Consultation on Draft Model for APA Programme

After years in the making, the SARS finally published draft legislation and a proposed model for establishing an APA programme at the end of 2021. This article sets out the background to SARS’ decision to introduce an APA programme at this point in time and analyses the main features of the proposed APA programme, including the proposed process model, time frames and costs.

1. Background

Nearly a year after the release of the draft public discussion paper on the introduction of an advance pricing agreement (APA) programme, on 10 December 2021, the South African Revenue Services (SARS) published draft legislation and a proposed model for establishing an APA programme in South Africa. This comes about as a result of the recommendations by the Davis Tax Committee, in line with international practice.

Whilst SARS had for years raised a lack of skills and funding as the key inhibitors to the introduction of an APA programme, the change of policy seems to be the result of a number of recent international and local developments, in particular:

- the change in the international investment and tax landscape and the perceived importance of an APA programme for the success of South Africa’s drive to position itself as the leading investment destination and gateway into Africa; and
- SARS’ strategic objective to provide clarity and certainty for taxpayers and rebuild public trust after a period mired by maladministration, poor performance and a lack of governance.

Internationally, South Africa has long been positioning itself as the main investment destination in Africa and as a gateway for foreign investment into the rest of Africa. This position, however, has come under pressure in recent years from various angles.

Whilst South Africa arguably still holds the status as a leader on the African continent and therefore the premier destination for inward investment on the continent, due to its location, sizable economy, political stability, and overall strength in financial services, this position has become increasingly threatened in recent years, due to the emergence of a number of strong competitors on the continent, such as Nigeria, Kenya and Ethiopia.

In respect of South Africa’s position as a location for the establishment of regional holding companies by foreign multinationals, the situation is slightly different. While the above-mentioned factors, together with its headquarter company regime and network of tax treaties, should make South Africa the ideal jurisdiction for foreign multinationals investing into Africa to set up an intermediary holding company, in the past, it was always overshadowed by the success of Mauritius as the gateway into Africa. However, the heightened awareness and sensibility of both multinationals and African tax authorities when it comes to issues such as transfer pricing abuse or treaty shopping as a result of the OECD/G20’s Project on Base Erosion and Profit Shifting (hereinafter BEPS Project), has put pressure on Mauritius’ position as the jurisdiction of choice for intermediate holding companies and opened up an opportunity for South Africa to re-position itself in this regard.

On the local front, it is important to understand that for a number of years, SARS had been characterized by maladministration, poor performance and lack of governance. In the context of a challenging fiscal and economic outlook, increased social tensions and the COVID-19 pandemic, SARS has committed to a strategy aimed at (re-)building public trust and confidence in the tax administration system. Increased clarity and certainty is a key aspect of this strategy, which is hoped to increase voluntary compliance by taxpayers. One of the mechanisms that SARS intends to use to provide increased certainty is the APA programme.

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1. As at 30 April 2022, Nigeria, Tanzania and Uganda already had promulgated APA legislation.
Providing certainty to taxpayers regarding the tax treatment of their cross-border activities, is arguably the most important role played by an APA. While APAs are not primarily a means of increasing tax revenue, they play a valuable role in providing certainty and comfort to a taxpayer that they will not be subject to a costly audit with an uncertain outcome, in relation to the transaction(s) that fall within the ambit of the APA. This increases not only compliance, but it creates an environment of tax certainty that investors look for before they invest.

As already mentioned above, up until now, the main stumbling blocks standing in the way of South Africa’s implementation of an APA regime were lack of skills and funding. SARS’ focus in the meantime was on curtiling BEPS and building transfer pricing capacity, as it was believed that these issues are precursors to a successful APA programme. However, SARS appears to have now realized that the two elements, transfer pricing capacity and the APA programme, can be developed concurrently. Although the APA unit will ultimately require independence from the transfer pricing unit, it is envisaged that in the APA unit’s early stages of development the relationship between the units will be relatively fluid, necessitating the exchange of expertise and personnel between the units. Involvement of personnel in the negotiating of APAs could serve the dual purpose of meeting SARS’ strategic objective of achieving certainty to encourage foreign investment, while simultaneously building valuable specialist transfer pricing skills and knowledge.

While SARS is fairly advanced in developing a model, it is acknowledged that this will take time and a number of aspects require further consideration. As a result SARS has published a discussion document on the proposed APA programme, dealing with two issues:
- the proposed process model for establishing an APA programme in South Africa; and
- the draft legislation.

2. Main Features of Proposed Process Model for Establishing an APA Programme

Concept

The draft legislation proposes the following definition of an APA:

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

This definition is in line with the concept as set out in the OECD Guidelines.

Scope

The draft legislation limits the scope of APAs to “affected transactions” as defined in section 31 of the Income Tax Act No. 58 of 1962 (hereinafter Act), and therefore does not include transactions between a permanent establishment and its head office.

The draft legislation further indicates that the APA programme will only apply to affected transactions above a minimum value, still to be prescribed by the Commissioner by public notice.

The APA programme covers both the determination of the most appropriate transfer pricing method and the arm’s length price, concepts which are defined in the draft legislation. Importantly, all OECD-accepted methods of determining the price may be used.

Who is eligible to apply for an APA?

The persons that are eligible to apply to SARS for an APA are still to be determined at this stage. This will be done through a public notice to be issued by the Commissioner of the SARS.

Types of APAs

APAs may be granted unilaterally, bilaterally or multilaterally. Bilateral or multilateral APAs are normally only possible if treaties or relevant multilateral agreements are in place between the countries involved. These APAs take much longer to conclude than unilateral APAs, as they require cooperation between parties with conflicting interests. Despite the lengthy periods of time associated with bilateral and multilateral APAs, the OECD Guidelines encourage the conclusion of these types of APAs and recommend that an APA should be concluded on a bilateral or multilateral basis between the competent authorities wherever possible. This is because bilateral and multilateral APAs provide the parties to them with a much higher degree of certainty than unilateral APAs, as the APA reduces the risk of a transaction being challenged in one country, despite being accepted in another.

At this stage, the draft legislation envisages for only bilateral APAs to be issued, with the potential expansion to also include multilateral APAs after an initial pilot phase. There is no indication whether unilateral APAs will be considered in the South African context.

How long will an APA apply?

Integral to the definition of an APA is the fact that it is only intended to apply for a prescribed period of time. According to the draft legislation, this period of time is limited to a maximum of five years. However, SARS may grant an extension for a defined period of no more than three years, provided that the facts and circumstances have not changed materially from the original application for an APA.

Due to the fact that an APA can take a considerable length of time to negotiate, a number of countries have included so-called “roll-back” clauses, which have the effect that an APA, once concluded, can apply retrospectively. There is no provision for such a “roll-back” in the draft legislation.
What is the process to apply for an APA?
The discussion document details the envisaged high-level process flow through the various stages of the proposed model for establishing an APA programme. This process flow consists of five steps, starting with an APA pre-application consultation and ending with the signed APA agreement. Further detail on this process will be discussed below.

The process flow also envisages the implementation and ongoing monitoring of the APA, and provides SARS the option to terminate, amend or extend the relevant APA.

What are the fees for an APA?
Fees are envisaged for all the steps in the process. This is unsurprising in view of SARS' capacity and funding constraints. The fees payable are still to be determined by the Commissioner by way of public notice. However, if the fee structure that SARS uses for advance tax rulings are an indication of how the fees in the present context will be charged, we don't expect SARS' fees to be a material stumbling block in light of the typical costs of advisory fees and management time involved in an APA process.

What are the reporting requirements?
The APA holder will have to prepare and submit an annual compliance report to SARS. The compliance report is reviewed by the APA unit and, if necessary, audited, whereafter the APA holder will have to correct any non-compliance.

Can an APA be terminated?
Finally, the draft legislation provides for the termination of an APA. The termination can be initiated by either the APA holder (usually when there is a change of fact) or by the APA unit at SARS. Termination by SARS may be necessitated by fraud, misrepresentation, non-compliance, unwillingness by the APA holder to amend the APA when the law changes, public interest considerations or the completion of the defined term of the APA. Termination by SARS may be retrospective.

For the proposed process model and time frames, see the Table.

3. Comments
The OECD Guidelines provide guidance on APAs in the context of avoiding and resolving transfer pricing disputes. The OECD Guidelines indicate that to ensure the timely, effective and efficient resolution of treaty-related disputes, as a non-binding best practice, jurisdictions should implement bilateral APA programmes as soon as they have the capacity to do so, recognizing that APAs provide a greater level of certainty in both treaty partner jurisdictions, lessen the likelihood of double taxation and may proactively prevent transfer pricing disputes. The proposed model is in line with this international best practice.

However, there are a number of areas that still need to be determined through public notice by the Commissioner, including relevant factors that need to be considered in determining the most appropriate transfer pricing method; the parameters within which the competent authority of South Africa may enter into an APA; which persons are eligible for an APA; the quantum of the relevant fees; the minimum value of affected transactions in order to qualify for the APA process; and procedures and guidelines for the implementation and operation of the APA process. It is only upon the determination of these areas that it will be possible to get a full picture of the scope and extent of the model, and to evaluate whether it meets the standards of international best practice.

In principle, the model proposed by SARS is commendable, but the effectiveness of this model will, to a large degree, depend on whether it will be possible to obtain an APA within a reasonable time frame. The Communication from the Commissioner to the Council, the European Parliament and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU (hereinafter EU APA Guidelines) acknowledge that there are inherent dangers in stipulating a common timetable for every APA, because they are all different. The EU APA Guidelines indicate that best practice is for all parties to formulate a timetable as early as possible, once the APA application has been received, and to keep the time taken to conclude an APA to a minimum. The period envisaged by the EU APA Guidelines is 18 to 24 months. The OECD/G20 BEPS Project Action 14: 2015 Final Report (hereinafter Action 14 Report) indicates that countries should commit to a timely resolution of mutual agreement procedure cases and that they should seek to resolve them within an average time frame of 24 months.

Based on the time frames in the draft legislation, the APA process is envisaged to last approximately 13 months, in the best-case scenario. However, Step 3 dealing with APA processing does not delineate a time frame, but merely requires SARS to provide feedback every 90 days. Due to SARS' limited capacity and inexperience with APAs, it is unclear how long this process would take in reality.

2. In terms of the fee structure for advance tax rulings, an application for a binding ruling is subject to both an application fee and a cost recovery fee. The application fee is ZAR 2,500 for small, medium-sized and micro enterprises and ZAR 14,000 for any other taxpayer. The cost recovery fee is based upon the number of hours that it takes to consider the issues raised in the application, as well as any direct costs incurred in connection with the issuing of the ruling. The amount of the cost recovery fee is dependent upon several factors, including the number and complexity of issues raised, the complexity of the proposed transaction and the volume of information to be reviewed. In this context, a standard hourly rate of ZAR 650 applies, except in the case of urgent applications where it increases to ZAR 1,000. Therefore, in the case of standard applications, which are estimated to take 20 days to complete, fees can range between ZAR 10,000 and ZAR 35,000, while in the case of complex applications, which are estimated to take 60 days to complete, fees can range between ZAR 70,000 and ZAR 105,000.

Provided a similar fee structure is used in the context of APAs, given their complex nature and the reality that negotiating an APA will take substantially longer than 60 days, it seems likely that the fees will far exceed ZAR 100,000.
order for the proposed APA model to be effective, SARS would need to keep this processing phase as short as possible, but because there are no constraints envisaged in the legislation, there is no guarantee how long it will take.

If the effectiveness of South Africa’s mutual agreement procedure processes is anything to go by, a targeted timeframe of 18 to 24 months appears to be rather optimistic in light of the ongoing lack of skills and resources.

While the implementation of an APA programme in South Africa might be perceived as premature, particularly due to lack of funding and capacity constraints on SARS’ side, the proposal of an APA regime is a step in the right direction. In view of the fact that the conditions will likely never be perfect and the considerable period of time it takes to implement an APA regime, it is arguably the correct time for South Africa to pursue this programme. Through the implementation of the APA programme and the exposure of SARS’s transfer pricing personnel to APA negotiations, the concurrent development of South African transfer pricing expertise and APA capacity, might in the end create the certainty which is one of the most important building blocks in positioning South Africa as the premier destination for foreign multinationals to set up intermediary holding companies, while also playing an important role in curtailing BEPS, which is crucial for a developing country like South Africa.

### Table – Proposed process model and time frames

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Action</th>
<th>Section of the Tax Administration Act</th>
<th>Outcome/deliverable</th>
<th>Time frame</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>APA Pre-application (entry point for all new applications)</td>
<td>Initial screening, pre-application consultation and indication of quantum of cost recovery fees</td>
<td>90F</td>
<td>Decision by SARS as to whether or not an APA application can be made</td>
<td>Pre-application consultation within 60 days of application; decision by SARS within 90 days of consultation</td>
</tr>
<tr>
<td>2</td>
<td>APA Application (entry point for all extensions, amendments and re-negotiations)</td>
<td>Submission of formal application (including functional and economic analysis) and payment of fees</td>
<td>90G</td>
<td>Initial screening of the APA application to determine completeness and acceptability of the application</td>
<td>Must be made within 60 days of notification by SARS in terms of step 1; and an applicant may request an amendment to the application within 30 days of submitting an application to SARS</td>
</tr>
<tr>
<td>3</td>
<td>APA Processing</td>
<td>Allocation of application to an APA team; comprehensive examination and analysis of application; and engagement with the applicant on any relevant aspect</td>
<td>90K</td>
<td>Establishing and approval of SARS position and parameters for negotiation with foreign tax authority; and drafting of preliminary APA</td>
<td>No time frame, but feedback must be provided every 90 days</td>
</tr>
<tr>
<td>4</td>
<td>APA Negotiations</td>
<td>Negotiations with foreign tax authority in order to reach agreement in respect of preliminary APA; and sending draft preliminary APA to applicant for input</td>
<td>90K(4)</td>
<td>Draft preliminary APA</td>
<td>Decision by applicant whether to proceed with APA must be made within 60 days of receipt of preliminary APA</td>
</tr>
<tr>
<td>5</td>
<td>APA Finalization</td>
<td>Payment of outstanding fees and signature by the applicant of the final preliminary APA, by SARS and by the foreign tax authority</td>
<td>90L</td>
<td></td>
<td></td>
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</tbody>
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