

\(^{88}\) Ibid at page 5.
\(^{89}\) Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 78. (see Chapter 1, footnote 14)
3 Chapter Three: Global snapshot of APA programmes

This chapter provides key insight into APAs that are currently in place around the world and sets the scene for the manner in which it has been implemented by tax administrations globally. This chapter summarizes the findings in the Cahiers De Droit Fiscal International Report\(^1\) (Cahiers Report) and where necessary, updated information was sourced to supplement this section.

3.1. Overview

Tax administrations around the globe grapple with profit shifting activities undertaken by MNEs. Although the issue of transfer mispricing is not a new one, cross border activities within MNES face a great deal of scrutiny in light of the awareness created by the BEPS project. Often taxpayers find themselves in litigious disputes with tax administrations that incur a significant amount of resources without a guaranteed outcome.

Considering that the frequency of international tax disputes has increased, tax administrations together with taxpayers around the world have recognized the need for proactively attaining certainty and transparency with regard to transfer pricing policies. APAs offer the taxpayer the certainty and transparency it requires to bed down its transfer pricing policies.

As per the Cahiers Report, a global snapshot\(^2\) as done in this chapter is useful to gain insight into the countries that use APAs as a means of dispute avoidance and the manner in which APAs were implemented:

\[\text{"The situation in each state may be very different and the solutions implemented may not suit every legal system. Being able to compare the situation in states around the world gives a better picture of the real situation that companies have to deal with when they make international investments."}\]

The following chapter provides a brief country by country analysis on its implementation of APAs as well as the form in which the programme takes place.

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\(^1\) Del Campo, C and Danilak M, 2016. Dispute resolution procedures in international tax matters. 2016. Cahiers De Droit Fiscal International. 101(a)

\(^2\) There are 32 countries with active APA structures that have been analysed in this chapter in accordance with the Cahiers Report. The countries are Australia, Austria, Belgium, Canada, Chinese Taipei, Denmark, Finland, France, Germany, Greece, Italy, Japan, Korea, Liechtenstein, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Russia, Singapore, Spain, Sri Lanka, Sweden, Switzerland, Turkey, Ukraine, UK and Venezuela.

\(^3\) Del Campo, C and Danilak M, 2016. Dispute resolution procedures in international tax matters. Page 24. (See Chapter 3, Footnote 1)
3.2. Country analysis

3.2.1. Australia

Being one of the first countries to sign a bilateral APA in March 1991, the ATO has expressed its commitment to making dispute resolution procedures a priority.\textsuperscript{94} There are a number of alternative procedures to manage taxation controversies and the ATO is consistently attempting to improve the efficiencies of such procedures.\textsuperscript{95}

Although the taxpayer has the option of applying for a unilateral, bilateral or multilateral APA, the ATO has expressed a preference for bilateral/multilateral arrangements. The ATO’s preference for bilateral APAs is linked to the potential minimization of double taxation and the protection against adjustments on all covered transactions involved.\textsuperscript{96}

3.2.2. Austria

There is no official APA programme in Austria. However, an APA can be conducted as part of the MAP route:

“According to administrative practice, an APA is conducted only as a special form of MAP in accordance with article 25 paragraph 3 of the OECD MC, where it is stated that the competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.”\textsuperscript{97}

As a result, an APA can only be concluded if there is a DTA in place with Austria, however, the APA will not only apply to transfer pricing cases but for any issue that arises under the DTA.\textsuperscript{98} Interestingly, APAs are free of charge in Austria and are only binding on the tax administrations not on the taxpayer. The applicability of rollback features and time frame relating to the APA in Austria are as follows:

\textsuperscript{94} Ibid at Page 83.
\textsuperscript{95} Ibid.
\textsuperscript{96} Ibid.
\textsuperscript{97} Ibid at Page 112.
\textsuperscript{98} Ibid.
“According to Austrian practice, APAs are normally concluded for a period of three to five years. They can be prolonged after expiry. Since the legal tool for an APA is the MAP article of Austria’s double taxation conventions, a roll-back effect can easily be implemented.”

3.2.3. Belgium

Belgium makes use of unilateral and bilateral APAs. For unilateral APAs, the taxpayer makes the request under the Belgian advance tax rulings system. These APAs may extend to transfer pricing, permanent establishments and other interpretative issues. Unilateral APAs have no rollback application, however the transactions that have not produced any tax effect may be considered for the advance tax ruling system. Where there is a dispute between the taxpayer and the foreign tax administration concerning a transaction that is covered by the unilateral APA, MAP can be invoked as provided for by the DTA:

“The Belgian competent authority is prepared to agree on an appropriate adjustment of the taxpayer’s profits so as to relieve double taxation and to depart from the unilateral APA.”

Bilateral APAs, on the other hand, can be concluded using article 25(3) of DTAs. The timeframe for concluding a bilateral APA may take about one to three years depending on the complexity of the case. The applicability of rollback features and time frame relating to the APA in Belgium are as follows:

“The BTA does not provide for the “roll-back” of APAs where the issues resolved are relevant with respect to previous tax years. However, where an MAP request has been presented with respect to earlier tax years, the Belgian competent authority may agree to take a relevant APA into consideration to resolve the dispute relating to those earlier years.”

99 Ibid.
100 Ibid at 135.
101 Ibid.
102 Ibid.
103 Ibid.
3.2.4. Canada

In Canada, taxpayers can apply for an APA under the Income Tax Act RSC 1985, c. 1 (5th Supp.), as amended (ITA) or Canada’s DTAs. There is an option of applying for a unilateral, bilateral or multilateral APA. The purpose of a unilateral APA is for income tax purposes where as a bilateral APA involves transfer pricing issues between Canada and states that have a DTA with Canada. A multilateral APA is available where the transfer pricing issues involve Canada and two or more treaty jurisdictions. In practice, the preference is bilateral APAs. The applicability of rollback features and time frame relating to the APA in Canada are as follows:

“A “roll-back” is only available for BAPAs and MAPAs and not for unilateral APAs. In general, the competent authority division will usually consider a roll-back of the APA where the facts and circumstances in the prior taxation years are the same as for the proposed APA term, the appropriate waivers are filed to extend the assessment period for such taxation years, and the prior taxation years have not been selected for audit by the CRA. The foreign tax administration(s) must also agree to a roll-back.”

From a monitoring perspective, the taxpayer must file an annual report with the CRA describing the taxpayer’s actual operations for the year and provide the information required by the APA. For a BAPA or MAPA, a joint report may be required. Failure to file the report may result in the APA being revoked.

3.2.5. Chinese Taipei

Chapter 5 of the “Regulations governing Assessment of Profit-Seeking enterprise Income Tax on Non-Arm’s-Length” governs APA programmes in Chinese Taipei. Article 23 sets out the basic requirements and procedures for making an APA application.

The requirements are that the related party transactions need to be NT$500 million or more or the annual amount of the transaction is NT$200 million or more. Secondly the MNE must not be guilty of any serious violation of tax law in the previous three years. There must also be a preparation of documents as required by article 24 must be prepared and any other requirements as set out by the

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104 Ibid at Page 180.
105 Ibid.
106 Ibid.
107 Ibid at Page 183.
108 Ibid.
109 Ibid at Page 201.
Ministry of Finance must be adhered to by the taxpayer. From a renewal perspective, Article 32 applies:

“Finally, article 32 states that if the applicant has abided by all the clauses of the APA, the applicant, before the applicable period of the agreement expires, may apply for an "extension of the application period" (yanhang shiyong qijian). Article 32 also stipulates that such an application for extension should include materials showing that the relevant facts and environment of the APA have not substantially changed and that if the relevant tax authority accepts the application after its review, another APA may be signed to extend the applicable period for a period of no longer than five years.”

3.2.6. Denmark

Denmark does not have a formal bilateral APA programme. However, there has been an established practice by the Danish Tax Administration (SKAT) of accepting, processing and negotiating bilateral APA requests. SKAT has the discretion to reject or accept a potential bilateral APA application. Typically, the length of APA is five years, however there is some flexibility offered by SKAT to alter the period of applicability. The applicability of rollback features relating to the APA in Denmark are as follows:

“Bilateral APA requests can in some situations include a formal roll-back request. In some situations, SKAT (or the counterparty competent authority to the transaction) may strongly encourage a roll-back request being made as part of the submission. Similarly, there may also be situations where SKAT (or the counterparty competent authority) does not wish a roll-back to be applied.”

110 Ibid at Page 202.
111 Ibid at Page 205.
112 Ibid at Page 214.
3.2.7. Finland

Although there is no formal APA programme in Finland, the taxpayer has the option of filing an application for Finland and one or more other states to negotiate on a transfer pricing issue in advance.\textsuperscript{113} This process is governed by the MAP article contained in DTAs.

For the APA process to be started, the taxpayer has to consult with the competent authority as to whether the issue is suitable for an APA application. Should it be agreed upon that the issue deserves to be documented by an APA, the process will continue to the pre-filing meeting.\textsuperscript{114}

APAs deal with transfer pricing issues futuristically. For all matters that have occurred in the past, taxpayers must make use of MAP for a resolution.

3.2.8. France

Bilateral and unilateral APAs form part of the French legislation, however multilateral APAs do not. The competent authority has a special team of TP specialists that are dedicated to the review of APA applications. The applicability of rollback features relating to the APA in Denmark are as follows:

"In France, the validity of an APA ranges from three to five years. The agreement may be revised during the period of validity if the operating conditions change. On expiry, the APA may be renewed at the request of the taxpayer, with the renewal following a streamlined procedure."\textsuperscript{115}

There are no rollback effects in place.

3.2.9. Germany

Germany has an established APA programme that aims to target transfer pricing and permanent establishment issues only. The option of applying for an APA only kicks in when there is a DTA between Germany and the other state. Therefore, Germany uses Article 25 of DTAs, being the MAP, as a legal basis for an APA. If the DTA does not exist between Germany and the state that the taxpayer wishes to negotiate, then Germany may allow a unilateral APA.\textsuperscript{116} For the most part, however, Germany concludes bilateral APAs.

Another option is also available if the taxpayer has concluded a unilateral APA in a foreign country:

\textsuperscript{113} Ibid at Page 228.
\textsuperscript{114} Ibid at Page 228.
\textsuperscript{115} Ibid at Page 245.
\textsuperscript{116} Ibid at Page 268.
“he may file a request to the German tax authorities in order to obtain recognition of the foreign APA by the German tax authorities and hence the binding of the German tax authorities by this APA. The German tax authorities, however, would only accept this request if it were obvious that this unilateral APA would not interfere with German taxation policy.”  

The period of an APA is more than three years and less than five years. The rollback feature is an active option for the taxpayer as well.

3.2.10. Greece

Greece’s APA programme is fairly new. It was formally introduced in January 2014 and deals specifically with transfer pricing issues. An APA, once concluded is valid for not more than four years. Taxpayers can see a huge benefit of using APAs:

“The advantage of the APA is that in case of audit, the tax auditors are not allowed to challenge the content of a valid APA. The audit is limited to examining whether the taxpayer is complying with provisions of the APA and whether the assumptions, the circumstances and the conditions on which the APA was based are still valid.”

3.2.11. Italy

The APA programme for Italy has been in force since 2004. In Italy, APAs are seen as:

“Part of the tax compliance policy which is intended to improve cooperation and dialogue between taxpayers and the tax administration. Furthermore, it provides legal certainty to taxpayers and tax administrations, preventing tax disputes and reducing the risk of international double taxation.”

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117 Ibid.
118 Ibid at Page 294.
119 Ibid at Page 324.
Due to the influx of applications and pre-filings that have happened in the recent years, it has proved that more resources are required such as more personnel and specialized training. This will assist in improving the time spent on APA applications.¹²⁰

3.2.12. Japan

The Japanese tax administration has implemented an APA programme that deals with transfer pricing issues.

Although taxpayers request unilateral APAs, there is no guarantee that other tax jurisdictions will abide by it. Therefore the Japanese tax administration can negotiate with the other tax jurisdiction in order to make the APA a bilateral one. This essentially will avoid double taxation. The applicability of rollback features relating to the APA in Japan are as follows:

“APAs generally cover a period of three to five years. A taxpayer who has agreed to an APA with the Japanese authority may receive approval from the NTA to apply the TP method described in the APA to the years preceding those covered by the APA, if that method is considered to be the most appropriate for those years.”¹²¹

3.2.13. Republic of Korea

Korea makes use of the APA programme for transfer pricing issues and it applies to futuristic matters. The APA programme does not extend to other international tax matters such as withholding of interest or permanent establishments. When taxpayers apply for an APA, they must satisfy a few requirements such as:

“pre-filing consultation, deadline for application, submission of required documents along with the application form.”¹²²

The APA is binding on tax administrations and, if applicable, it has a roll-back effect on past taxable years. Taxpayers can apply for unilaterally, bilaterally or multilaterally APAs depending on the number of countries involved in the conclusion of the APA.¹²³

¹²⁰ Ibid at Page 326.
¹²¹ Ibid at 345.
¹²² Ibid.
¹²³ Ibid at Page 359.
3.2.14. Liechtenstein

Although there is no formal APA programme in Liechtenstein, there is a practice of the competent authority issuing rulings which are the same as an APA. Such rulings do not only deal with transfer pricing, but also domestic tax law, DTAs and valuation issues with regard to permanent establishments.

As regards the effect and timeframe of applicability:

"Rulings do not have a retroactive effect, as they only apply to present and future transactions. Rulings are binding on the fiscal authority as long as they reflect the true facts of the case and the relevant provisions do not change. On the other hand, rulings are not binding on any instances of appeal outside the fiscal authority."\(^{124}\)

3.2.15. Luxembourg

Luxembourg does not have an independent APA programme, however there is an advance tax clearance procedure that APAs fall under. The scope of the APA extends to any type of transfer pricing confirmation such as pricing of any type of transaction, the allocation of profits to a permanent establishment and the valuation of any type of asset transferred between related parties.\(^{125}\) The APA is also valid for a time period of a maximum of five tax years.

Prior to 2015, there was no fee for filing an APA application. However on 1 January 2015 there is a fee payable and it can range (in theory) between 3,000 and 10,000 Euro, depending on the complexity of the request.\(^{126}\)

3.2.16. Mexico

Mexico’s APA programme functions such that the response from the competent authority to an APA request should be valid for the year of the request, the previous one and the three following years.\(^{127}\) Should the taxpayer request an extension, the competent authority may grant it if the resolution derives from a bilateral procedure based on a tax convention signed by Mexico.

The extension of bilateral APAs means that:

\(^{124}\) Ibid at Page 381.
\(^{125}\) Ibid at Page 394.
\(^{126}\) Ibid.
\(^{127}\) Ibid at Page 448.
“The resolution does not have a specific time frame for application, but its validity depends on the agreement reached by the tax authorities of both countries. The law only specifies that the application period of a resolution based on tax treaties can be extended, so in the reporters’ opinion (and in practice) retroactive effects are also allowed.”  

3.2.17. Netherlands

The Netherlands place a great deal of significance on clarity and transparency for related party transactions. The APAs cover transfer pricing matters and extends to issues such as valuation of permanent establishments.  

Although the taxpayer can apply for unilateral APAs, the Dutch authorities prefer to involve the competent authorities of other jurisdictions in order to conclude bilateral or multilateral APAs should there be a willingness by the other jurisdiction and there is sufficient legal basis in the MAP section of the tax treaty to do so.  

3.2.18. New Zealand

New Zealand currently has an option for taxpayers to make an application for unilateral, bilateral, and multilateral APAs. APAs have the following time frame of applicability:

“Provided the critical assumptions in the APA are not breached, the agreed transfer prices apply for an agreed period (typically three to five years, and up to seven years).”  

There is a preference for the Inland Revenue to favor unilateral APAs with countries other than Australia. There is a willingness by the Inland Revenue to make bilateral discussions, if necessary, where a unilateral APA has been agreed.

3.2.19. Norway

There is no formal APA programme in Norway. However, there has been a practice to issue unilateral APAs for intra-group pricing of natural gas extracted on the Norwegian continental shelf.

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128 Ibid.
129 Ibid at Page 477.
130 Ibid at Page 478.
131 Ibid at Page 499.
132 Ibid.
APAs, on the other hand, have been entered into since 2011 by using MAP provisions within tax treaties.\textsuperscript{133}

It is noted that there is a peeking interest and demand for bilateral APAs in Norway. Accordingly the tax administration has been allocating more resources to bilateral APA work.\textsuperscript{134}

\textbf{3.2.20. Peru}

Peru’s APA programme is still very young. There is the option of applying for a bilateral or multilateral APA with jurisdictions with which Peru has a treaty. Although the Peruvian tax authority does not have a great deal of experience on concluding APAs, it has accepted training from other tax authorities within the region:

“The Peruvian tax authority has confirmed that according to its new institutional strategy to assist taxpayers, it has a strong wish to receive APA applications and to accelerate the evaluation stage of this process.”\textsuperscript{135}

\textbf{3.2.21. Poland}

Poland has had an APA programme in place since 2006. The programme is regulated by domestic law and allows the taxpayer to apply for unilateral, bilateral, and multilateral APAs.\textsuperscript{136} Once the APA is concluded, the decision binds the tax auditors and the Polish legislation clearly guarantees the confidentiality of information gathered during the APA proceeding, which also cannot be used later in the tax audit.\textsuperscript{137}

\textbf{3.2.22. Portugal}

Portuguese tax legislation offers both a unilateral APA and a bilateral/multilateral APA since 2008. In the case of a unilateral APA, there can be double taxation. Should this happen, the taxpayer has the option of requesting the revenue authority to consider initiating MAP. With regard to bilateral or multilateral APAs, the following must be noted:

“Bilateral or multilateral APAs can only be entered into within an MAP, which means that the Portuguese tax authorities can establish an agreement with the foreign country or

\begin{flushright}
\textsuperscript{133} Ibid at Page 524.  \\
\textsuperscript{134} Ibid.  \\
\textsuperscript{135} Ibid at Page 550.  \\
\textsuperscript{136} Ibid at Page 561.  \\
\textsuperscript{137} Ibid.
\end{flushright}
countries involved in the MAP ensuring that the income associated with the transaction will not be subject to double taxation in both or all countries involved.  

3.2.23. Russia

In 2012, the option of applying for APAs was a reality in Russia. There is a threshold of annual tax payments exceeding RUB 1 billion and annual revenue and assets exceeding RUB 20 billion. Also APAs only cover transfer pricing issues. APAs may be bilateral or multilateral and the maximum term of an APA is three years.  

3.2.24. Singapore

In Singapore, the APA programme forms part of the transfer pricing compliance programme. The IRAS has released comprehensive guidelines which provides insight into the application of the arm’s length principle to related party transactions. Administrative guidance is also contained in the guidelines.  

Unilateral APAs are made pursuant to the ARS and bilateral APAs are made pursuant to the MAP.  

3.2.25. Spain

The main intention for the Spain Revenue Authority to introduce an APA programme was to avoid double taxation and provide legal certainty for any type of transfer pricing transactions. Taxpayers are able to apply for both unilateral and bilateral APAs. The average completion time for a unilateral APA is between 6 and 9 months whereas a bilateral APA may take between 18 and 24 months.  

3.2.26. Sri Lanka

The concept of APAs has been introduced in Sri Lanka as a part of transfer pricing regulation. However, the concept has not been actively implemented as transfer pricing is still developing. This APA system cannot be invoked for transactions other than transfer pricing transactions.  

139 Ibid at Page 577.  
140 Ibid at Page 609.  
141 Ibid.  
142 Ibid at Page 638.  
143 Ibid.  
144 Ibid.  
145 Ibid at Page 652.
3.2.27. Sweden

Sweden’s APA programme was formally introduced in January 2010 and has been widely used by taxpayers in order to avoid the double taxation for transfer pricing transactions. APAs in Sweden are concluded as follows:

“The programme allows for bi- and multilateral APAs, which are technically treated as mutual agreements with the countries involved, with a validity of normally three to five years.”146

3.2.28. Switzerland

Taxpayers in Switzerland have the option of applying for bilateral and multilateral APAs under the MAP in tax treaties.147 To deal with APA requests, the competent authority in Switzerland relies on the submissions of the OECD guidelines for conducting APAs under the MAP.148

3.2.29. Turkey

APAs, whether unilateral, bilateral or multilateral, are available to corporate taxpayers only in Turkey. It is possible to apply for an APA that deals with transfer pricing for transactions that occur among the corporate taxpayers operating in the free trade zones of Turkey and other corporate taxpayers in the scope of related parties. Although personal income taxpayers are subject to transfer pricing regulations, they cannot request an APA, whether for internal or cross-border transactions.149

3.2.30. Ukraine

Although the possibility of concluding APAs in Ukraine is possible, there has been none concluded thus far. It is, however, believed to pick up soon. The process would work as follows:

“A taxpayer wishing to conclude an APA should submit a preliminary application to the SFSU indicating his desire to conclude an APA, the parties to the proposed APA, the subject matter of the proposed APA and supporting documentation. Within 60 days the SFSU must provide a

146 Ibid at Page 665.
147 Ibid at Page 683.
148 Ibid.
149 Ibid at Page 723.
substantiated answer to the preliminary request, indicating whether it is willing to conclude the APA or not.\textsuperscript{150}

3.2.31. UK

APAs in the UK can apply to the attribution of income to a permanent establishment in the UK and elsewhere, thin capitalization queries, the extent to which income is treated as arising outside the UK; and transfer pricing methodologies.

APAs may take a unilateral, bilateral or multilateral form. The following is noted in practice:

“In a potential multilateral situation, HMRC will negotiate a bilateral agreement first with one of the other principal countries and then use this APA as evidence in support of a series of parallel bilateral agreements with the other countries.”\textsuperscript{151}

Rollbacks are also possible.

3.2.32. Venezuela

In Venezuela APAs are exclusively intended for transfer pricing matters:

“Taxpayers must prove that the future transaction will be conducted at values comparable to those used in transactions with non-related parties.”\textsuperscript{152}

APAs can take the form of unilateral or bilateral applications.

3.3. Trend analysis

Given that the jurisdictions discussed in the Cahiers Report do not include each and every country in the world, it still remains as an accurate depiction of the global landscape for APAs.

It has been observed that some countries have made an active effort to implement formal and independent APA programmes. Other countries have allowed taxpayers to make use of APAs via the MAP article in tax treaties. The roll back feature and the preference for bilateral treaties seem to be quite popular among the countries as well.

\textsuperscript{150} Ibid at Page 734.
\textsuperscript{151} Ibid at Page 747.
\textsuperscript{152} Ibid at Page 784.
Even in the face of challenges such as expertise and personnel, many countries have persevered with their endeavors and succeeded in decreasing the amount of transfer pricing disputes by the use of APAs.

South Africa does not have much motivation and is shying away from the implementation of APA programmes. Being an active BEPS participant, South Africa has recently developed its transfer pricing regulations. There is a great deal of uncertainty and much needed clarity on acceptable transfer pricing methodologies for MNEs. APAs would assist the taxpayer inasmuch as it can assist SARS with gaining an understanding of the various industries.

It is apparent from the global landscape of APAs, that South Africa can implement APAs even in the face of challenges such as resources and lack of expertise.
4 Chapter Four: Analysis of the Chevron Case

As mentioned earlier in this paper, transfer pricing analyses are often time consuming and costly. For the most part, taxpayers are often uncertain on whether the transfer pricing policies that they have implemented will be accepted by tax authorities. This uncertainty is further embedded when tax authorities issue transfer pricing adjustments which may also lead to double taxation for the taxpayer.

The Chevron case is a prime example of the challenges that taxpayers face when it comes to transfer pricing disputes. This chapter will highlight the facts and issues of the Chevron case, together with a summary of the judgement. This chapter will use the judgement in support of the argument for APA programmes.

4.1. Facts of the Chevron Case

Chevron is a well-known oil and gas multinational. The parent company is listed and resident in the US. The applicant, Chevron Australia Holdings (Pty) Ltd (Chevron Australia), entered into a loan agreement with Chevron Texaco Funding Corporation (CFC) on 6 June 2003. The primary purpose of the loan agreement was for CFC to make advances to Chevron Australia from time to time.

Prior to the CFC lending Chevron Australia money, the CFC borrowed 2.5 billion United States Dollars (USD) from the commercial paper market at rates of interest at or below USD LIBOR (approximately 1 to 2%). CFC then loaned Chevron Australia an amount according to Australian equivalent of USD 2.5 billion. A monthly interest rate of “1-month AUD-LIBOR-BBA as determined, with respect to each interest period +4.14% per annum”154, was payable by Chevron Australia.

As regards the taxes, there was no withholding tax on the interest payments from CAHPL to CFC. It was also revealed that during a cross-examination, that CFC was not taxable in the US on the interest income. Accordingly, CFC generated profits (as a result of the interest differential) and paid dividends to Chevron Australia, which were exempt from tax in Australia.155 Chevron Australia then paid dividends to its shareholder.

Interestingly, there was no guarantee or no security over assets provided from Chevron Australia to CFC. In addition, CFC was allowed to terminate the loan agreement at any time without cause. It

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153 Chevron Australia Holdings (Pty) Ltd v Commissioner of Taxation (No. 4) [2015] FCA 1092 at para 2.
154 Ibid.
must be noted that Chevron Australia and CFC were related parties seeing that both entities had a common parent, being Chevron Corporation and CFC was a subsidiary of Chevron Australia.\textsuperscript{156}

The Australian Tax Office, being the respondent in this case, raised an assessment whereby it made transfer pricing adjustments. The applicant objected to this assessment and the case came before the Court of first instance. This case was later appealed and rejected by the appeal court. The examination of the appeal does not form part of this analysis.

The relevant rule of law that is applied to this case is the arm’s length principle and cross-border transfer pricing rules found under Part IVA of the Income Tax Assessment Act 1936\textsuperscript{157} (ITAA). In addition, the transfer pricing rules in the Australian double tax agreement\textsuperscript{158} were relevant for this case.

\subsection*{4.2. The Issues and the Findings of the Case}

\subsection*{4.2.1. The determination of the interest rate}

The key issue in this case was the determination of the interest rate. The ATO’s approach to determine the interest rate was to determine the credit rating of Chevron Australia, as well as the loan itself, and to benchmark an arm’s length interest rate based on comparable market rates.

However, the Court’s approach differed from that of the ATO. The Court was of the opinion that the correct approach was to determine Chevron Australia’s creditworthiness through the lens of a commercial lender such as a bank, rather than through a credit rating agency. The Court felt that commercial lenders don’t normally use credit rating agencies to determine a borrower’s creditworthiness.\textsuperscript{159} Commercial lenders normally focus on the credit profile of the company, as well as the parent company, and any implicit support offered by the parent company, in relation to the loan being borrowed.\textsuperscript{160}

\subsection*{4.2.2. Implicit support}

The respondent put forward an argument that implicit support from parent companies has a material effect in determining the borrower’s creditworthiness. The applicant rebutted this submission and submitted that the parental affiliation concept had no bearing on the current case. The applicant

\begin{footnotes}
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\footnotetext[156]{Chevron Australia Holdings (Pty) Ltd v Commissioner of Taxation (No. 4) [2015] FCA 1092 at para 2.}
\footnotetext[160]{Ibid.}
\end{footnotes}
relied on the statutory test to determine the arm’s length price, i.e., under what conditions would two independent entities under similar circumstances enter into such a loan agreement?

Although the Court accepted the importance of parental affiliation in determining the Arm’s Length nature of the transaction, it rejected its relevance for the current case. Chevron Australia received no parental guarantee for the loan in question. Robertson J said:

“The applicant's submission that the existence and worth of "implicit support" is a matter of fact, remains unaffected. I accept the applicant's submission, that in the absence of a legally binding parental guarantee, implicit credit support had very little, if any, impact on pricing by a lender in the real world.” 161

4.2.3. Currency of loan

One of the main bones of contention in the Chevron case was the currency of the loan. The applicant had argued that Chevron Australia borrowed the funds in Australian Dollars, while the respondent argued that the funds were denominated in USD. The reason this issue was of great importance was due to the USD interest rates in 2003 being much lower than the Australian Dollar interest rate. 162

The Court accepted that the taxpayer’s submission that Chevron Australia’s borrowing in Australian Dollars would avoid or limit foreign currency gains and losses. Accordingly, it is clear that Chevron Australia received the loan from CFC in Australian Dollars and it was a pleasant consequence that the CFC made a foreign exchange gain rather than a loss, when Chevron Australia repaid the loan on maturity. 163

4.2.4. Standards of comparability

One of the causes for concern in the Chevron case for taxpayers, was the high standards of comparability set by the Court. This related to the use of the comparable uncontrolled price method in order to gather benchmarking data for interest rates. The Court rejected comparable data put forward by both the respondent and applicant. There were a number of reasons that the Court put forward for rejecting the data. Some of the reasons were around the amount of the loans being significantly different to the amount in question. The fact was that security was provided in the comparable loan agreements whereas the current loan agreement had no security, and there was

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161 Chevron Australia Holdings (Pty) Ltd v Commissioner of Taxation (No. 4) [2015] FCA 1092 at para 606.
163 Ibid.
confusion on whether the loan in question should be benchmarked against senior debt or subordinated debt.\textsuperscript{164}

The Court, by way of its rejection of the comparable data, set the precedent for an incredibly high standard of comparability for loan transactions.

4.3. The Australian APA Process

Since the early 1990s, the ATO has had an APA initiative for cross-border transactions between related party entities.\textsuperscript{165} The most recent governing regulation for APAs in Australia is the Practice Statement Law Administration 2015/4\textsuperscript{166} (PSLA 2015/4).

PSLA 2015/4 establishes a formal APA Program Management Unit and ATO triage function. It also clarifies the ATO’s decision-making process for APA applications and streamlines the APA process as a whole.\textsuperscript{167} Although the ATO strongly encourages taxpayers to make use of APAs, not every taxpayer has the requisite eligibility to do so.

MNEs that have cross-border transactions that are unlikely to change significantly during the period of the APA and will employ a TP methodology more aligned with the OECD TP Guidelines, are more likely to enter an APA with the ATO.\textsuperscript{168} In addition, there has to be an element of complexity and uncertainty on how the TP rules are to apply, as well as a risk of double taxation for the taxpayer.

Subsequent to the publication of PSLA 2015/4, the APA process is streamlined to consist of three stages. The first stage of the APA process lasts six months and is called the early engagement stage, which includes a triage review of the APA application, as well as discussions with the taxpayer.\textsuperscript{169} The next stage requires the ATO to formally invite the taxpayer to file its APA application, should the triage phase see positive results. Lastly, there is an annual compliance report that is issued and monitored.\textsuperscript{170}

4.4. The Importance of the Chevron Case considering APAs

The Chevron case highlights the need for taxpayers to proactively think about its transfer pricing strategies. If one had to analyse the judgement of the Chevron case, one would conclude that the

\textsuperscript{164} Ibid.
\textsuperscript{168} Ibid.
\textsuperscript{169} Ibid.
\textsuperscript{170} Ibid.
issues manifested could have been resolved in a mutually beneficial manner for both Chevron and the ATO.

The terms such as securities or guarantees, interest rates and conditions of the loan arrangement could have been decided with the ATO, prior to the conclusion of the transaction.

Thomas, Novak and Lowell submit that:

"The upfront cost, time, and effort needed to obtain an APA may be considerable and are valid concerns, but an APA should be viewed as something of a long-term investment. When compared to the often overlapping costs of pursuing the traditional means of addressing transfer pricing and international tax issues through a combination of (i) transfer pricing documentation, (ii) examination, administrative appeals, and/or litigation, and (iii) competent authority proceedings, an APA may actually end up being very economical." 171

Any litigious matter incurs a great deal of time and money. Given that the Chevron case, in its magnitude of complexity, has been heard on appeal, one can aver that the Chevron entities spent a large amount of resources on the Court case alone. In such cases, the benefits of the APA programme can be acutely perceived.

5 Chapter Five: Merit for APAs in South Africa

Tax evasion has ripple effects across both developing and developed countries. More importantly for developing countries, commercial tax evasion not only strips revenues meant for socio-economic growth, but also encourages corruption and undermines the authenticity of governments.\textsuperscript{172}

In the light of the BEPS project, transfer pricing has attracted a great deal of attention in developing countries. Although South Africa is not a formal member of the OECD, it follows and adopts the findings of the OECD's projects closely. With the adoption of more formalistic procedures such as MAP, SARS and the National treasury have heeded the recommendations of the OECD and it appears that transfer pricing has become the core focus of their compliance programmes.

This chapter will look at the current transfer pricing and dispute resolution procedures in South Africa against the need for an APA programme. In other words it will assess the need for an APA programme in South Africa and attempt to investigate SARS’ reasoning for deciding against its implementation.


Section 31 of the Income Tax Act sets the tone for arm’s-length trading, with respect to international transactions between connected persons. Briefly, Section 31 speaks to:

- "where any transaction, operation, scheme, agreement or understanding (hereinafter, transaction) which constitutes an ‘affected transaction’ has been concluded between connected persons; and
- such transaction contains a term or condition which differs from any term or condition that would have existed had the parties to the transaction been independent vis-à-vis one another and transacting at arm’s length; and
- the term or condition results in a tax benefit for a party to the transaction; then
- the tax payable by the benefiting party must be calculated as if the transaction had been concluded between independent parties transacting at arm’s length." \textsuperscript{173}

\textsuperscript{172} Mail & Guardian. 2016. Gupta dealings are small change, December 2016. Available: https://mg.co.za/article/2016-12-07-00-gupta-dealings-are-small-change (Accessed on 2 September 2018)

Practice Note 7 explains that Section 31 enables the Commissioner to adjust, for tax purposes, should it find that the pricing is not in accordance with the arm’s length principle.\textsuperscript{174} If the taxpayer objects to the adjustment made by the Commissioner, the taxpayer has the option of disputing the decision, in line with rules stipulated in Chapter 9 of the Tax Administration Act.

The dispute resolution process is tiered. The first point of call is the SARS officer’s immediate supervisor.\textsuperscript{175} The taxpayer must consult with the supervisor, to clarify the decision taken and resolve any uncertainties.\textsuperscript{176} Should the taxpayer not be satisfied with the resolution, then the taxpayer can institute a formal internal administrative appeal.

According to SARS:

\begin{quote}
"Appeals must be lodged on a Form DA51 at the office where the decision was made, and must be delivered to the manager of the office head of Division at Head Office, within 30 days of the date of the decision. Alternatively, where reasons for a decision were requested within 30 days from the date they were advised, that sufficient reasons had already been provided, or within 30 days from the date the reasons were, in fact, provided; should such clients be unhappy with the decision of any appeal committee, their recourse will be to lodge an application for Alternative Dispute Resolution (ADR), with that relevant appeal committee which made the decision."\textsuperscript{177}
\end{quote}

Subsequent to a final decision being issued of the internal administrative appeal, the taxpayer has the option of recourse via the ADR process or the Tax Court.\textsuperscript{178} The ADR process is meant to be an alternative to litigation, as it can get quite expensive for the taxpayer.\textsuperscript{179} To apply for ADR, the taxpayer must complete a Form DA52, together with the relevant supporting documents. This form must then be submitted to the person who informed the taxpayer of the decision, within 30 days from the date of the letter.\textsuperscript{180}

\begin{footnotes}
\item[176] ibid.
\item[177] ibid.
\item[178] ibid.
\item[179] ibid.
\item[180] ibid.
\end{footnotes}
The ADR process takes place before an independent SARS official. Both the taxpayer and SARS will have an opportunity to discuss the merits of the case, as well as present their arguments on the matter. However, it is important to note that SARS is not bound to the recommendations made by the independent SARS official. In other words, SARS has the option of following-up, or disregarding the findings of the ADR process.

An interesting concept, with reference to the dispute process, is the “pay now, argue later rule”. The rule requires the taxpayer to pay the tax debt prior to the dispute being finalised or resolved. This means that the taxpayer is out of pocket once the assessment is issued, and payment is not automatically suspended once the dispute process is invoked. The validity of the rule was confirmed by the Constitutional Court.181

The Constitutional Court held that:

“the public interest in requiring vendors to pay tax before finality of a dispute is significant, and reasoned that ensuring prompt payment amounts assessed to be due is clearly an important public purpose.”182

On the one hand, the pay now, argue later principle prevents taxpayers from making frivolous objections when assessments are issued. However, the taxpayer is disadvantaged in that they are out of pocket until such time as the dispute is resolved. In order to address this disadvantage, the taxpayer may request SARS to suspend payment until such time that the dispute is resolved.

Another route available to the taxpayer is the MAP under the relevant treaty. In line with Action Plan 14 of the BEPS project, South Africa endorsed the MAP, and its remedies are available to taxpayers under domestic law. Generally, Article 25 of the South African Treaties speaks to the dispute resolution process.183 In the case of juridical or economic double taxation that has already taken place, the taxpayer has the option of invoking the MAP, in order to present its case to the competent authority of residence or both competent authorities of the treaty. Both competent authorities will then enter into consultation in order to resolve the taxpayer’s matter.184

According to Article 25(1) of the treaty, a taxpayer has three years from the first notification, to present its case to the competent authorities under the MAP. In order for the MAP to proceed to the

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181 Metcash Trading Ltd v Commissioner, South African Revenue Service and Another 2001 (1) SA 1109 (CC)
182 SARS. 2014. Dispute resolution guide. (See Chapter 5, footnote 175)
184 Ibid.
bilateral state, the objection must appear to be justified and the competent authority must be seen as being unable to arrive at a satisfactory unilateral solution.\textsuperscript{185}

The MAP can also apply to transfer pricing cases. Where the taxpayer’s objection relates to the attribution of profits to a permanent establishment, including the determination of whether a permanent establishment exists in a contracting jurisdiction, or the determination of profits between associated enterprises, then a case for transfer pricing MAP can be made. Although SARS allows taxpayers to access MAP for transfer pricing, it has explicitly excluded requests for APAs from the MAP.\textsuperscript{186} Although taxpayers have the option of invoking MAP, it does not necessarily mean that there will be a solution for the taxpayer. SARS has an obligation to endeavour to resolve MAP cases, however, there is no specific timeline given in which the issue will be resolved neither does SARS offer a guaranteed outcome for the taxpayer.

5.2. Absence of APAs within the South African Legal Framework

After various consultations with stakeholders such as SARS, the South African Reserve Bank, and tax practitioners, the DTC released its first “BEPS Interim Report” on 23 December 2014.\textsuperscript{187} Interestingly, one of the DTC’s general recommendations was for SARS to ensure sufficient transfer pricing training and building capacity thereon, within the transfer pricing unit.\textsuperscript{188} More specific to Action Plan 13 (Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting) of the BEPS Project, the DTC recommended again, that SARS should also employ business analysts and economists, in addition to lawyers and accountants, in order to build its skills in understanding commercial operations.\textsuperscript{189}

Although there is a large focus placed on the arm’s length principle, the legislation in relation to transfer pricing is silent on proactive dispute resolution mechanisms such as APAs. Practice Note 7 specifically states\textsuperscript{190}:

\begin{quote}
"Due to various factors, the APA process will not in the foreseeable future, be made available to South African taxpayers. This Practice Note will thus not deal with APA’s."\textsuperscript{191}
\end{quote}

\textsuperscript{185} Ibid.
\textsuperscript{186} Ibid.
\textsuperscript{188} The Davis Tax Committee. 2014. First Interim Report on BEPS for public comment by 31 March 2015. Page 31. (see Chapter 5, footnote 187)
\textsuperscript{189} Ibid.
\textsuperscript{190} Although Practice Note 7 is dated, it is nonetheless relevant as no new guidance has been issued in this regard.
SARS has not reported on, or explained, not implementing an APA program in South Africa. Therefore one can only speculate around the reasons for SARS's decision. South Africa’s Davis Tax Committee was formed in July 2013 with the mandate of investigating and providing recommendations on fiscal policies for South Africa. As part of its initiatives, it set up the BEPS Sub-Committee, to address concerns around BEPS and to provide recommendations in this regard.\textsuperscript{192}

From the Davis Tax Committee’s recommendations, it is clear that SARS is missing an integral component of skills and resources within the transfer pricing unit. Perhaps it is for this reason that SARS is reluctant to initiate a program that would require additional skills and resources, over and above what they currently have on hand.

The United Nations has highlighted the following consideration with regard to building an APA capacity:

\begin{quote}
"An important consideration in the light of scarcity of resources is whether to build audit or APA capacity. For developing countries with fledgling transfer pricing regimes, there need to be safeguards against offering APAs without having developed key knowledge of how transfer mispricing occurs in certain industries, transaction types or countries. Given that practically, an APA consideration is similar to an audit approach, it stands to reason that a country with little audit capability should not be entering into APAs."\textsuperscript{193}
\end{quote}

Assuming that SARS is of the same view as the United Nations, it can be argued that the current audit capacity within the transfer pricing unit of SARS is inadequate to take on new projects like an APA program.

Moving away from the resource issue, SARS may be of the view that APA programs offer little advantage to the tax system. The following view on the shortcomings of the APA program may be a reason for SARS not to implement an APA program:

\begin{quote}
Other countries are concerned that APAs are not useful in a transfer pricing regime, because they tend to be sought by companies that are in broad conformity with the arm’s length
\end{quote}

\begin{thebibliography}{9}
\bibitem{UN} UN, 2017. UN Practical Manual. Page 375 at paragraph D.5.3.1. (see Chapter 1, footnote 19)
\bibitem{ibid} Ibid at paragraph D.5.10.2
\end{thebibliography}
principle, and may divert scarce resources from achieving compliance in the worst cases of avoidance.\textsuperscript{194}

As mentioned before, there is very little reported on SARS’s view for not implementing APAs. Although the speculation is endless, it is more important to understand whether or not there is a need for an APA program in South Africa. In order to assess whether or not an APA program needs to be implemented, the benefits and flaws of such a framework need to be considered.

5.3. Pros and Cons of an APA Program

As mentioned before, skilled resources need to be employed, in order to maintain the efficiency of an APA program. Competent authorities will therefore be required to up skill current staff or hire external candidates, to ensure the sustainability of the APA program.\textsuperscript{195} This adds to the budget constraints of competent authorities. In addition, there needs to be financial resources available, for travel and accommodation, during the negotiation phase.\textsuperscript{196} As the negotiation phase involves communication between personnel from competent authorities, it would be the taxpayer’s resident State’s responsibility to pick up these costs. For developing countries that already face strained budgets, and more pressing economic costs such as housing and education, competent authorities may not be willing to cater for such expenses.

One of the key factors that influence competent authorities from implementing APA programs is the time factor. Mulachella stated that it takes an average of more than thirty (30) months to conclude an APA.\textsuperscript{197} During this time, the taxpayer is often left uncertain regarding its current transfer pricing activities, and may have to endure transfer pricing adjustments. Further to the timing issue, the documentation required by taxpayers to make an application for an APA is onerous and complex. Mulachella verifies this position and submits:

“The meticulous requirements may lead the taxpayer to suffer additional significant financial and time costs. In addition, the application of BEPS Actions 13 and 14 in a domestic APA regulation, has added to the burden of the taxpayer’s compliance obligation. While there is no immediate solution to resolve the issues of satisfying such mandatory requests, the taxpayer may consider the costs of litigating the dispute, compared to the compliance costs. Further consideration is also needed with

\textsuperscript{194} Ibid at paragraph B.8.10.4.
\textsuperscript{195} Mulachella, Z., 2018. Improving the Effectiveness of the International Advance Pricing Agreement Process. Page 74. (see Chapter 1, footnote 21)
\textsuperscript{196} Ibid.
\textsuperscript{197} Ibid.
regard to the cost of the risk of facing examinations from another competent authority, including the future risk of penalties, litigation and reputation damage.\(^{198}\)

In preparing the application of an APA, the taxpayer runs the risk of exposing sensitive information such as trade secrets or certain confidential company policies.\(^ {199}\) Although there is a duty of confidentiality owed to the taxpayer, there is no guarantee that the tax authority will not investigate certain transactions that deviate from the assumptions of an APA.

While there is a vast range of disadvantages for APA programs, the benefits in my view certainly outweigh them. Through the creation of APA programs, taxpayers will enjoy the elimination of uncertainty with regard to the pricing of transactions. Tax authorities will be able to engage with each other in a mutually constructive manner, to establish and concur on the principles of an arm’s length transaction.

By virtue of creating a sound framework of the arm’s length principle, the taxpayer and tax authority will free-up time to focus on more complex issues. This will allow each party to consult with the other/s in a non-adversarial context, with the aim of finding common ground.\(^ {200}\)

Annual transfer pricing analyses and examinations are often time consuming and expensive for taxpayers to undertake. Given the lifespan of an APA, the taxpayer will be able to save the time and money incurred in repetitive transfer pricing exercises. Furthermore, once the APA has been concluded and accepted by all parties, the taxpayer will face a reduction in the risk of double taxation. Lastly, as APAs have a rollback feature, taxpayers are able to enjoy the flexibility of having to address and resolve issues on a multiple year basis.\(^ {201}\)

The disadvantages of the APA program discussed above can be resolved as well. With regard to the resourcing issue, competent authorities already have an accounting, economic and legal skillset that it employs to function adequately, Competent authorities can combat the skilled resource issue by putting together a team of existing experienced employees in routine roles, to deal with APA applications only, and hire new staff members to do the more generalised tasks. There will be an upfront investment borne by the competent authority to hire new staff. However, this cost can easily be absorbed into the number of filing fees paid by the applicant of an APA. On the issue of travel and accommodation expenses, competent authorities can use technology such as video

\(^{198}\) Ibid at pages 74-75.
\(^{199}\) Ibid at page 75.
\(^{201}\) Ibid.
conferencing to achieve the same result, as would be achieved if the personnel had met face to face. This would eliminate the burden of travel costs on the State.

With regard to the extensive amount of time taken to conclude an APA, there have been various improvements by countries such as India, to reduce the time spent. The Annual report published by the CBDT states:

“In 2017-18, the average time taken by the CBDT to conclude the 58 unilateral agreements was 38.62 months. This is more than the combined average time taken in the previous 4 years. As a result, the average time taken to conclude unilateral APAs in India has increased from about 29 months (as on 31st March 2017) to 31.75 months (as on 31st March 2018). This is better than most countries have achieved.”

It seems that as time passes, employees of competent authorities get more experience with APAs, and become innovative in the manner in which they deal with applications. Lastly, on the issue of taxpayers running the risk of exposing certain sensitive information, it is recommended that taxpayers interrogate the data that they give to competent authorities. This exercise needs to be carried out prior to the filing phase of the application. This will ensure that any sensitive information is filtered-out before the application is filed.

5.4. Is there a need for an APA program in South Africa?

Currently the dispute resolution processes, such as ADRs and the MAP, deal with cases where the assessment has already been issued and the taxpayer has subsequently objected to the decision. In other words, the process is a reactive rather than proactive one.

Whilst the ADR process provides the taxpayer with options to appeal the decision of the commissioner, it is after the fact, and the process that follows is a lengthy one. The flaw with the ADR route is; should there be an agreement on the decision, subsequent to the ADR procedure, the taxpayer loses the possibility of securing a formal court judgement and the protection that encompasses the ruling.

Moreover, although the ADR is an alternative to litigation, there is a possibility that the decision reached during the ADR process will not be accepted by the taxpayer. Therefore the taxpayer will

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inevitably spend more money and time having the decision appealed in a tax court via litigation. Therefore the ADR process offers no guarantee that the case will not reach the litigation phase. \(^{204}\)

Similar to the ADR, the MAP is not without imperfections. As the MAP involves the engagement of competent authorities, there is a possibility that the time taken to conclude the MAP request might be a lengthy one. As mentioned before, the time period to lodge a MAP request is three years from the date of the first notification. This time frame is a safe indicator of the period within which MAP requests will be dealt with upon receipt thereof.

The most significant feature of the MAP and ADR process is that it does not include a request for an APA. In other words taxpayers are not permitted to request an advanced ruling on transfer pricing matters, as part of the dispute resolution process. From this flows a need for SARS to implement an APA program.

As mentioned before, the benefits of an APA program exceed the disadvantages. The most significant benefit provided for by an APA program is the certainty for both taxpayers and tax authorities. It appears with no doubt, that implementing an APA program will be a mammoth task for SARS, from a cost and time perspective. However, an APA program can be seen as a long-term investment, given the benefit for taxpayers and SARS. Instead of dealing with lengthy ADR and MAP requests, SARS and the taxpayer can proactively deal with MNE’s pricing and understanding of complex transactions. SARS will be afforded the opportunity to gain insight into various industries and business models, without having to summon such information through other processes. The taxpayer on the other hand, will eliminate the costs of expensive transfer pricing analyses, achieve certainty on its intercompany transactions and avoid drawn-out dispute resolution processes.

Having established the need for APAs in South Africa, it is important to understand the framework in which they should operate. The next chapter will conclude this study with a recommendation of how an APA program should be implemented.

\(^{204}\) Ibid.
Chapter Six: Recommendations and concluding remarks

Thus far this study has motivated for SARS to implement an APA program in South Africa. In an effort towards completeness, the chapter will conclude the study by documenting a suggested form of how the APA program should be introduced, and whether there are any contradictions from a legislative perspective, that may prevent an APA program from being introduced in South Africa.

6.1. Chapter 7 of the TAA

Currently Chapter 7 of the TAA governs the issuing of advanced tax rulings. According to Section 75 of the TAA, an advance tax ruling means a ‘binding general ruling’, a ‘binding’ private ruling’ or a ‘binding class ruling’.205

A binding general ruling refers to a statement put together by a SARS official, under the tenets of Section 89, which deals with the interpretation or application of a tax Act to the given facts and circumstances submitted by the taxpayer.206 A binding private ruling is similar to the BGR, except for the fact that it deals with the application of a tax Act to one or more parties to a ‘proposed transaction,’ in respect of that ‘transaction’;207 Lastly, a binding class ruling deals with the application of a tax Act to a specific 'class' of persons, in respect of a 'proposed transaction.'208

According to SARS, the main objective of the advance tax ruling system is to provide clarity, consistency and certainty regarding the interpretation or application of tax legislation.209 SARS makes it clear that taxpayers can only make an application for a binding ruling, if there is a proposed transaction, which is to take place in the future.210 In other words, queries on current tax affairs and transactions of the taxpayer will not qualify for consideration by SARS under the advance tax ruling systems.

When the binding ruling is issued, it will apply to the transaction upon implementation, in accordance with what was agreed by SARS. It is interesting to note that SARS admits to the lengthy nature of these advance tax ruling applications and encourages taxpayers to submit their information timeously.211

207 Ibid.
208 Ibid.
210 Ibid.
211 Ibid.
Given that the advance tax ruling system applies to proposed transactions, Section 80(1)(a)(iii) of the TAA makes it explicitly clear that connected persons' transactions are excluded from the advance tax ruling system. SARS goes further to say that a taxpayer may not use the advance tax ruling system to request an advance pricing agreement, or its equivalent.\textsuperscript{212}

Considering that APAs are expressly excluded from the advance tax ruling system as per legislation, it is imperative to understand how an APA can then be introduced in South Africa. The OECD TP Guidelines make reference to the way APAs can be introduced, alongside a country's laws.

6.2. \textbf{OECD TP Guidelines on the conclusion of APAs}

The OECD TP Guidelines suggest the following:

"APAs involving the competent authority of a treaty partner should be considered within the scope of the mutual agreement procedure under Article 25 of the OECD Model Tax Convention; even though such arrangements are not expressly mentioned there."\textsuperscript{213}

Article 25(3) of the OECD Model Tax Convention states that competent authorities can resolve, by mutual agreement, difficulties or doubts of the taxpayer regarding interpretation or application of the convention.\textsuperscript{214} Furthermore, Article 25(3) encourages competent authorities to consult together, for the elimination of double taxation, in cases that are not provided for within tax treaties.

It is given that APAs come about when there are cases of doubt or confusion by the taxpayer on transfer pricing. Regarding the elimination of double taxation, it must be noted that bilateral APAs can fall within the ambit of this provision, because the objective of such an APA is to eliminate double taxation. The OECD TP Guidelines offer the following direction:

"Even though the Convention provides for transfer pricing adjustments, it specifies no particular methodologies or procedures, other than the arm’s length principle, as set out in Article 9. Thus, it could be considered that APAs are authorised by paragraph 3 of Article 25, because the specific transfer pricing cases subject to an APA, are not otherwise provided for in the Convention. The exchange of information provision in Article 26 could also facilitate APAs, as it provides for co-operation.

\textsuperscript{212} Ibid.
\textsuperscript{213} OECD. 2017. \textit{OECD TP Guidelines}. Section F.3 at paragraph 4151. (See Chapter 1, footnote 6)
\textsuperscript{214} Ibid.
between competent authorities, in the form of exchanges of information.\textsuperscript{215}

Another angle provided for by the OECD TP Guidelines is the lack of provision in a country’s domestic law, to enter into APAs. The OECD TP Guidelines suggest that, notwithstanding the gap in domestic law, if a tax treaty has a clause mirroring Article 25 discussed therein, then the competent authorities should be allowed to conclude an APA, should the transfer pricing issues lead to double taxation or raise uncertainty on the interpretation and application of the convention.

The OECD TP Guidelines warn that even though double tax treaties take precedence over domestic law, the lack of provision in domestic law does not mean that APAs cannot be concluded, in terms of the mutual agreement procedure:

“Some countries lack the basis in their domestic law to enter into APAs. However, when a tax convention contains a clause regarding the mutual agreement procedure, similar to Article 25 of the OECD Model Tax Convention, the competent authorities generally, should be allowed to conclude an APA, if transfer pricing issues were otherwise likely to result in double taxation, or would raise difficulties or doubts as to the interpretation or application of the Convention. Such an arrangement would be legally binding for both states, and would create rights for the taxpayers involved. Inasmuch as double tax treaties take precedence over domestic law, the lack of a basis in domestic law to enter into APAs, would not prevent the application of APAs based on a mutual agreement procedure.”\textsuperscript{216}

6.3. Application of Article 25 within South African Tax Treaties

With regards to South African tax treaties, Article 25 thereof provides a dispute resolution mechanism for the taxpayer, should the taxation result in a ruling that is not in accordance with the tax treaty in question.\textsuperscript{217} This dispute resolution mechanism assists the taxpayer in the following manner:

“The taxpayer may, irrespective of the remedies provided by the domestic law of the jurisdictions, present its case in the first instance, to the competent authorities of the jurisdiction of

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\item \textsuperscript{215} Ibid.
\item \textsuperscript{216} Ibid at Section F.3 at paragraph 4152.
\item \textsuperscript{217} SARS. 2018. Legal Counsel for Income Tax: Guide on mutual agreement procedures. (See Chapter 5, footnote 183).
\end{itemize}
\end{footnotesize}
However, on the 10th of October 2018, SARS published a second issue on the guidance for MAP. The MAP guidance provides insight on the applicability and procedure for taxpayers that wish to embark on the process. Notwithstanding that MAP is applicable to transfer pricing cases post factum, the guidance provides that relief under Article 25 is only limited to MAP, and cannot be used to conclude APAs, because South Africa does not have an APA program.

To introduce an APA program, the TAA would need to be amended as a point of first call. Section 80(1)(a)(iii) of the TAA will need to be repealed by Parliament. This would effectively enable the advance tax ruling system to apply to transfer pricing cases. The manner in which the advance tax ruling system can then apply to transfer pricing, would be through an APA program.

Thereafter, SARS would need to introduce an APA program under Article 25(3) of South African tax treaties, through the publication of a guide on APAs like the way it was done for the MAP. Such a guide would take the form of a protocol or memorandum of understanding wherein SARS can include detailed rules on the application, evaluation, examination, negotiation and conclusion of APAs. The timeframe within which it takes to complete such a process and any practical limitations thereof, are not discussed in this study. The following section provides some key considerations for SARS around the proposed introduction of APAs in South Africa.

6.4. Key Considerations around the Proposed Introduction of APAs

When considering the introduction of APAs, it is important to consider key issues that need to be addressed by tax administrations, prior to the introduction thereof. The goal of an APA programme must be borne in mind when establishing the parameters of such an endeavour:

“To be successful, the process should be administered in a non-adversarial, efficient and practical fashion and requires the cooperation of all the participating parties. It is intended to supplement, rather than replace, the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues. Consideration of an APA may be most appropriate when the methodology for applying the arm’s length principle gives rise to significant questions of reliability and accuracy, or when the

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218 Ibid.
One of the key considerations put forward by the OECD TP Guidelines is specificity of APAs. One must be cautioned on how specific APAs can be, when prescribing a taxpayer’s transfer pricing policy, over several years. Due to the predictive nature of APAs, the critical assumptions relied upon need to be accurate, and the nature of the prediction needs to be carefully considered. For example:

“It would not be reasonable to assert that the arm’s length short-term borrowing rate for a certain corporation on intragroup borrowings, will remain at six percent (6%) during the entire coming three years. It would be more plausible to predict that the rate will be LIBOR plus a fixed percentage. The prediction would become even more reliable if an appropriate critical assumption were added, regarding the company’s credit rating (for example the addition to LIBOR will change if the credit rating changes).”

Therefore, tax administrations, together with taxpayers, need to take a great deal of care when deliberating over transfer pricing methodologies for the purposes of an APA. The facts and the circumstances of each case will play a vital role in determining the critical assumptions of any prediction.

Another key issue is the use of bilateral APAs versus unilateral APAs. Where the taxpayer and the tax administration in the jurisdiction of the taxpayer reach an agreement, without the involvement of other tax administrations, this is referred to as a unilateral APA. The difficulty with unilateral APAs is that the findings contained therein may affect the tax liability of other connected persons in the taxpayer’s group. A bilateral APA, on the other hand, involves the other tax administrations in jurisdictions where the connected persons are resident. The OECD TP Guidelines offer the following approach, under these circumstances:

“Where unilateral APAs are permitted, the competent authorities of other interested jurisdictions should be informed about the procedure, as early as possible, to determine whether they are..."
Accordingly, most tax administrations prefer bilateral APAs over unilateral ones. In this way, tax administrations can avert the risk of double taxation, to a greater extent.

Monitoring compliance in terms of the APA by the tax administration can be done in two ways. The first manner is for the tax administration to require the taxpayer to file annual reports illustrating its compliance, in accordance with the terms, conditions and critical assumptions of the APA. The second approach involves the re-evaluation of the transfer pricing, with the exception of the transfer pricing methodology, by the tax administration. This can be performed during the regular audit cycle by the tax administration.

Lastly, APAs need to contain a cancellation clause, especially a retroactive one, should there be any fraud or misrepresentation of information, upon concluding the APA. In addition, when the taxpayer fails to comply with the terms and conditions in the APA, it should be subject to cancellation or revocation. Upon termination, the tax administration should alert other tax administrations of its proposed actions, and the reasons for doing so.

These key considerations discussed are not exhaustive. However, these issues are pertinent for consideration when attempting to introduce an APA program in a country.

6.5. Conclusion

Notwithstanding the advance tax ruling system which does not apply to transfer pricing matters, dispute resolution mechanisms for South African taxpayers currently consist of ADR and MAP procedures. Currently, the dispute resolution process in South Africa is known to be lengthy, expensive and of a reactive nature, rather than proactive. The DTC has noted the following, with respect to MAP:

“MAP has not been very effective among African countries. South Africa has participated in a minimal number of MAP processes, presumably because of taxpayers who have not applied for MAP and due to capacity issues.”

223 Ibid.
224 Ibid at Section F.3 at paragraph 4148.
225 Ibid.
226 Ibid at Section F.3 at paragraph 4149.
Given that the area of transfer pricing is a growing area of international tax policy, it is more important now than ever, for taxpayers and tax authorities to proactively discuss and to agree on transfer pricing policies. In this study thus far, it has been submitted that APAs can be a valuable tool, used by taxpayers to proactively obtain certainty on transfer pricing matters with tax authorities. Many tax authorities around the world, such as the Central Board of Direct Taxes (CBDT) in India, have used APAs successfully, despite the initial challenges with the implementation of the program.

South Africa, more specifically SARS, has opted to exclude APAs from its dispute resolution mechanisms. Even though there has been deliberation on whether to implement APA’s, there has not been much traction by SARS, to take this forward. It is assumed that the main reason for SARS’ apprehensiveness is around the administrative and the technical capacity of its audit team to implement and to maintain such a system. However, this challenge can be overcome in a number of ways, for example the hiring of independent experts until SARS can source the necessary skills required to run an APA department. In any event, the current resourcing that it takes SARS to conduct transfer pricing audits is significantly higher than what is required to run an APA department.

This study has attempted to outline the need for an APA system in South Africa. An APA system would be beneficial for both the taxpayer and for SARS, in that, it would enable both parties to engage in a non-adversarial spirit, to achieve a mutually beneficial outcome. In support of the need for APAs, the DTC has acknowledged the importance thereof:

“Advance pricing agreements (APAs) lessen the likelihood of transfer pricing disputes. Lack of an APA program in South Africa is an inhibitor to foreign direct investment, as it removes the opportunity to seek certainty on transactional pricing; particularly when Multinationals expand into the rest of Africa.”

The advantages of an APA program outweigh any negative connotations that may arise in this regard. Certainty and transparency around transfer pricing issues are key goals that can be achieved via the implementation of such a program. The Chevron case is a prime example of the need for an APA program. In other words, securing an arrangement between the taxpayer and the tax administration would avert a great deal of time and costs spent during litigation.

From a legislative perspective, this study has also outlined a suggested approach in which an APA program can be introduced in South Africa. This will involve participation by both SARS and

229 The Davis Tax Committee. 2017. Second interim report on BEPS. Page 4. (See Chapter 6, footnote 227)
parliament, to collaborate regarding the key considerations for APAs, and to eliminate any difficulties from a legislative angle.

Given that there are no further doubts around APAs for South Africa, this study highly recommends that the implementation thereof must be considered by SARS.
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