CURBING TRANSFER PRICING MANIPULATION IN SOUTH AFRICA: LESSONS FROM SELECTED JURISDICTIONS

by

ABEL MABAWUZENI MBOWENI

STUDENT NUMBER:

12289711

submitted to the Faculty of Law in accordance with the requirements for the degree of

DOCTOR OF LAWS (LLD)

at the

UNIVERSITY OF PRETORIA

SUPERVISOR:

Dr BT KUJINGA

DECLARATION

I declare that "**CURBING TRANSFER PRICING MANIPULATION IN SOUTH AFRICA: LESSONS FROM SELECTED JURISDICTIONS**" is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

______________________________ ___________________________

SIGNATURE DATE

(Mr)

ACKNOWLEDGEMENTS

The fear of God is the beginning of all wisdom. Let me give glory and exaltations Him the creator of all things. I would not have succeeded with this work had it not been for the love and unwavering support of the following people:

My wife Ausie, for your patience and support throughout this long, arduous and winding road. Your prayers were a pillar of strength when I felt weak and thought of throwing the towel. Thank you very much.

My children, Singi and Mimi- thanks for understanding when I sometimes did not have time to be with you. Your patience and innocent smiles kept me going. I owe you my success; this one is for you my angels.

My parents thank you for your love and guidance I would not be the man that I am today had it not been for you. Inkomu Vacanyi.

All my siblings thank you for your support. My twin brother Lawrence, we are in this together.

My brother in law, Khumbula Masinge, your computer skills are beyond measure. Thank you very much for your patience and unquestionable support. You have been the mainstay of my success. This thesis would not have seen the light of day had not been for you. Khanimambo.

Sibongile Dhlamini, your incisive and intelligent comments, your ability to see my blindspots is what made this thesis a masterpiece that it is. I am indebted to you. Bayete!

The SARS library staff, Antoinette de Beer and Lisa Letoaba, thanks for your patience, and support. You are heavenly sent.

Last but not least, Dr BT Kujinga, your patience, understanding, guidance, constructive criticism and expert knowledge in the field of tax, I will forever be grateful to you. Thank you very much, Doc.

SOLI DEO GLORIA

SUMMARY

Transfer pricing manipulation is a worldwide problem which results in a massive loss of revenue which is meant to finance government socio-economic programmes. South Africa is not immune to this problem. South Africa is losing billions of Rands in tax revenue due to this scourge.

This research is an attempt to find ways and means which can be employed to combat or control the problem. In order to find the envisaged solutions, this research investigates the causes of the problem by analysing the weaknesses and the strong points of the arm's length principle which is the basis of transfer pricing practice in South Africa and elsewhere.

The research also investigates and analyses the corporate reasons for Multinational Enterprises (MNEs) to engage in transfer pricing with a view to demonstrating that transfer pricing is a neutral tax avoidance concept if it is applied for genuine business considerations.

The investigation also entails analysing the legal framework of transfer pricing in South Africa which is embodied in section 31 of the Income Tax Act 58 of 1962. The research analyses the efficacy of section 31 in dealing with the sophisticated transfer pricing manipulation schemes. In addition, an extensive reference to the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines is made as South Africa relies heavily on the guidelines.

A comparative analysis of selected topics is also conducted with the United States (US) and India with a view to drawing lessons from those jurisdictions. Based on the outcome of the analysis and the lessons drawn from the comparative analysis, findings are presented followed by legislative proposals or recommendations which will help to eradicate the problem. It is hoped that implementation of the recommendations taking into account the socio-economic conditions of South Africa will help to deal with the problem.

KEYWORDS

Advance Pricing Arrangements

Arm’s Length Principle

Arm’s Length Range

Associated Enterprise

Connected Persons

Comparability Analysis

Comparable Uncontrolled Price Method

Contribution Analysis

Cost Plus Method

Formulary Apportionment Method

Impermissible Tax Avoidance

Independent Enterprises

International Transactions

Multinational Enterprises

Mutual Agreement Procedure

Profit Split Method

Resale Price Method

Tax Avoidance

Tax Planning

Thin Capitalisation

Transfer Pricing Manipulation

Transfer Pricing Methods

CONTENTS

CHAPTER 1

INTRODUCTORY CHAPTER

1.1 Background: The Transfer Pricing Concept

Transfer pricing is the setting of the price for goods and services sold between controlled legal entities within an enterprise.[1] For example, if a subsidiary company sells goods to a parent company, the cost of those goods paid by the parent to the subsidiary is the transfer price.[2] A transfer price is different from 'a market price which is the price set in the marketplace for the transfer of goods and services between unrelated persons.[3] Transfer pricing is a major issue as it is estimated that 60 per cent of all international trade consists of transfers between connected persons.[4] Transfer pricing cannot take place between independent parties because independent parties are generally presumed to transact using open market terms and conditions.[5] A transfer price may be recorded as revenue by one member of a Multinational Enterprises (MNE) group and recorded as a cost by the other member in the transaction.[6]

---

[1] BJ Arnold & MJ *McIntyre International Tax Primer* 2 ed (2002) at 55. See also W Schon & KA Konrad *Fundamentals of International Transfer Pricing In Law and Economics* (2011) at 47; WM Abdallah *Critical Concerns in Transfer Pricing and Practice* (2004) at 23; M Markham *The Transfer Pricing of Intangibles* (2005) at 10; WA Raabe, GE Whittenburg, DL Sanders & RB Sawyers *Federal Tax Research* 9 ed (2012) at 330; P Daniel, M Keen & C McPherson *Taxation of Petroleum and Minerals: Principles, Problems and Practice* (2010) at 389.

[2] A Miller & L Oats *Principle of International Taxation* (2006) at 205. See also JJ Cordes, RD Ebel & JG Gravelle *The Encyclopaedia of Taxation and Tax Policy* (2005) at 154; M Ehrhardt & E Brigham *Corporate Finance: A Focused Approach* (2009) at 612; W Anson & D Suchy *Fundamentals of Intellectual Property Evaluation: A Primer for Identifying and Determining Value* (2005) at 180; AJ Easson *Tax Incentives for Foreign Direct Investment* (2004) at 43; RA Ajani, K Cool, GJ Goddard & D Khambata *International Business Theory and Practice* 2 ed (2006) at 252.

[3] Arnold & McIntyre *International Tax Primer* at 55. See also South African Revenue Services (SARS) 'Practice Note No 7: Determination of Taxable Income of Certain Persons from International Taxation (Section 31 of the Income Tax Act 58 of 1962)' (6 August 1999) at 5; BB Greaves *Free Market Economics: A Syllabus* (2007) at 52; JT Knoedler & RE Prasch *Thorstein Veblen and the Revival of the Free Market Capitalism* (2007) at 98.

[4] FDS Choi & GK Meek *International Accounting* 5 ed (2005) at 472. See also M Lang, P Melz, E Kristofferson & T Ecker *Value Added Tax and Direct Taxation: Similarities and Differences* (2009) at 837.

[5] Arnold & McIntyre *International Tax Primer* at 55. See also SARS 'Practice Note No 7' at 5; JE Fishman, SP Pratt & MJ Morrison *Standards of Value: Theory and Applications* 2 ed (2013) at 22.

[6] Choi & Meek *International Accounting* at 472. See also J Morrison *Business Ethics: New Challenges in a Globalised* World (2015) at 173.

The setting of transfer pricing is done using the arm's length principle (fully discussed in Chapter 2). The arm's length principle is the standard which is used to determine whether the transfer prices between connected parties are similar to those charged for transactions concluded between independent persons.[7] The arm's length principle requires that prices charged between related parties should be equivalent to those which would have been charged between independent parties for the same transaction.[8] An arm's length price is determined by applying transfer pricing methods, which are used to compare prices between transactions conducted by controlled and uncontrolled parties.[9] Where related parties fail to transact at arm's length, the Commissioner of the South African Revenue Services (hereinafter Commissioner of SARS) is empowered by section 31 of the Income Tax Act 58 of 1962 (herein referred to as the SA Income Tax Act) to adjust the price to the one which would have been charged if the transaction was concluded between independent parties dealing at arm's length.[10]

1.1.1 Example of a Transfer Pricing Transaction

Transfer pricing can be illustrated in the following example. Assume that there is a company called World Inc., which produces a type of food in Africa, then processes it and sells the finished product in the United States (US). World Inc. does this via three subsidiaries: Africa Inc. (in Africa), Haven Inc. (in a tax haven, with zero taxes) and America Inc. (in the US). Africa Inc. sells the produce to Haven Inc. at an artificially low price, resulting in Africa Inc. having artificially low profits and consequently an artificially low tax bill in Africa. Haven Inc. then sells the product to

---

[7] IBFD *International Tax Glossary* 6th ed (2005) at 23. P Adam *Managing Internationalisation* (2015) at 218; D Campbell International Taxation of Low-Tax Transactions (2009) – High Tax Jurisdictions (2009) at ixxxiv; I Richelle, W Schon & E Traversa *State Aid Law and Business Taxation* (2016) at 149.

[8] C Rolfe *International Transfer Pricing* (1993) at xvii; H Abrams & RL Doernberg *Essentials of United States Taxation* (1999) at 150; W Kersten *Global Logistics Management: Sustainability, Quality, Risks* (2008) at 6; O Shenkar, Y Luo & T Chi *International Business* 3 ed (2014) at 426; A Thorson *A Legal Guide to Doing Business in the Asia Pacific* (2010) at 464; RHC Luga *Assessment and Recovery of Tax Incentives in the EU and the WTO: A View on State Aid, Trade Subsidies and Direct Taxation* (2003) at 112-113.

[9] Organisation for Economic Co-operation and Development (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017)* at 33.

[10] Section 31 which is based on the arm's length principle was introduced into the Act with effect from 19 July 1995 to combat transfer pricing practices which may have adverse tax implications for the South African fiscus. This section consists of a combination of transfer pricing and thin capitalisation provisions. An in-depth analysis of this section is undertaken in Chapter 6.

America Inc. at a very high price, almost as high as the final retail price at which America Inc. sells the processed product. As a result, America Inc. also has artificially low profitability and an artificially low tax bill in America. By contrast, however, Haven Inc. has bought at a very low price, and sold at a very high price, artificially creating very high profits. However, it is located in a tax haven, so it pays no taxes on those profits. The end result is that World Inc. has shifted its profits artificially out of both Africa and the US, and into a tax haven. As a result, taxable income has been artificially shifted from both African and US tax authorities and has been converted into higher profits for the multinational. This simple example shows how transfer pricing can be used to shift profits to low tax jurisdiction and, consequently, the importance of effective transfer pricing regulation.

1.2 Historical Overview of Transfer Pricing Regulation

Transfer pricing is as old as cross-border trade itself but in this research, this concept will be studied from the period around 1917 as it is believed that is the time when some of the modern-day concepts were conceived. It is difficult to give a general overview of the history of transfer pricing because each and every country has its own diverse experiences. The historical overview in this research will only be limited to the countries which are analysed in this research. The transfer pricing history of these countries will be discussed in greater detail in the country-specific chapters. However, a brief historical overview of transfer pricing rules in the countries selected for this research will now follow.

It is said that transfer pricing practice regulations were first codified by the US through the War Revenue Act of 1917.[11] Through this Act, the Inland Revenue Service (IRS) was given the authority to consolidate and verify whether or not the accounts of related trades or businesses were made at market prices. In the 1920's the IRS commissioner gained the power to adjust accounts of related parties if he was of the view that tax was being avoided. In 1935, the arm's length principle was

[11] AM Heimert & M Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* (2010) at 5; T Althunayan *Dealing with the Fragmented International Legal Environment: WTO, International Tax and Internal Tax Regulations* (2010) at 116. For an alternative view on the origins of transfer pricing rules, see J Henshall *Global Transfer Pricing: Principles and Practice* 2 ed (2013) at 3, where it is contended that 'it is wrong to say that transfer prices originated in the USA'. Henshall argues that transfer pricing rules were first tried in the UK in the case *Stanley v The Gramophone and Typewriter Ltd* [1908] 2 KB 89 CA.

introduced in the US transfer rules for the first time.[12] In 1968, the US government adopted and codified the arm's length pricing methods.[13] In 1954, section 482 of the Internal Revenue Code (IRC) was enacted and was amended in 1986.[14]

Elsewhere, developments in transfer pricing were starting to gain momentum. In 1979 and 1984, respectively, the Organisation for Economic Co-operation and Development (OECD) reports on transfer pricing and MNEs were published.[15] In 1995, the first OECD transfer pricing guidelines were published.[16] In 1995, South Africa introduced transfer pricing legislation in terms of section 31 of the SA Income Tax Act and the South African Revenue Service (SARS) 'Practice Note No 7' was published in 1999.[17] Over the years, the South African transfer pricing and tax avoidance rules have gone through various amendments to conform to the ever-changing dynamics of the transfer pricing practice.

The Transfer Pricing Regulations (TPR) in India were introduced through the Finance Act of 2001,[18] and this culminated in the strengthening of the then existing

---

[12] K Vogel & P Kirchhoff *International and Comparative Taxation: Essays in Honour of Klaus Vogel* (2002) at 51.

[13] L Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (1998) at 51; BJ Arnold & MJ McIntyre *International Tax Primer* 2 ed (2002) at 58.

[14] AR Belkaoui *Advanced Management Accounting* (2001) at 291. Section 482 of the IRC allows the IRS to allocate assets, income, deductions, between different branches of the same company or between different companies controlled by the same interests. That is, the IRS may treat these branches or companies as one branch or one company for tax purposes. This section also exists to reduce tax evasion by preventing a company from hiding its taxable income in a subsidiary or a separate company. An in-depth analysis of this section is undertaken in Chapter 7. For a further reading of objectives of s 482 see also JG Gravelle *The Economic Effects of Taxing Capital Income* (1994) at 281 and RW Blasi *US Master Bank Tax Guide* (2009) at 416.

[15] OECD *Transfer Pricing and Multinational Enterprises Report of the OECD Committee on Fiscal Affairs* (1979) at 12.

[16] M Helminen *EU Tax Law: Direct Taxation* (2011) at 261; OECD *Meeting of the OECD Council at Ministerial Level 2002: Key Information* (2002) at 53; A Bakker & S Kloosterhof *Tax Risk Management: From Risk to Opportunity* (2010) at 153; J Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* Vol 35 (2010) at 107; M Bungenberg, C Herrman, M Krajewski & JP Terhechte *European Yearbook of International Economic Law* (2016) at 15; BD Lepard *Customary International Law: A New Theory with Practical Applications* (2010) at 293; ZD Altman *Dispute Resolution under Tax Treaties* (2005) at 65.

[17] SARS Practice Note 7 at B Croome, AW Oguttu, E Muller, T Legwaila, M Kolitz, RC Williams & C Louw *Tax Law: An Introduction* (2013) at 539; A Bakker & B Obuoforibo *Transfer Pricing and Customs Valuation* (2009) at 225; R Maelah *Sustaining Competitiveness in a Liberalised Economy: The Role of Accounting* (2009) at 232.

[18] J Paul *International Marketing: Texts and Cases* (2008) at 239; Bakker & Levey *Transfer Pricing and Dispute Resolution* at 366; BN Patel *India and International Law* Vol 2 (2008) at 326; U Dhar *New Age Marketing: Emerging Realities* (2008) at 231; M Lang, P Pistone, J Schuch, C Staringer, A Stork & M Zagler *Tax Treaties: Building Bridges between Law and Economics* (2010) at 539.

section 92 by the introduction of new subsections 92A to 92F in the Indian Income Tax Act (herein referred to as the Indian Income Tax Act) and relevant rules 10A to 10E in the Income Tax Rules of 1961. As already mentioned, detailed discussions of the history of these countries' transfer pricing rules will be conducted in the relevant chapters.

1.3 Transfer Pricing Manipulation

Transfer pricing as a business concept is not illegal, it is actually one of the vehicles used by associated enterprises to trade with each. Transfer pricing itself is neutral (neither bad nor good) until the setting of the prices contribute to avoidance of tax. In other words, transfer pricing becomes problematic when it is used to derive unwarranted tax benefits which were not envisaged by the legislature. When this happens, it becomes manipulation, which is not acceptable. Transfer pricing manipulation, also known as transfer mispricing refers to trade between related parties at prices meant to manipulate the markets or to fleece tax authorities of the much-needed tax revenue.[19] The setting of prices in this manner does not conform to the requirements of arm's length principle (fully discussed in chapter 2 below). Although transfer pricing manipulation is not necessarily illegal according to the prevailing legal provisions in South Africa, but may result in loss of revenue and as already alluded to, point to non-compliance with the arm's length principle.[20] Transfer pricing manipulation, unlike legit transfer pricing can be used to strategically set transfer prices above or below opportunity cost so as to pay little or no tax all.[21] When little or no tax is paid when it is supposed to be paid, lines are blurred between permissible and impermissible transfer pricing practices.[22]

---

[19] WM Abdallah *Critical Concerns in Transfer Pricing and Practice* (2004) at 23; L Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (1998) at 308; J Li & A Paisey *International Transfer Pricing in Asia Pacific: Perspective on Trade between Australia, New Zealand and China* (2005) at xxviii.

[20] L Eden *Taxing Multinationals: Transfer Pricing and Income Taxation in North America* (1998) at 20. 'The Internalization Benefits of Transfer Price Manipulation' George Bush School of Government and Public Service (2003) at 4; P Spencer *Property Tax Planning* 13 ed (2013) at 45.

[21] KA Reinert & RS Rajan *Encyclopaedia of the World Economy* Vol 1 (2009) at 1132; T Pogge & K Mehta *Global Tax Fairness* (2016) at 157; MN Javanovic *The Economics of European Integration: Limits and Prospects* (2005) at 296; S Brakman & H Garretsen *Foreign Direct Investment and the Multinational Enterprise* (2008) at 117; ST Cavusgil, G Night & JR Riesenberger *International Business: The New Realities* (2015) at 537; GG Schulze *The Political Economy of Capital Controls* (2000) at 143.

[22] H Compton *King Trends and the Future of Public Policy* (2006) at 196; PLL Mo *Tax Avoidance and Anti Avoidance Measures in Major Developing Economies* (2003) at 94; W Jia Chinese *Foreign*

Through transfer pricing manipulation, it is easy for an MNE to transfer its before-tax profits from a high tax jurisdiction to a low tax jurisdiction. As already alluded to, transfer pricing is not problematic if the prices between connected parties are set at arm's length.[23] The problem arises when the prices are set in ways that confer an unwarranted tax benefit to the taxpayer. The fundamental problem lies in the fact that the law as it stands in South Africa does not consider transfer pricing manipulation as a crime, hence the South African tax legislation does not have any penalty provisions when a taxpayer does not comply with the arm's length principle. It would be slightly easier to control transfer pricing manipulation using the principles of criminal law if the law classified transfer it as criminal.

1.4 Thin Capitalisation

When analysing the efficacy of transfer pricing rules, it is important to also refer to thin capitalisation rules. Thin capitalisation refers to the situation in which a company is financed through a relatively high level of debt compared to equity.[24] The reason for the connection between these two concepts is that the setting of prices between related parties does not only affect prices set for the exchange of goods and services but also affect the financing of transactions between cross-border related parties. In South Africa Cross-border financing is regulated by thin capitalisation rules contained in section 31(4) of the South African Income Tax Act.[25] It is imperative to mention that financing between connected parties is also prone to manipulation. A company is said to be thinly capitalised when its capital is made up of a much greater proportion of debt than equity.[26] Debt and equity capital or financing attract

---

Investment Laws and Policies: Evolution and Transformation (1994) at 97; G Dukes, J Braithwaite & JP Moloney *Pharmaceuticals, Corporate Crime and Public Health* (2014) at 315; SO Oloruntuba & T Falola *The Palgrave Handbook of African Politics, Governance and Development* (2017) at 625.

[23] L Eden *Taxing Multinationals: Transfer Pricing and Income Taxation in North America* (1998) at 20; A Alkhafaji *Competitive Global Management: Principles and Strategies* (1995) at 45; D Hansen & M Mowen *Cost Management: Accounting and Control* 5 ed (2006) at 461.

[24] L Olivier & M Honiball *International Tax: South African Perspective* 5 ed (2011) at 649; A Miller & L Oats *Principle of International Taxation* at 205.

[25] Transfer pricing rules and thin capitalisation rules are usually contained in the same provision. In South Africa, for instance both these rules are contained in s 31 of the Income Tax Act.

[26] AN Birts *Balance Sheet Structures* (2001) at 84; MA Cameira *Legal Studies: Portuguese Perspective* 2 ed (20015) para 1.3.5; PWC Mergers and Acquisitions: A Global Tax Guide (2006) at 269; R Williams *Unjust Enrichment and Public Law: A Comparative Study of England, France and the EU* (2010) at xvi; CHJI Panayi *Advanced Issues in International and European Tax Law* (2015) at

different tax consequences. Financing a company by means of equity normally results in a distribution of profits to the shareholder through dividends, but only after taxing such profits in the hands of the subsidiary. Pre-tax profits can be manipulated to avoid payment of dividend tax. Debt financing, in turn, results in a payment of interest to the financiers but such payments generally reduces the taxable profits of the subsidiary because the interest is not treated as profit which can be subjected to tax. Thin capitalisation rules ensure that financial assistance between connected parties meets the arm's length standard.[27] The concept of thin capitalisation was first dealt with in the 1979 OECD Report. It was later incorporated into the 1987 OECD Thin Capitalisation Report.[28] Thin capitalisation rules, as set out in paragraph 49 of the 1987 OECD Thin Capitalisation Report, formed the basis for the new interpretation of article 9(1) of the Model Tax Convention on Income and on Capital:

> Article 9(1) allows the tax authority of a contracting state to adjust the taxable profit of an enterprise of that State to include profits which have not accrued to it in its accounts, but which would have accrued to it in the arm's length situation. Thus, if profits have not accrued to the enterprise in its accounts because it has paid what has been described as interest to an associated enterprise and this payment has been deducted in arriving at the profits shown in the accounts but, in the arm's length situation, the payment would not have been deductible; then, in adjusting the taxable profits of the enterprise to include the payment, the tax authority would be acting in conformity with article 9(1). Provided therefore that the re-categorisation of interest as a distribution of profit under domestic thin capitalisation rules has the effect of including in the profits of a domestic enterprise only profit which would have accrued to it.

1.5 Problem Statement

Transfer pricing manipulation, as illustrated above, results in non-compliance with the arm's length principle which result in significant revenue losses in South Africa and elsewhere. Because of the secrecy around this issue, the magnitude of the problem is uncertain and the revenue loss cannot be accurately quantified. For this reason, various research groups and scholars come to different figures. For

---

209. P Strik *Shaping the Single European Market in the Field of Foreign Direct Investment* (2014) at 43; S Douma *Optimisation of Tax Sovereignty and Free Movement* (2011) at 227.

[27] L de Broe *International Tax Planning and Prevention of Abuse* (2008) at 503; MZ Brooke & PJ Buckley *Handbook of International Trade* (2016) at 245.

[28] OECD *Thin Capitalisation Report* (1987) paras 28-30. For a further discussion on thin capitalisation, see also AJ Easson *Tax Incentives for Foreign Direct Investment* (2004) at 43, BJM Terra & PJ Wattel *European Tax Law* 4 ed (2005) at 600.

example, Christian Aid estimates that about 60 per cent of total capital flight from developing countries is as a result of transfer pricing.[29] Developing or poor countries are the worst hit by the transfer pricing manipulation.[30] Although this research is focused on the loss of revenue in South Africa, which is a developing country, it does not mean that developed countries are immune from this problem.[31] The figures above illustrate the financial incentives for multinational organisations that result in the significant loss of the much-needed revenue to fund the government's socio-economic programmes.[32] In view of this problem, this research examines the problem of transfer pricing manipulation and the comparative efficacy of section 31 of the Income Tax Act, as a measure against this problem.

1.6 Research Questions

The following questions will guide the outcome of this research:

(i) What is transfer pricing and how does it fit within the definition, applicationand interpretation of the tax avoidance and tax evasion concepts?

(ii) What are the possible weaknesses of the transfer pricing methods, if any and what is the contribution of the arm's length principle's weaknesses, if any, to the transfer pricing manipulation problem?

---

[29] Christian Aid is a Christian based non-profit organization that tackles poverty in the world and they provide practical and effective assistance to alleviate poverty through research programs and one of their areas of research is capital flight from poor and developing nations through transfer pricing manipulation, available at http://www.christianaid.org.uk/whatwedo/africa/south_africa.aspx, accessed 30 January 2017.

[30] R Schaffer, F Agusti & LJ Dhooge *International Business Law and its Environment* 9 ed (2015) at 523.

[31] According to a study by the Organisation for Economic Cooperation and Development (OECD) at the end of 2015, tax havens have attracted worldwide assets worth $5 000-7 000 billion, but the exact amount of the capital transferred is difficult to determine a high degree of secrecy in tax havens. Although there are no clear figures about the extent of international tax evasion/avoidance in the European Union (EU), however, a value was estimated: between 2 and 2.5 per cent of EU GDP, i.e. between €200-250 billion. According to a report by the Economic and Monetary Affairs Committee in 2009, the international tax evasion has generated following specific situations: about one third of the 700 largest corporations in the UK did not pay anything in the corporate income tax in 2005 and 2006; 25 per cent of US companies that hold assets worth over $250 million or income exceeding $50 million per year is not paid, also no income tax between 1998 and 2005; the largest French corporations currently pay a tax of 8 per cent in average real benefits, even though the official corporate tax rate is around 33 per cent.

[32] JJB Hickey, R Matthew & C Rose *e-Commerce Law, Business and Tax Planning* (2000) at 110; R Jenkins *Transnational Corporations and Uneven Development* (2013) at 120; JE Baiden *Exchange Traded Funds* (2012) at 105; JJ Cordes, RD Ebel & JG Gravelle *The Encyclopaedia of Taxation and Tax Policy* (2005) at 135.

(iii) What are the causes of transfer pricing manipulation or what drives MNEs to engage in transfer pricing manipulation? Given the structure and wording of section 31, can it be said that this provision is effective to combat transfer pricing manipulation? If not, what are the amendments that can be effected to strengthen the efficacy of the South African transfer pricing provisions?

(iv) What are the practical measures or lessons that can be drawn from the Indian and the US transfer pricing regimes?

1.7 Methodology

This thesis analyses information from various sources.[33] Legislation, case law, articles, international tax instruments, and books (local and foreign written textbooks) on transfer pricing and tax avoidance will be widely consulted. In addition, the SARS Practice Notes 2 and 7 and Commentaries on the OECD Transfer Pricing Guidelines will also be consulted. The South African, Indian and US transfer pricing legislation will be analysed and compared in this work in an attempt to examine the transfer pricing manipulation problem in South Africa. India has been selected for this research because it is a developing country with similar economic challenges like South Africa and as it will be seen in chapter 8 has implemented some measures which can be beneficial to South Africa. The US has been selected in order to draw lessons from its advanced legislation and experience in dealing with similar issues since the late 1910s.[34]

1.8 Scope of the Study

The work is limited to transfer pricing arrangements between companies; it does not deal with transfer pricing between trusts and other juristic persons. The research includes transfer pricing and thin capitalisation because these concepts are

[33] Terre Blanche et al *Research In Practice* at 102.

[34] AM Heimert & M Johnson *Guide to International Transfer Pricing, Law, Tax Planning and Compliance Strategies* (2010) at 5 of chapter 3; J Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* Vol 35 (2010) at 39. In the USA, s 1331(*a*) of the War Revenue Act of 1917 was one of the provisions which originally dealt with transfer pricing. It required US corporations to file consolidated returns to equitably determine the invested capital or taxable income. Transfer pricing was further dealt with in the Revenue Act of 1921; DR Right 'Transfer Pricing in the United States: Recent Events and Expectations for the Future' (2001) Vol 55 Issue No 9; *International Bureau of Fiscal Documentation* at 418.

regulated by section 31 of the Income Tax Act.[35] Thin capitalisation will, however, be briefly discussed and it will only be dealt with from a transfer pricing perspective.[36] Any discussion of the transfer pricing manipulation in this thesis shall *mutatis mutandis* apply to abuse or transgression of thin capitalisation rules. The research includes both international transfer pricing and specified domestic transfer pricing transactions.

1.9 Outline of the Chapters

Chapter 2

In this chapter, the arm's length principle will be fully discussed. Its advantages and disadvantages are pointed out to link them with the transfer pricing manipulation. An attempt is also made to determine whether transfer pricing manipulation is classified as a tax avoidance scheme or as a purely tax evasion stratagem. An analysis is made to determine whether transfer pricing manipulation is a criminal offence.

Chapter 3

The determination of the arm's length price is achieved through the application of various transfer pricing methods. In this chapter, various transfer pricing methods are analysed in relation to the problem at hand. The nature and the application of the methods will be discussed.

Chapter 4

In order to understand the genesis for transfer pricing manipulation, this chapter attempts to find legitimate business reasons that cause MNEs to engage in transfer pricing. The reasons for transfer pricing are plenty but for the purposes of this research, they will be limited to among other things: reducing income tax liability, tariffs regulation, exchange risk, cash flow management and competition.

---

[35] Section 57 of the Taxation Laws Amendment Act 24 of 2011.

[36] Thin capitalisation refers to the situation in which a company is financed through a relatively high level of debt compared to equity whereas 'transfer pricing' (which is the focus of this work) refers to the pricing of the business transactions between connected parties. See also L Olivier & M Honiball *International Tax: South African Perspective* 5 ed (2011) at 649; A Miller & L Oats *Principle of International Taxation* at 205.

Chapter 5

This chapter deals with general problems which are encountered by taxpayers and tax administrations within the transfer pricing sphere. The non-exhaustive challenges contributing to transfer pricing manipulation include: lack of comparable data and or transactions, use of secret data, the implications of some of the OECD Base Erosion and Profit Shifting (BEPS) Action Plans on certain transfer pricing issues such as ecommerce, value creation, permanent establishments, document requirements challenges and administrative challenges. This chapter will illustrate how all these and other problems contribute to the transfer pricing manipulation problem.

Chapter 6

In this chapter, the South African transfer pricing system will be fully discussed. Among other things, the legal framework of the South African transfer pricing regime is analysed. In this regard, section 31 will be central to this discussion and analysis. Various challenges which are thought to be the causes of the transfer pricing problem are analysed.

Chapters 7 and 8

Since transfer pricing manipulation is a global problem, reliance on locally based solutions may not be sufficient; a comparative analysis will be conducted with the United States and India to draw lessons from those jurisdictions. Just like in Chapter 6 above, the legal frameworks of these two jurisdictions will be analysed. Relevant aspects of these jurisdictions' transfer pricing systems are selected for analysis to draw lessons from their practice and experiences. Within the US system, some of the aspects which will be analysed are:

(i) The arm's length principle as it is applied in the US in relation to the research problem.
(ii) The application of certain transfer pricing methods in the US; and
(iii) The dispute resolution mechanisms such as APAs.
(iv) Supplementary rules to the principal legislation
(v) The Transfer pricing document requirements
(vi) Domestic transfer pricing in the US

Within the Indian system some of the aspects which will be analysed are:

(i) The arm’s length principle as it is applied in India;

(ii) The impact of domestic transfer pricing in India;

(iii) Legislative powers accorded to transfer pricing officers in India;

(iv) Supplementary rules to the principal legislation in India;

(v) Dispute resolution mechanisms such as APAs in India.

Chapter 9

This chapter will conclude the thesis by dealing with the research findings and recommendations which will be formulated from the analysis in the chapters described above.

CHAPTER 2

THE ARM'S LENGTH PRINCIPLE AND TAX PLANNING CONCEPTS

2.1 Introduction

The previous chapter briefly referred to a number of concepts that are central to the analysis in this research. Some of the concepts entail the arm's length principle, tax avoidance and tax evasion. This chapter deals with the arm's length principle and various international tax law concepts in greater detail. Its aim is to show the role played by these concepts in transfer pricing manipulation. The chapter starts with the brief discussion of the history of the arm's length principle. It also focuses on the nature of the arm's length principle, its advantages, challenges and the problems associated with its application. Tax avoidance and terms such as tax evasion are briefly analysed as they have a direct connection with transfer pricing manipulation.

2.2 The Arm's Length Principle

2.2.1 The Arm's Length Principle as Basis for Transfer Pricing

The OECD Transfer Pricing Guidelines define the arm's length price as the price which would have been agreed upon between unrelated parties engaged in the same or similar transactions under the same or similar conditions in the open market.[37] This definition has become the model for many of the world's tax systems and can be further elaborated by dissecting some of the arm's length principle's salient features.[38] These features must not be confused with transfer pricing methods used to determine the arm's length principle. The arm's length principle, which is also known as the arm's length standard, is the basis for evaluating transfer

[37] OECD *Transfer Pricing Guidelines* at 33. See also L Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (1998) at 27; A Bakker & B Obuoforibo *Transfer Pricing and Customs Valuation* (2009) at 18; X Oberson & HR Hull *Switzerland in International Tax Law* (2006) at 329.

[38] C Sommer *Separate Accounting or Unitary Apportionment? The Fairytale of the Arm's Length Pricing and General Equilibrium Analysis of Multinational Enterprise Behaviour under the Formulary Taxation Alternative* (2010) at 59; Markham *Transfer Pricing of the Intangibles* at 20.

pricing transactions between related parties.[39] As already mentioned above, the arm's length principle is based on the provisions of article 9(1) of the OECD Model Tax Convention. Article 9(1) dictates that transfer prices between connected persons must be set at an arm's length basis. The arm's length principle is the standard on which the OECD Transfer Pricing Guidelines are based. The authoritative statement on the arm's length principle is found in paragraph 1 of article 9 of the OECD Model Tax Convention which provides that:

> [w]hen conditions are made or imposed between two [associated] enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any profit which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2.2.2 Historical Overview of the Arm's Length Principle

The arm's length principle dates back to the League of Nations Model Tax Conventions that formed the international consensus on cross-border trade in the first half of the twenty-first century.[40] In 1963, the arm's length principle was added to article 9 of the OECD Model Tax Convention.[41] In 1980, the United Nations also adopted the arm's length principle,[42] and this is reflected in article 9 of the United Nations Model Double Taxation Convention between Developed and Developing Countries. Since 1979, the OECD has developed practical guidance for the implementation of the arm's length principle. The OECD Transfer Pricing Guidelines

---

[39] M Heimert & M Johnson *Guide to International Transfer Pricing Law, Tax Planning and Compliance Strategies* (2010) at 5. See also M Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* (2011) at 73; J Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 405; MM Levey, SC Wrappe & K Chung *Transfer Pricing Rules and Compliance Handbook* at 11; E Riemer, N Urban, & S Schmid *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective* (2011) at 12; F Keuper and K Kleug *Finance Bundling and Finance Transformation: Shared Services Next Level* (2013) at 493; C Read & GN Gregoriou *International Taxation Handbook: Policy, Practice, Standards and Regulations* 1 ed (2007) at 152; M Lang, P Melz, E Kristofferson & T Ecker V*alue Added Tax and Direct Taxation: Similarities and Differences* (2009) at 729; L Kreiser, S Lee, K Ueta, JE Milne & H Ashiabor *Environmental Taxation and Green Fiscal Reform: Theory and Impact* (2014) at 99; A Miller & L Oats *Principle of International Taxation* at 471.

[40] E Kemmeren, DS Smit & P Essers *Tax Treaty Case Law around the Globe* 2014 (2015) at 55.

[41] Lepard *Customary International Law: A New Theory with Practical Applications* at 292; Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 147; Dziurdz and Marchgraber Non-*Discrimination in European and Tax Treaty Law: Open Issues and Recent Challenges* at 522.

[42] Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 252; A Amatucci *International Tax Law* (2006) at 152; A Lymer & J Hasseldine *The International Taxation System* (2002) at 56.

for Multinational Enterprises and Tax Administrations (OECD TPG) are continuously revised and updated with new rules in order to address and cope with the enormous changes and challenges posed by an increasingly globalised economy.

2.3 The Features of the Arm's Length Principle

2.3.1 Comparability

The arm's length principle is based on a comparison between the uncontrolled transactions undertaken by independent enterprises and the controlled transactions undertaken by related parties.[43] Uncontrolled transactions relate to transactions which are concluded between enterprises which are independent of each other.[44] Controlled transactions are transactions between two enterprises that are associated with each other. Arm's length pricing requires that related parties must calculate their pre-tax profits based on the prices that would have applied between unrelated parties under similar circumstances.[45]

The definitions controlled and uncontrolled transactions introduce two important terms which must also be examined in order to contextualise the functioning of the arm's length principle. The terms are independent enterprises and associated enterprises. Enterprises are said to be independent of each other if they are not associated or related enterprises with each other.[46] According to the glossary of the

---

[43] A Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* (2011) at 173; K Spies & R Petruzzi *Tax Policy Challenges in the 21st Century* (2014) at 358; OECD *The Taxation of Global Trading of Financial Instruments* (1998) at 31; Wittendorf *Transfer Pricing and the Arm's Length in International Tax Law* at 389; A Krimpmann *Principles of Group Accounting under IFRS* (2015) at 329.
[44] F Keuper & K Kleug *Finance Bundling and Finance Transformation: Shared Services Next Level* (2013) at 497; C Wendt *A Common Tax Base for Multinational Enterprises in the European Union* (2009) at 81; S Basu *Global Perspective on E-Commerce Taxation Law* (2007) at 136; D Pirvu *Corporate Income Tax Harmonisation in the European Union* (2012) at 75; WD Geach & J Yeats *Trusts: Law and Practice* (2008) at 234.
[45] OECD 'OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Aspects of Intangibles' (2014) at 14; DR Carmichael & L Graham *Accountants Handbook, Special Industries and Special Topics* 12 ed (2012) at 13; IMF *Balance of Payment Manual* 5 ed (1997) at 27; Spitz *International Tax Havens Guide* at 280; A van de Vijver T*he New US-Belgian Double Tax Treaty: A Belgian and EU Perspective* (2009) at 160; G Maisto T*he Meaning of Enterprise, Business and Business Profits under Tax Treaties and EU Tax Law* Vol 7 (2011) at 336.
[46] K Dziurdz & C Marchgraber No*n Discrimination in European and Tax Treaty Law: Open Issues and Recent Challenges* (2015) at 463; L Riccardi *Chinese Tax Law and International Treaties* (2013) at 88; A Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* at 412; T Ecker *A VAT/GST Convention Model: Tax Treaties as Solutions for Value Added Tax and Services Tax Double Taxation* (2013) at 383; CTIA *Consolidated*

OECD Transfer Pricing Guidelines, two enterprises are associated to each other if they meet the requirements of Article 9(1a) or (1b) of the OECD Model Tax Convention.[47] The arm's length principle operates on the basis that a transaction must be compared with another transaction under the same or similar conditions.[48] In practice, the comparison may be difficult or impossible in certain instances because no two transactions are exactly the same in every respect. The comparison is further complicated by comparing controlled and uncontrolled transactions. Controlled transactions are subject to internal MNE group supply chain procedures which are closely controlled to align with the group's policy, and, due to the internal control and lack of tax administration at that point, transfer prices are prone to manipulation. In contrast, uncontrolled transactions are subject to open market conditions which cannot be manipulated easily because the transaction takes place between unrelated independent parties who are motivated by market competition. Furthermore, the comparison produces less than ideal results because controlled and uncontrolled transactions often exist under different set of economic, market, political, legal and geographical circumstances.[49] The conclusion here is that due to these factors, the results of the transfer pricing comparability will most likely be distorted and vulnerable to manipulation.

Treaties and International Agreements Vol 1 (2009) at 396; IBP Inc *Turkey Taxation Laws and Regulations: Corporate Taxation* Vol 1 (2015) at 220.

[47] Article 9(1a) or (1b) of the OECD Model Tax Convention provides that 'Where a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.' For a further reading on more comments on art 9 read OECD 'Transfer Pricing Guidelines' at 23.

[48] A Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* (2011) at 305; Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 396; Markham *Transfer Pricing of the Intangibles* at 24; M Antani & G Gokhale *Contract Research and Manufacturing (CRAMS) in India* (2012) at 55.

[49] Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 287; L De Broe *International Tax Planning and Prevention of Abuse* (2008) at 98; C Sommer *Separate Accounting or Unitary Apportionment?: The Fairytale of the Arm's Length Pricing and General Equilibrium Analysis of Multinational Enterprise Behaviour under the Formulary Taxation Alternative* (2010) at 89; G Maisto *Taxation of Intercompany Dividends under Tax Treaties and EU Law* Vol 8 (2012) at 792; Spitz *International Tax Havens Guide* at 281; A Arnull & D Chalmers *The Oxford Handbook of European Union Law* (2015) at 825; Keuper & Kleug *Finance Bundling and Finance Transformation: Shared Services Next Level* at 493; J Monsenego *Taxation of Foreign Business Income within the European International Market* Vol 2 (2012) at 337.

2.3.2 Functional Analysis

Functional analysis is an analysis of the functions performed (taking into account assets and risks assumed) by associated enterprises in controlled transactions against independent enterprises in comparable uncontrolled transactions.[50] In order to establish the method that must be used to determine the arm's length price, a functional analysis must be conducted. Functional analysis is not a transfer pricing method, but a tool used to assist in the selection of a transfer pricing method with the view to ensure a proper determination of an arm's length price.[51]

The functional analysis is considered to be a practical way of evaluating functional comparability. It is used to find and organise facts about a business' functions.[52] When determining the arm's length price, the respective roles performed by all members of the group of companies involved in the transaction should be taken into account in setting the price. Group members should be allocated income or profit according to a set criterion such as the level of risk undertaken, level of capital available or any other reasonable and measurable criteria.[53] This is important as it

---

[50] OECD 'Transfer Pricing Guidelines' at 26. See also J Glabush *IBFD International Tax Glossary* 6 ed (2009) at 199; L Riccardi *Chinese Tax Law and International Treaties* (2013) at 87; L Riccardi *Vietnam Tax Guide: Domestic Fiscal System and International Treaties* (2014) at 35; Levey, Wrappe & Chung *Transfer Pricing Rules and Compliance Handbook* at 138; J Li & A Paisey *International Transfer Pricing in Asia Pacific: Perspective on Trade between Australia, New Zealand and China* (2005) at 32; A Bakker & MM Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* (2012) at 377; F Lessambo *Fundamentals of Hedge Funds: Alternative Investment Vehicles* (2011) at xvii; A Bakker & B Obuoforibo *Transfer Pricing and Customs Valuation* at 40; Spitz *International Tax Havens Guide* at 929; OECD 'Addressing Base Erosion and Profit Shifting' (2013) at 36.

[51] L Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (1998) at 235.

[52] SARS 'Practice Note No 7' at 11. See also Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 147; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 29; J Elliot *International Transfer Pricing: A Survey of UK and Non-UK Groups* (1998) at 12; P Valente, A Della Rovere & P Schipani *Analisi Di Comparabilita Nel Transfer Pricing: Metodologie Applicative* (2013) at 128; R Feinschreiber *Transfer Pricing Handbook* at 17-25; Markham *The Transfer Pricing of Intangibles* at 42; Feinschreiber *Transfer Pricing Methods: An Application Guide* at 43; RJ *Peroni International Income Taxation, Code and Regulations* (2008) at 1370.

[53] Spitz *International Tax Havens Guide* at 218. See also Muchlinski *Multinational Enterprises and the Law* at 280; Cordes, Ebel & Gravelle *The Encyclopaedia of Taxation and Tax Policy* at 303, Schreiber *International Company Taxation: An Introduction to the Legal and Economic Principles* at 20; R Russo *The Attribution of Profits to Permanent Establishments: The Taxation of Intra-Company Dealings* (2005) at 303; Peroni *International Income Taxation, Code and Regulations* at 1330; OECD 'Global Forum on Transparency and Exchange of Information for Tax Purposes' (2012) at 21.

will ultimately determine the price which will be transferred between that enterprise and the offshore (holding) company.

Functional analysis is critical for the determination of the nature and characteristics of the connected party's goods or services that have to be priced.[54] A functional analysis addresses some of the following issues within an MNE:[55]

(i) an overview of the organisation;
(ii) the overall structure and nature of the business undertaken by a member of a multinational;
(iii) general commercial and industry conditions affecting the member of a multinational;
(iv) an explanation of the current business environment and its predicted changes;
(v) the nature and terms of the transaction;
(vi) the functions undertaken by the relevant members of the multinational group and the relevant contributions of various functions. In this regard, the number of transactions taken by a member is not an indication that they will be highly compensated, but it is the quality and importance of each function which is important. The quality and importance of the transaction will determine whether the price attributed to it will meet the arm's length requirements; and
(vii) the functional analysis addresses an appraisal of risk because the norm in the open market is that the assumption of risk will be compensated for by an increase in the expected return. The risk assumed should be taken into account in the functional analysis which means that the higher the risk, the higher the returns.

2.3.3 Transactional Feature

In terms of this concept, the arm's length principle operates on the basis that the arm's length price must be set in reference to a particular transaction or a clearly defined set of transactions,[56] not in reference to an unspecified number of transactions. One finds that in

---

[54] K Vogel *Interpretation of Tax Law and Treaties and Transfer Pricing in Japan and Germany* (1998) at 157. See also Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 155; IMF *Romania Technical Assistance Report – Improving Compliance Risk Management of Large Taxpayers* (2016) at xi; Markham *Transfer Pricing of Intangibles* at 130; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 23; CS Chapman, AG Hopwood & MD Shields Handbook of Management Accounting Research (2007) at 580.

[55] JS Kuan *Global Transfer Solutions* (2004) at 64; R Feinschreiber *Transfer Pricing Methods: An Application Guide* (2004) at 43; MM Levey, SC Wrappe & K Chung *Transfer Pricing Rules and Compliance Handbook* (2006) at 13; L Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (1998) at 235.

[56] B Spitz *International Tax Havens Guide* at 280; M Lang *Introduction to the Law of Double Taxation Conventions* 2 ed (2013) at 147; J Calder *Administering Fiscal Regimes for Extractive Industries; A Handbook* (2014) at 72; RJ Peroni I*nternational Income Taxation, Code and Regulations* (2008) at

reality there is no such defined set of transactions. The reason is that transfer pricing only takes place between related parties.

2.3.4 Open Market Feature

In terms of this concept, successful implementation of the arm's length principle is based on the idea that all transactions must depict a normal open market feature.[57] Ideally, this means that an arm's length price must be based on open market conditions and must reflect ordinary business practice. In most economic models, open market conditions imply the inability of a single company or individual to affect the market price of goods and services.[58] The efficacy of the comparison becomes affected because transfer pricing does not take place in an open market setup.

2.4 The Advantages of the Arm's Length Principle

There are many reasons for applying the arm's length principle but for the purposes of this research, only a few will be mentioned. The arm's length principle provides equal tax treatment for connected and independent parties.[59] In other words, it places controlled and uncontrolled transactions on an equal footing for tax purposes and eliminates any economic distortion that differential tax treatment may create.[60] The arm's length principle has been found to work effectively in the vast majority of cases (not all) involving transfer pricing and thin capitalisation transactions.[61] The application of the arm's length principle substantially decreases the risk of double taxation.[62] There are different ways in

---

1229; JJ Cordes, RD Ebel & JG Gravelle *The Encyclopaedia of Taxation and Tax Policy* (2005) at 445; P Daniel, M Keen & C McPherson *Taxation of Petroleum and Minerals: Principles, Problems and Practice* (2010) at 389.

[57] Wittendorf *Transfer Pricing and the Arm's Length in International Tax Law* at 783; K Spies & R Petruzzi *Tax Policy Challenges in the 21st Century* (2014) at 358; M Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* (2011) at 73; A Paisey & J Li Transfer *Pricing: A Diagrammatic and Case Study Introduction, with Special Reference to China* (2012) at 70.

[58] Markham *Transfer Pricing of the Intangibles* at 19; A Paisey & Li Transfer *Pricing: A Diagrammatic and Case Study Introduction, with Special Reference to China* at 70.

[59] M Keller *An Analysis of Adequate Transfer Pricing Methods for Intangible Property* (2015) at 1; I Richelle, W Schon & E Traversa *Allocating Taxing Powers within the European Union* (2013) at 96.

[60] OECD 'Transfer Pricing Guidelines' at 36. See also T Hooper, S Uddin, M Tsamenyi and D Wickramasinghe *Handbook of Accounting and Development* (2012) at 274; A Miller & L Oats *Principle of International Taxation* at 549; H Abrams & RL Doernberg *Essentials of United States Taxation* (1999) at 139; N Sury *Foreign Direct Investment: Global and Indian Aspects* (2004) at 22; A Miller & L Oats *Principle of International Taxation* (2006) at 208.

[61] OECD 'Transfer Pricing Guidelines' at 36. See also W Schon & KA Konrad *Fundamentals of International Transfer Pricing In Law and Economics* (2011) at 125; Kobesty *International Taxation of Permanent Establishments: Principles and Policy* at 347.

[62] OECD 'Model Tax Convention on Income and Capital' (2008) para 1 describe double taxation as the imposition of comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for identical periods. P Rendahl *Cross-Border Consumption Taxation of Digital*

which double taxation can occur, but a full discussion of the concept is not the subject of this research.[63] One of the most important advantages of the arm's length principle is that, if applied properly, it ensures that taxpayers set correct transfer prices to reflect the correct amount of income that they earned before paying taxes.

2.5 Problems Associated with the Application of the Arm's Length Principle

Some of the shortcomings of the arm's length principle are:

2.5.1 Difficult to Apply in Some Cases Involving Intangibles

It is difficult to apply the arm's length principle in certain instances.[64] It is particularly difficult to apply the arm's length principle in the case of unique intangibles and the provision of specialised services.[65] The main problem with unique intangibles (mostly in pharmaceutical products) is that by their nature they cannot be duplicated owing to the exclusivity created by copyrights and registered patent protections that are closely guarded by their registrant companies. The criticism levelled against unique intangibles in the context of transfer pricing is that there are insufficient and unreliable comparables to determine the appropriate price. This means that the

---

Supplies (2009) at 23 describes double taxation as a situation where the same transaction is taxed in more than one state. For a further discussion of this concept see also A Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* (2009) at 217; WI Innes, PJ Boyle and JA Nitikman *The Essential GAAR Manual: Policies, Principles and Procedures* (2006) at 250.

[63] For a discussion and examples of double taxation see: J Barenfeld *Taxation of Cross-Border Partnerships: Double Tax Relief in Hybrid and Reverse Hybrid Situation* (2005) at 86, Arnold & McIntyre *International Tax Primer* at 28; A Lymer and J Hasseldine *The International Taxation System* (2002) at 7; F Walker *Double Taxation in the United States* (2004).

[64] OCED *Transfer Pricing Guidelines* at 37. See also V Thuronyi *Tax Law Design and Drafting* Vol 1 (1996) at 782, Markham *Transfer Pricing of Intangibles* at 26; A Wendt *Common Tax Base for Multinational Enterprises in the European Union* at 101, A Bakker & B Obuoforibo *Transfer Pricing and Customs Valuation* (2009) at 353; AM Rugman *The Oxford Handbook of International Business* 2 ed (2008) at 615, R Rawal *The Taxation of Permanent Establishments: An International Perspective* (2006) at 131.

[65] Feinscreiber & Kent *Transfer Pricing Handbook Guidance for the OECD Regulations* at 12 provides that intangible assets are non-physical, such as patents, trademarks, franchises, goodwill and copyrights. Depending on the type of business, intangible assets may include Internet domain names, performance events, licensing agreements, service contracts, computer software, blueprints, manuscripts, joint ventures, medical records, permits and trade secrets. Intangible assets add to a company's possible future worth and can be much more valuable than its tangible assets. Tangible assets are physical assets such as land, vehicles, equipment, machinery, furniture, inventory, stock, bonds and cash. These assets are the backbone of a company that keep it in production but are not available to customers. Tangible assets are at risk of damage either from naturally occurring incidents, theft or accidents. The two types of tangible assets are current and fixed. Current assets are inventory, or items a company turns into cash usually by the end of the year. These assets can be used as liquidation to save a company from debt problems or as financial aid. Fixed assets are physical items that will not be sold at any point in the business. These assets include machinery, equipment, vehicles or land, and they are needed to run the business continually.

prices set for these assets cannot be compared with any price in the open market. The mere fact that these transfers and the price setting take place between connected parties away from the reach of tax authorities also exacerbates the problem. There is a lack of reliable projections of future cash flow to be derived from the transferred intangible because these products cannot be compared with other products due to their unique nature.[66]

The difficulty with applying the arm's length principle also occurs in the production of highly specialised goods involving work-in-process inventory.[67] Work-in-process inventory occurs when one associated enterprise transfers its unfinished work inventory to another associated enterprise as part of its integrated production activities.[68] This is the manufacturer's inventory that is in the production line which is incomplete and not part of the finished goods inventory. This account contains the cost of the direct material, direct labour, and factory overhead placed into the products on the factory floor. A manufacturer must disclose in its financial statements the cost of its work-in-process as well as the cost of finished goods and materials in hand. Because of the difficulty (experienced by tax authorities) in verifying the costs associated with the work-in-progress inventory, it is easy for the MNE to manipulate the prices in order to bring down the tax liability associated with the sale of the final product.

2.5.2 Failure to Differentiate Profits made by Related and Unrelated Parties

One of the greatest criticisms levelled against the arm's length principle is that it produces inaccurate results in some cases because it cannot account for the profits

---

[66] RS Avi-Yonah *International Tax as International Law: An Analysis of International Tax Regime* (2007) at 113; P Muchlinski *Multinational Enterprises and the Law* 2 ed (2007) at 284.

[67] Feinscreiber & Kent *Transfer Pricing Handbook Guidance for the OECD Regulations* at 12 provides that in accounting terms work-in-progress inventory is that part of a manufacturer's inventory that is in the production process and has not yet been completed and transferred to the finished goods inventory. This account contains the cost of the direct material, direct labour, and factory overhead placed into the products on the factory floor. A manufacturer must disclose in its financial statements the cost of its work-in-process as well as the cost of finished goods and materials on hand.

[68] To read more about work-in-progress inventories see: A Shtub *Enterprise Resource Planning (ERP): The Dynamics of Operations Management* (2002) at 87; SM Bragg *Wiley GAAP Policies and Procedures* 2 ed (2007) at 78; M Kinney & C Raiborn *Cost Accounting: Foundations and Evolutions* (2009) at 150; CS Warren, JM Reeve & J Duchac *Financial and Management Accounting* (2008) at 864.

that related enterprises typically enjoy from an integrated business.[69] The arm's length principle is based on the separate entity approach. The separate entity approach does not always account for the economies of scale and interrelation of diverse activities created by integrated businesses.[70] This is so because those separate entities are treated differently in relation to the other aspects of the enterprise but only converge for transfer pricing purposes. This problem is further exacerbated by the fact that there are no widely accepted objective criteria for allocating the economies of scale or benefits between associated enterprises.

Another practical difficulty with the application of the arm's length principle which relates to the differentiation of profits is that connected persons may engage in transactions that independent parties would not undertake. Such transactions may not necessarily be motivated by tax considerations but by other commercial considerations that may not be experienced by independent enterprises.[71] The arm's length principle is difficult to apply where independent parties seldom undertake transactions of the type entered into by associated parties because there is little or no direct evidence of what conditions would have been established by independent enterprises.[72]

2.5.3 Treating Related Companies as Though they were Unrelated

Another weakness of the arm's length principle is that it is based on the unrealistic assumption of treating connected persons as though they were not connected for transfer pricing purposes by expecting them to conduct their business-like

---

[69] OECD *Model Tax Convention on Income and on Capital, Condensed Version* (2014) at 322.See also Markham *The Transfer Pricing of Intangibles* at 22; L Henderson *The Taxation of Electronic Commerce* (2001) at 126; PA O'Hara *Encyclopaedia of Political Economy* Vol 2 L-Z (2001) at 1168.

[70] OECD 'Transfer Pricing Guidelines' at 34. See also Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* (2011) at 288; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 49; Bakker & Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 7.

[71] OECD *Transfer Pricing Guidelines* at 37.See also Bakker & Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 107; J Gray *International Accounting and Transnational Decisions* (1983) at 202; Spitz *International Tax Havens Guide* at 297; J Smullen *Transfer Pricing for Financial Institutions* (2001) at 19.

[72] OECD *Transfer Pricing Guidelines* at 37, A Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* (2011) at 412.

independent parties.[73] The application of this principle disregards the real business considerations for connected parties to operate as a group. It also disregards the fact that in practice, related and unrelated parties operate in different economic circumstances.[74]

The notion of treating related entities as though they were unrelated and thereby disregarding the true economic realities of taxpayers is also echoed in the Canadian case of *Canada v GlaxoSmithKline Inc.*[75] In this case, the Canadian Supreme Court held that, in determining the appropriate arm's length prices, the courts will be required to consider the totality of the economic and business realities out of which non-arm's length transactions arise, to the extent that those realities would have prevailed if the parties to such transactions had been dealing at arm's length. In other words, the court affirmed that the application of the arm's length principle requires the Canadian Revenue Agency to consider all relevant economic factors surrounding the intercompany transaction between the Canadian company, *GlaxoSmithKline Inc*. and its related Swiss company,[76] in comparison with what would have prevailed if the parties were unconnected and dealing at arm's length. The fact that connected parties operate differently from independent parties should

[73] Markham *Transfer Pricing of the Intangibles* at 29. See also W Schon & KA Konrad *Fundamentals of International Transfer Pricing in Law and Economics* at 124. An alternative view to the unrealistic assumption of treating connected persons as though they were not connected for transfer pricing purposes is that a lot of anti-tax abuse doctrines are based on the recharacterisation of transactions. In many tax jurisdictions, recharacterisation is the renaming or recasting of a taxpayer's transaction by a tax administration or the courts to match its perceived substance or true character. This is a source of continuing controversy in tax law as the acceptability of certain recharacterisation of taxpayer transactions and the unsuitability of others in the eyes of both the courts and the tax administrations remains a mystery. It is generally understood that taxpayers may be held to the form in which they cast a transaction if this form is agreeable to the tax administration. The presumption is that the transactions took a form that in reality they never took. Little is known about those types of forms that taxpayers may employ successfully to escape various taxes or the extent of the tax administration's powers to exercise the discretion to recharacterize various taxpayer manoeuvres. The recharacterisation of transactions in terms of s 31 of the Income Tax Act is discussed in depth in Chapter 6.

[74] MJ Graetz *Follow the Money: Essays on International Taxation* (2016) at 191, CR Emmanual, K Merchant & DT Otley *Accounting for Management Control* 2 ed (2004) at 409.

[75] *Canada v GlaxoSmithKline Inc.* 2012 SCC 52 [2012] 3 S.C.R.3 para 42.

[76] The Transfer Pricing Guidelines identify five factors that may be important when determining comparability. These are: 1) the characteristics of the property or services transferred; 2) the functions performed by the parties (taking into account assets used and risks assumed), in relation to the controlled transaction. An examination thereof is often referred to as a functional analysis; 3) the contractual terms of the controlled transaction 4) the economic circumstances of the parties; 5) the business strategies pursued by the parties in relation to the controlled transaction. The extent to which each of these factors matters in establishing comparability can vary on a case-by-case basis and will depend in particular on the nature of the controlled transaction and the transfer pricing method adopted.

not be ignored because that would be tantamount to creating fictitious transactions for the sake of applying the arm's length principle.

2.5.4 The Administrative Burden of Using the Arm's Length Principle

The OECD acknowledges that applying the arm's length principle causes an administrative burden for the MNEs.[77] Taxpayers also maintain that, due to its complicated nature, the application of the arm's length principle causes an administrative burden for the multinational enterprises and tax administrations;[78] the administrative burden emanates from transfer pricing documentation,[79] sourcing and maintenance of comparable information. The arm's length principle places an obligation on the tax administration to engage in a verification process regarding the transactions that the taxpayer has entered into.[80] The verification takes long and requires the availability of skills to accomplish. The taxpayer also needs to prepare its documentation to demonstrate that its transactions are consistent with the arm's length principle.[81]

[77] OECD 'OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Documentation and Country by Country Reporting' (2014) at 20; K Vogel & P Kirchhoff *International and Comparative Taxation: Essays in Honour of Klaus Vogel* (2002). For a further discussion on this matter see also Kuan *Global Transfer Pricing Solutions* at 152; S Mayer *Formulary Apportionment for the Internal Market* (2009) at 225; DM Weber & B Da Silva *From Marks & Spencer to X-Holding: The Future of Cross Border Group Taxation* (2011) at 187.

[78] Kuan Global *Transfer Pricing Solutions* at 152; OECD 'Transfer Pricing Guidelines' at 163; A Schafer *International Company Taxation in the Era of Information and Communication Technology* (2006) at 119; MN Javanovic *The Economics of European Integration: Limits and Prospects* (2005) at 166; Schon & Konrad *Fundamentals of International Transfer Pricing In Law and Economics* at 281 W Schon, U Schreiber & C Spengel *A Common Consolidated Corporate Tax Base for Europe* (2008) at 122; AJ Cockfield *Globalisation and its Tax Discontents: Tax Policy and International Investments* (2010) at 72.

[79] Transfer pricing documentation is a typical example as illustrated by AM Heimert & M Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* (2010) at 24; Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 466; K Wundisch *International Transfer Pricing in the Ethical Pharmaceutical Industry* 2 ed (2003) at 142.

[80] M Peppitt *Tax Due Diligence* (2009) at 163; J Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014); F Keuper & K Kleug *Finance Bundling and Finance Transformation: Shared Services Next Level* (2013) at 506.

[81] OECD *Transfer Pricing Guidelines* at 229. See also Feinscreiber & Kent *Transfer Pricing Handbook Guidance for the OECD Regulations* at 15. See also Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 16. For a further discussion on transfer pricing documentation requirements see also E Baistrocchi & I Roxan *Resolving Transfer Pricing Disputes: A Global Analysis* (2012) para 16.3.3; M Butani *Transfer Pricing: An Indian Perspective* (2007) at 648; P Schuster *Transfer Prices and Management Accounting* (2015) at 44; RYW Tang *Intrafirm Trade and Global Transfer Pricing Regulations* (1997) at 121.

Where the industry in question is vertically integrated,[82] comparable information might not exist at all. The objective of transfer pricing is to find a reasonable estimate of the arm's length outcome based on reliable information. The OECD, however, fails to delineate the parameters of the reasonable estimate determination. In other words, there is no yardstick which is used to determine the degree of the reliability of the information and as such the estimation is prone to manipulation by taxpayers.

The above problems or weaknesses point directly to the inadequacies of the arm's length principle in general and indicate the issues that adversely affect legislation based on it such as section 31 of the SA Income Tax Act. An in-depth analysis of section 31 is done in Chapter 6; the comments made here are a build-up to illustrate the impact of the weaknesses of the arm's length principle as the basis for section 31.

2.6 Tax Avoidance

Transfer pricing is one of the tax avoidance schemes. An analysis of transfer pricing manipulation will not be complete without an exposition of the tax avoidance concept. For this reason, it is important to juxtapose the transfer pricing manipulation concept with tax avoidance and evasion in order to determine where it (transfer pricing manipulation) converge with the two concepts. This classification is important to correctly classify transfer pricing manipulation. In broad terms, tax avoidance involves the legal exploitation of tax laws to one's own advantage.[83] A discussion of the impermissible tax avoidance concept is not within the ambit of this research as it is provided for in section 80A- 80L of the South African Income Tax Act which deals with general anti avoidance rules (GAARs). The discussion of tax avoidance will be confined to section 31 as a specific anti avoidance rule.

---

[82] In microeconomics and management, vertical integration is an arrangement in which the supply chain of a company is owned by that company. Usually each member of the supply chain produces a different product or (market-specific) service, and the products combine to satisfy a common need. It is contrasted with horizontal integration, wherein a company produces several items which are related to one another. For a further discussion of this concept see: PA Gaughan *Mergers: What Can Go Wrong and How to Prevent It* (2005) at 100; MG Colombo *The Changing Boundaries of the Firm: Explaining Evolving Inter-Firm Relations* (1998) at 158; MG Blackford *The Rise of Modern Business: Great Britain, the United States, Germany, Japan and China* (2008) at 88; P Sadler *Strategic Management* 2 ed (2003) at 96.

[83] A Tooma *Legislating Against Tax Avoidance* (2008) at 12. See also D Kang & A Mason *Macroprudential Regulation of International Finance: Managing Capital Flows and Exchange Rates* (2016) at 303; D Mele *Business Ethics in Action: Seeking Human Excellence in Organisations* (2009) at 136; RW McGee *Ethics of Tax Evasion: Perspectives in Theory and Practice* (2012) at 73; G Zuckman *The Hidden Wealth of Nations: The Scourge of Tax Havens* (2015) at 102.

2.6.1 Permissible Tax Avoidance

As mentioned above, tax avoidance is defined as a process which allows a taxpayer to arrange his or her affairs in a perfectly legal manner, with the result that the taxpayer reduces their tax on income or has no income on which tax is payable.[84] The hallmark of permissible tax avoidance is the reduction of tax liability in accordance with the spirit and letter of the law.[85] A tax avoidance scheme is permissible if the fiscally attractive option is offered to the taxpayer by the law, if the scheme is not sanctioned by the law, it cannot be considered to be permissible.[86] MNEs have a right to use legal constructions and tax stratagems to exploit the loopholes in the tax laws.[87] An example of a permissible tax avoidance scheme may be the transference of a business to a new company where the rollover provisions for company formations are invoked in relation to the disposal of allowance assets and goodwill.[88] The terms permissible tax avoidance; tax mitigation and tax planning have similar meanings as they all refer to the arrangement of a taxpayer's affairs in a legally acceptable manner in order to pay less or no tax. In this thesis, these terms are used interchangeably to mean one and the same thing.

In most tax jurisdictions, including South Africa, the term tax avoidance is not statutorily defined.[89] Where SAARs are adopted, sufficient detail of the avoidance disallowed ought to be contained within those SAARs.[90] Where the GAARs are used,

---

[84] M Stiglingh, AD Koekemoer, Van Schalkwyk, JS Wilcocks, RD Swardt & K Jordaan *Silke: South African Income Tax* (2015) at 773. See also AW Oguttu 'Transfer Pricing and Tax Avoidance: Is the Arm's Length Principle Still Relevant in the E-Commerce era?' (2006) 18 *SA Mercantile Journal* (*SA Merc LJ*) at 138.

[85] M Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* (2011) at 39. See also W Vlcek *Offshore Finance and Small States: Sovereignty Size and Money* (2008) at 36; GW Pitts *The Personal Trainer's Legal Bible: Legalities for Fitness Professionals* (2014) at 517; C Watson *Watson's Tax Procedure and Tax Fraud in a Nutshell* 4 ed (2012) para 311, V Thuronyi *Tax Law Design and Drafting* Vol 1 (1996) at 45; PLL Mo *Tax Avoidance and Anti- Avoidance Measures in Major Developing Economies* (2003) at 3.

[86] *CIR v Willoughby* [1997] 4 All ER 65 at 73.

[87] J Hughes *The Theory, Principles and Management of Taxation: An Introduction* (2015) at 114; B Morgan & K Yeung *An Introduction to Law and Regulation: Text and Materials* (2007) at 165; AT Guzm & AO Sykes *Research Handbook in International Economic Law* (2007) at 344; N Feetham *Tax Arbitrage: The Trawling of the International Tax System* at 64; *Aiken Industries Inc. v Commissioner of Inland Revenue* (1971) 56 TC 925.

[88] Section 42(2)(*c*) of the SA Income Tax Act.

[89] IG Wallschutzy 'Towards a Definition of the Term Tax Avoidance' (1985) *Australian Tax Review* at 48.

[90] D Blum & M Seiler *Preventing Treaty Abuse* (2016) at 509. Blum & Seiler provide that specific anti avoidance rules (SAAR) are provisions which are intended to regulate a specific conduct or transaction by the taxpayer or to deny the benefit of a loss, relief or exemption which may otherwise arise when a particular type of transaction or series of transactions are undertaken. A typical example

the term 'avoidance' is typically wide-ranging as the GAAR is intended to be sufficiently broad to capture all tax avoidance schemes.[91] Some tax commissions and courts of law have over the years formulated their own definitions of tax avoidance. In 1955, the Royal Commission of Taxation of Profits and Income, UK (Radcliffe Commission) attempted to distinguish between tax evasion and tax avoidance by stating that tax evasion is illegal whereas tax avoidance is legal.[92] The Radcliffe Commission noted that tax avoidance is:[93]

> [s]ome act by which a person so arranges his affairs that he is liable to pay less tax than he would have paid but for the arrangement. Thus, the situation which he brings about is one in which he is legally in the right.

In 1966, the Royal Commission on Taxation, Canada (Carter Commission) described tax avoidance as:[94]

> [e]very attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provision or lack of provision in the law…it presupposes the existence of alternatives, one of which would result in less tax than the other.

In the United Kingdom case of *CIR v Willoughby*,[95] the court held that:

---

of a SAAR is section 31 which specifically regulate cross-border transfer pricing transactions between connected parties by providing that such transactions must meet the arm's length requirements. SAAR is an opposite of GAAR which regulates any conduct or transaction within a tax statute.

[91] Tooma *Legislating Against Tax Avoidance* at 12.

[92] For a further discussion on the differences between these tax evasion and tax avoidance see: R Eicke *Tax Planning with Holding Companies: Repatriation of US Profit from Europe* (2009) at 28; M James *The UK Tax System: An Introduction* 2 ed (2009) at 129; AM Bardopoulos *e-Commerce and the Effects of Technology on Taxation: Could VAT be the e-Tax Solution* (2015) at 129; E Kirchler *The Economic Psychology of Tax Behaviour* (2007) at 22-24; D Deak *Hungary International Tax Planning* (2003) at 351, V Thuronyi *Comparative Tax Law* (2001) at 155; RA Gordon *Tax Havens and their Use by United States Taxpayers: An Overview* (2002) at 59-61; G Morris *Tax Cheating: Illegal, But is it Immoral?* (2012) at 4; JG Head & RE Krever *Tax Reform in the 21st Century: A Volume in Memory of Richard Musgrave* (2009) at 532; N Feetham *Tax Arbitrage: The Trawling of the International Tax System* (2011) at 52.

[93]The 1955 Royal Commission on the Taxation of Profits and Income' available ahttp://www.kessler.co.uk/wp-content/uploads/2012/05/Royal-Commission-on-the-Taxation-of-Profits-and-Income-1955-comments-on-what-is-a-trade.pdf, accessed on 6 January 2017. See also Wallschutzy *Towards a Definition of the Term Tax Avoidance* at 53.

[94] 'Report on Royal Commission on Taxation: Implications of the Proposed Tax Reforms' Vol 3 (1966) available at https://books.google.co.za/books?id=B1VxenZtvU8C, accessed on 6 January 2017. See also KB Brown *A Comparative Look at Regulation of Corporate Tax Avoidance* (2012) at 315; P Webley *Tax Evasion: An Experimental Approach* (1991) at 2; G Kofler, MP Maduro & P Pistone *Human Rights and Taxation in Europe and the World* (2001) at 479; N Swart *Personal Financial Management* 2 ed (2002) at 68, J Mikesell *Fiscal Administration* 10 ed (2016) at 387. F Alberto & V Borego *Limitations on Benefit Clauses in Double Taxation Conventions* (2006) at 60.

> [t]he essence of tax planning is when a taxpayer takes advantage of a fiscally attractive option afforded to him by the legislation and genuinely suffers the economic consequences that parliament intended to be suffered by those taking advantage of the option.

Tax planning is achieved by taking into account all relevant tax factors, with the object of keeping the tax burden as low as possible while attaining the desired business, personal and other objectives.[96] Over the years, various court decisions have emphasised the notion that no legal obligation rests upon the taxpayer to pay higher taxes if they can find a way of minimising such payment. The most widely recognised judicial pronouncement on this is the UK case of *IRC* v *Duke of Westminster*,[97] where Lord Tomlin held that:

> [e]very man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result then however inappropriate to the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

The *Duke of Westminster* case may be one of the most popular cases in this regard, but cases dealing with avoiding payment of taxes can be traced back to the much earlier case of *United States v Isham*,[98] where the court said that:

> [a] careful individual, having the amount of twenty dollars to pay, pays the same by handing to his creditor two checks of ten dollars each. He thus draws checks in payment of his debt to the amount of twenty dollars, and yet pays no stamp duty. This practice and this system he pursues habitually and persistently. While his operations deprive the government of the duties it might reasonably expect to receive, it is not perceived that the practice is open to the charge of fraud. He resorts to devices to avoid the payment of duties, but they are not illegal. He has the legal right to split up his evidences of payment and thus to avoid the tax.

---

[95] *CIR v Willoughby* [1997] 4 All ER 65 at 73.
[96] B Spitz *International Tax Planning* 2 ed (1983) at 2. See also H Liu, WP Sung & W Yao *Computing, Control, Information and Education Engineering* (2015) at 821; JO Everett, CJ Hennig, N Nichols *Contemporary Tax Practice: Research, Planning and Strategies* (2009) CCH at 11-2; BD Singh *Compensation and Reward Management* (2007) at 238; KK Agrawal *Direct Tax Planning and Management, Incorporating: Corporate Tax Planning, Business Tax Procedure and Management* 5 ed (2006) at 6; J Tiley & G Loutzenhiser *Revenue Law: Introduction to UK Law, Income Tax, Capital Gains Tax, Inheritance Tax* 7 ed (2012) para 5.1.
[97] *ICR v Duke of Westminster* (1936) 51 TIR 467 at 19-20.
[98] *United States v Isham 4 U.S.* (17 Wall) 496 (1873) at 84.

In another US case of *Gregory v Helvering*,[99] Judge Learned Hand noted that it is:

> [t]he legal right of a taxpayer to decrease the amount at what otherwise would be his taxes or altogether avoid them, by means which the law permits cannot be doubted.

In the South African case of *CIR v Sunnyside Centre (Pty) Ltd* 1997(1) SA 68(A), Schultz JA commented that:[100]

> [c]ompanies are often used in the variety of ways to avoid taxes. When a scheme works, no tears are shed for the commissioner. That is because the taxpayer is entitled to order his affairs so as to pay the minimum of the tax. When he arranges them so as to attract more than the minimum he has to bear and grin.

Where options exist for payment and non-payment of tax, the taxpayer is at liberty to exploit that option. The right to exploit a tax loophole also came before the court in South Africa. In the case of *CIR v Estate Kohler and Others*,[101] it was held by Centlivres CJ that:

> [i]t is true that the device adopted was designed in order to escape death duties, but it has long been a well-recognised principle of law that a person may so order his affairs to escape taxation.

Lord President Clyde held in *Ayrshire Pullman Motors Services and DM Ritchie v IRC* that:[102]

> [n]o man in this country is under the smallest obligation, moral or otherwise, to arrange his legal relations to his business or to his property so as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow- and quite rightly-to take advantage, which is open to it under the Taxing Statutes for the purpose of depleting the taxpayer's pocket. The taxpayer is in the like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.

---

[99] *Gregory v Helvering* 1934 (69 F2d 809) at 810.
[100] *CIR v Sunnyside Centre Pty Ltd* 1997(1) SA 68A at 77F. See also *Hicklin v SIR* 1980(1) A 481(A) at 483F.
[101] *CIR v Estate Kohler and Others* 1953 (2) SA 584 (A) at 591F.
[102] *Ayrshire Pullman Motors Services and DM Ritchie v IRC* (1929)14 TC 754 at 763.

In the British case of *Levene v IRC,*[103] Viscount Summer held that:

> [i]t is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the Taxing Act. They incur no legal penalties, and they, strictly speaking, no moral censure if having considered the lines drawn by the legislature for the imposition of taxes, they, make it their business to walk outside them.

Lord Templeman in the UK case of *CIR V Challenge* defined tax mitigation or tax planning as follows:[104]

> [i]ncome is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduces his assessable income or entitles him to reduction in his tax liability.

The right to exploit a tax loophole was also heard in the case of *SIR v Hicklin,*[105] where it was held that taxpayers are at liberty to choose business methods that attract the least tax. Permissible tax avoidance, although legal as indicated above, has drawn fierce criticism because of its negative effects on the collection of revenue, a result that can also be ascribed to tax evasion but the difference here is that the manner in which the revenue is lost is not considered to be apprehensive because the law does not attach any illegality to it because the practice is within the confines of the law.[106]

In *Vestey's (Lord) Executors v IRC,* Lord Normand went as far as to mention that:[107]

> [t]ax avoidance is an evil, but it would be beginning of much greater evil if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved.

---

[103] *Levene v IRC* [1928] AC 21 at 227.
[104] *CIR v Challenge Corporation* [1987] AC 155 at 167H.
[105] *Hicklin v SIR* 1980 (1) SA 481(A) at 183.
[106] S Basu *Global Perspectives on E-Commerce Taxation Law* (2007) at 177; DS Kerzner & DW Chodikoff *International Tax Evasion in the Global Information Age* (2016) at 61; J Cullis, P Jones & PR Jones *Public Finances and Public Choice: Analytical Perspectives* 3 ed (2009) at 252; A Giovannini, RG Hubbard & J Slemrod *Studies in International Taxation* (1996) at 77; SP Green *Lying, Cheating and Stealing: A Moral Theory of White Collar Crime* (2006) at 245-246; SI Ajayi & L Ndikumana *Capital Flight from Africa: Causes, Effects and Policy Issues* (2015) at 306.
[107] *Vestey's (Lord) Executors v IRC* (1949) 1 All ER 1108 (HL) at 1120.

2.7 Tax Evasion

According to the OECD 'Report on International Tax Avoidance and Evasion',[108] the term tax evasion can generally be defined as the direct violation of a tax provision with the view of not paying what is legally due to be paid, and the aforementioned report states that:

> [w]ithin tax evasion, a distinction is sometimes made between the less serious offence of omission, such as the failure to submit complete returns of income, and more serious offences such as false declarations or fake invoices.

Tax evasion (intentional) is an illegal practice where a taxpayer intentionally fails to pay taxes due.[109] Furthermore, one of the descriptions put forward for tax evasion is:[110]

> [t]he taxpayer avoids the payment of tax without avoiding the tax liability, so that he escapes the payment of tax that is unquestionably due according to the law of the taxing jurisdiction and even breaks the letter of the law.

Tax evasion is the general term for efforts by taxpayers to dodge payment of taxes by illegal means.[111] In other words, evasion of tax is the unlawful escaping of tax liabilities.[112]

---

108 OECD 'International Tax Avoidance and Evasion–Four Related Studies, Issues in International Taxation Series No 1' at 12, as quoted by S Van Weeghel in his book *The Improper Use of Tax Treaties with Specific Reference to the Netherlands and the United States* (1998) at 34.

109 KE Murphy & M Higgins *Concepts in Federal Taxation* (2017) at 1-34; K Raczkowski & F Schneider *The Economic Security of Business Transactions: Management in Business* (2013) at 92; Z Chen & Y Zhou *Income Distribution during System Reform and Economic Development in China* (2005) at 335; Kirchler *The Economic Psychology of Tax Behaviour* at 22; McGee *Ethics of Tax Evasion: Perspectives in Theory and Practice* at 120; L Bernadi, M Chandler & L Gandulia *Tax Systems and Tax Reforms in New EU Member States* (2005) at 76; James *The UK Tax System: An Introduction* at 129; Morris *Tax Cheating: Illegal, But is it Immoral?* at 5. ES Herman *Beyond Hypocrisy: Decoding the News in an Age of Propaganda* (1992) at 178.

110 Russo et al *Fundamentals of International Tax Planning* at 50.

111 C Finnerty, P Merks, M Petriccione & R Russo *Fundamentals of International Tax Planning* (2007) at 49. See also KF Palda *Tax Evasion and Firm Survival in Competitive Markets* (2001) at 125; DL Barlett & JB Steele *The Great American Tax Dodge: How Spiralling Fraud and Avoidance are Killing Fairness Destroying the Income Tax and Costing You* at 4,

112 PW McCabe 'Background to the Bottom of the Harbour Investigation in Tax Avoidance and the Economy' (1984) *Australian Research Foundation* at 2. See also S Haseler *The Super-Rich: The Unjust World of Global Capitalism* (2000) at 21; JA Alonso & JA Ocampo *Global Governance Rules for the Post 2015-Era: Addressing Emerging Issues in the Global Environment* (2015) at 94; S Li *The Legal Environment and Risks for Foreign Investment in China* (2007) at 73; S Hiatt *A Game as Old as Empire: The Secret World of Economic Hitmen and the Web of Global Corruption* Vol 1 (2008) at 124; JC Edmunds & JE Marthinsen *Wealth by Association: Global Prosperity Through Market Unification* (2003) at 11; JH Sears *Trust Estates as Business Companies* 2 ed (1998) at 14; H Stiftung & R

Intentional tax evasion requires actual knowledge on the taxpayer's part that the statement made is false. To establish this, the taxpayer must know and perfectly understand the effect of the relevant tax provision and how it applies to them and despite the knowledge reconcile themselves with the consequences and make a deliberate choice not to comply. Apart from intentional tax evasion, there is also unintentional tax evasion. This is where the taxpayer did not intend to evade the taxes but acted in a grossly negligent manner. Paragraph 16.5.5 of the SARS 'Short Guide on the TAA' (Guide) states that gross negligence:

> Essentially means doing something in a way that, in all circumstances, suggests or implies complete or a high level of disregard for the consequences. The test is objective and is based on what a reasonable person would foresee as being conduct which creates a high risk of a tax shortfall occurring. Gross negligence involves recklessness but, unlike evasion, does not require an element of *mens rea* meaning wrongful intent or guilty mind or intent to breach a tax obligation.

It must be emphasised that the fact that certain tax evasion may be negligent in nature does not mean that a taxpayer will not be held liable. It simply means that the severity of punishment and attendant penalty may be lower as illustrated in s 223 of the TAA. The classification of a transaction as legal or illegal for tax purposes depends on the national laws of a particular country and differs from state to state because what may be illegal in one state may be perfectly legal in another state.[113] Some common examples of tax evasion include but not limited to:[114]

(a) the failure to notify the taxing authorities of one's presence in the country if he is carrying on taxable activities;
(b) the failure to report the full amount of income; deductions of claims for false expenses;
(c) falsely claiming relief that is not due; the failure to pay over the proper amount of tax due;

Schonenberg *Transnational Organised Crime: Analyses of a Global Challenge to Democracy* (2014) at 36.

[113] James *Taxation: Critical Perspectives on World Economy* at 243; G Fibbe *EU Law Aspects of Hybrid Entities* (2009) at 161; Bergman *Tax Evasion and the Rule of Law in Latin America: The Political Culture of Cheating and Compliance in Argentina and Chile* at 73; Terra & Wattel *European Tax Law* at 240; EL Feige *The Underground Economies: Tax Evasion and Information Distortion* (1989) at 17.

[114] Spitz *International Tax Havens Guide* at 8; Haynes, Dillard & Murray *Corporate Social Responsibility: A Research Handbook* at 91; D Shilling *Lawyer's Desk Book* (2017) at 21-47; PW Bernstein *The Ernst and Young Tax Guide 2004* (2004) at 26; J Brimer & L Smith-Porter *Annual Franchise and Distribution Law Development* (2005) at 40; TL Leap *Dishonest Dollars: The Dynamics of White Collar Crime* (2007) at 60; J Bovard *Lost Rights: the Destruction of American Liberty* (1995) at 284.

(d) departing from a country without paying a tax due with no intention of paying them; and

(e) the failure to report items or sources of taxable income profits or gains where there is an obligation to provide such information or if the taxing authorities have made a request for such information.

Tax evasion is a crime against the people in South Africa.[115] Those caught evading taxes are generally subjected to criminal charges and substantial penalties. In South Africa, taxpayers who are found evading tax and obtaining undue refunds by fraud, commit an offence and are upon conviction subjected to a fine or imprisonment for a period not exceeding five years.[116] Where evasion does not warrant imprisonment, penalties are imposed to punish the offenders. For the sake of brevity, understatement penalties in terms of s 223 of the TAA are tabulated as follows:[117]

1	**2**	**3**	**4**	**5**	**6**
Item	Behaviour	Standard case	If obstructive, or if it is a 'repeat case'	Voluntary disclosure after notification of audit or criminal investigation	Voluntary disclosure before notification of audit or criminal investigation
(i)	'Substantial	10%	20%	5%	0%

[115] P Haupt *Notes on South African Income Tax* (2018) at 629. See also Thuronyi *Comparative Tax Law* at 223; M Pickhardt & A Prinz *Tax Evasion and the Shadow Economy* (2012) at 5; M Bergman *Tax Evasion and the Rule of Law in Latin America: The Political Culture of Cheating and Compliance in Argentina and Chile* (2009) at 51; DO Friedrichs *Trusted Criminals: White Collar Crimes in Contemporary Society* 4 ed (2010) at 21-23, J D'Souza *Terrorist Financing, Money Laundering and Tax Evasion: Examining the Performance of Financial Intelligence Units* (2012) at 27; N Hayoz & S Hug *Tax Evasion, Trust and State Capabilities: How Good is Tax Moral in Central and Eastern Europe?* (2007) at 42; P Gottschalk *Policing White Collar Crime: Characteristics of White Collar Criminals* (2014) at 17; RD Hartley *Corporate Crime: A Reference Handbook, Contemporary Issues* (2008) at 21.

[116] Sections 222 and 223 of the TAA. Section 223 ranks the extent of the penalties based on the severity of the offence. For instance, where there are no reasonable grounds for the tax position given and if the conduct is obstructive or it is a repeat case the penalty is 75 per cent of the understatement penalty. Where their gross negligence and the conduct is obstructive or a repeat case the penalty is 125 per cent of the understatement penalty and lastly, where there is intentional tax evasion and the conduct is obstructive or it is a repeat case the penalty is 200 per cent of the understatement penalty.

[117] According to section 221 of the TAA an understatement penalty means any prejudice to SARS or the fiscus as a result of (a) a default in rendering a return, (b) an omission from a return, (c) an incorrect statement in a return or (d) if no return is required, the failure to pay the correct amount of ;tax'.

	understatement'				
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for 'tax position' taken	50%	75%	25%	0%
(iv)	'Impermissible avoidance arrangement'	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

The main difference between tax avoidance and tax evasion is that tax avoidance is legal and tax evasion is outright illegal.[118] This difference is confirmed by the following statement:[119]

> [t]ax avoidance" connotes stratagems which are *prima facie* lawful, which is to say, which are lawful unless proscribed by the Act. By contrast, "tax evasion" connotes inherently unlawful methods, such as incorrect statements in income tax returns (such as the non-disclosure of income or the exaggeration of expenditure claimed as a deduction) and sham or disguised transactions.

[118] DN Hyman *Public Finance: A Contemporary Application of Theory to Policy* (2014) at 383; TC Halliday & G Shaffer *Transnational Legal Orders* (2015) at 165; R Said, D Crowther & A Amran *Ethics, Governance and Corporate Crime: Challenges and Consequences* (2014) at 107; Mo *Tax Avoidance and Anti- Avoidance Measures in Major Developing Economies* at 2; M Lang, P Pistone, A Rust, J Schuch & C Staringer *Base Erosion and Profit Shifting BEPS: The Proposals to Revise the OECD Model Convention* (2016) at 211; A Lewis *The Cambridge Handbook of Psychology and Economic Behaviour* (2012) at 306; G Gravelle *Tax Havens: International Tax Avoidance and Evasion* (2010) at 1.

[119] A De Koker & RC Williams *Silke on South African Income Tax* (2012) at 19-21. For further reading see also, M Hampton *The Offshore Interface: Tax Havens in the Global Economy* (1996) at 34; WH Muller, CH Kalin & JG Goldworth *Anti-Money Laundering: International Law and Practice* (2007) at 5; K Artaraz & M Hill *Global Social Policy: Themes, Issues and Actors* (2016) at 44.

The difference between tax evasion and tax avoidance has also been articulated in the courts, such as in the case of *R v Mears*,[120] where it was noted by Gleeson CJ that:

> the difference between the two is simple and clear. Tax avoidance involves using or attempting to use useful means to reduce tax obligations. Tax evasion involves using unlawful means to escape payment of tax. Tax avoidance is lawful and tax evasion is unlawful.

2.8 Classification of Transfer Pricing Manipulation

In paragraph 1.3 of Chapter 1, transfer pricing manipulation also known as transfer mispricing or fraudulent transfer pricing, refers to trade between related parties at prices meant to manipulate the markets or to deceive tax authorities. The classification of transfer pricing manipulation (into either tax avoidance or tax evasion) will depend on the definition of each of these concepts. As mentioned above, on one hand, tax evasion is outright illegal and punishable by various sanctions in the law. On the other hand, tax avoidance is considered to be perfectly legal, despite its negative impact that it (might) have on the revenue collection and general compliance with tax laws. The hallmark of tax evasion is that it defrauds the tax authority of the revenue; tax evasion is fraudulent irrespective of the stratagem which has been used and that is what makes it a crime.

Section 31 in its current form does not consider transfer pricing manipulation as a crime and there transfer pricing manipulation cannot be considered to be illegal despite the fact that in certain instances loss of revenue may be considered to very reprehensible or compared to theft or corruption. To prove that transfer pricing manipulation is not a crime according to South African law; the Income Tax Act does not prescribe any criminal sanction for taxpayers who do not comply with the arm’s length principle. as it will be seen when the South African transfer pricing regime is discussed in chapter 6, section 31 only permit the Commissioner to adjust the transfer price to ensure that it accords with the arm’s length. For this reason transfer pricing manipulation can be classified as a specific tax avoidance scheme which is combated by a specific anti avoidance provision in the form of section 31. Considering the definition and nature of tax evasion above, transfer pricing

[120] *R v Mears* (1997) 37 ATR 321.

manipulation cannot be considered to be tax evasion in South Africa. It can however be argued that the setting of a transfer price which is not compliant with the arm's length principle may amount to a contravention of section 31 especially if the transfer pricing avoidance scheme was so aggressive that it resulted in a massive loss of tax revenue. This may be a situation where the dividing line between tax evasion and tax avoidance is blurred. To cure this undesirable situation, the adjustment of the transfer price by the Commissioner should be accompanied by severe penalties, this will indirectly deem noncompliance in such instances to be criminal and push transfer pricing manipulation towards the evasion ambit.

2.9 Conclusion

From the afore going discussion, it can be concluded that the arm's length principle is effective in most instances to provide solutions on transfer pricing issues but it is also true that it is not effective in all problematic transfer pricing situations. For an example, the principle is less effective in issues that have to do with transfer pricing of intangibles; it can also be burdensome when it comes to documentary requirements. It can thus be concluded that the arm's length price is not the panacea to all transfer pricing problems. Although it is legally incorrect to assert that transfer pricing manipulation is a facet of tax evasion in terms of the South African and international tax law but by their nature, transfer pricing manipulation schemes tend to blur the dividing line between evasion and avoidance. Where these schemes are more aggressive and somewhat tilting the legality scale, the law should be tailored in a way that classifies such conduct under the tax evasion category. The dividing line is very blurred and delicate, this explains why reports by non-governmental organisations such as the Tax Justice Network, the Economic Freedom Fighters (EFF) and the Thabo Mbeki reports on illicit financial flow (IFF) list transfer pricing as a component of IFF,[121] which of course is illegal. There is however international

[121] The EFF is South African political party which in February 2015 submitted a paper to the South Africa parliament highlighting the problems associated with illicit financial flows. The title of the paper is: "Transfer Pricing in South Africa: Economic Freedom Fighters Submission to the Portfolio Committee on Finance, Republic of South Africa Parliament." The party singled out transfer pricing as one of the main contributors to the problem. In their statement they say: "Transfer pricing constitutes the core of illicit financial flows, which according to credible research institutions such as the Tax Justice Network, Global Financial Integrity, OXFAM, the High Level Panel on Illicit Financial Flows led by former President Thabo Mbeki, and tentatively the Organisation of Economic Co-operation and

consensus that transfers pricing is legal. As already mentioned, the current law point to the fact that transfer pricing is not illegal but the same law is silent about the legal nature of transfer pricing manipulation activities.

Development (OECD) costs the African continent billions of dollars annually, and far exceeds the amount Africa receives in developmental aid". The full document can be read from https://webcache.googleusercontent.com/search?q=cache:_tae_MqnyoYJ:https://pmg.org.za/files/150519eff.doc+&cd=2&hl=en&ct=clnk&gl=za, accessed on 25 October 2013. Former state president of South Africa Mr Thabo Mbeki also released a report about the impact of illicit financial outflows; the report is available at http://www.theafricareport.com/illicit-financial-flows.html, accessed on the 5 November 2018.

CHAPTER 3

TRANSFER PRICING METHODS

3.1 Introduction

The previous chapter dealt with tax planning as it relates to transfer pricing. This chapter will now deal with transfer pricing methods. Transfer pricing methods are set rules which are used to determine the arm's length price of a transaction between related parties. As already mentioned in the previous two chapters, transfer pricing manipulation occurs when the prescripts or requirements of these methods are manipulated or distorted to achieve an unwarranted tax benefit. The study of transfer pricing methods is important because the application of the arm's length principle is given effect by the application of these methods. The analysis of these methods is applicable to India, South Africa and the US although minor variations will be discussed in the chapters dealing with the specific analysis of the transfer pricing rules of these countries. There are five main OECD methods for transfer pricing and they are:

(i) Comparable uncontrolled price method

(ii) Cost plus method

(iii) Resale price method

(iv) Transactional net margin method

(v) Profit split method

There is no overt hierarchy of transfer pricing methods. All facts and circumstances of each case must be taken into account in choosing the most appropriate method. The lack of hierarchy is advantageous because it brings flexibility, but it is disadvantageous because it can lead to uncertainty as it presupposes that any method can be applied to any situation. No method is preferred over the other; the circumstances of each case play an important role in the applicability of a particular method.[122] Over and above these methods, the global formulary method of apportionment is also used to control how prices or profits are transferred between related parties. The global formulary method which is predominantly applied by certain states like Massachusetts and California in the US will be discussed as an alternative to the OECD transfer pricing methods in chapter 7 that deals with the comparative analysis with the US.

3.2 Overview of the Transfer Pricing Methods

The transfer pricing methods are set out in the OECD Transfer Pricing Guidelines;[123] as already mentioned, these are internationally accepted set of rules which have been agreed upon by the OECD member states to aid in the determination of the arm's length principle.[124] Although South Africa is not a member of the OECD, SARS makes use of these methods to determine the arm's length standard of the transfer pricing transactions.[125] All transfer pricing methods recommended by the OECD can be applied to establish an arm's length price of a transaction.[126] In order to choose

[122] D Laro & SP Pratt *Business Valuation and Federal Taxes: Procedure, Law and Perspective* 2 ed (2011) at 116; AK Das Mohapatra *International Accounting* 2 ed (2012) at 158; Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 269; Rathore *International Accounting* at 308; J Isenbergh *International Taxation* 3 ed (2010) at 76.

[123] OECD *Transfer Pricing Guidelines* at 97. It's important to note that the OECD Transfer Pricing Guidelines are not the only international instrument that set out transfer pricing methods in the world, the United Nations 'Practical Manual on Transfer Pricing for Developing Countries' available at http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf, accessed on 06 April 2016 also contains invaluable principles relating to transfer pricing practice. For a further discussion on the origin and application of transfer pricing methods, see R Feinschreiber *Transfer Pricing Methods, An Application Guide* (2004) at 51; M Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* (2011) at 89.

[124]AM Heimert & M Johnson *Guide to International Transfer Pricing, Law, Tax Planning and Compliance Strategies* 4 ed (2014) at 23; L Kurukulasuriya & NA Robinson *Training Manual on International Environmental Law* (2006) at 377; I Seidi-Hoheneldem *International Economic Law* (1999) at 17; P Daniel, M Keen & C McPherson *Taxation of Petroleum and Minerals: Principles, Problems and Practice* (2010) at 389.

[125] SARS 'Practice Note No 7' at 6. It is provided in the Practice Note that 'although South Africa is not a member country of the OECD, the OECD Guidelines are acknowledged as an important influential document that reflects unanimous agreement amongst countries, reached after an extensive process of consultation with industry and tax practitioners in many countries. The OECD Guidelines are also followed by many countries which are not OECD members and are therefore becoming a globally accepted standard'.

[126] Miller & Oats *Principles of International Taxation* at 211; A Martel & W Klibi *Designing Value-Creating Supply Chain Networks* (2016) at 350; D Pirvu *Corporate Income Tax Harmonisation in the European Union* (2012) at 73.

the most appropriate method or methods some of the following factors must be considered:[127]

(i) the nature of the activities being examined;
(ii) the availability, coverage and reliability of the data;
(iii) the degree of comparability that exist between the controlled and
(iv) uncontrolled transactions and between enterprises involved including all the circumstances in which the transaction took place and lastly;
(v) the nature and extent of underlying assumptions

Transfer pricing methods are divided into 'traditional transaction' methods and 'transactional profit' methods.[128] Traditional transaction methods compare third-party prices, or other less direct measures such as gross margins on third-party transactions, with the same measures on the transactions under review.[129] The traditional transaction methods are regarded as the most direct means of establishing the arm's length conditions.[130] Transaction-based methods are transfer pricing methods which examine the net operating profits that arise from the intercompany transactions under review.[131] Transaction-based methods are applied by comparing the price charged in controlled transactions between related enterprises against prices charged in comparable transactions between independent

---

[127] Singh & Bagchi *Transfer Pricing and Regulations for India* at 43; P Harris & D *Oliver International Commercial Tax* (2010) at 236; D Laro & SP Pratt *Business Valuation and Federal Taxes: Procedure, Law and Perspective* 2 ed (2011) at 143; Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 414; Schon & Konrad *Fundamentals of International Transfer Pricing In Law and Economics* at 72; Ishikawa Firms' Location Selection and Regional Policy in the Global Economy at 86.

[128] MO Lucas-Mas 'Section 1059A: An Obstacle to Achieving Consistent Legislation?' (2008) 15(1) *International Transfer Pricing Journal* at 4; G de Spenke & M de Vries *Taxation in the Netherlands* 4 ed (2011) at 56; X Oberson & HR Hull *Switzerland in International Tax Law* 4 ed (2011) at 240; S Rathore *International Accounting* 2 ed (2009) at 303.

[129] FJ Contractor *Valuation of Intangible Assets in Global Operations* (2001) at 173; A Schafer *International Company Taxation in the Era of Information and Communication Technology* (2006) at 160; F Keuper & K Kleug *Finance Bundling and Finance Transformation: Shared Services Next Level* (2013) at 494.

[130] A Rahmanov 'Transfer Pricing' (2015) 2(1) *Baku State University Law Review* at 110; Pirvu *Corporate Income Tax Harmonisation in the European Union* at 73, Kobestsky International 'Taxation of Permanent Establishments, Principles and Policy' at 89; Kuan Global Transfer Solutions at 70.

[131] A Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* at 140; Markham *Transfer Pricing of the Intangibles* at 128; J Li & A Paisey *International Transfer Pricing in Asia Pacific: Perspective on Trade between Australia, New Zealand and China* (2005) at 117; M Lang *Tax Compliance Costs for Companies in an Enlarged European Community* (2008) at 369.

enterprises under similar circumstances.[132] The traditional methods operate on the basis that if there is any difference between the two prices, then the same can be traced directly to the commercial and financial conditions imposed between the associated parties.[133] The traditional transaction methods are divided into three categories which are: comparable uncontrolled price method, resale price method and the cost plus method.

The second group of methods, the 'transactional profit' methods, examines and compares the profits that arise from controlled transactions of one or more of the associated enterprises participating in those transactions.[134] Profit-based methods are considered to be secondary methods and are applied only when the transaction-based methods are found to be inapplicable.[135] The profit-based methods are divided into two categories which are the: transactional net margin method and the profit split method.

3.3 The Comparable Uncontrolled Price Method

The Comparable Uncontrolled Price (CUP) method is defined as:[136]

> [a] transfer pricing method which compares the price of property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

According to the definition above, the CUP allows a direct comparison between the price of a controlled transaction and the price charged for the same or similar goods or services transferred between independent parties. This method compares the

---

[132] OECD *Transfer Pricing Guidelines at* 97. See also SP Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 44; RF Reilly & R Schweibs *The Handbook of Business Valuation and Intellectual Property Analysis* (2004) at 547; RJ Peroni, CH Gustafson & RC Pugh *International Income Taxation: Code and Regulations* (2008) at 1350.

[133] OECD *Transfer Pricing Guidelines* at 97; M Lang, J Herdin & I Hofbauer *WTO and Direct Taxation* (2005) at 707; P Spencer *Property Tax Planning* 13 ed (2013) at 45; FJ Fabozzi *The Use of Derivatives in Tax Planning* (1998) at 66.

[134] Y Holtzman & P Nagel 'An Introduction to Transfer Pricing' (2014) 33(1) *Journal of Management Development* at 59; A Lymer & J Hasseldine *The International Taxation System* (2002) at 92; Juta Statutes Editors *SAIT Compendium of Tax Legislation* (2010) at 507; P Muchlinski *Multinational Enterprises and the Law* 2 ed (2007) at 288.

[135] JS Kuan *Global Transfer Solutions* (2004) at 183; U Schreiber *International Company Taxation: An Introduction to the Legal and Economic Principles* (2013) at 20; S Onkvisit & JJ Shaw *International Marketing: Analysis and Strategy* 4 ed (2004) at 491.

[136] OECD *Transfer Pricing Guidelines* at 24. See also G Campos 'Transfer Pricing for Major Trading Nations (1996) 50 *Bulletin for International Fiscal Documentation* at 217.

price setting between controlled and uncontrolled transactions. Where it is possible to locate comparable uncontrolled transactions, the CUP method offers the most direct way of determining an arm's length price charged for a specific product in a controlled transaction and the price charged for a closely comparable or similar product in an uncontrolled transaction.[137] Theoretically, it means that one has to find the price that is charged by similar companies selling similar or the same products in the same or similar circumstances.[138]

In terms of this method, any difference between the two prices indicates the existence of non-arm's length conditions. Thus the price charged in the controlled transaction may need to be adjusted to be the same as the price charged in an uncontrolled transaction.[139] Examples of situations where CUP can be used include but are not limited to: the interest rate charged on a loan between related parties, and transactions where the price charged is for the transfer of a homogenous item, such as traded commodity.[140] Generally, this method is widely used in transactions for pricing commodities such as oil, ore, wheat and other goods sold on public commodity markets.[141]

3.3.1 Advantages of CUP

It is easy to use the CUP if the transactions between related and independent parties have been concluded under the same circumstances, because the degree of similarity of goods or services always determines the degree of comparability.[142]

---

137 Henshall *Global Transfer Pricing Principles and Practice* at 25; Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* at 33; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 11; R Feinschreiber *Transfer Pricing Handbook* Vol 1 (2001) at 14-5.

138 B Spitz *International Tax Havens Guide* at 285; AM Rugman *The Oxford Handbook of International Business* 2 ed (2008) at 601; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 74.

139 A Bakker & MM Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* (2012) at 536; SARS 'Practice Note No 7' at 15. This means that the price charged between connected persons must be viewed in the same way as it would be in the open market transaction taking place between unrelated parties. See also AW Oguttu *International Tax Law Offshore Tax Avoidance in South Africa* (2015) at 215.

140 Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 322; Pagan & Wilkie *Transfer Pricing in a Global Economy* at 105; SM Saudagaran *International Accounting: A User Perspective* (2009) at 135.

141 Arnold & McIntyre *International Tax Primer* at 62.

142 Abdallah *Critical Concerns in Transfer Pricing and Practice* at 166; R Schaffer, F Agusti & LJ Dhooge *International Business Law and its Environment* 9 ed (2015) at 521-522; Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 431; RA Mann & BS Roberts *Business Law and the Regulation of Businesses* (2014) at 462.

CUP can be the most suitable method of determining the arm's length price where an independent enterprise buys or sells the same product as is supplied in the controlled transaction.[143] This method is also appropriate for pricing manufactured goods that do not depend substantially for their value on special know-how or brand names.

This method brings the best results if there are no material differences between the two comparable transactions.[144] However, if there are any differences between the transactions, an adjustment has to be made to account for the difference.[145] In reality, it is difficult to find a situation where related and independent parties transact under exact same circumstances.

3.3.2 Disadvantages of CUP

It is difficult to apply this method where there are material differences in the comparable transactions. The differences can be brought by contract terms and conditions, as well as economic market conditions and the business functionality of the comparable enterprises.[146] If there are material differences occasioned by these factors, adjustments cannot be made and the CUP method cannot be applied.[147] These differences can contribute to transfer pricing manipulation because if similar transactions cannot be found, the veracity of the information used in the transaction

[143] Henshall *Global Transfer Pricing Principles and Practice* at 27; A Johnson *Brazil Tax, Law and Business Briefing* 3 ed (2006) at 91; Kuan *Global Transfer Pricing Solutions* at 71; M Terterov *Doing Business with Ukraine: A Guide to Investment Opportunities and Business Practice* 3 ed (2005) at 247.

[144] OECD *Transfer Pricing Guidelines* at 102; Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 507; RJ Peroni, CH Gustafson & RC Pugh *International Income Taxation: Code and Regulations* at 1228.

[145] Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 46; Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 396; PR McDaniel, HJ Ault & JR Repetti *Introduction to United States International Taxation* 5 ed revised (2005) at 147.

[146] PLL Mo *Tax Avoidance and Anti- Avoidance Measures in Major Developing Economies* (2003) at 97. See also E King *Transfer Pricing and Corporate Taxation Problems, Practical Implications and Proposed Solutions* (2009) at 22; R Feinschreiber *Transfer Pricing Methods: An Application Guide* at 71; Markham *Transfer Pricing for Intangibles* at 103; E King *Transfer Pricing and Valuation in Corporate Taxation: Federal Legislation v Administrative Practice* (2004) at 47; A Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* (2011) at 292.

[147] Lessambo *Fundamentals of Hedge Funds: Alternative Investment Vehicles* at 157; M Lang, P Melz, E Kristoffersson & T Ecker *Value Added Tax and Direct Taxation: Similarities and Differences* (2009) at 841; R Feinschreiber *Transfer Pricing Methods, an Application Guide* (2004) at 65. Some of the non-inclusive differences which can be taken into account in making transfer pricing adjustments using this method are: quality of product, contractual terms, level of market, date of transaction, intangible property associated with the sale, foreign currency risks and alternatives realistically available to the buyer and seller.

cannot be verified. The practical difficulty in applying the CUP method is also evident where dealings between related persons involve a variety of transactions and the conditions for comparability are completely different. This method will not apply where goods and services are unique to the extent that they cannot be compared to any other product in the market.[148] The method will also not apply in the case of partially finished goods or partially rendered services because there may not be data to compare with those partially finished goods or rendered services.[149]

This method is not suitable for setting the price of goods that are highly dependent on the trade name of the producer for their value.[150] This means that this method is not well adapted for pricing multi intermediate goods such as custom-made car parts that are not generally sold to unrelated parties. As an example, this method will not operate adequately where Ford wants to sell their custom-made part like their emblem to Toyota because a Ford emblem can only be used in Ford vehicles and its related parties but never on a Toyota. This method also fails even where the product is not so unique and revolutionary but the context of the comparison is that of a monopolistic environment where there are no comparable goods or services.[151] Transfer pricing adjustments may be difficult to effect, if there are differences in the characteristics of the products especially if one takes into account the similarity requirement of this method.[152]

3.4 The Resale Price Method

The resale price method (RPM) is defined as:[153]

---

[148] Spitz International *Tax Havens Guide* at 229; KK Agrawal *Corporate Tax Planning* Vol 1, 6 ed (2007) at 253; Arnold & McIntyre *International Tax Primer* at 64; Martel & Klibi *Designing Value-Creating Supply Chain Networks* at 350; J Avis *Performance Management, Managerial Level* (2009) at 397; Mo *Tax Avoidance and Anti- Avoidance Measures in Major Developing Economies* at 98.

[149] FDS Choi & GK Meek *International Accounting* 5 ed (2005) at 479; Spitz *International Tax Havens* at 285; Peroni, Gustafson & Pugh *International Income Taxation: Code and Regulations* at 1312; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 15.

[150] RS Avi-Yonah *Advanced Introduction to International Tax Law* (2015) at 30. See also JH Dunning *Multinational Enterprises and the Global Economy* (1992) at 522.

[151] Spitz *International Tax Havens Guide* at 230. See also P Harris & D Oliver *International Commercial Tax* (2010) at 236-237.

[152] SARS 'Practice Note 7' at 15; SM Saudagaran *International Accounting: A User Perspective* (2009) at 135; A Johnson *US Transfer Pricing Sourcebook* (2005) at 28.

[153] OECD Transfer Pricing Guidelines at 29; Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 390; International Monetary Fund (IMF) Export and Import Price Index Manual: Theory and Practice (2009) at 451.

> [a] transfer pricing method which determines an arm's length price based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise.

The resale price method (RPM) as an alternative to CUP focuses on one side of the transaction, either the manufacturer or the distributor and like all other methods, it arrives at the arm's length price by using a functional approach or comparability analysis.[154] This method is suitable where there is a sale of manufactured goods to a related party acting as a distributor followed by a resale to unrelated customers without any further processing of the goods.[155] According to this method, similar profits are earned for similar transactions.[156] The resale price is reduced by the resale price margin. According to the OECD Transfer Pricing Guidelines, a resale price margin is defined as:[157]

> [a] margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risk assumed), make an appropriate profit.

The resale price represents the amount of income out of which the reseller in the open market would seek to cover its direct and indirect costs, in addition to making an appropriate level of profit.[158] What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties),[159] as the arm's length price of the original transfer of

---

[154] WM Abdallah *Critical Concerns in Transfer Pricing and Practice* (2004) at 75; Bakker & Levey *Transfer Pricing and Dispute Resolution* at 392. See also Feinschreiber *Transfer Pricing Methods* at 52, where factors such as functions of the business, contractual terms, risk assumed, economic conditions are used for comparability analysis. For a further discussion of this concept, see Olivier & Honiball *International Tax* at 631-632; Dunning *Multinational Enterprises and the Global Economy* at 631.
[155] Arnold & McIntyre *International Tax Primer* at 62; HA Poniachek *International Corporate Finance: Markets, Transactions and Financial Management* (2013) at 327.
[156] Abdallah *Critical Concerns in Transfer Pricing and Practice* at 76; AM Rugman *The Oxford Handbook of International Business* 2 ed (2008) at 604; Markham *Transfer Pricing of the Intangibles* at 100.
[157] OECD *Transfer Pricing Guidelines* at 29.
[158] OECD *Transfer Pricing Guidelines* at 106.
[159] Section 1 of the Customs and Excise Act 91 of 1964 define customs duty as the type of tax which is paid on the importation or exportation of goods. For a further reading on this see P Van den Bossche *The Law and Policy of the World Organisation: Text, Cases and Materials* 3 ed (2013) at 420; T Lyons *EC Customs Law* (2001) at 116; P Bozyk *Globalisation and the Transformation of Foreign Economic Policy* (2006) at 55; World Trade Organisation Dispute Settlement Reports Volume XIII (2005) at 3272; V Balachandran & S Thothadri *Taxation Law and Practice* Vol 1 (2013) at 234.

property between associated enterprises.[160] The margin in the controlled dealing is compared against either the resale margin that the same reseller earns on the same items purchased or sold in comparable uncontrolled dealings from an unrelated party which are sold to another unrelated party or the resale margin earned by an independent enterprise in a comparable uncontrolled transaction.[161] This method can be applied if none of the differences (if any) between the transactions being compared could materially affect the resale price margin in the open market or reasonable adjustments can be made to eliminate the material effects of such differences.[162]

According to this method, the arm's length price is determined by subtracting an appropriate mark-up from the price at which the goods are sold to unrelated parties.[163] In other words, the resale price method takes the price at which a product is resold to an independent entity after being initially purchased from an associated entity and reduces it by an appropriated gross margin or the resale price margin.[164] The most important feature of this method is that the transactions of the independent entity are comparable to the transactions performed by the member of the multinational selling to an independent enterprise.[165] The guiding principle of this method is that there should not be any difference which will have a material effect on the price which will result in adjustments not being carried out.[166]

When assessing the comparability of controlled and uncontrolled transactions under the resale price method, the similarity of products is not the main determining factor

---

[160] MM Levey 'Inbound Transfer Pricing' (1989) 15(2) *International Tax Journal* at 113.
[161] Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 48. See also LL Knowles & I Mathur 'Designing International Transfer Pricing Systems' (1985) 11(2) *Managerial Finance* 21–4.
[162] JB Roseberg, BN McLennan, AH Mohamed & AD McInnes 'Transfer Pricing Comparability: Concepts and Applications' (2003) 5(3) *Corporate Business Taxation Monthly* at 6. See also, A Ackerman & E Chorvat 'Modern Financial Theory and Transfer Pricing' (2002) 10(4) *George Mason Law Review* at 643.
[163] Arnold & McIntyre *International Tax Primer* at 62. See also, Levey *Inbound Transfer Pricing* at 113; L Eden *International Taxation, Transfer Pricing and Multinational Enterprises* (2001) at 241.
[164] Henshell *Global Transfer Pricing: Principles and Practice* at 26. See also, Finnerty et al *Fundamentals of International Tax Planning* at 36.
[165] OECD *Transfer Pricing Guidelines* at 106.
[166]SARS 'Practice Note No 7' at 17; Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 508; Edwards et al *Transfer Pricing Techniques and Uses* at 126; MA Livingston & DS Gamage *Taxation: Law, Planning and Policy* 2 ed (2010) at 725.

but the similarity of the functions performed, risk borne and the contractual terms agreed to by the buyer and the seller. The resale price method is applicable to transactions dealing with the resale of finished products where such goods are resold by the related distributors to unrelated customers or third parties. According to this method, the arm's length price is the resale price charged by the related distributor, reduced by the arm's length gross profit margin for such resales and adjusted for any material differences that exist between the controlled and uncontrolled transactions. The gross profit margin realised by the independent distributors on similar uncontrolled sales provides an estimate of the arm's length gross profit which is expressed as a percentage of the resale price.

3.4.1 Advantages of the Resale Price Method

The resale price method is best applied when the distributor adds little or no value to the product so that the value of its functions is easier to estimate. [167] The application of the resale price method is based on the assumption that the affiliate is a contract distributor, sourcing out the distribution function to the person who can perform that function as cheaply as possible. The resale price margin is more accurate if it is realised within a short space of time of the reseller's purchase of the goods.[168] If more time is allowed between the original purchase and resale, other factors such as price fluctuations and other changes in the market may have a negative impact, thereby rendering the effectiveness of the method less reliable.[169]

3.4.2 Disadvantages of the Resale Price Method

Despite the advantages mentioned above, the Resale Price Method also has a few that warrants a discussion and some of those are discussed herein. It is difficult to apply this method where the goods are further processed resulting in loss of their

[167] Miller & Oats *Principles of International Taxation* at 218. See also A Bakker & B Obuoforibo *Transfer Pricing and Customs Valuation* (2009) at 42; HA Poniachek *International Corporate Finance: Markets, Transactions and Financial Management* (2013) at 108.
[168] OECD *Transfer Pricing Guidelines* at 68. See also Feinschreiber *Transfer Pricing Handbook* at 17-27; M Butani *Transfer Pricing: An Indian Perspective* (2007) at 118.
[169] Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 50. See also SARS 'Practice Note 7' at 17.

original identity.[170] This difficulty may pose a tax challenge because failure to set an exact transfer price on semi-processed goods could mean speculation which often leads to taxpayers manipulating the prices for transfer pricing purposes. A slight product difference is allowed in this method but similarity of products is still considered to be very important. [171] It is always difficult to find a transaction between independent parties that is similar to a controlled transaction. This disadvantage makes it very difficult to determine an arm's length resale price gross margin.[172] The difficulty in determining the arm's length resale margin is one of the contributory factors in the perpetuation of transfer pricing manipulation because if the gross margin cannot be determined with certainty, then the determination of the transfer prices becomes vulnerable to manipulation. This method requires that the ultimate sale must be made to a third party or unconnected consumer, it is therefore not suitable where goods or services are sold to an associate; it is rather more applicable where the sale takes place in the open market.[173]

It may also be difficult to apply this method where the reseller has exclusive rights to resell the goods because the appropriate margin will be influenced by non-tax factors such as: [174]

(i) The size of the geographical market;
(ii) Existence of competitiveness of possible substitute goods;
(iii) The level of activity taken by the reseller; and
(iv) The risk associated with being dependent on the supplier.

---

[170] Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* at 30; RYW Tang *Intrafirm Trade and Global Transfer Pricing Regulations* at 124; Markham *Transfer Pricing of the Intangibles* at 100; R Scarlet Ma*nagement Accounting- Performance Evaluation* (2005) at 424; Transfer Pricing Methods at 18 available at http://www.un.org/esa/ffd/tax/2011_TP/TP_Chapter5_Methods.pdf, accessed on the 2nd of March 2016.
[171] OECD *Transfer Pricing Guidelines* at 108. See also SARS 'Practice Note 7' at 17.
[172] SARS 'Practice Note No 7' at 17. See also M Prysuski, S Lalapet & H Swaneveld 'Transfer Pricing Method Selection in the United States and Canada' (2004) 5 *Corporate Business Taxation Monthly* at 11.
[173] Henshell *Global Transfer Pricing: Principles and Practice* at 27. See also Agrawal *Corporate Tax Planning* at 253.
[174] RJ Misey Jr 'A Primer on Transfer Pricing' (1999) 77(8) *Taxes -The Tax Magazine* at 44.

In order to effectively apply this method, appropriate adjustments must be made to the data used in calculating the resale price margin in order to ensure that the same types of costs are used in each case to arrive at a gross margin; this means that the examination of accounting principles followed in different tax jurisdictions becomes imperative.[175] This may be a recipe for manipulation because accounting principles differ in different jurisdictions and it may be very difficult to obtain the required information to verify the correctness of the figures declared. This method tends to evaluate transactions from a buyer's perspective whilst ignoring the seller's because it ensures that the buyer receives an arm's length margin consistent with margins earned by similar companies engaged in similar transactions.[176] Having determined the buyer's arm's length margin, all excess profit on the transaction is assigned to the seller; for that very reason, the RPM tends to overestimate the transfer price because it gives all unallocated profit on the transaction to the manufacturer.[177] Once again this may negatively influence the transfer price being declared.

The fact that this method depends on the ability to compare cost structures by enterprises often leads to undesirable results because cost structures differ from one business to another business. In this regard, the risk of overstating or understating the transfer price is huge, and transfer prices can be manipulated on the strength of the difference on the costs incurred. Because of this, the application of this method would therefore bring the fairness and the accuracy of the comparison into question.[178] The gross profit margin for the distributor is mostly determined in an arm's length manner but nothing is done to ensure that the manufacturer's profit margin is consistent with the margins earned by other manufacturers; this technical oversight inadvertently leads to the adjustment being one sided.[179] For this reason, the application of the resale price method tends to overestimate the transfer price

[175] Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 50.
[176] Abdallah *Critical Concerns in Transfer Pricing and Practice* at 77.
[177] Isenbergh *International Taxation at 76, Abdallah Critical Concerns in Transfer Pricing and Practice* at 76.
[178] AW Oguttu 'Resolving Transfer Pricing Disputes: Are Advance Pricing Agreements the Way Forward for South Africa?' (2006) 18 *SA Merc LJ* at 464.
[179] L Eden *International Taxation, Transfer Pricing and Multinational Enterprises* (2001) at 606. See also EE Lester 'International Transfer Pricing Rules: Unconventional Wisdom' (1995) 2(283) *Journal of International and Comparative Law* at 290.

and thereby giving all unallocated profits of the transaction to the upstream manufacturer.[180]

3.5 The Cost Plus Method (CPM)

The OECD 'Transfer Pricing Guidelines' defines the cost plus method as:[181]

> [a] transfer pricing method using the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark-up is added to this cost, to make an appropriate profit in light of the functions performed (taking into account assets used and risks assumed) and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction.

The cost plus method is arguably the most popular method of establishing an arm's length price because it can be applied to transactions where there are no comparable sales of the commodity to independent third parties.[182] This method is more appropriate in the case of intermediate or partly finished goods.[183] The frequent problem with this method is the lack of a standardised formula in determining the cost of the goods or services being transferred.[184] This method focuses on the seller and attempts to set a comparable gross margin between transactions with associates and transactions with unconnected third parties.

This method is preferable where two or more companies in the group add significant amounts of value to the product, for example by further processing.[185] The

[180] PA Ziegler 'Transfer Pricing: A problem Seeking Solution' (1989) 6(4) *Australian Tax Forum* at 464.
[181] OECD *Transfer Pricing Guidelines* at 26. See also C Rohde & CP Rossing *Transfer Pricing* (2011) at 21-22; L Riccardi *Chinese Tax Law and International Treaties* at 87; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 23.
[182] Miller & Oats *Principles of International Taxation* at 219. See also JB Rosenberg, BN McLennan, AH Mohamed & AD McInnes 'Transfer Pricing Comparability: Concepts, Methods and Applications' (2003) *Corporate Business & Taxation Monthly* at 7.
[183] Choi & Meek *International Accounting* at 481.
[184] SARS 'Practice Note 7' at 19. See also Finnerty et al *Fundamentals of International Tax Planning* at 36; X Oberson & HR Hull *Switzerland in International Tax Law* (2006) at 227. See also Eden *International Taxation, Transfer Pricing and Multinational Enterprises* at 13; Spitz *International Tax Havens Guide* at 285; E Ahmad & NH Stern *The Theory and Practice of Tax Reform in Developing Countries* (1991) at 92, KS Jomo *Japan and Malaysian Economic Development: In the Shadow of the Rising Sun* (1998) at 128.
[185] Miller & Oats *Principles of International Taxation* at 219; RW McCalley *Marketing Channel Management: People, Products, Programs and Markets* (1996) at 206; Li & Paisey *A International Transfer Pricing in Asia Pacific: Perspective on Trade between Australia, New Zealand and China at*

application of this method begins with the comparison of costs incurred by the supplier in a controlled transaction with the goods and services transferred or rendered to a related purchaser.[186] This method seeks to determine if the costs are commensurate with the services rendered or goods supplied. Over and above the costs incurred, an appropriate mark-up is then added to remunerate the supplier for functions performed, assets utilised and risks borne. For the sake of clarity, the OECD defines the cost plus mark up as:[187]

> [a] mark-up that is measured by reference to margins computed after the direct and indirect costs incurred by a supplier of property or services in a transaction.

The mark up is calculated by reference to similar transactions either between the associated enterprise and a third party, or between non-related parties. CPM determines the arm's length price by using the costs incurred by the supplier of property (or services) in a controlled transaction.[188] The cost plus method uses the manufacturing and other costs of the related seller for establishing the arm's length price.[189] An appropriate cost plus mark-up is added to this cost to make an appropriate profit in light of the functions performed and the market conditions. By adding the cost plus mark up to the costs, an arm's length price of the original controlled transaction is arrived at.[190] A paradigm case for the application of the cost plus method is a sale by a taxpayer of goods it has manufactured to a related party, with the related party affixing its brand name to the goods and selling them to unrelated parties.[191]

10, A Krimpmann Principles of Group Accounting under IFRS at 330; SC Rogers *Marketing Strategies, Tactics and Techniques: A Handbook for Practitioners* (2001) at 71-74.

[186] Henshell *Global Transfer Pricing: Principles and Practice* at 29; Pirvu *Corporate Income Tax Harmonisation in the European Union* at 75; Markham *Transfer Pricing of Intangibles* at 101,

[187] OECD *Transfer Pricing Guidelines* at 26. For an accounting analysis of this concept see also Z Hoque *Handbook of Cost and Management Accounting* (2005) at 508 and Drury *Management and Cost Accounting* at 508.

[188] SARS 'Practice Note No 7' at 18; R Feinschreiber *Transfer Pricing Methods* at 78; Markham *Transfer Pricing for Intangibles* at 101; Mayer *Formulary Apportionment for the Internal Market* at 15; C Wendt *A Common Tax Base for Multinational Enterprises in the European Union* (2009) at 81.

[189] Arnold & McIntyre *International Tax Primer* at 63. See also DP Mittal *Law of Transfer Pricing in India* (2014) at 377. The cost plus is appropriate in post-sale sale manufacturing and it is suitable in the case of sale of semi-finished goods or provision of services which are not subject-matter of normal trade and it therefore involves establishing the seller's cost and add up an appropriate mark-up.

[190] OECD *Transfer Pricing Guidelines* at 111; P Valente, A Della, Revere and P Schipani *Analisi di Compatibilita nel Transfer Pricing* (2013) at 144; Lang, Melz, Kristofferson & Ecker *Value Added Tax and Direct Taxation: Similarities and Differences* at 729.

[191] Arnold & McIntyre *International Tax Primer* at 63 emphasises that the paradigm will in most cases involve an arrangement where a company purchases semi-finished goods from the principal, carries

This method requires an estimation of an arm's length consideration by adding an appropriate mark-up to the costs incurred by the supplier of goods or services in a controlled transaction.[192] The mark-up must constitute profit to the supplier.[193] This method is dependent upon the physical similarities between the goods transacted,[194] which is a direct opposite of the CUP method.[195]

3.5.1 Advantages of the Cost Plus Method

The best way to utilise this method is to look for an uncontrolled transaction entered into by the taxpayer with an independent entity, and if this is not achieved, comparable dealings by independent enterprises in uncontrolled transactions must be considered.[196] The determination of the appropriate profit margin can be achieved where similar items are purchased and sold in uncontrolled transactions. If no uncontrolled sales were made, then a comparison with uncontrolled sellers performing the same type of business will have to be undertaken.[197] In terms of this method, the arm's length consideration is artificially estimated by adding the mark-up to the costs incurred by the taxpayer in a controlled environment. However, this may

---

out certain processes and thereafter sells the goods to the principal, involving in some cases the transfer or licensing of intangible property from the principal to the manufacturer.

192 Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 726; Croome et al *Tax Law: An Introduction* at 545; CCH *Australia Staff Australian Master Tax Guide* 50 ed (2012) at 1238.

193 SARS 'Practice Note No 7' at 18. The economic basis for applying this method is an assumption that enterprises on the same product market are paid identical compensation (gross-profit mark-up) for performing identical functions (product market equilibrium), the compensation must be commensurate with the gross profit mark-up that an independent enterprise would have obtained under comparable circumstances.

194 Wittendorff *Transfer Pricing and the Arm's Length Principle International Tax Law* at 727. Broader product differences may mean that different functions are performed and that the gross profit mark-ups of independent enterprises differ. The similarity of the products also has a bearing on the value, similar products will most likely have similar values, the CPM is most likely to produce unreliable results if there are significant differences in the values of the products.

195 The two methods differ in that the Comparable Uncontrolled Price (CUP) method compares the price charged for property or services transferred in a controlled transaction with the price charged for property or services in a comparable transaction undertaken between independent parties, whereas the cost plus method seeks to determine an arm's length range of prices for a transaction by identifying the costs incurred by the vendor of the goods or services in a controlled transaction and then adding an arm's length mark-up to that cost base. The mark-up should be comparable to what a third party would earn if it performed comparable functions, bore comparable risks, owned the same assets and operated in comparable market conditions.

196 SARS 'Practice Note No 7' at 18. See also King *Transfer Pricing and Corporate Taxation* at 12.

197 Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 54. See also T Pfeiffer, U Schiller & J Wagner *Review Accounting Studies* (2011) at 220.

not be possible in normal business transactions because there may be situations where there is no link between the level of costs incurred and the market price.[198]

3.5.2 Disadvantages of the Cost Plus Method

One of the main weaknesses of this method is that there is also no guarantee that all independent parties used for comparison purposes will add the mark-up to the costs as is required by this method. The cost plus method is also a one-sided method (just like the resale price method) which focuses only on the profit mark-up of the seller.[199] Because of this, the cost plus method duplicitously insists that the seller should earn only what arm's length sellers engaging in a similar transaction would have earned in an open market.[200] The problem with this method is the lack of a standardised formula in determining the cost of the goods or services being transferred.[201] The lack of the standardised formula means that it is easy for MNEs to conceal the true cost of the goods or services with the result that the true value of the goods or services may be manipulated. Another problem with this method is that it is suitable for the sale of semi-finished goods or provision of services which are not the subject-matter of normal trade. This is problematic for correct determination of transfer prices because it is difficult or impossible to get the right prices or comparable prices for goods which are not the subject-matter of normal trade.

---

[198] Oguttu *Resolving Transfer Pricing Disputes* at 464. See also R Feinschreiber & M Kent 'What You Need to Know about OECD's Transactional Profit Split Methods' (2011) 1(5) *Corporate Business Taxation Monthly* at 30-31.

[199] M Marajan & N Prakashan *Managerial Economics* (2008) at 63.

[200] Feinschreiber *Transfer Pricing Methods* at 80. See also AW Oguttu 'Transfer Pricing and Tax Avoidance: Is the Arm's Length Principle Still Relevant in the E-commerce Era' (2006) 18(2) *South African Mercantile Law Journal* at 144. In this regard, Oguttu points out that '[t]he cost-plus method requires an estimation of an arm's length consideration by adding an appropriate mark-up to the costs incurred by the supplier of goods or services in a controlled transaction. This mark-up should provide for an appropriate profit to the supplier, in the light of the functions performed, assets used and risks assumed'. For further comments, see also CJ Kotarba 'Better than the Best: Transfer Pricing Methodology in the Wake of Roche' (2009) 48(1) *Columbia Journal of Transnational Law* at 149. On whether or not this is a one-sided method see Feinschreiber & Kent *What You Need to Know about OECD's Transactional Profit Split Methods* at 29.

[201] SARS 'Practice Note 7' at 19. See also Finnerty et al *Fundamentals of International Tax Planning* at 36; X Oberson & HR Hull *Switzerland in International Tax Law* (2006) at 227. See also Eden *International Taxation, Transfer Pricing and Multinational Enterprises* at 13; Spitz *International Tax Havens Guide* at 285; E Ahmad & NH Stern *The Theory and Practice of Tax Reform in Developing Countries* (1991) at 92; KS Jomo *Japan and Malaysian Economic Development: In the Shadow of the Rising Sun* (1998) at 128.

3.6 The Transactional Net Margin Method

The transactional net margin (TNMM) method is defined as:[202]

> [a] transactional profit method that examines the net profit margin relative to an appropriate base (e.g. cost, sales, assets) that a taxpayer realises from a controlled transaction (or transactions that it is appropriate to aggregate.

Under the TNMM, the taxpayer must establish for itself or a related party commonly known as the tested party an arm's length range of profits on a set of transactions.[203] For the sake of clarity an arm's length range is defined as:[204]

> [a] range of figures that are acceptable for establishing whether the conditions of a controlled transaction are arm's length and are derived either from applying the same transfer pricing method to multiple comparable data or from applying different transfer pricing methods.

In terms of this method, the profits must lie within a certain mid-point range in order to determine if it meets the arm's length standard.[205] If the tested party's reported profits on the transactions fall within the range, then its transfer prices will be considered to be arm's length.[206] If its profits lie outside the required range, the price will not be meeting the arm's length range. The profits of a tested party are determined by establishing the ratio of profits of an unrelated person and then applying that ratio to calculate the profits of the tested party.[207] According to the OECD Guidelines, the TNMM examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled

[202] OECD *Transfer Pricing Guidelines* at 31. See also Bakker *Transfer Pricing and Business Restructurings* at 52 where TNMM is loosely described as a method where an arm's length remuneration that a taxpayer realizes from controlled transactions is established by reference to the net profit margin of an appropriate base (e.g. costs, sales or assets) earned in a comparable uncontrolled transaction.

[203] OECD *Transfer Pricing Guidelines* at 149. A tested party is that party with the most easily compared functions and risks with the actual party.

[204] OECD *Transfer Pricing Guidelines* at 23.

[205] OECD *Transfer Pricing Guidelines* at 121 defines the arm's length range as a range of figures that are acceptable for establishing whether the conditions of a controlled transaction are arm's length and that are derived either from applying the same transfer pricing method to multiple comparable data or from applying different transfer pricing methods. See also SARS 'Practice Note No 7' at 27 where it is emphasised that an arm's length range is arrived at by applying a transfer pricing method to multiple comparable data by taking into account a number of considerations in arriving at that decision.

[206] Arnold & McIntyre *International Tax Primer* at 66.

[207] Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 739.

transaction.[208] In transfer pricing parlance these bases are called net profit indicators and they refer to:[209]

> [t]he ratio of net profit to an appropriate base (e.g. costs, sales, assets) the transactional net margin method relies on a comparison of an appropriate net profit indicator for the controlled transaction with the same net profit indicator in comparable uncontrolled transactions.

In this method, the net profit margin of a taxpayer is the object of comparison. The profit level or profit potential of the related party is compared to the profit level indicators of the comparable independent parties.[210] To apply the TNMM successfully, the taxpayer must determine a range of profits that unrelated persons would be expected to earn from engaging in comparable transactions.[211]

3.6.1 Advantages of TNMM

One of the strengths of the TNMM is that the net profit indicators are less affected by transactional differences if compared to the CUP method, and it can therefore offer solutions for highly integrated operations for which a one-sided method would not be appropriate.[212]

3.6.2 Disadvantages of TNMM

The net margin can be affected by factors that either do not have an effect, or have a less substantial effect on the price or gross margin, and due to this, the

---

[208] OECD *Transfer Pricing Guidelines* at 123. See also Bakker *Transfer Pricing and Business Restructurings* at 52.
[209] OECD *Transfer Pricing Guidelines* at 28. For the concise application of this concept see Schreiber *International Company Taxation: An Introduction to the Legal and Economic Principles* at 19-20.
[210] SARS 'Practice Note No 7' at 19. OECD *Transfer Pricing Guidelines* at 123 defines a profit potential as the expected future profit. In some cases, it may encompass losses. The notion of profit potential is often used for valuation purposes, in the determination of an arm's length compensation for a transfer of intangibles or of an ongoing concern, or in the determination of an arm's length indemnification for the termination or substantial renegotiation of existing arrangements, once it is found that such compensation or indemnification would have taken place between independent parties in comparable circumstances.
[211] Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 44 emphasises the point that in terms of the TNMM the net margin of the taxpayer from a controlled transaction may be established by reference to the net margin that the same taxpayer earns in comparable uncontrolled transactions or by reference to the net margin that would have been earned in comparable transactions by an independent enterprise operating under similar circumstances taking into account all comparable factors.
[212] R Feinschreiber & M Kent *Transfer Pricing Handbook, Guidance for the OECD Regulations* (2012) at 110.

determination of an arm's length net margin may be difficult to achieve.[213] Some of the notable factors that may affect the net margin are the fluctuations in the demand for the products. Availability of reliable information is also an important factor affecting the net margin. Information relating to uncontrolled transactions is also difficult to obtain which may make it arduous for taxpayers to apply the TNMM correctly in the case of controlled transactions.[214] The risk of overburdening the taxpayer with disproportionately high costs in obtaining relevant documentation or in an exhaustive search for comparable data that may not exist is a big disadvantage. In order to mitigate this cost, taxpayers may manipulate transfer prices by reducing a portion of their income with the proportionate amount commensurate with the cost of documentation.

There may also be difficulties in determining an appropriate corresponding adjustment when applying the TNMM, particularly where it is not possible to work back to a transfer price.[215] For the sake of clarity, the concept corresponding adjustment is defined as:[216]

> [a]n adjustment to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent.

The taxpayer might have difficulty in making an appropriate corresponding adjustment, especially when dealing with associated enterprise on both the buying

---

213 Singh *Transfer Pricing and Regulations for India Approvals and Alternatives* at 63.
214 Miller & Lermer 'Practical Application of Transactional Profit Methods' (2000) *International Transfer Pricing Journal* at 195.
215 Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 739.
216 OECD *Transfer Pricing Guidelines* at 25. There are two principal types of transfer pricing adjustments. The primary adjustment occurs when the value of a transaction is amended before the fiscal year ends. The OECD 'Transfer Pricing Guidelines' at 25 categorises a primary adjustment as 'an adjustment that a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction'. This is the very first adjustment made by tax authorities and represents the difference between the transaction value as set by the taxpayer and the transaction value as set by the tax authorities. A secondary adjustment can only occur as a consequence of a primary adjustment. The primary adjustment results not only a direct difference in taxable income (the adjustment itself), but also an entirely new situation in economic terms. A secondary adjustment thus aims to fix the economic reality back to what would have been true should the firms have transacted within arm's length. Secondary adjustments make use of the concept of 'notional transactions' to restore the intended balance in the transactions, most commonly through notional interest or loans.

and the selling sides of the controlled transaction. This difficulty may be as a result of transfer mispricing and or the under-invoicing of the goods and services.

The TNMM does not consider the effects of the determined price on the comparable transaction.[217] The calculations in the application of this method are significantly affected by operating expenses and operating expenses fluctuate depending on the business circumstances and may be easily manipulated.[218] This renders the TNMM less reliable in comparison to other transfer pricing methods. The lack of stringency in determining operating expenses may lead to transfer pricing manipulation because prices between connected persons may be affected by their relationship. In order to overcome this weakness and maximise the reliability of this method, the MNE member and the comparable independent, unrelated party must ideally be structurally similar. This is a stringent requirement because in practice companies are structured differently and uniquely. For this very reason, the comparison with controlled MNE member will be distorted and will result in very unreliable analysis at the gross margin level which will eventually affect the profit which must be transferred.

3.7 The Profit Split Method

This method is defined by the OECD Guidelines as:[219]

> [a] transactional profit method that identifies the combined profit to be split for the associated enterprises from a controlled transaction (or controlled transactions that is appropriate to aggregate under the principles of chapter III) and then split those profits between the associated enterprises based upon an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

The profit split method is usually applied in situations where the transactions are so interrelated that they cannot be evaluated separately.[220] This method provides that the combined profit must be split between connected persons based on an

[217] SARS 'Practice Note No 7' at 20; R Feinschreiber *Transfer Pricing Handbook* Vol 1 (2001) at 24-11; R Feinschreiber *Transfer Pricing Methods: An Application Guide* (2004) at 236.
[218] Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 510.
[219] OECD *Transfer Pricing Guidelines* at 29.
[220] Miller & Lermer *Practical Application of Transactional Profit Methods* (2000) at 194.

economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.[221] Under this method, the worldwide taxable income of related parties engaging in a common line of business is determined.[222] The distinctive feature of this method is that it applies to aggregate profits from a series of transactions and not to individual transactions.[223] After the income has been determined, it is then allocated or divided among the related parties in proportion to the degree or extent to which they have earned the income.[224]

Through this method, the net profit of each of the associated enterprises is combined and divided according to the relative economic value that each enterprise has contributed to that transaction; the contribution analysis is used to arrive at that decision.[225] In terms of the profit split method, the arm's length price is achieved through a division of the consolidated profits of the associated enterprises.[226] The profit split method is actually divided into specific categories which are the comparable profit split method and the residual split method.[227] The comparable split method depends on the profit of comparable transactions between two unrelated enterprises. The purpose of the comparable split method is to divide operating profits

---

[221] Miller & Lermer *Practical Application of Transactional Profit Methods* at 194. It is important to note that the profit split method is not confused with the global formulary apportionment method discussed in paragraph 3.7 of this chapter. The differentiation is important because when applying the profit split method, the division of profits arising from the controlled transactions between associated enterprises is based on a scientific analysis while in the case of global formulary methods, the division of profit is based on a pre-determined formula.
[222] Arnold & McIntyre *International Tax Primer* at 64.
[223] Arnold & McIntyre *International Tax Primer* at 65; A Martel & W Klibi *Designing Value-Creating Supply Chain Networks* (2016) at 350.
[224] V Chand & S Wagh 'The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan' (2014) *International Transfer Pricing Journal* at 403.
[225] OECD *Transfer Pricing Guidelines* at 136-137 provides that under a contribution analysis, the total profit arising from a controlled transaction is divided among the associated enterprises based upon a reasonable approximation of profit division that independent enterprises would have expected to realise from engaging in comparable transactions. If comparables do not exist, the contribution analysis should be based on a detailed analysis of functions performed, assets used and risks assumed.
[226] S Pantelidaki, P Opara & A Hickman 'CUPs and Profit Split: When and How to Use' (2011) *International Transfer Pricing Journal* at 3.
[227] E King *Transfer Pricing and Corporate Taxation* (2009) at 29. See also RL Doernberg *International Taxation* (1999) at 262.

among controlled taxpayers into amounts similar to those arising from uncontrolled transactions.[228]

The second profit split method is the residual profit method, under this method the combined operating profit or loss from the relevant business activity is allocated between controlled taxpayers in a two-step process. First, the operating income is allocated to each participant in a manner that will yield a market return to the participant for routine contribution to the business activity. Secondly, residual profit that is attributable to the controlled group's valuable intangible property is apportioned.[229] A process called residual analysis is used to achieve the objective of this method. The residual analysis is defined as:[230]

> [a]n analysis used in the profit split method which divides the combined profit from the controlled transactions under examination in two stages. In the first stage, each participant is allocated sufficient profit to provide it with a basic return appropriate for the type of transactions in which it is engaged. Ordinarily this basic return would be determined by reference to the market returns achieved for similar types of transactions by independent enterprises. Thus, the basic return would generally not account for the return that is generated by any unique and valuable assets possessed by the participants in the second stage, any residual profit (or loss) remaining after the first stage would be allocated among the parties based on an analysis of facts and circumstances that might indicate how this residual would have been divided between independent enterprises.

The residual analysis is achieved by identifying all the basic functions of the group such as manufacturing, distribution, service provision and allocating a return to them using a formula.[231] Once this exercise has been carried out, some residual non-basic contribution will be found to remain along with profit or loss that must be split between the parties taking into account their relative contribution to the group.[232] A

[228] Feinschreiber *Transfer Pricing Methods* at 192. See also RL Parr & GV Smith *Intellectual Property: Valuation, Exploitation and Infringement Damages* (2008) at 128.
[229] M Milewska & M Hurtado de Mendoza 'Increasing Importance of Intangible Assets and the Rise of Profit Split Methods' (2010) 17(2) *International Transfer Pricing Journal* at 162.
[230] *OECD Transfer Pricing Guidelines* at 29. See also Chand & Wagh *The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan International Transfer Pricing Journal* at 403.
[231] Henshell *Global Transfer Pricing: Principles and Practice* at 30. The residual analysis aims at dividing the total profits arising from a controlled transaction among associated enterprises by allocating the remuneration for its routine contributions through the TNMM by reference to the remuneration of comparable transactions between independent enterprises..
[232] Pantelidaki et al *CUPs and Profit Split: When and How to Use* at 3.

comparison with independent parties is also taken to ensure the arm's length basis of the transaction. This method is used when none of the traditional methods can be applied.[233] The method produces good results if a group of affiliated companies has more than one product line where the method can be applied to each product line separately.[234]

3.7.1 Advantages of the Profit Split Method

The profit split method places less reliance on comparability with third-party transactions. This method can still be applied adequately even if comparable transactions cannot be found.[235] This method offers flexibility by taking into account unique facts and circumstances of the associated enterprises that are not present in the independent enterprises. This method provides a two-sided approach to achieving a division of the profits that takes into account the economic circumstances of the taxpayer. In this way, both parties to the arrangements are examined and profit is unlikely to be allocated in such a way as to leave one or other in an extreme or improbable profit position.[236]

3.7.2 Disadvantages of the Profit Split Method

One of the fundamental weaknesses of this method is the division of profits where transactions are not separated. The setting of transfer prices must be based on a specific transaction because no two transactions are exactly the same. Even if the transactions are similar, each transaction must be separately considered for tax purposes. The transfer price of each transaction must be set individually to reflect the facts and circumstances of that particular transaction. It is difficult to know how

[233] WM Abdallah & AS Maghrabi 'Do Multinational Companies have Effective Transfer Pricing Systems of Intangible Assets and E-commerce' (2009) 19(2) *International Journal of Commerce and Management* at 122. The profit split method may also serve as an alternative to the traditional or profit orientated methods, for a further discussion on this see VH Miesel, HH Higinbotham & CW Yi 'International Transfer Pricing: Practical Solutions for Intercompany Pricing-Part II' (2003) 29(1) *International Tax Journal* at 122.

[234] OECD *Transfer Pricing Guidelines* at 134.

[235] Sing & Bagchi *Transfer Pricing Regulations for India* at 60. See also Chand & Wagh *The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan* at 403 where it is also emphasised that the profit split method can also be applied even when comparable transactions do not exist.

[236] Feinschreiber *Transfer Pricing Methods* at 192. See also King *Transfer Pricing and Corporate Taxation* at 29. The income is allocated among the members of the MNE group based on the relative value of the contribution they have made to the joint endeavour.

and which factors were taken into account when transactions have not been separated. The failure to separate the transactions has a negative bearing on the division of profits. In order to arrive at a quantum, all cost factors of each transaction must be taken into account; otherwise, the risk of transfer pricing manipulation is huge because there is no accountability for an individual transaction. It is very important that profits are properly accounted for in order to have certainty that correct tax has been paid on the income. The division of profits where transactions are not separated is artificial and inconsistent with normal business practices and is therefore not a suitable yardstick to determine an arm's length price.

The method strongly relies on worldwide group data which is always difficult to obtain.[237] This is problematic because economic, geographical social and political circumstances of enterprises may be different and may not be compatible with the circumstances of the comparable tax jurisdiction where the method is being applied. Both the taxpayer and the tax authority may have difficulty in accessing information from foreign affiliates.[238] Because of this shortcoming, the risk of manipulation is huge if transfer prices are going to be set based on inadequate information which cannot be verified or compared.

Certainty is required that revenue and costs have been consistently reported by all parties to the arrangement. This might mean that special efforts might have to be made by the parties to re-state their books or modify their internal accounting systems appropriately. Closely related to the previous weakness is the fact that it may be difficult to measure combined revenue and costs for all the associated enterprises participating in the controlled transactions as this would require maintaining books and records on a common basis and making adjustments in accounting practices and currency conversions.[239] The difficulty in measuring

---

[237] SARS Practice Note No 7 at 22. See also OECD *Transfer Pricing Guidelines* at 169-170 where lack of comparable data has been highlighted as one of the general problems relating to transfer pricing practice.
[238] Miller & Lermer Practical Application of Transactional Profit Methods at 197. For a general lack of comparable data and criticism of the transfer pricing methods, see also Schon & Konrad Fundamentals of International Transfer Pricing in Law and Economics at 126.
[239] Sing & Bagchi *Transfer Pricing Regulations for India* at 60. For a comprehensive criticism of this method see also King *Transfer Pricing and Corporate Taxation* at 30.

revenue and costs may lead to incorrect payment of tax which may result in the shifting of income which has not been properly accounted for.

3.8 Conclusion

The transfer pricing practice is heavily reliant on the transfer pricing methods. At face value, the OECD transfer pricing methods may appear to be beguilingly simple and practical to apply, but it does not take long to recognise that each method can be hard to apply in practice due to the complex criteria associated with each method and the different comparability factors that need to be considered when applying a particular method. This problem proves that reliance on the OECD transfer pricing methods without adapting the methods to the South African or country-specific situation may not yield better results in dealing with transfer pricing manipulation. This means that the law must further be amended to provide guidelines on how each and every method can be applied together with the types of transactions that can be applicable in a specific method.

Considering the relative advantages and disadvantages of both the arm's length principle and the formulary apportionment concept, it may be argued that these approaches may not be considered as direct opposites of each other as they strive towards a correct and equitable reflection of prices between related parties. For this reason, it is therefore proposed that considering the modern competitive environment, a combination of both methods would be more appropriate. In any case, the OECD has not ruled out the possibility of ever adopting the formulary apportionment. In one of its reports which were concerned with the taxation of profits generated by e-commerce, the OECD is open to the idea of replacing the use of the source and residence principles for allocating taxing rights with a system of formulary apportionment.[240] Because of its similarity with the profit split method, it may not be too difficult to adopt it as an alternative method despite its shortcomings. Transfer

[240] OECD Report 'Are the Current Treaty Rules for Taxing Business Appropriate for E-commerce' at 59 available at http://www.oecd.org/ctp/treaties/35869032.pdf, accessed on 01 April 2016. In paragraph 296 of that report it is mentioned that due to the difficulties encountered in the implementation of the separate entity and arm's length principles which underlie the existing transfer pricing rules, the OECD have suggested that these rules should be replaced by a system based on formulary apportionment as the international method of allocating and measuring business profits that countries may tax. Although this report was specifically concerned with e-commerce transactions, there is no reason why the global formulary apportionment method would not be applied in other spheres of business.

pricing manipulation is a big problem which cannot be eradicated by relying only on the arm's length principle. It is for this reason that s 31 should be amended to include alternative methods like the GFA in instances where the OECD transfer pricing methods cannot yield the desired results.

CHAPTER 4

MNES' REASONS FOR TRANSFER PRICING

4.1 Introduction

This chapter briefly analyses some of the reasons that motivate MNEs to engage in transfer pricing. It has already been mentioned in Chapter 1 that transfer pricing is not illegal and that it only becomes illegal when it is used to derive tax benefits in an abusive or illegal way. It was further mentioned in Chapter 2 that transfer pricing is a form of a tax avoidance scheme which can benefit the MNE without criminal repercussions if it is used within the confines of the law. These conclusions lend credence to the fact that transfer pricing is a legitimate business practice, not a measure that is primarily used to defraud tax administrations of their tax revenue. It is against this background that some of the reasons for transfer pricing are briefly discussed here. This chapter also seeks to emphasise that transfer pricing without any manipulation is acceptable. The strategic objectives of international transfer pricing fall into three areas, which are: taxation related objectives, internal management orientated objectives and operational objectives.[241]

There are many reasons for MNEs to engage in transfer pricing but only six relevant reasons will be discussed for the purposes of this research. While transfer pricing policies help corporations to avoid double taxation and maximise profits, they also help tax administrations to receive a fair share of the tax base of multinational enterprises. The abuse of transfer pricing rules whether real or perceived is a constant problem facing many tax administrations. There is a constant suspicion that the aim of transfer pricing is to manipulate transfer pricing rules in order to illegally repatriate profits in a tax-free form to tax havens. This means that despite the good

[241] KS Cravens 'Examining the Role of Transfer Pricing as a Strategy for Multinational Firms' (1997) 6(2) *International Business Review* at 130; Heimert & Johnson *Guide to International Transfer Pricing* at 14; JW Bush & D Johnston *International Oil Company Financial Management in Nontechnical Language* (1998) at 86; JK Shim & M Constas *Encyclopaedic Dictionary of International Finance and Banking* (2001) at 171: RZ Aliber & RW Click *Readings in International Business: A Decision Approach* (1999) at 411.

intentions for using transfer pricing, MNEs are suspected of nefarious reasons for engaging in transfer pricing.[242]

4.2 Transfer Pricing as a Neutral Concept

Despite the suspicion raised above, transfer pricing policies are not only designed to illegitimately minimise the payment of tax, there are other compelling and legitimate business reasons for transfer pricing.[243] Cross-border transactions in relation to transfer pricing do not always signify the existence of impermissible avoidance of tax or evasion. Even the OECD Transfer Pricing Guidelines proclaim that tax administrations must not automatically assume that MNEs set up transfer pricing policies for the purpose of manipulating their profits as there are genuine business reasons for doing so.[244]

MNEs use transfer pricing to maximise their global profits by managing overseas production and marketing policies in a world market characterised by different international tax rates, foreign exchange rates, government regulations,[245] currency manipulation and other economic related problems.[246] These problems create challenges for MNEs within a regular market environment; it is for this reason that MNEs create their own internal strategies such as transfer pricing to deal with some of these problems.[247] Furthermore, transfer pricing exists due to cost-benefit reasons for doing business between related parties, globalisation and competitive reasons.[248]

---

[242] R Tremblay & S Suarez 'The OECD Discussion Draft On Transfer Pricing Aspects of Business Restructurings Canadian Considerations' (2009) 38(2) *Tax Management International Journal* at 98-9. For a further reading on tax compliance costs see M Lang *Tax Compliance for Companies in an Enlarged European Community* (2008) at 154; JM Poterba *Tax Policy and the Economy* (1996) at 36; WB Hildreth & JA Richardson *Handbook on Taxation* (1999) at 568.
[243] M Cools, C Emmanuel & A Jorissen 'Management Control in the Transfer Pricing Tax Compliant Multinational Enterprise' (2008) 33(6) *Accounting, Organizations and Society* at 8.
[244] OECD *Transfer Pricing Guidelines* at 33.
[245] TM Lin, YL Chen & B Lin 'A research on transfer Pricing Strategies and Management Performance of MNEs' (2010) 8(2) *International Journal of Management and Enterprise Development* at 119. See also SJ Pendse 'International Transfer Pricing: A Review of Non-Tax Outlook' (2012) 37 *Procedia Social & Behavioural Sciences* at 506.
[246] Abdallah *Critical Concerns in Transfer Pricing and Practice* at 43; Abdallah *International Transfer Pricing Policies: Decision-Making Guidelines for Multinational Companies* at 29; WM Abdallah *Managing Multinationals in the Middle East: Accounting and Tax* (2001) at 217-220; H Vernon & LH Wortzel *Global Strategic Management* (1991) at 299.
[247] Chan KH & L Chow *International Transfer Pricing in China* (1998) at 4.
[248] G Gillies *Transnational Corporations and International Production: Concepts, Theories and Effects* 2 ed (2012) at 227; KL Hagen *International Finance and Financial Services* (2008) at 149; I Moosa

Lastly, transfer pricing is a neutral business imperative which is aimed at motivation and performance evaluation of foreign managers, alleviation of foreign exchange risks and ensuring competitiveness in foreign markets.[249]

4.3 Reasons for Transfer Pricing

In order to achieve their corporate goals, MNEs design transfer pricing policies as a business imperative not as a measure to derive unwarranted tax benefits. There are many reasons for MNEs to engage in transfer pricing but only six will be briefly discussed for the purposes of this research. The following factors are discussed as the reasons for the MNEs to engage in transfer pricing practice:

4.3.1 Reduction of Income Tax Liability

Transfer pricing is an effective tool for MNEs to achieve maximum corporate-wide profit through allocation of income-generating resources. Transfer prices are very important for tax purposes because they directly affect the allocation of profits and losses to related business enterprises.[250] Most countries impose some form of direct tax on the profits of enterprises resident within their tax jurisdiction.[251] Profit maximisation is the main object for many businesses. In the quest to maximise the profit, tax is one of the liabilities that businesses want to avoid or mitigate. Permissible transfer pricing becomes one of the most effective ways which can be used to reduce the global income tax liability of an MNE group.[252] While transfer pricing may maximise profits for MNEs, this may have far-reaching negative

---

Foreign Direct Investment: Theory, Evidence and Practice (2002) at 239; Markham *The Transfer Pricing of Intangibles* at 12, J Norregaard & TS Khan 'Tax Policy: Recent Trends and Coming Challenges' (2007) WP/07/274 *IMF Working Paper* 1-59; J Stotsky & A WoldeMariam 'Central American Tax Reform: Trends and Possibilities' (2007) WP/02/227 *IMF Working Paper* 1-41.

[249] R Petruzzi & K Spies *Tax Challenges in the 21st Century* (2014) at 700; Ching-Wen Lin Hsiao-Chen Chang *Motives of transfer pricing strategies – Systemic Analysis* at 1219; A Razin & J Slemrod *Taxation in the Global Economy* (1990) at 151.

[250] OECD 'Addressing Base Erosion and Profit Shifting' (2013) at 36; LF Sheng-Wang & Y Chin Wang 'Brand Proliferation and Inter-Brand Competition' (2016) 35(3) *Journal of Economic Studies* at 279. Sheng-Wang and Wang point out that the transfer pricing of internal transactions which is inherently the main purpose of transfer pricing is a tax issue that tax authorities are very much concerned about.

[251] For a better understanding of one of the comprehensive empirical analysis of the relationship between transfer prices and their effect on the collection of taxes see JT Bernard & RJ Weiner 'Multinational Corporations, Transfer Pricing and Taxes: Evidence from the US Petroleum Industry' (1990) *Chicago University Press* at 123-154; I Walden & J Hornle *E-Commerce Law and Practice in Europe* (2001) at 35.

[252] Abdallah *Critical Concerns in Transfer Pricing and Practice* at 44. See also RL Benke and JD Edwards *Transfer Pricing: Techniques and Uses* (1980) at 114.

implications for the tax revenue where MNEs operate if the maximisation is achieved through transfer pricing manipulation.[253] As already mentioned, international transfer pricing policies are designed to maximise the after-tax profitability of the global MNE. Whilst achieving this objective MNEs should ensure that the setting of transfer prices complies with the regulations of the tax authorities.

Tax reduction through transfer pricing must be within the bounds of the arm's length principle. Global tax liabilities can be reduced by setting up manufacturing operations in a low-tax jurisdiction and sell back the finished products to the mother company for selling in the home market. In this way, the foreign affiliate will generate substantial profits that are taxed at a low rate. This is taking advantage of the low tax rates without transgressing any law. This is permissible tax avoidance as discussed in chapter two above. MNEs applying this tactic must, however, ensure that the pricing of the transaction between the foreign affiliate and the mother company is within the arm's length.

4.3.2 Alleviate Effects of Differences in Tax Rates between Countries

The levying of tax is *inter alia* enabled by tax rates. Where the effective tax rates of the countries involved in the setting of transfer prices differ significantly, multinational enterprise groups are inclined to allocate their profits in the tax jurisdiction with low tax rates thereby reducing the group's worldwide tax liability. Tax rate differentials are quite common in the world, for that reason, various countries have different factors to consider when promulgating tax rates in their pieces of national tax legislation.[254] Transfer pricing can be used to circumvent the effects of tax rate differentials as long as the circumvention is done within the parameters of the law. High tax rates may also be closely connected to rigid rules limiting the repatriation of profits from the countries where subsidiaries are located. A factor which is closely related to the effects of tax differentials is double taxation in cross-border transactions. The apprehension of double taxation may induce MNEs to engage in

---

[253] Chan & Chow *International Transfer Pricing in China* at 4. See also A Smallman & H Adrien 'Inter-Divisional Transfer Pricing' (1987) 25(2) *Management Decision* at 27.

[254] JM Poterba *Tax Policy and the Economy* Vol 12 (1998) at 194. For a comprehensive study on the effects of tax differentials in the tax rates see also S James *Taxation Critical Perspectives on the World Economy* Vol 2 (2002) at 101; A Giovannini, RG Hubbard & J Slemrod *Studies in International Taxation* (1996) at 283; T Matheson, VJ Perry & C Veung *Territorial vs Worldwide Corporate Taxation: Implications for Developing Countries* (2013) at 6-7.

transfer pricing.[255] This usually happens where corporate taxes paid by a non-resident affiliate or subsidiary to the host country on profits earned are deducted from the tax payable in the parent country when the profits are remitted. The tax paid to the host country counts as foreign tax credits against taxable profits in the parent country.

Generally, tax treaties are used to eliminate juridical cross-border or international double taxation. However, in some instances, the tax treaties may also eliminate or reduce the international economic double taxation by requesting tax administrations to provide a reduced withholding tax rate on inter-company cross-border dividends. Within the transfer pricing context, the tax administration may be requested to provide the obligatory corresponding adjustment, in this way transfer pricing is used positively to prevent double taxation.[256]

4.3.3 Minimising Exchange Rate Risk

The participation in international trade is associated with the risk of foreign exchange fluctuations. High fluctuations in foreign exchange rates may cause loss of profit. International transfer prices may be used to reduce an MNE's foreign exchange risk which results from volatile movements in the foreign exchange rates.[257] To mitigate the negative effects of exchange rate risks, transfer prices can be set in such a way that they absorb any volatility resulting from the exchange risks. In some instances, profits can be protected by means of forward exchange contracts; this is a contract concluded between an importer and a bank where the rate of exchange for customs value purposes is fixed at a specified rate.[258] Over the years transfer pricing has been one of the effective ways to minimise foreign exchange losses from currency fluctuations. Transfer pricing can also be used to mitigate losses from one country to

[255] U Schreiber *International Company Taxation: An Introduction to the Legal and Economic Principles* (2013) at 51; C Wendt *A Common Tax Base for Multinational Enterprises in the European Union* (2009) at 96; Grimwade *International Trade: New Patterns of Trade, Production & Investment* at 142.
[256] Articles 9 and 10 of the OECD Model Tax Convention.
[257] L Oxekheim *International Financial Market Fluctuations* (1985) at 61; JJ Park, I Stojmenovic, M Choi & F Xhafa *Future Information Technology* (2104) at 414; CR Emmanuel & M Mehafdi T*ransfer Pricing* (1994) at 71-75; JC Pagan & JS Wilkie *Transfer Pricing in a Global Economy* (1993) at 122.
[258] AJ Evans *Markets for Managers: A Managerial Economics Primer* (2014) at 175; P Collier & S Agyei-Ampomah *Performance Strategy* (2009) at 440; EW Streissler *Exchange Rates and International Finance Markets* (2002) at 83; SARS 'Customs Valuation Guide' (2002) at 57.

another under the floating exchange rates systems.[259] This can be done by determining what currency is to be used for payment and also by verifying whether the buying or selling subsidiary has the foreign exchange risk.[260] When this is done the transfer price for foreign activities will have an impact on the exposure of the foreign subsidiary.[261] The net effect is that funds to the weak currency countries are moved through the use of transfer pricing.[262]

In order to effectively take advantage of volatile exchange rates, currency hedging techniques (leading or lagging) are applied to allow MNEs to avoid exchange risks and extract more funds out of a weak currency for conversion into a strong currency.[263] Generally, assets in weak currencies countries are moved through the use of international transfer pricing adjustments by taking advantage of expected movements in the volatile exchange rate.[264] This allows the MNE to charge high transfer prices when the currency is expected to decline, by doing so the MNE maintains the gross profit margins in terms of the strong currency even though the weak currency's gross profit margin may have increased.[265] MNEs may reduce transfer prices to overcome foreign exchange controls through low transfer-in prices and by doing so they will reduce the local subsidiary's expenditure of foreign exchange when importing goods.[266] it must be mentioned that foreign exchange

[259] JD Daniels, J Hough & EW Neuland *Global Business: Environments and Strategies* (2000) at 317; Abdallah *Managing Multinationals in the Middle East: Accounting and Tax* at 226; Abdallah *International Transfer Pricing Policies: Decision-Making Guidelines for Multinational Companies* at 38.
[260] Lin & Chang *Motives of Transfer Pricing Strategies Systemic Analysis* at 1219 provide that transfer pricing can be used to 'overcome foreign exchange controls on restrictions of imports. If the market opportunities of a country are excellent, and government implemented foreign exchange controls are not conducive to local subsidiaries importing products from other countries, MNEs may reduce transfer prices to overcome such foreign exchange controls through low transfer-in prices, which reduce the local subsidiaries' expenditures of foreign exchange, when importing a large quantity of products.'
[261] CS Eun & BG Resnick *International Financial Management* (2009) at 494.
[262] FL Bartels & C Pass *International Business: A Competitive Approach* (2000) at 215; GV Henderson, GL Trennepohl & JE Wert *Introduction to Financial Management* (1984) at 488; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 54.
[263] SFR Plasschaert 'The Multiple Motivations for Transfer Pricing Modulations in Multinational Enterprises and Governmental Counter Measures: An Attempt at Clarification' (1994) 34(1) *Management International Review* at 40; AM George *Exchange Management and the Multinational Corporation: A Manager's Guide* (1978) at 181.
[264] Pendse *International Transfer Pricing: A Review of Non-Tax Outlook* at 508.
[265] N Grimwade *International Trade: New Patterns of Trade, Production & Investment* (2000) at 141.
[266] Lin & Chang *Motives of Transfer Pricing Strategies Systemic Analysis* at 1219; Lin et al *A Research on Transfer Pricing Strategies and Management Performance of MNEs* at 119; SL Muhr, BM Sorensen & S Vallentin *Ethics and Organisational Practice: Questioning the Moral Foundations of Management* (2010) at 23.

tampering may negatively affect the foreign exchange situation which in turn may trigger the government to impose restrictions on imports.[267] It must however be mentioned that exchange control regulations have eased since the introduction of transfer pricing in South Africa.

4.3.4 Cash Flow Management in Foreign Countries

High operational risks in the host country may cause MNEs to seek early return on their investments through transfer pricing.[268] Political uncertainty like the threat of expropriation and nationalisation are some of the reasons that may cause the MNEs to transfer their income to places which they consider to be investor friendly and stable politically. In most cases, expropriation and nationalisation are coupled with restrictions on the repatriation of profits or funds. To reduce capital outflow and improve the balance of payment; many developing countries introduce measures to restrict MNEs in the repatriation of profits, royalties and management fees by imposing high taxes on these remittances.[269]

In view of these reasons, MNEs may control their cash flow in foreign countries through the use of transfer pricing techniques. Within the transfer pricing context, cash flow can be achieved by setting high transfer prices on goods and services transferred to foreign subsidiaries by another subsidiary within the same MNE group; this will then enable the withdrawal of funds from another country. Where there is expropriation and nationalisation, charging high transfer prices is mostly the only way to shift income and profit out of the country. It was once remarked by an officer of a large MNE that:[270]

---

[267] Chan & Chow *International Transfer Pricing in China* at 4.
[268] Chan & Chow *International Transfer Pricing in China* at 40.
[269] DR Wiegel *Foreign Direct Investment* (1997) at 35; BL Billet *Investment Behaviour of Multinational Corporations in Developing Areas: Comparing the Development Assistance Committee, Japanese and American Corporations* (1991) at 68; WR Feist, JA Heely, MH Lu & RL Nersesian *Managing a Global Enterprise: A Concise Guide to International Operations* (1999) at 27-28. Many authorities use Exchange Control Regulations, Transfer Pricing Regulations to curb the illicit outflow of profits and taxes. As already alluded to in the text above, South Africa relies on the Currency and Exchanges Act 9 of 1933 and section 31 of the Income Tax Act 58 of 1962, a full analysis of section 31 is undertaken in Chapter 6.
[270] Wrappe et al *The Transfer Price is Right…Or Is It?* at 40.

> [i]f I cannot get dividends out and my royalty fee is fixed and I want to remit more money, then I do this on an uplift of my transfer prices.

In this regard, transfer pricing is used to legally safeguard their income and assets by raising transfer prices between subsidiaries in order to ensure cash flow within the MNE group.[271]

4.3.5 Transfer of Intra-Group Services

Transfer of intra-group services is a very wide concept which may be a subject of research on its own. It will not be justifiable to discuss this concept in one paragraph here. The concept is briefly discussed here to highlight the role of the transfer price system in the transference of services within an MNE group. One of the major reasons for transfer pricing policies is to ensure the transference of services among members of the MNE group. An intra-group service is a business activity undertaken within the MNE group (e.g. administrative, technical and commercial) which an independent enterprise would have been willing to pay or perform for itself.[272] Intra-group services are broadly divided into four main categories, and they are:

(i) Commercial services which include sales, marketing sourcing, and other relevant services.

(ii) Technical services which include research and development, technical support, engineering, and such related services.

(iii) Financial services which include treasury functions, hedging, and factoring.

(iv) Management services which include human resources services, legal, accounting, and other support back office services.[273]

There are various fees or charges imposed among members of the MNE group for various services rendered. Some of the prevalent services relate to payment of

[271] Robbins & Stobaugh *Money in the Multinational Enterprise* at 91.
[272] OECD *Transfer Pricing Guidelines* at 27; Spitz *International Tax Havens Guide* at 298; L Riccardi *Vietnam Tax Guide: Domestic Fiscal System and International Treaties* (2014) at 36; L Riccardi *Chinese Tax Law and International Treaties* (2013) at 88; A Bakker & MM Levey *Transfer Pricing and Dispute Resolution* (2011) at 64.
[273] J Glabush *IBFD International Tax Glossary* 6 ed (2009) at 247.

dividends, royalty payments, interest on loans, and management services.[274] Transfer prices play an important role in ensuring the payment of the services mentioned above.

Management fees merit a brief discussion due to the prevalence of these fees within many MNEs' transfer pricing practices. Management services are generally classified into three categories: custodial or stewardship charges,[275] charges for specific identifiable services to a particular taxpayer, and charges reflecting an allocation of group expenses.[276] In terms of the arm's length principle, when a member of the group performs an activity for one or more members of the group, such activity is regarded as a service rendered which must be compensated provided such an activity enhances the commercial or economic status of the member of the group to whom it has been rendered.[277] This means that the service must be one that an independent enterprise would have required and would have given a similar consideration (price) for it.[278] In other words, the activity must be chargeable under the arm's length principle. If the activity is not the one which the independent would have required, paid for or performed for it, then the activity should not ordinarily be considered to be chargeable under the arm's length principle and tax authorities may be justified in categorising such a transaction as tax evasion scheme.[279]

Transference of services within the group is not a problem as long as the transference is at arm's length. There are two requirements which must be met for

---

[274] OECD *Transfer Pricing Guidelines* at 331-332; K Keuper & K Lueng *Finance Bundling and Finance Transformation: Shared Services, Next Level* (2013) at 476; Baker & Levey *Transfer Pricing and Intra-Group Financing* at 7.

[275] Glabush *IBFD International Tax Glossary* at 247. A shareholder activity is typical example of non-chargeable activities. Shareholder activities comprise costs of activities relating to the legal structure of the parent itself and to reporting requirements of the parent. Also, costs of raising funds for the acquisition of participations are shareholders' costs. The term is sometimes used for categories of costs which cannot be charged to group members. In this regard, see N Mehta 'Formulating an Intra-Group Management Fee Policy' (2005) 12(5) *International Transfer Pricing Journal* at 253;

[276] Pagan & Wilkie *Transfer Pricing Strategy in a Global Economy* at 110.

[277] OECD *Transfer Pricing Guidelines* at 319. See also Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 276.

[278] G Cottani 'Transfer Pricing' (2014) *IBFD* para 14.2; Glabush *IBFD International Tax Glossary* at 247.

[279] OECD *Transfer Pricing Guidelines* at 320.

intra-group services to be considered as arm's length.[280] The first requirement is that the intra-group chargeable services must have been rendered and must have a beneficial effect to its receiver.[281] If there is no benefit, it means that the setting of the price may point to a ploy to manipulate the transaction in order to avoid the payment of applicable taxes. The second requirement is how to determine an arm's length consideration for the service rendered in relation to the degree of the benefit which has been received. The price must be commensurate with the service being rendered. If the price and the service are disproportionate to each other, that may be an indication that the transaction does not accord with normal business considerations and may not meet the arm's length standard.

A controversial tax hurdle in relation to the two requirements is the difficulty in determining the deductibility of the charges when computing the taxpayer's income.[282] Charges for specific identifiable services to a member of the MNE group are not difficult to determine, provided such service would have been rendered had the transaction occurred between independent enterprises dealing at arm's length.[283] The problem of deductibility may also manifest itself in relation to duplication of services. Problems arise where there is a duplication of services; the pivotal question is whether or not a taxpayer is in the business of providing the service for which a charge is being made. If this question can be answered in the affirmative, then the duplication of services cannot be ascribed to transfer pricing manipulation. There are legitimate instances where duplication of services is acceptable. One of the exceptions may be where the duplication of services is only temporary; for example, where an MNE group is reorganising to centralise its management functions. Another exception would be where the duplication is undertaken to reduce the risk of a wrong business decision (e.g. by getting a second legal opinion on a query).[284] All

---

[280] Feinschreiber *Transfer Pricing Methods: An Application Guide* at 222; Johnson *US Transfer Pricing Sourcebook* at 45,

[281] S Allen, R Tomar & DR Wright 'Section 482 Service Regulations: Implications for Multinationals' (2006) 13(6) *International Transfer Pricing Journal* at 279.

[282] Pagan & Wilkie *Transfer Pricing in a Global Economy* at 110.

[283] OECD *Transfer Pricing Guidelines* at 320. See also M Prysuski 'OECD Transfer Pricing of Intra-Group Services' (2005) 6(8) *Corporate Business Monthly* at 26; TM Zollo, CP Bowers & JP Cowan Jr 'Transfer Pricing for Services: The Next Wave' (2003) 81(3) *Taxes - The Tax Magazine* at 21. Zollo, Bowers & Cowan Jr *Transfer Pricing for Services* at 21.

[284] OECD *Transfer Pricing Guidelines* at 323. Prysuski *OECD Transfer Pricing of Intra-Group Services* at 25 provides that 'duplicative services are those that a group member offers to any other member.

in all the brief discussion above clearly demonstrate that transfer pricing is an important vehicle for the transference of services between members of the MNE group.

4.3.6 Transfer Pricing as a Performance Monitoring Tool

One of the economic reasons for charging transfer prices for intra-group trade is to be able to measure the performance of the individual entities in a multinational enterprise group.[285] Transfer pricing is also used to encourage competition among members of the MNE group in order to meet the strategic objectives of the enterprise.[286] Transfer pricing systems are used to motivate the performance of foreign subsidiary managers by comparing profits transferred to the parent company.[287] The individual entities within a multinational company group are separate profit centres and transfer prices are used to determine the profitability of each entity by comparing their individual profits based on the risks assumed and allocated resources. It is a worldwide view that the individualisation of the entities brings about competition which stimulates performance.[288] Transfer pricing figures are to be used to monitor the contribution made by individual entities to ensure that MNE members meet the required financial targets.[289] The effect of using transfer pricing as a motivator for foreign manager's performance is that it can have a positive impact on the profits of the MNE group as a whole. The profits of individual members of the group are shared in the group to draw lessons from top performers.

These services can be considered duplicates in the sense that the recipient or arm's length party already performs such a service on its behalf. In such a case, the group member should not be charged for intra-group services'.

[285] WM Abdallah 'How to Motivate and Evaluate Managers with International Transfer Pricing Systems' (1989) *Management International Review* at 65. See also PB Oyelere & JD Turner 'A survey of transfer pricing practices in UK banks and building societies'' (2000) 12(2) *European Business Review* 93-99.

[286] SB Nielsen, P Raimondos-Moller & G Schjelderup 'Formula Apportionment and Transfer Pricing under Oligopolistic Competition' (2003) 5(2) *Journal of Public Economic Theory* at 420. See also Markham *Transfer Pricing of the Intangibles* at 30.

[287] P Milgrom & J Roberts *Economics, Organization and Management* (1992) at 78. See also A Lymer & J Hasseldine *The International Taxation System* (2002) at 162; WM Abdallah *International Transfer Pricing Policies: Decision-Making Guidelines for Multinational Companies* (1989) at 46-47; AM Rugman *International Business Critical Perspectives on Business and Management* (2002) at 142.

[288] G Hamel & C Prahalad 'Do You Really Have a Global Strategy?' (1985) *Harvard Business Review* at 140. See also E Hoffmann *Interorganisational Operations Management: Performance in Supply Chains* (2013) at 239.

[289] Benke & Edwards *Transfer Pricing: Techniques and Uses* at 27.

4.4 Conclusion

The discussion of the corporate reasons for transfer pricing above also supports the view that there is no impediment in reducing one's tax liability as long as it is done within the parameters of the law. This view supports the conclusion reached in chapter two that tax liability may be reduced within the ambit of permissible tax avoidance strategies. It has also been mentioned here that these legitimate business reasons may be manipulated to derive unwarranted tax benefits. In the event where these reasons are circumvented for nefarious reasons, there are measures which can be put in place to correct the situation. These measures include *inter alia*, the strengthening of currency conversion measures, enactment of clear rules in the transfer of intra-group services, relaxation of exchange control regulations, encourage more information sharing among nations of the world to deal with issues like tax differentials and related matters. The measures herein are a subject of further research and will therefore not form part of the recommendations of this research as it is geared towards the analysis of section 31. When dealing with the circumvention of legitimate transfer pricing reasons within the transfer pricing context, it must be stressed that an effective transfer pricing regime should be able to target only manipulative transfer pricing practices and allow the legitimate practice of transfer pricing. Any intended amendment to the transfer pricing legislation to cure any inadequacies (as discussed elsewhere in this text) must not overreach its limit as that may create problems that it intends to solve in the first place.

CHAPTER 5

GENERAL CHALLENGES CONTRIBUTING TO TRANSFER PRICING MANIPULATION

5.1 Introduction

This chapter must be seen in the context of the previous chapters where different issues that contribute to the transfer pricing manipulation problem have been identified. In each instance, different issues are discussed to highlight how they contribute to the transfer pricing manipulation problem. It is therefore important to link this chapter with the issues discussed in those chapters. For instance, it was concluded in Chapter 2 that one of the main contributors of transfer pricing manipulation is the weakness of the arm's length principle. Chapter 3 has seen problems associated with the application of transfer pricing methods and the lack of express endorsement of those methods within section 31. It was also found in Chapter 4 which deals with the business reasons for transfer pricing that legitimate business reasons can be circumvented to manipulate transfer prices. All these problems can be linked to the inherent problems associated with transfer pricing discussed in this chapter.

This chapter highlights some of the inherent problems that make it difficult to apply transfer pricing legislation. It is important to note that although most of the problems encountered in this chapter are not necessarily due to the structural weaknesses of the transfer pricing legislation (section 31), they nevertheless make it difficult or impossible to apply or comply (as the case may be) with section 31 as envisaged by the legislature. Transfer pricing issues pose a number of challenges for all tax administrations. The challenges are often the breeding ground for the transfer pricing manipulation problem as it will be seen in this analysis. The non-exhaustive challenges contributing to transfer pricing manipulation include: lack of comparable data and or transactions, use of secret data, lack of convergence between transfer pricing and customs valuation, inadequate e-commerce legislation to deal with tax abuse, document requirements challenges and administrative challenges. These challenges are discussed in the following paragraphs. The analysis of some of the above problems will not be complete without discussing relevant OECD BEPS Action plans on certain issues. In 2013 the OECD introduced the base erosion and profit shifting (BEPS) Action Plans. The OECD's Action Plan on BEPS was published in July 2013 with a view to address perceived flaws in international tax rules. The 40-page Action Plan, which was negotiated and drafted with the active participation of its member states, contained 15 separate action points, some of which were further split into specific actions or outputs. The Plan was focused on addressing these issues in a coordinated, comprehensive manner, and was endorsed by the G20 leaders and finance ministers at their summit in St. Petersburg in September 2013.

5.2 Lack of Comparable Transactions

As already mentioned revenue authorities (SARS included) and taxpayers experience difficulties in obtaining sufficient and relevant information about comparable transactions in order to apply the comparative analysis. There are many other reasons for the lack of comparable information but only a few are mentioned here for the purposes of this research. Some of those causes are the integration of corporations into homogeneous groups, the secrecy surrounding transfer pricing, competition among comparable enterprises, the cost of obtaining and maintaining the information and an increase in mergers and acquisitions which restricts sharing of information outside the merged entity.[290] In the main, the lack of comparable transactions has been described as one of the weaknesses of the arm's length principle.

It is estimated that more than two-thirds of the world trade is conducted between related or connected parties.[291] It is therefore not surprising that information is kept

[290] DR Wright 'Transfer Pricing in the United States: Recent Events and Expectations for the Future' (2001) 55 *Bulletin for International Fiscal Documentation* at 425; Markham *Transfer Pricing of Intangibles* at 136; Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* at 76; M Butani *Transfer Pricing: An Indian Perspective* (2007); Miller & Oats *Principle of International Taxation* at 520.

[291] S Rosenow & BJ O'Shea *A Handbook on the WTO Customs Valuation Agreement* (2010) at 71; G Rubel & H Runge *Real and Monetary Issues of International Economic Integration* (2000) at 27-28; Schaffer, Agusti and Dhooge *International Business Law and its Environment* at 85.

within the inner circles of related persons beyond the reach of tax authorities. In most international transactions there is a lack of reliable data to conduct watertight transfer pricing comparisons.[292] The other major problem is that independent parties seldom undertake transactions of the type that are entered into by associated enterprises, this then makes the comparison questionable or difficult due to the lack of comparable transactions that are applicable to both related and independent enterprises.[293] Lack of adequate data is compounded by the fact that information on the databanks is not instructive enough to guarantee a thorough and reliable comparative analysis between controlled and uncontrolled transactions.[294]

Another problem which is closely connected to the lack of adequate comparable data is the fact that some transactions are inherently unique and as such cannot be subjected to a comparable analysis.[295] On one hand, associated enterprises do from time to time engage in unique transactions (for purposes other than tax avoidance) that independent enterprises would not undertake, for instance, intra-company transactions such as management services, asset or financial services.[296] On the other hand, independent enterprises do also undertake transactions of a particular type that may not necessarily be undertaken by associated enterprises. This

[292] K Miller & D Lermer 'Practical Application of Transactional Profit Methods' (2000) 7(5) *International Transfer Pricing Tax Journal* at 197; Feinschreiber *Transfer Pricing Handbook* at 23-3; Pogge & Mehta *Global Tax Fairness* at 155; HJ Aaron, L Burman & CE Steuerle *Taxing Capital Income* (2007) at 220; C Sommer *Separate Accounting or Unitary Apportionment: The Fairytale of the Arm's Length Pricing and General Equilibrium Analysis of Multinational Enterprise Behaviour under the Formulary Taxation Alternative* (2010) at 74.

[293] OECD *Transfer Pricing Guidelines* at 37; See also Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* at 412; GV Smith, RL Parr *Intellectual Property: Valuation, Exploitation and Infringement Damages* (2005) at 123; Spies & Petruzzi *Tax Policy Challenges in the 21st Century* at 313; D Alexander & A Britton *Financial Reporting* 7 ed (2007) at 541.

[294] M Boos *International Transfer Pricing, The Valuation of Intangible Assets* (2003) at 174; Schaffer, Agusti & Dhooge *International Business Law and its Environment* at 160; Dunning *Multinational Enterprises and the Global Economy* at 14. See also Hooper, Uddin, Tsamenyi, & Wickramasinghe *Handbook of Accounting and Development* at 270; GN Niels, H Jenkins & J Kavanagh *Economics for Competition Lawyers* (2011) at 401; Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* at 16; Markham *Transfer Pricing of the Intangibles* at 129; AR Negandhi *Functioning of Multinational Corporations: A Global Comparative Study* (1982) at 55; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 145; AM Rugman *Multinationals in Canada: Theory, Performance and Economic Impact* (1980) at 94.

[295] OECD *Transfer Pricing Guidelines* at 37. See also RJ Peroni, CH Gustafson & RC Pugh *International Income Taxation: Code and Regulations* (2008) at 1204; Bakker *Transfer Pricing and Dispute Resolution* at 702.

[296] Bullen *Arm's Length Transaction Structures* at 412.

dichotomy means that any information produced on either side cannot aid in the comparative analysis because the transactions are completely unique and different. Sometimes independent enterprises which can be used for comparisons do not exist. As already mentioned, the transactions between connected persons are so unique that the information at their disposal becomes irrelevant for comparison purposes. Furthermore, the OECD points out that the information that is accessible may be incomplete or difficult to interpret, a factor which may render comparison a futile exercise.[297] Trade secrets and competition among companies also restrain free sharing of information for fear of exposing competitive strategies by competing enterprises.[298] Connected and unconnected persons may operate in different geographical locations with different economic climates, which may make comparison difficult or irrelevant.[299] This is a real threat to legitimate transfer pricing because if taxpayers are aware that the tax authority cannot access certain information, it then makes it easy for them to manipulate the transfer prices. The cost of contemporaneous and regular updating of transfer pricing documentation also adds to the problem.

Regular or annual updating of documents can be very costly for the taxpayers.[300] Both the taxpayer and the tax administration often have difficulty in obtaining adequate data or information to apply the arm's length principle. The difficulty is caused by the fact that the arm's length principle requires the tax administration and the taxpayer to compare uncontrolled transactions and controlled transactions, this exercise demands a substantial amount of data which is not available.[301] This

[297] Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* at 137; AD Johnson *Andean and Southern Cone Regions Tax, Law and Business Briefing* (2006) at 121.
[298] IBFD 'International Tax Glossary' at 377; T Ishikawa F*irms' Location Selection and Regional Policy in the Global Economy* (2015) at 92; K Spies & R Petruzzi *Tax Policy Challenges in the 21st Century* (2014) at 309; Miller & Oats *Principles of International Taxation* at 426.
[299] Markham *The Transfer Pricing of Intangibles* at 174; DN Shaviro *Fixing US International Taxation* (2014) at 41; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 62; A Paisey & J Li *Transfer Pricing: A Diagrammatic and Case Study Introduction, with Special Reference to China* (2012) at 73; OECD 'Dealing Effectively With the Challenges Of Transfer Pricing' at 14.
[300] Lang *Tax Compliance for Companies in an Enlarged European Community* at 432; Markham *Transfer Pricing of Intangibles* at 231; CS Chapman, AG Hopwood & MD Shields *Handbook of Management Accounting Research* (2007) at 582; GC Hufbauer & A Assa *US Taxation of Foreign Income* (2007) at 251-253. Record keeping in South Africa is provided for in ss 29 to 32 of the Tax Administration Act 28 of 2011.
[301] OECD *Transfer Pricing Guidelines* at 37. See also A Schafer *International Company Taxation in the Era of Information and Communication Technology* (2006) at 160; F Michell, H Norreklit & M

problem is fuelled by the fact that comparability is evaluated by taking into account different factors which may affect the controlled and uncontrolled transactions differently which in turn will not produce desired results due to the implications of the different factors.[302] It is impractical to legislate for or against the lack of comparable data; however, rules to section 31 of the Income Tax Act can be promulgated to indicate primary transfer pricing documentation which is required for transfer pricing purposes.[303] This will cut costs and allow SARS to ask for additional or supporting documentation where the information in the primary documentation does not yield the required results. It is important to note that where there is no information, comparison and detection of transfer pricing manipulation becomes impossible.

5.3 Use of Secret Comparables

Secret comparable is a term used in the transfer pricing context. It means a comparable transaction whose data is not disclosed to the public or the taxpayer but known only to the tax authority which is making the transfer pricing adjustment.[304] In addition to the lack of adequate comparable data, the uncertainty in the use of secret comparables is another major challenge facing tax administrations and taxpayers alike. The OECD transfer pricing guidelines recommend that tax administrations should not use secret comparables when making transfer pricing adjustments. The rationale is that it is unfair to a taxpayer because they are not privy to the information which may adversely affect them and as such cannot adequately defend themselves against a decision taken on the basis of that information.[305] This notion is also

---

Jakobsen *The Routledge Companion to Cost Management* (2013) at 140-1; S Vob & DL Woodruff *Introduction to Computational Optimization Models for Production Planning in a Supply Chain* (2003) at 189.

[302] HJ Ault & BJ Arnold *Comparative Income Taxation: A Structural Analysis* 2 ed (2004) at 421; Peroni *International Income Taxation, Code and Regulations* at 1229; SP Pratt & RJ Grabowski *Cost of Capital: Applications and Examples* 3 ed (2008) at 393; Reilly & Schweibs *The Handbook of Business Valuation and Intellectual Property Analysis* at 570-572; Laro & Pratt *Business Valuation and Federal Taxes: Procedure, Law and Perspective* at 143.

[303] Some of the primary documents for transfer pricing purposes include: OECD compliant transfer pricing documentation, intercompany agreements, documents containing reasons for transfer pricing adjustments, details of import customs declaration where applicable and examples of independent comparable values.

[304] Financial Glossary available at http://www.moneycontrol.com/glossary/, accessed on 11 January 2017.

[305] OECD *Transfer Pricing Guidelines* at 158 See also Bakker *Transfer Pricing and Dispute Resolution* at 399; Markham *Transfer Pricing of Intangibles* at 181 E Kemmeren, DS Smit & P Essers

supported by the OECD guidelines which provide that a tax administration may apply a transfer pricing method on the basis of such data if:[306]

> [t]he tax administration was able, within the limits of its domestic confidentiality requirements, to disclose such data to the taxpayer so that there would be an adequate opportunity for the taxpayer to defend its own position and to safeguard effective judicial control by the courts.

There is no uniformity among tax jurisdictions on the application of the guidelines regarding the use of secret comparables. The problem is due to the fact that the OECD guidelines are not binding to member countries and that not all tax jurisdictions are members of the OECD. The use of secret comparables is rife among OECD member countries. A survey of practitioners from 26 countries found that certain jurisdictions which include Argentina, Australia, Canada, China, Germany, India, Italy, Mexico, France and Switzerland use secret comparables to varying degrees against the directive of the OECD transfer pricing guidelines.[307] For instance, in the case of *Nestle Enterprises v Minister of Economy and Finances* (case no 12PA00469),[308] the court ruled in favour of Nestle in relation to the use of secret comparables in terms of Article 57 of the French Tax Code. This Article provides that the French tax authorities are allowed to use secret comparables when conducting transfer pricing audits against a taxpayer. In this case, the French tax authorities secretly used comparable cash pooling operations of three major groups listed on the French Stock Exchange. On appeal, the court ruled that the tax authorities failed to use a valid comparable structure due to the fact that the three major groups were selected without any indication of the company names, terms and conditions of the cash pool agreements. The court also held that the French tax authorities failed to show if the guarantee of the selected comparables is comparable to Nestle Enterprises. Therefore, the court of appeal considered that secret comparables cannot be used as per Article 57.

Tax Treaty Case Law around the Globe 2014 (2015) at 178; M Tally *Practical Experiences with the OECD Transfer Pricing Guidelines* (1999) at 32.

[306] OECD *Transfer Pricing Guidelines* at 158. See also Kemmeren, Smit & Essers *Tax Treaty Case Law around the Globe* at 178; Markham *Transfer Pricing of Intangibles* at 280; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 29; T Ishikawa *Firms' Location Selection and Regional Policy in the Global Economy* (2015) at 92.

[307] K Bell 'Transfer Pricing Forum Examines Treatment of Secret Comparables' *Bloomberg* available at https://tax.thomsonreuters.com/blog/onesource/transfer-pricing-global-tax-compliance/bloomberg-bna-transfer-pricing-forum-examines-treatment-of-secret-comparables/, accessed on 13 August 2016.

[308] *Nestle Enterprises v Minister of Economy and Finances* case no 12PA00469.

The problem with secret information is that in most cases it cannot be verified through comparative independent information in the same circumstances and if it cannot be verified, then it can be manipulated very easily. The use of secret comparables is also against the rules of natural justice of *audi alteram partem* since it is used without giving them a hearing and must therefore be avoided especially in a constitutional democracy like South Africa. To counteract this problem, a well-documented comparability criterion must be adopted in order to make the comparability standard transparent and uniform to avoid credibility issues when challenged. This will in turn ensure that results are not considered to be arbitrary or unfair since the reasons for adjustment or rejection of the transfer price (if any) of each potential comparable are provided. There are no indications that South Africa is currently using secret comparables, however, 'prevention is better than cure' as such, an express prohibition will go a long way in ensuring certainty around this issue. To this end, section 31 may be amended to regulate comparability procedures which may also include the collection and application of comparable data, importantly, a statutory prohibition on the use of secret comparables within the transfer pricing context will fully protect taxpayers against any potential use of secret comparables by SARS and will also ensure that the tax authority operate within the OECD guidelines.

5.4 Challenges Posed by E-Commerce on Transfer Pricing

Before conducting an in-depth analysis of the challenges posed by the e-commerce, it is important to describe what this important concept entails. The OECD has defined e-commerce to be: [309]

> the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders. The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or services do not have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals, governments, and other public or private organisations. To be included are orders made over the web, extranet or electronic data interchange. The type is defined by the method of placing the order. To be excluded are orders made by

[309] OECD Glossary of Statistical Terms available at https://stats.oecd.org/glossary/detail.asp?ID=4721 accessed on the 29 October 2018.

telephone calls, facsimile or manually typed e-mail. This concept is also defined by the US legislation as:[310]

> any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer or delivery of property, goods, services, or information, whether or not for consideration and includes the provision of Internet access.

Generally speaking, electronic commerce is defined as: [311]

> the conduct of commerce in goods and services, with the assistance of telecommunications and telecommunication-based tools.

The implications of e-commerce on transfer pricing is a very broad subject which warrants research on its own. An attempt to discuss all the issues in these few paragraphs will not do justice to this dynamic topical issue; however, a brief overview is conducted here to illustrate how the advent of e-commerce can contribute to transfer pricing manipulation. E-commerce is discussed here as a general problem encountered in transfer pricing. The legislative defences around this issue and recommendations within the South African context are fully discussed in Chapter 6 that deals with transfer pricing in South Africa. It must however be mentioned that South Africa, like many other countries, is also grappling with the possible loss of tax revenue from transactions conducted through e-commerce. This is largely attributed to the lack of an adequate legal framework that deals with e-commerce within the tax sphere.

The growth of the use of the internet as a trading tool in recent times poses a challenge to the tax policy design and the administration of taxes in general. Governments and international agencies are aware of this challenge but are uncertain about its magnitude. However, there is no doubt that e-commerce and the anonymity of the internet offer real opportunities for those seeking to avoid and

---

[310] G Aryya *Managing Business with Electronic Commerce: Issues and Trends* (2002) at 200; Internet Tax Freedom Act of 1998. See also JJB Hickey *Internet Business Commerce and Tax* (2012);, S Basu *Global Perspective on E-Commerce Taxation Law* (2007) at 15; D Pinto *E-Commerce and Source Based Income Taxation* (2003) at 1.

[311] OECD 'Defining and Measuring Electronic Commerce: OECD Workshop on 21st April 1999' available on http://www1.oecd.org/dsti/sti/ec/act/agenda_ECworkshop.htm, accessed on 24 July 2015.

evade tax.[312] As it has already been mentioned in the previous chapters, ordinarily, the application of the arm's length principle is difficult and it is even more difficult when it has to be applied to cross-border transactions which have been concluded electronically.[313] E-commerce may be a unique problem but it is definitely not a new problem for transfer pricing, it has been with us for a long time.[314] The increase in the use of technology and the removal of physical boundaries in the conclusion of cross-border transactions makes it very difficult for tax administrations to identify, trace, quantify and verify the prices set in those cross-border transactions.[315] This is due to the fact that prices are set in the cyberspace where it is difficult for tax authorities to trace the goods and services which are in most cases supplied in digitised format.[316] The digitisation of the setting of transfer prices through e-commerce may be a stumbling block in the comparative analysis process due to the difficulty in tracing the audit trail.[317] The challenges relating to e-commerce for the purposes of this research are briefly discussed as follows:

---

[312] Lymer and Hasseldine *The International Taxation System* at 61; P Rendahl *Cross Border Consumption Taxation of Digital Supplies* (2009) at 111; K Yutaka *Global Information Technology and Competitive Financial Alliances* (2006) at 269; WB Hildreth, GJ Miller & J Rabin *Handbook of Public Administration* 3 ed (2007) at 459; N Warren 'Internet Challenge to Tax System Design' (2002) *International Taxation System* at 61.

[313] D Hay, F Horner & J Owens 'Past and Present Work in the OECD on Transfer Pricing and Selected Issues' (1994) 10 *Intertax* at 424; Schafer *International Company Taxation in the Era of Information and Communication Technology* at 118; Basu *Global Perspective on E-Commerce Taxation Law* at 136; Walden & Hornle E-*Commerce Law and Practice in Europe* at 27; Miller & Oats *Principle of International Taxation at 520, E Druica Digital Economy Innovations and Impacts on Society* (2012) at 40.

[314] MR Czinkota & IA Ronkainen *International Marketing* 10 ed (2003) at 487; OECD 'Report of the Committee on Fiscal Affairs Electronic Commerce: A Discussion Paper on Taxation Issues' (1998) para 1; Levey & Wrappe *Transfer Pricing Rules Compliance and Controversy* at 350; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 134; Z Qin *Introduction to E-commerce* (2009) at 214; Shenkar, Luo & Chi *International Business* at 611.

[315] GB Delta & JH Matsuura *Law of the Internet* (2014) at 15-31; Pinto E-*Commerce and Source Based Income Taxation* at 138; AM Bardopoulos *E-Commerce and the Effects of Technology on Taxation: Could VAT be the e-Tax Solution* (2015) at 68; SR James *Taxation: Critical Perspectives on World Economy* Vol 1 (2002) at 11; Qin *Introduction to E-commerce* at 209.

[316] JS Schwartz 'Transfer Pricing and Electronic Commerce' (1999) *Bulletin for International Fiscal Documentation* at 286; Doernberg, Hinnekens, Hekkerstein & Li *Electronic Commerce and Multi-Jurisdictional Taxation* at 459-460; HH Perritt *Digital Communications Law* (2015) at 15-11; S Kamel *Electronic Business in Developing Countries: Opportunities and Challenges* (2006) at 83; H Bidgoli *Electronic Commerce Principles and Practice* (2002) at 350.

[317] AW Oguttu 'Transfer Pricing and Tax Avoidance: Is the Arm's Length Principle Still Relevant in the e-Commerce Era?' (2006) *SA Merc LJ* at 146; B Paulos *The Legal Architecture for E-commerce in Ethiopia: Lessons from the EU Experiences* (2015) at 40-42; CL Mann, SE Eckert & SC Knight *Global Electronic Commerce: A Policy Primer* (2000) at 85-86.

5.4.1 Quantifying E-Commerce in Transfer Pricing

Quantifying the extent of electronic commerce is difficult for reasons such as the complications in defining the parameters of electronic commerce due to its virtual nature, the speed of its growth and evolution and the fact that in many cases firms conduct both electronic commerce and traditional commerce simultaneously and often do not divulge the e-commerce site of their transactions.[318] Quantifying the value associated with electronic commerce activities can be challenging since many of its key qualities such as convenience, variety and ease of access to information are difficult to measure. Because of this, official statistical offices and tax departments are unable to provide accurate statistics on electronic commerce. In the end, the quantitative insight into the nature of this activity is mostly gained through reliance on private providers of data whose information cannot be adequately compared to other sources as they are not readily available.

The digital economy which, as already mentioned above has profound implications on transfer pricing and profit shifting is addressed in the OECD BEPS Action Plan 1. This action plan addresses concerns about tax planning by multinational enterprises (MNEs) that exploit gaps in different tax systems to artificially reduce taxable income or shift profits to low-tax jurisdictions in which little or no economic activity is performed. The shifting of profits is made possible by the instantaneous nature of the digital economy. The problem is also exacerbated by inherent features of the digital economy such as mobility, reliance on data, network effects, the spread of multi-sided business models, a tendency toward monopoly or oligopoly and volatility.[319]

Issues to be examined by Action Plan 1 include but not limited to, the ability of a company to have a significant and meaningful digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules. The Action plan also investigates the attribution of value created from the generation of marketable location relevant data through the use of

[318] Doernberg, Hinnekens, Hekkerstein & Li *Electronic Commerce and Multi-Jurisdictional Taxation* at 308; M Bachetta *Electronic Commerce and the Role of the WTO* (1998) at 41; AC Leer *Masters of the Wired World: Cyberspace Speaks Out* (1999) at 293; JM Mintz *The Role of Allocation in Globalised Corporate Income Tax* (1998) at 23.

[319] OECD BEPS Action Plan 1. Addressing the Tax Challenges of the Digital Economy. Available at http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf.accessed on the 18 October 2018.

digital products and services. The characterization of income derived from new business models and the application of related source rule is also the focus of this action plan. By its nature, of the OECD BEPS Action 1 merely describes the problem, and does not necessarily provide any solution on how such a problem can be resolved. Instead, the problems caused by the digital economy are dealt with under the other actions of the report. The reason for this is that electronic commerce has become the economy itself, and thus the digital economy cannot be "ring-fenced" from the general economy for tax purposes. The digital economy is inextricably linked to the concept of PE, it therefore comes as no surprise that the problems identified in Action 1 are mostly resolved by Action 7 that deals with status of permanent establishments in the digital economy. The solutions will be fully ventilated in the paragraph that deals with the status of PE in relation to the digital economy.

5.4.2 Permanent Establishment Challenges in relation to E-Commerce

One of the most controversial and complex issues in the area of transfer pricing and e-commerce regards the concept of permanent establishment.[320] Before delving deeper into the issues relating to e-commerce and permanent establishments, the permanent establishment concept is briefly described. In most countries, the meaning of permanent establishment is derived from art 5 of the OECD Model Tax Convention on Tax and Capital.[321] According to art 5, a permanent establishment is a fixed place of business through which the business of an enterprise is wholly or partly carried on. Article 5 of the Model Convention, in particular paras 1 and 2 provides that:

> 1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. 2. The term "permanent establishment" includes especially: a) a place of management; b) a

---

[320] Alm, Martinez-Vazquez & Rider *The Challenges of Tax Reform in a Global Economy* at 113; D Pinto E-*Commerce and Source Based Income Taxation* at 204; S Mayer *Formulary Apportionment for the Internal Markets* (2009) at 203, OECD 'Taxation and Electronic Commerce Implementing the Ottawa Taxation Framework Conditions' (2001) at 104-105.

[321] Glabush *IBFD International Tax Glossary* at 11; OECD *Model Tax Convention on Income and on Capital, Condensed* (2014) at 246; A Van de Vijver *The New US-Belgian Double Tax Treaty: A Belgian and EU Perspective* (2009) at 87; T Eulenpesch *Attribution of Profits to Permanent Establishments in the OECD-View* (2012) at 2; BJM Terra & PJ Wattel *European Tax Law* 4 ed (2005) at 556.

> branch; c) an office); d) a factory; e) a workshop, and (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

From the above definition, it can therefore be inferred that the permanent establishment must be fixed and, to a certain extent, stable. The definition above includes a place of management, a branch, an office or factory.[322] In terms of this article, if the site is only intended to store, display or deliver goods or merchandise for the enterprise, or to carry on “activity of a preparatory or auxiliary character”, it is not considered to be a permanent establishment. Article 5(5) provides that a dependent agent acting on behalf of a parent company in another state is also considered to be a permanent establishment provided its activities are not of preparatory or auxiliary nature. In case of an enterprise with international business operations (which incidentally includes cross-border transactions), the profits generated in the country, other than that of residence, can be taxed only if such an enterprise has a permanent establishment in that jurisdiction, article 7(1) of the OECD Model Convention provides that:

> The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

For the purposes of transfer pricing, it is important to determine the extent to which the concept of permanent establishment is applicable in an e-commerce scenario. The definition of permanent establishment signifies that there must either be a physical presence or dependent agent acting on behalf of a parent company in another state. This can be inferred from the use of the phrase: ‘fixed place of business through which the business of an enterprise is carried on’. It is important to

---

[322] The term permanent establishment as defined in Article 5 also includes a workshop, a mine, an oil or gas rig, a quarry, or other place of extraction of natural resources.it also includes a building site or construction or installation project which last for more than twelve months. For a further reading see also K Van Raad *Model Income Tax Treaties* (1983) at 17; J Law *Oxford Dictionary of Law* 8 ed (2015) at 456; GJH Smith *Internet Law and Regulation* 4 ed (2007) at 1092; M Ardizzoni *German Tax and Business Law* (2005) at 4059; E Riemer, N Urban & S Schmid *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective* (2011) at 15; A De Mestral & C Levesque *Improving International Investment Agreements* (2013) at 316; Vaidya *Globalization: Encyclopaedia of Trade, Labour and Politics* at 217.

note that a business may also exist where no premises are available or required for the purposes of carrying on of business.[323]

One of the most important considerations is that despite the fact that the place of business must be fixed (in that there must be a link between the activities and a specific geographical point),[324] it does not mean that the equipment constituting the place of business has to be actually fixed to the soil on which it stands. It only means that the enterprise has to be conducted through the establishment.[325] The notion that the business of the enterprise has to be carried out through the establishment means that the activities taking place in that place must be related to the business for which the permanent establishment was established.[326]

Even though permanent establishments play an important role in the smooth running of the business, it is, however, not without its own tax challenges in the context of e-commerce. Article 7 of the OECD Model Convention provides for shifting passive income taxation to the residence country while providing for source taxation of active income attributable to a permanent establishment by stating that a contracting state may not tax business profits therein unless they are attributable to a (PE).[327] This

---

[323] Paragraph 4 of the Commentary on Article 5 of the OECD 'Model Tax Convention'. See also E Kemmeren, DS Smit & P Essers *Tax Treaty Case Law Around the Globe 2014* (2015) at 20; Lang, Melz, Kristofferson & Ecker *Value Added Tax and Direct Taxation: Similarities and Differences* at 1032.

[324] M Lang, J Schuch & C Staringer *The Dependant Agents as Permanent Establishments* (2014) at 38; V Ramsey, A Minogue, J Baster & M O'Reilly *Construction Law Handbook* (2007) at 284; Riemer, Urban & Schmid *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective* at 32-4; K Olsen *Characterization and Taxation of Cross Border Pipelines* (2012) at 152.

[325] Paragraph 5 of the Commentary on art 5 of the OECD 'Model Tax Convention'; Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* at 73; C Malke *Taxation of European Companies at the Time of Establishment and Restructuring* (2010) at 68; T Althunayan *Dealing with the Fragmented International Legal Environment: WTO International Tax and Internal Tax Regulations* (2010) at 169.

[326] RL Doernberg, L Hinnekens, W Hekkerstein & J Li *Electronic Commerce and Multi-Jurisdictional Taxation* (2001) at 206; AR Kontrimas *International Expatriate Employment Handbook* (2006) at 683; Doernberg, Hinnekens, Hekkerstein & Li *Electronic Commerce and Multi-Jurisdictional Taxation* at 135; F Cao *Corporate Income Tax Law and Practice in the People's Republic of China* (2011) at 227; BM Harding *The Tax Law of Colleges and Universities* 3 ed (2008) at 443.

[327] OECD 'Model Tax Convention on Income and Capital' at 26; P Brundage & A Starchild *Tax Planning for Foreign Investors in the United States* (1983) at 116; M Rasmussen *International Double Taxation* at 137; Miller & Oats *Principle of International Taxation* at 211; R Brand *Fundamentals of International Business Transactions* (2000) at 1258; Rawal *The Taxation of Permanent Establishments: An International Perspective* at 50; C Parry, JP Grant and JC Barker *Parry and Grant Encyclopaedia Dictionary of International Law* 3 ed (2009) at 594; A Amatucci *International Tax Law* (2006) at 166.

does not accord with the fact that e-commerce takes place in cyberspace. However, the arcane concept of a PE as a fixed place, carrying on a business or trade, needs a fundamental rethink in the light of the e-commerce which makes it much easier to sell products into countries without using a subsidiary or a PE. There is a strong perception by the tax administrations that the permanent establishment definition is used or abused, to make sure the source countries do not collect appropriate revenue from the tax base.[328] This notion is more reprehensible if one takes into account that the operation of the PE concept fails to consider the impact brought by the e-commerce.

5.4.3 Failure by PE to Take into Account Virtual World of E-Commerce

The emphasis by the OECD Model on Tax and Capital on the physical requirement of a permanent establishment becomes a serious challenge in ensuring that the allocations between permanent establishment and its parent company are at arm's length within the e-commerce sphere.[329] This challenge is more cumbrous when the residence of the server which was used to conclude the transaction must be determined. One of the pertinent questions to be asked is whether a website or server which is used by a taxpayer to purchase goods from a connected non-resident person can be considered to be a permanent establishment of the enterprise. It must also be determined whether the activities carried out through the website or server constitutes carrying on of business activities which would result in a permanent establishment. Article 5 must be briefly analysed in an attempt to deal with these issues.

[328] OECD 'Report on the Attribution of Profits to Permanent Establishments' (2006); DV Bellan *Individuals Income Under Double Taxation Conventions: A Brazilian Approach* (2010) at 139; M Dalberg *Direct Taxation in Relation to the Freedom of Establishment and Movement of Capital* (2005) at 271; R Russo *The Attribution of Profits to Permanent Establishments: The Taxation of Intra-Company Dealings* (2005) at 468-469.

[329] Oguttu *Transfer Pricing and Tax Avoidance* at 150; JM Weiner *Company Tax Reform in the European Union from the United States and Canada on Implementing Formulary Apportionment in the European Union* (2006) at 106; V Tanzi *Globalisation, Technological, Developments and the Work of Fiscal Termites* (2000) at 16; Basu *Global Perspective on E-Commerce Taxation Law* at 135-136.

Before delving into the application of Article 5 principles,[330] it is necessary to briefly distinguish between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on that equipment. Furthermore, a distinction must be made between an internet website and a server. An internet website is a software and electronic data that is stored on the server and it allows an enterprise to interact with its customers, since this is not a physical shop or office as we know it, it is referred to as the 'virtual office'.[331]

The gist of Article 5 is that it considers a permanent establishment as a fixed geographical area where a business is carried out. This sentiment transaction taking place in the cyberspace or 'virtual world' as the latter does not exist within a specified geographical area. Permanent establishment does not relate to e-commerce carried but it is limited to activities covered by paragraph 4 of Article 5.[332] This means that the physical location where automated equipment is situated or operated may be considered to be a permanent establishment in the country where the equipment is situated.

Having put the objective of Article 5 into perspective, an attempt will be made to determine implications of the role of the websites, servers and the internet in the determination of the PE in relation to transfer pricing manipulation. The website is

---

[330] Article 5 of the OECD *Model Tax Convention on Income and on Capital' deals with Permanent Establishments.*

[331] Arnold & McIntyre *International Tax Primer* at 153; SA Cox M*anaging Information in Organisations: A Practical Guide to Implementing an Information Management Strategy* (2014) at 236; NO Dochartaigh *The Internet Research Handbook: A Practical Guide for Students and Researchers in the Social Sciences* (2002) at 120-122.

[332] Commentaries on the Articles of the Model Tax Convention 2010 at 111 para 42.7; Para 4 of art 5 provide that 'Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of good or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.'

clearly an intangible property which is incapable of being considered to be a fixed place of business as required by this Article. On the other hand, a server is an equipment (a physical one) on which the internet is stored; it can therefore be argued that a server may constitute a fixed place of business.[333] In other words, the server on which the website is stored and through which it is accessible, on the other hand, is a piece of equipment having a physical location and such location thus constitute a fixed place of business of the enterprise that operates that server. The problem is that even though the server can be located, it often very difficult to identify the parties to the transaction. In this way the cardinal feature of connected persons in transfer pricing becomes irrelevant. In most cases, the internet only identifies the person staging and maintaining the internet platform with no details of the persons involved in the transaction.[334] This makes it easy for the participants to disregard the arm's length and manipulate transfer prices very easily. Article 5 seems to implicitly suggest that the OECD is willing to apply the traditional concept of permanent establishment to e-commerce scenarios by linking the computer device to a physical location where it is operated.[335]

5.4.4 Jurisdictional Issues Relating to the Hosting of Websites

The hosting of a website typically would not cause an ISP to be a permanent establishment of its principal except where the business of an ISP is enmeshed in the business of its principal. An ISP would be treated as a dependent agent,[336] care must be taken that characterising an ISP as a dependent agent does not necessarily mean that the ISP is a permanent establishment of its principal.[337] According to the

[333] Oguttu *Transfer Pricing and Tax Avoidance* at 152; Riemer, Urban & Schmid *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective* at 125; Bardopoulos *e-Commerce and the Effects of Technology on Taxation: Could VAT be the e-Tax Solution* at 44; T Allmer *Critical Theory and Social Media: Between Emancipation and Commodification* (2015) at 152; H Bidgoli *The Internet Encyclopedia* Vol 3 (2004) at 69; CR Kalmanek, S Misra & YR Yang *Guide to Reliable Internet Services and Applications* (2010) at 557.
[334] Oguttu *Transfer Pricing and Tax Avoidance: Is the Arm's-length Principle Still Relevant in the e-Commerce Era* at 154.
[335] O Pastukhov International Taxation of Income Derived from Electronic Commerce: Current Problems and Possible Solutions' (2006) 12(2) *Boston University Journal of Science & Technology Law* at 319.
[336] The term 'dependent agent' is a treaty concept which refers to a person who acts on behalf of another person. For a further reading see: Sood *Cyber Law Simplified* at 359.
[337] P Rendahl *Cross-Border Consumption Taxation of Digital Supplies* (2009) at 304-305; C Reed *Internet Law: Texts and Materials* 2 ed (2004) at 238; WF Fox *International Commercial Agreements: A Primer on Drafting, Negotiating and Resolving Disputes* 4 ed (2009) at 207; J Singh *Regulation,*

Model Tax Treaty, a dependent agent can only be considered to be a permanent establishment if it exercises the authority to conclude contracts on behalf of its principal.[338]

From the foregoing analysis of article 5, it can be concluded that only a server (managed and controlled by the enterprise) can constitute a permanent establishment,[339] the Commentaries underline that 'computer equipment' at a given location may only constitute a permanent establishment if it meets the requirement of being fixed.[340] The additional requirement is that the server must be capable of being moved from one place to another.[341] It must be born in mind that what is relevant is not the possibility of the server being moved, but whether it is in fact moved. It is, then, essential to establish, on a case-by-case basis, what constitutes the reasonable period of time, provided for by the Model Convention, during which the server does not have to be moved in order to qualify as a PE. Taking into account the commentary on article 5,[342] the twelve months can be deemed to be a reasonable period for the purpose of making that determination. From a different perspective, tax authorities have to assess whether the business of the enterprise is (totally or partly) carried on at the location where the server is situated.

If one considers, in fact, that the company may have more servers located around the world, and that it can be difficult to keep track of the transactions made by the enterprise through these servers, then the chances of transfer pricing manipulation

---

Institutions and the Law (2007) at 77; Vaidya *Globalization: Encyclopaedia of Trade, Labour and Politics* 222; R Tassabehji *Applying E-Commerce in Business* (2003) at 234; C Cnossen & H Sinn *Public Finance and Public Policy in the New Century* (2003) at 413.

[338] Croome, Oguttu, Muller, Legwaila, Kolitz, Williams & Louw *Tax Law: An Introduction* at 42; AJ Cockfield *Globalization and its Tax Discontents: Tax Policy and International Investments* (2010) at 198; Lang, Schuch & Staringer *The Dependant Agents as Permanent Establishments* at 142; LA Low, DM Drory & PM Norton *International Lawyer's Deskbook* 2 ed (2002) at 193; Oberson & Hull *Switzerland in International Tax Law* at 109.

[339] OECD *Model Tax Convention on Income and on Capital, Condensed Version* at 104; C Reed *Internet Law: Texts and Materials* at 236; United Nations *Improving Resource Mobilization in Developing Countries and Transition Economies* (2002) at 65; Oberson & Hull *Switzerland in International Tax Law* at 110.

[340] OECD *Model Tax Convention on Income and on Capital, Condensed Version* at 104; McDaniel, Ault & Repeti *Introduction to United States International Taxation* at 186; C Gringas *The Laws of the Internet* (2003) at 406; A Christians, A Donaldson & PF Postlewaite *United States International Taxation* 2 ed (2011) at 205; AF Simpson & NS Kinsella *World Online Business Law* Vol 1 (2003) at 106.

[341] OECD *Model Tax Convention on Income and on Capital, Condensed Version* at 104.

[342] OECD *Model Tax Convention on Income and on Capital, Condensed Version at* 101.

using e-commerce cannot be ruled out. It must also be stated that it is very difficult to apply the arm's length principle to the dependent agents because they are excluded from the confines of the permanent establishment concept in terms of Article 5(4)*(e)* of the OECD Model Convention. In order to establish whether a server constitutes a fixed place of business, the presence of the enterprise's personnel must be verified. In this regard, the Commentaries clearly state that:[343]

> Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise is required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location where no personnel are in fact required to carry on business activities at that location.

In conclusion, a permanent establishment will be deemed to be present only when the following requirements are met: the enterprise carries on business through a website that has a server at its own disposal, in a fixed location and when the business of the enterprise is not of a preparatory or auxiliary nature. The first requirement presents serious challenges to apply the arm's length principle in e-commerce where the enterprise has no server at its disposal but still carries on e-commerce using servers belonging to third parties and does not even know where those servers are located. Secondly, it is problematic to determine if the business of the enterprise is auxiliary in nature as the parameters of this concept may differ from business to business and if the business is purely conducted through the internet, tax authorities have no way of knowing or classifying the business as auxiliary or preparatory. All these uncertainties may result in e-commerce enterprises supplying goods and services at prices which do not measure up to the arm's length standard and thereby avoiding paying taxes in a source country [344]

[343] OECD *Model Tax Convention on Income and on Capital, Condensed Version* at 104.
[344] WM Abdallah 'Critical Concerns in Transfer Pricing and Practice' at 4; Druica *Digital Economy Innovations and Impacts on Society* at 33; MG Rao & M Rakshit *Public Economics: Theory and Policy* (2011) at 290; S Dixit & AK *Sinha E-Retailing Challenges and Opportunities in the Global Marketplac*e (2016) at 281; AJ Mambi *ICT Law Book: A Sourcebook for Information and Communication Technologies and Cyber Law* (2010) at 149; B Paulos *Regulating Cross-Border E-commerce by Ethiopia: Prospects and Challenges* (2015) at 28; X Fan *Communications and Information in China: Regulatory Issues Strategic Implications* (2001) at 65.

The OECD came with OECD BEPS Action Plan 7 to deal with the abuse of the PE status.[345] In this regard, BEPS Action 7 addresses the artificial avoidance of PE status,[346] and contains three different categories of appropriate measures set to tackle the issue. The first measure addresses the commissionaire arrangements,[347] the second measure addresses avoidance through specific exemptions and the third addresses the fragmentation of business activities.[348] In the following paragraphs, the different proposals will be discussed in brief.

One of the exceptions provided for in Article 5(4) of the OECD Model Tax Convention is that fixed places of business for the purpose of storage, display or delivery of goods or fixed places of business which solely serve for the purpose of purchasing goods or collecting of information shall not be deemed as a PE.[349] A new condition is that the exceptions shall only apply if the listed activities have a preparatory or auxiliary character. In this way the OECD aims to affirm PEs especially in that countries where value-added activities are performed for a foreign associated enterprise.[350]

In order to prevent abuse in connection with preparatory or auxiliary activities a new provision has been added to Article 5(4) of the OECD Model Tax Treaty. This section provides that enterprises cannot fragment a cohesive operational activity into several small operations in order to argue that each is merely of a preparatory or auxiliary character (so-called"anti-fragmentation-rule").[351] For the purposes of determining whether or not a PE is constituted, all single activities should be regarded as a unit. If the single activities as a total cannot be considered as preparatory or auxiliary activities, the exemption in Article 5(4) of the OECD Model Tax Treaty will not apply.[352]

---

[345] OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports, available at http://www.oecd.org/tax/beps/beps-actions.htm .accessed on the 10 October 2018.
[346] I Kerschner & M Sonare *Taxation in a Global Digital Economy* (2017) at 191.
[347] OECD Revised Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status at 12. Available at http://www.oecd.org/ctp/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf, accessed on the 15 October 2018.
[348] Panayi *Advance Issues in International European Tax Law* at 99.
[349] OECD *Model Tax Convention on Income and on Capital* at 31.
[350] Ibid.
[351] Kerschner & Sonare *Taxation in a Global Digital Economy* at 203.
[352] OECD *Model Tax Convention on Income and on Capital* at 139.

The current Article 5(5) of the OECD Model Tax Treaty provides that an agency PE status is given where a person is acting on behalf of a foreign enterprise and has, and habitually exercises, in a contracting state an authority to conclude contracts in the name of the enterprise. The OECD noted that enterprises frequently misuse the current PE definition and thereby artificially avoid the PE status. To prevent the artificial avoidance of PE status the OECD suggested a comprehensive amendment of the definition of agency PEs in Article 5(5) and 5(6) of the OECD Model Tax Convention.[353]

The amendment is such that the authority to conclude agreements shall not longer be considered as a condition for a PE. The amendment further provides that the requirement that an agent shall act in the name of the principal should be eliminated in the requirements. The new definition does not require the agent to sign contracts in his own hand, according to the amendment, a contract is deemed to be concluded when the agent negotiates the essential elements and details of the contract that ultimately binds the principal.[354] This means that the condition for PE establishment is not only the conclusion of contracts, but also when the agent is acting as a principal to facilitate the conclusion of the contract. The essential consideration is that the principal must ultimately accept the negotiated terms and conditions by the agent without any significant changes and that shall be considered to be sufficient to establish a foreign PE.

Currently, the dependency of an agent is a positive condition for the constitution of a PE.[355] Previously an agent was deemed to be a dependent agent if the agent successfully negotiated business deals for another company under the auspices of the principal. The new definition of dependency has now been extended to provide that an independent agent is a person who acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related.[356] From the above, it can thus be concluded that an agent shall be deemed to be a dependent agent if the sales generated for the associated company exceed 90% of agent's overall sales.

[353] OECD/G20 Base Erosion and Profit Shifting Project Executive Summaries 2015 Final Reports at 7, available at http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf , accessed on the 16 October 2018.
[354] OECD *Revised Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status* at 18.
[355] OECD *Model Tax Convention on Income and on Capital* at 32.
[356] OECD *Revised Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status* at 18.

According to this analysis, commissioning activities are relevant, other activities such as proprietary trading or services are not relevant. The new Article 5 paragraph 6 of the OECD Model Tax Treaty now also contains an own definition for associated enterprises, enterprises shall be deemed as associated if one enterprise controls the other.

In responding to the broader international tax challenges, the 2015 OECD BEPS report considered tax policy options to deal with the challenges posed by the digital economy to international trade and tax. The policy options in relation to the digital economy were encapsulated in the OECD BEPS Action Plan 1. The 2015 report considered a new tax nexus concept of “significant economic presence”.[357] This concept was conceived in the OECD BEPS Action Plan 1. The concept entails that enterprises whose business model is fully digital and non-material would have a PE if the enterprise maintained a “significant digital presence” in the economy of a foreign state. The concept is still on its infantry state and cannot be regarded as a credible solution to the abuse of the PE status; it needs to be developed further. It would also require addressing the rules of profit allocation to branches. The current Article 5 paragraph 1 of the Motel Tax Convention, based on a relevant economic interpretation of what constitutes an “enterprise” can still allow the systematic and consistent identification of a “significant economic presence” for purposes of international taxation.[358] Furthermore, the” the use of a withholding tax on certain types of digital transactions is also another avenue.[359] Withholding of tax on certain digital transactions would necessitate new definitions as to what should be characterized as a “digital transaction” (or whichever wording may be used) as opposed to other transactions. This could possibly be a complicated process, as the digital element is more or less a part of every transaction these days. A common definition would be very important to avoid mismatch arrangements. Otherwise, this could produce a risk of artificial avoidance which impairs the effective enforceability of the system. This could also lead to double taxation.

[357] OECD/G20 Base Erosion and Profit Shifting Project Executive Summaries 2015 Final Reports, available at http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf , accessed on the 16 October 2018.

[358] OECD/G20 *Base Erosion and Profit Shifting Project Tax Challenges Arising from Digitisation-Interim Report* (2018) at 135.

[359] OECD/G20 *Base Erosion and Profit Shifting Project Tax Challenges Arising from Digitisation-Interim Report* at 139.

Withholding tax is similar to equalization levy (discussed below),[360] being revenue based (levied on gross value of the transaction). The possible disadvantages for this are that it may create a tax burden too high for the enterprise to handle. It could also impair the early growth of start-up companies, who tend to suffer heavy losses in a start-up phase. If this measure is implemented, these issues must be mitigated. Another possible challenge tied to withholding tax is its enforcement considering the way digital payments are made. Since such transactions are often made using credit cards or other electronic means, it would probably have to involve the cooperation of financial institutions. Even with the cooperation of financial institutions, the possibilities of anonymous payments may lead to difficulties in tracking the source of a payment,[361] for instance by the help of a Virtual Private Network (VPN – a service that allows you to disguise your whereabouts),[362] it is thus contended that withholding tax on digital sales is not the desirable way to tackle the long-term challenges posed by the digital economy. Digital equalisation levy is also an option in terms of the BEPS Action Plan. The equalization levy involves discriminating between foreign and domestic enterprises, leading to unequal treatment of taxpayers and this will certainly impair cross border trade. Equalization levy is revenue based,[363] meaning that it is levied upon the gross value of payments exiting the source state. Therefore, it could mean imposing a tax exceeding the net profit gained on the transaction. This does not resonate well with the ability-to-pay principle. It could make it harder for growing companies to expand into foreign markets. A worldwide implementation of this tax could thus impede the development and worldwide availability of new technology. None of these options was recommended for adoption, although it was acknowledged that countries could introduce any of these options in their domestic laws as additional safeguards against BEPS, provided they respected existing tax treaties and international obligations.

---

[360] OECD/G20 *Base Erosion and Profit Shifting Project Tax Challenges Arising from Digitisation-Interim Report* (2018) at 140.
[361] Davis Tax Committee Addressing Base Erosion and Profit Shifting in South Africa at 2. Available at http://www.taxcom.org.za/docs/New_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf accessed on the 10 October 2018.
[362] O Kolesnikov & B Hatch *Building Linux Virtual Private Networks (VPNs)* (2002) at 4.
[363] Kerschner & Sonare *Taxation in a Global Digital Economy* at 22.

The Action Plan is laudable in addressing the tax challenges of the digital economy but this action plan offers little guidance on the practical steps which can be taken to deal with this problem except to ask OECD member states to 'establish international coherence in corporate income taxation. This international consensus is yet to materialise, some of the reasons for this impasse are that there is no obligation for member countries to include these recommendations into their national laws, there is competition between tax jurisdictions for revenue generated by the digital economy and there is no international consensus on whether digital businesses should be treated separately for tax purposes or as part of a common framework applying to all businesses.

The South African transfer pricing regime is fully dealt with in chapter 6 below but it should be mentioned here that in order for South Africa to effectively deal with the abuse of PE status, provisions dealing with PE must be aligned to OECD BEP Action Plan 7 to the effect that future tax treaty negotiations must take into account recommendations dealing with fragmentation of activities and avoidance of permanent establishment status through specific activity exemptions.

5.4.5 Transfer Pricing Documentation in Relation to E-Commerce

Documentation for transfer pricing purposes is controversial even in the conventional areas of commerce due to cost and availability problems. E-Commerce documentation is just another minefield.[364] The current documentation requirements do not adequately address the challenges posed by the advent of electronic commerce because tax administration does not have the legal framework and the resources to trace and monitor e-commerce transactions as they mostly take place in private spaces like homes and company offices far from the eye of the auditors. The recommendation of the Committee on Fiscal Affairs is that revenue authorities should monitor developments in electronic commerce to see whether additional guidance on the application of the guidelines is necessary and update their policies to keep up with the e-commerce.[365] Existing guidance on documentation

[364] Abdallah *Critical Concerns in Transfer Pricing and Practice* at 12.
[365] OECD 'Taxation and Electronic Commerce Implementing the Ottawa Taxation Framework Conditions' at 232; OECD 'Consumption Tax Trends 2006: VAT/GST and Excise Rates, Trends and Administration Issues' (2006) at 113; Qin *Introduction to E-commerce* at 133.

requirements needs to be revised for businesses engaged in electronic commerce in order to ensure the availability of transactional data. The revision of documentation requirements can be achieved through the promulgation of rules relating to e-commerce. In order to deal with this problem, an amendment of section 31 to align with the Electronic Communications and Transactions Act 25 of 2002 is required to control and monitor electronic cross-border transactions.

5.5 Administrative Challenges of Transfer Pricing

In addition to the general challenges facing the transfer pricing, there are administrative challenges faced by both the taxpayers and tax administrations alike.[366] Two main administrative challenges are identified, it must, however, be stressed that the list of administrative challenges is non-exhaustive, but the discussion will be confined to these two for the purposes of this study. The challenges are: documentation requirements issues and the lack of skills by the tax administrations. These issues are dealt with as follows:

5.5.1 Issues Relating to Documentation Requirements

Tax authorities (SARS included) worldwide are increasingly imposing new and stricter transfer-pricing documentation requirements on taxpayers and failure to comply can result in significant penalties.[367] To cope with this burden, it is essential that taxpayers have in place an efficient framework for producing the documentation required to defend their transfer pricing decisions. The general guidance for tax administrations in developing rules and procedures on how to obtain documents in connection with a transfer pricing inquiry are dealt with in Chapter 5 of the transfer pricing guidelines.[368] In most cases, documentation obligations are governed by the national laws of a particular country.

---

[366] C May *Global Corporate Power* (2006) at 116; W Schon, U Schreiber & C Spengel *A Common Consolidated Corporate Tax Base for Europe* (2008) at 95; IBFD *Bulletin for International Taxation* Vol 63 (2009) at 329; Muchlinski *Multinational Enterprises and the Law* Colorado at 277-279.

[367] Markham *Transfer Pricing for Intangibles* at 159; Wittendorf *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 10; Tang *Intrafirm Trade and Global Transfer Pricing Regulations* at 24.

[368] OECD *Transfer Pricing Guidelines* at 229. For further discussion on this issue see also BF Bobo *Rich Country: The Multinational as Change Agent* (2005) at 32; Emmanuel & Mehafdi *Transfer Pricing* at 35; Giovannini, Hubbard & Slemrod *Studies in International Taxation* at 77; Hooper, Uddin, Tsamenyi & Wickramasinghe *Handbook of Accounting and Development* at 270.

It is important to note that in considering whether documentation is adequate for the transfer pricing inquiry, a tax administrator should have due regard to the extent to which that information could reasonably have been available to the taxpayer at the time that transfer pricing was established.[369] Requiring taxpayers to provide substantial amounts of information that cannot possibly be useful to a local tax authority in achieving its compliance objectives may be costly to the MNEs. Therefore, it is in the interest of both taxpayers and tax authorities to limit the provision of information to that which is potentially useful.[370] The information relevant to an individual transfer pricing enquiry depends on the facts and circumstances of each case.[371] It is therefore not possible to define in any generalised way the precise extent and nature of information that would be reasonable for the tax administration to require, and for the taxpayer to produce at the time of examination but the law must be developed to set a primary set of documents can be used for transfer pricing purposes.[372]

The other challenge relating to request for information has to do with tax administrations asking for documents which are not in possession or control of the taxpayer. A good example is the request of information that cannot be legally obtained or that is not actually available to the taxpayer because it is confidential to the taxpayer's competitor or because it is unpublished and cannot be obtained by normal enquiry or market data.[373] The insistence by the tax administration to obtain

---

369 OECD *Transfer Pricing Guidelines* at 230; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 218; Paisey and Li Tr*ansfer Pricing: A Diagrammatic and Case Study Introduction, with Special Reference to China* at 109; Bakker & Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 70; Wundisch *International Transfer Pricing in the Ethical Pharmaceutical Industry* at 296; C Devonshire-Ellis, A Scot & S Woollard *Transfer Pricing in China* 2 ed (2011) at 28-30.
370 OECD *Transfer Pricing Guidelines* at 237.
371 Johnson *US Transfer Pricing Sourcebook* at 13; Markham *Transfer Pricing of the Intangibles* at 186; Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* at 469; Lang, Melz, Kristofferson & Ecker *Value Added Tax and Direct Taxation: Similarities and Differences* at 872; Rosenow & O'Shea *A Handbook on the WTO Customs Valuation Agreement* at 86; Pogge & Mehta *Global Tax Fairness* at 165.
372 OECD *Transfer Pricing Guidelines* at 236 provide that the need for the documents should be balanced by the costs and administrative burdens, particularly where this process suggests the creation of documents that would not otherwise be prepared or referred to in the absence of tax considerations. Documentation requirements should not impose on taxpayers' costs and burdens disproportionate to the circumstances.
373 OECD Transfer Pricing Guidelines at 240; H Jochum, P Essers & J Englisch *Taxing German-Dutch Cross-Border Business Activities: A Legal Comparison with Particular Focus on the New*

the information under these circumstances may result in the fabrication or manipulation of the required information in order to ward off the tax administration's demands.

The information that the OECD has identified as necessary to ensure transfer pricing compliance is often highly confidential and proprietary, and therefore ensuring the confidential treatment of this information is critical.[374] This includes not just preventing public disclosure, something that a number of MNEs have expressed great concern over, but also disclosure to people within the MNE that are not authorised to see the information, or disclosure to people within the tax authority that have no need to see the information in carrying out their duties. Some problems associated with digital documentation are with respect to protection of intellectual property and competitive strategies, compliance with local privacy laws, and management of information disclosures in legal actions unrelated to any tax issue.[375] All these issues may cause the MNE to be reluctant to provide required information and this may hamper the tax authority's efforts to deal with transfer pricing manipulation issues.

Compliance costs for taxpayers are significantly increased by inconsistent documentation requirements around the world.[376] Inconsistency leads to tailoring, or substantial re-working of documentation at additional cost, often with limited probative value. This inconsistency can easily lead to manipulation of prices in order to avoid the cost of documentation, especially within the e-commerce space because

---

Bilateral Tax Treaty (2015) at 396-397; Bakker & Levey *Transfer Pricing and Dispute Resolution* at 54.

374 OECD 'OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Documentation and Country by Country Reporting' (2014) at 24; M Lang, J Liu & G Tang *Europe-China Tax Treaties* (2010) at 46.

375 OECD 'OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Documentation and Country by Country Reporting' at 24-25; DM Webber *Europe Direct Taxation: Case Law and Regulation 2010* 2 ed (2010) at 1327; A Hoogvelt, AG Puxty & JM Stopford *Multinational Enterprises: An Encyclopaedia Dictionary of Concepts and Terms* (1987) at 229.

376 Lang *Tax Compliance for Companies in an Enlarged European Community* at 178; Schafer *International Company Taxation in the Era of Information and Communication Technology* at 11; Ishikawa *Firms' Location Selection and Regional Policy in the Global Economy* at 86; JA Roth & JT Scholtz *Taxpayer Compliance An Agenda for Research* Vol 1 (1989) at 89; Mayer *Formulary Apportionment for the Internal Market* at 16; H Aaron & J Slemrod *The Crisis in Tax Administration* (2004) at 180.

there are currently no adequate mechanisms to monitor the digital exchange of documents.

The analysis of the documentation requirements in transfer pricing will not be complete without discussing OECD BEPS Action Plan 13.[377] In summary, the OECD BEPS Action Plan 13 aims to:[378]

(i) ensure that taxpayers give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between associated enterprises and in report the income derived from such transactions in their tax returns;
(ii) provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and
(iii) Provide tax administrations with useful information to conduct thorough transfer pricing audit of entities within their jurisdiction.

According to this Action Plan, countries should adopt a standardized approach to transfer pricing documentation that includes the three-tiered structure that encompasses a Master file, a Local file and a Country-by-Country Report ("CbC Reporting").[379] MNEs to provide tax administrations with high-level information regarding their global business operations and transfer pricing policies in a "Master file" that must be made available to all relevant tax administrations. Secondly, guidelines also require that detailed transactional transfer pricing information relating to party transactions, the amounts involved in those transactions and the company's analysis of the transfer pricing determinations they have made with regard to those transactions and a comparability analysis be accessible to all relevant parties.[380] Thirdly, the newly introduced CbC Report requires tax administrations to perform high-level transfer pricing risk assessments which include the investigation of other BEPS-

[377] The OECD BEPS Action Plan 13 requires the development of "rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template".
[378] OECD *Transfer Pricing Guidelines* at 233.
[379] OECD *Transfer Pricing Guidelines* at 235. See also OECD Revised Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status at 37.
[380] Ibid.

related risks.[381] The CbC Reporting template will require multinational enterprises to provide annual reports on their transfer pricing activities for each jurisdiction in which they do business. This will also include the aggregated information relating to the global allocation of the multinational enterprises income and taxes paid. It is hoped that this will provide a clear overview of where profits, sales, employees and assets are located and where taxes are paid and accrued. According to the final version of BEPS Action 13 there would be an exemption from the general filing requirement for multinational enterprises, however the extent of the exemption will differ from country to country as that will be regulated by individual national legislation.

Apart from the positive spin-offs that can be gained from the implementation of BEPS Action 13, there are compliance issues which can stifle the successful implementation of the Action Plan.[382] Some of those issues are:

(i) The unilateral replacement of the current framework could result in global tax chaos marked by the massive re-emergence of double taxation.
(ii) The nature of the BEPS outputs do not have legal obligation. They are soft legal instruments and are not legally binding. There is an expectation that they will be implemented into law by countries that are part of the consensus but there is no guarantee for that commitment.
(iii) Development of expertise to respond properly to information requests issued by tax authorities concerning the transfer prices applied, particularly in respect to information with reference to other tax jurisdictions; this will have a negative financial effect in the appointment of extra personnel.
(iv) The interaction between the Master file, Local file and CbC Reporting requires a consistent transfer pricing position. MNEs that have not implemented a harmonized transfer pricing approach within the group must standardize and specify their transfer price directives, once again this is costly and it may not happen in some instances because countries are not obliged to implement.

[381] OECD *Transfer Pricing Guidelines* at 235-236.
[382] OECD Country by Country Reporting Handbook on Effective Tax Risk Assessment at 47, available at http://www.oecd.org/ctp/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf, accessed on the 20th October 2018.

The information in the CbC Report on its own does not constitute conclusive evidence that transfer prices are or are not appropriate. For this reason, the legitimate concern remains that tax administrations will use the CbC Reporting to propose adjustments on basis of a formula income allocation and not just for risk assessments.

5.5.2 Lack of Skills and Resources

The transfer pricing practice and the lack of skills and resources are synonymous because tax administrations in many developing countries (South Africa included) lack suitably qualified personnel needed to monitor trade between related enterprises in a way that will ensure compliance with legislative provisions.[383] The tax administration may have the best transfer pricing laws but that will not solve the problem if the people who are supposed to implement those laws are not skilled or adequately resourced. One of the major causes of the lack of skills is that its personnel have less relevant industry knowledge and are sometimes not very focused subject specialists when compared to their counterparts in the major tax firms as the latter only focus on transfer pricing.[384] The skills gap in transfer pricing is due to the fact that tax administrations have become the training ground of transfer pricing specialists who are recruited by the private firms with more resources than the tax administrations.[385]

Both developed and developing countries are extremely challenged by the complexity and volume of transfer pricing audits. Where there are poor skills, good transfer pricing legislation can be easily undermined by poor administration owing to the lack of proper transfer pricing skills. In some instances, tax administration does possess some skills to deal with transfer pricing issues but the inconsistent and aggressive application of the law usually negates the existence of such skills. For example, an inconsistent and overly aggressive administration may increase

---

[383] WR Thirsk *Tax Reform in Developing Countries* Vol 235 (1999) at 382; Hooper, Uddin, Tsamenyi & Wickramasinghe *Handbook of Accounting and Development* at 265; B Currie-Alder, R Kanbur, DM Malone & R Medhora *International Development: Ideas, Experience and Prospects* (2014) at 265.

[384] OECD 'Dealing Effectively with the Challenges of Transfer Pricing' (2012) at 58.

[385] OECD 'Dealing Effectively with the Challenges of Transfer Pricing' 89; United Nations *World Investment Report 2007 Transnational Corporations* (2007) at xxiv; Caves *Multinational Enterprises and Economic Analysis* 2018; OECD 'African Economic Outlook 2010' (2010) at 101; B McKern *Transnational Corporations and the Exploitation of Natural Resources* (1993) at 18.

uncertainty and compliance costs for taxpayers and result in instances of unrelieved economic double taxation, thus negatively affecting both the perception of the country's transfer pricing regime and its investment climate. Ineffective administration, on the other hand, may result in decreased tax revenues, if, for example, multinational enterprises assess the tax administrations' transfer pricing capabilities as lacking and adjust their transfer pricing policies in such a way that the tax administration will not cope with the transfer pricing audits. To deal with the inability to retain skills, the tax administration (SARS) should attempt to pay competitive salaries and improve the working conditions of the transfer pricing officers.

Continuous training and exchange programmes and benchmarking with other countries will also help to increase their exposure and improve efficiency. Since transfer pricing manipulation is a serious problem, it is recommended that s 31 should be amended to clearly set out the powers and duties of the transfer pricing officers, meaning that their powers and functions must specifically be drawn from the law. Once this is achieved, it will directly affect the kind of training that they should achieve which in turn will determine the qualities that a South African transfer pricing officer should have in order to be admitted in the transfer pricing team. It is important to deal with these administrative problems because it doesn't matter how well drafted s 31 is; if all these problems are not removed it will be difficult to properly administer it.

5.6 Conclusion

There are many factors which contribute to transfer pricing manipulation, some of those have to do with inadequate legislative framework and some have to do with administrative problems. Problems that are caused by the inadequacy of the legislative provisions can be solved by developing the law to deal with those problems. The relevant OECD BEPS Action Plans will help to shape the promulgation of the envisaged laws. The lack of comparable data cannot be solved by any legislation but by the openness of MNEs in their tax affairs and business dealings. It is hoped that the international consensus which is advocated by the OECD in the action plans will be materialised despite the competing aspirations for the tax base especially in the digital economy. Procedures around the generation and submission of documents can be improved by aligning section 31 with Chapter 4 of the TAA to prescribe the types of primary records that can be kept for transfer pricing purposes. The recommendations of BEPS Action 13 have already been made part of South African law as it is discussed in chapter 6 below. The recommendations regarding the effects of e-commerce are fully discussed in chapters 6 and 9 but it is mentioned here in passing that an adequate legislative framework is required to deal with the implications of e-commerce on the collection of revenue. Once again, the recommendations of the OECD BEPS Action Plan 1 and 7 should be seriously considered to improve the taxing of the digital economy. Section 31 should be amended to give transfer pricing officers' special statutory auditing powers which will empower them to perform their functions. The Indian perspective will be explored in chapter to provide guidance on how transfer pricing officers can be empowered in South Africa. It is also important to develop internationally shared principles between taxpayers and tax authorities to fight abusive transfer pricing.

CHAPTER 6

TRANSFER PRICING IN SOUTH AFRICA

6.1 Introduction

It has been shown in Chapter 1 that transfer pricing manipulation is a scourge that erodes the tax base and results in significant loss of tax revenue. In chapters 2 to 5, various problems that contribute to the transfer pricing manipulation have been highlighted. This chapter will therefore discuss the South African transfer pricing legislation (section 31) in light of the analysis that has already been done in the previous chapters. This chapter examines whether section 31 contains features or qualities which are potent to deal with transfer pricing manipulation. An attempt is made to highlight challenges that may contribute to transfer pricing manipulation in relation to the legal framework in section 31. The other purpose of this chapter is to investigate any weaknesses of section 31 with the view to provide mechanisms which will strengthen the law to withstand the manipulation. In a nutshell, this chapter will broadly deal with the history of transfer pricing in South Africa, the features of the South African transfer pricing regime and the challenges contributing to transfer pricing abuse or manipulation in South Africa.

6.2 History of Transfer Pricing in South Africa

Transfer pricing legislation has been part of South African law since 19 July 1995. In August 1999 the South African Revenue Service (SARS) 'Practice Note 7' was introduced as SARS' guideline on the transfer pricing practice in South Africa.[386] South Africa's transfer pricing and thin capitalisation regimes are contained in section 31 of Act 58 of 1962 to counter transfer pricing practices which may have adverse tax implications for the South African fiscus.[387] The main objective of section

[386] Manyaka *Prescriptiveness of the South African Transfer Pricing Tax Legislation in Providing Guidance on How to Transact at Arm's Length Price* at 16.
[387] SARS 'Practice Note 7' at 7.

31 is described in the following manner by the Explanatory Memorandum on the Income Tax Bill, 1995:[388]

> Section 31 will be used to address tax avoidance schemes involving the manipulation of prices for goods and services under cross-border transactions between connected persons.

Since its enactment, section 31 has gone through a series of amendments to refine the law and to ensure easy application. Some of the amendments include the addition of the word 'group of companies' in the connected persons' definition as contained in section 1 and the then section 31(2) of the Act. This amendment became effective on 1 January 2007. On 1 October 2007, section 31 was amended to remove the term international agreement. The most notable amendment was done in 2010 in terms of the Taxation Amendment Act 7 of 2010 and subsequently by Taxation Laws Amendment Act 24 of 2011. Some of the changes will be discussed when dealing with the salient features of the South African transfer pricing system. All the changes were in the main meant to align the South African transfer pricing rules with the wording of Article 9 of the OECD 'Model Convention on Income and Capital and the transfer pricing guidelines'.[389]

6.3 The Arm's Length Principle in South Africa

The South African transfer pricing regime is based on the arm's length principle. Both sections 1 and 31 of the Income Tax Act; do not define the arm's length principle. The application of this concept is however clearly articulated in the wording of the provision and in particular the heading of the section which provides that:

> Tax payable in respect of international transactions to be based on arm's length principle.

The application of the transfer pricing principle in South Africa is in terms of section 31(1) of the Act which provides that 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

[388] Clauses 23-27 of the Explanatory Memorandum on the Income Tax Bill 1995.
[389] Olivier & Honiball *International Tax: A South African Perspective* at 665. See also SAICA 'Transfer Pricing 2044, New Rules' available at https://www.saica.co.za/integritax/2012/2044._New_rules.htm, accessed on 10 May 2016.

and transacting at arm's length. Section 31(2) provides for the application of the arm's length principle if the term or condition results in a tax benefit for a party to the transaction. This provision also provides that the tax payable by the benefitting party must be calculated as if the transaction had been concluded between independent parties transacting at arm's length. Section 31(4) provides for the application of the arm's length principle in cases of excessive financial assistance between connected persons. Since the arm's length principle is not defined for the purposes of section 31 or the South African tax law. It is thus assumed that this concept carries the same meaning it has under Article 9 of the OECD Model Tax Convention and its commentary. In South Africa, the determination of the arm's length principle is based on the OECD transfer pricing methods which are: the comparable uncontrolled price method, resale price method, cost plus method, transactional net margin method and the profit split method. Section 31 does not directly refer to these methods but their application can be inferred by the reference to the arm's length principle by section 31. This lack of reference to the methods is due to the fact that section 31 does not prescribe how the transfer prices are determined except to say that that the arm's length principle must be used in that determination. Section 31 or any tax treaty entered into by South Africa does not prescribe any particular methodology for the purpose of ascertaining an arm's length consideration. Transfer pricing methods are however directly referred to in the SARS Practice note 7. [390] In *SIR v Downing*,[391] the court held that South Africa is bound to take cognisance of the guidelines for interpretation issued by the OECD in its commentaries on the concepts used in the OECD Model Tax Convention. In this regard Corbett JA said:

> The terms of the convention are evidently based upon a model convention contained in the 1963 report of the fiscal committee of the Organisation for European Economic Cooperation and Development (O.E.E.C.D.). This model has served as the basis for the veritable network of double taxation conventions existing between this country and other countries and between many other countries *inter se.*

A full exposition of the South African transfer pricing methods will not be undertaken here because these methods bear the same nature and characteristics of the OECD

[390] SARS Practice Note 7 at 13.
[391] *SIR v Downing* 1975 (4) SA 518 (A) at 523A.

transfer pricing methods as discussed in chapter 3 of this work. It is important to note though that the SARS Practice Note 7 does not impose any hierarchy for the transfer pricing methods. However, there is in effect some kind of hierarchy, in that certain methods may provide more reliable results than others, depending on the quality of available data and the taxpayer's circumstances.[392] The lack of hierarchy implies that the most appropriate method in a given case will depend on the facts and circumstances of that particular case taking into account the reliability of data used to conduct the comparability analysis be applied to determine a transfer price. SARS Practice Note 7 further provides that the most reliable method will be the one that requires fewer and more reliable adjustments to be made. This means that taxpayers are not be required to undertake an intricate analysis of all the methodologies, but should have a sound basis for using the selected methodology. This could entail providing reasons why secondary methods are not appropriate.[393] It is important to note that section 31 and the SARS Practice Note do not refer to the use of alternative methods. This means that alternative methods like the global formulary method does not form part of the South African transfer pricing landscape. This method has been rejected by both the OECD and its member countries.

6.4 Features of the South African Transfer Pricing Regime

Before dealing with the challenges facing the South African transfer pricing regime, it is important first to describe the features that make up the South African transfer pricing system. As already mentioned, these features are based on the OECD transfer pricing guidelines. The features are non-exhaustive but for the purposes of this research the features of the South African transfer pricing system are discussed as follows:

6.4.1 International Transactions

The heading of section 31 essentially provides that: [394]

> tax payable in respect of international transactions to be based on arm's length principle.

---

[392] SARS Practice Note 7 at 13.
[393] SARS Practice Note 7 at 13.
[394] Section 31 is a voluminous provision. In the interest of space and word count limitations of the thesis it cannot be quoted in full in the text, but relevant subsection will be quoted verbatim where necessary in this chapter or elsewhere in the subsequent chapters of this research.

The heading of this provision clearly indicates that section 31 is only applicable to international transactions. In the current section 31, the term international transaction does not appear nor is it defined for the purposes of this section. Section 31 which was in force until 31 March 2012 also did not define the term international transaction but contained the term international agreement in section 31(1). The international agreement that is referred to in this provision may be inferred to mean an affected transaction as defined in the current section 31 of the Income Act.

The exclusive regulation of international transactions does not take into account the possible existence of domestic transfer pricing manipulation. The effect of confining section 31 to international transactions is that domestic transfer pricing transactions are not covered by section 31 and therefore not regulated. Although it may be inferred that the term international transactions as used in the section may be referring to affected transactions as defined, it would help for the sake of clarity to specifically use the term international transactions as it is used in the heading. The use of the term "international transactions" in the heading and 'affected transaction' in the body of the provision may cause interpretational difficulties and ambiguity. Even though in *Mankayi v AngloGold Ashanti Limited*,[395] the Constitutional Court held that where the meaning of a statutory provision is unclear, courts may have regard to the heading of the relevant section, it is however important for inherently complicated provisions like section 31 to be couched in simple language. Despite the problems highlighted here, the critical thing is that transfer pricing in South Africa is only applicable to international transactions.

6.4.2 Affected Transactions

Section 31(1)*(a)* refers to an affected transaction as a transaction, operation, scheme, agreement or understanding which has been directly or indirectly entered into or effected between or for the benefit of either or both residents and non-resident persons. An affected transaction may refer to a relationship between a PE and its foreign head office. An example would be a South African business operating in a foreign jurisdiction through a company jointly owned with a local joint venture partner, where the contributions to be made by the joint venture partners and the

[395] *Mankayi v AngloGold Ashanti Limited* 2011 (3) SA 237 (CC) at para 101.

remuneration thereof are negotiated in terms of the joint venture agreement. In these scenarios, the joint venture partners might agree to provide goods or services at a price that is not necessarily an arm's length price for commercial purposes. The implications of this kind of an example are fully discussed in paragraph 5.5.4 where the implications of OECD BEPS Action plans 7, 8, 9 and 10 are analysed.

The terms transaction, operation, scheme, agreement or understanding although used to define the term affected transactions, are not specifically defined in section 1 or 31 of the Income Tax Act but they are included in the definition of the word ‘arrangement’ in section 80A-L of the Act which deals with the impermissible tax avoidance arrangements. Given the argument that the impermissible tax avoidance concept cannot be used to define and analyse the transfer pricing concept; it is doubtful if the definitions in section 80A (GAARs) would be appropriate in relation to section 31 (SAAR).

The term ‘scheme’ which is one of the concepts mentioned in section 80L was judicially considered in two South African cases. In the case of *Meyerowitz v CIR*,[396] the court held that the word ‘scheme’ has a wide scope and could be applied if, viewed as a whole, the steps taken were so connected with the other that they led to an avoidance of taxation. In the *CIR v Louw* case, it was held that the term ‘scheme’ is wide enough to cover situations in which later steps in a course of action were left unresolved at the outset.[397]

The terms ‘agreement’ and ‘understanding’ are a recently added component of section 31 and since they are not expressly defined in the Act, it remains to be seen how the courts will interpret them in future. The term understanding refers to the meeting of minds;[398] it means that there must be a consensus between parties as to the nature and the consequences of their arrangement. The term understanding is wide ranging in application and interpretation (both legally and factually) as it includes a non-exhaustive list of items such as any form of side letters, verbal

[396] *Meyerowitz v CIR* 1963 (3) SA 863 (A) 25 SATC 287 at 300.
[397] *CIR v Louw* 1983 (3) SA 551 (A) 45 SATC 113 at 134.
[398] AP De Koker & RC Williams *Silke on South African Income Tax* (2012) at 36.

understanding,[399] gentlemen's agreement and any kind of letter of wishes.[400] The agreements may be verbal, written or tacit as long as the arrangement can be proven to fall within the definition of section 80A.

The phrase 'directly and indirectly entered into' in the context of section 31 is not defined by the Income Tax Act. Ordinary rules of interpretation may be used to interpret these terms. Since section 31(1)*(a)* clearly provides that both direct and indirect transactions are taken into account for transfer pricing purposes,[401] it can be inferred that the adjustments may be conducted in situations where a matter relates directly to a transfer pricing transaction or to an indirect transfer pricing transaction as long as a taxpayer has derived an unwarranted tax benefit.[402]

The previous transfer pricing provisions under the then section 31(2) referred to the supply of goods and services and no reference was made to transactions entered into 'directly or indirectly'.[403] The introduction of the word 'indirectly' to the section further widened the scope of transfer pricing provisions.[404] The word implies that the Commissioner of SARS is not only entitled to probe a specific transaction[405] but may also analyse the economic substance of the entire relationship between connected persons.[406] Any transactions, including those of third parties which may influence the price of the transaction between connected persons, may also be subjected to a transfer pricing audit.

399 D Clegg & R Stretch *Income Tax in South Africa* (2009) para 26.3.2.
400 L Olivier, DM Davis & D Uruquhart *Juta's Income Tax* (2009) at 80A-4. See also SARS 'Draft Comprehensive Guide to the General Anti-Avoidance Rule' at 14.
401 Section 31(1)*(a)* of the Income Tax Act. See also Olivier & Honiball *International Tax: A South African Perspective* at 662.
402 Section 31(2)*(b)*(ii) of the Income Tax Act deals with 'tax benefit' in the context of transfer pricing. See also Brodbeck *International Transfer Pricing Journal* (2010) at 378.
403 Section 31(1)*(a)* of the Income Tax Act. See also Edward Nathan Sonnenbergs 'International Tax, Transfer Pricing' available at http://www.saica.co.za/integritax/2010/1901.-transfer-pricing.htm, accessed on 11 May 2016.
404 Section 31(1)*(a)* of the Income Tax Act. See also Webber Wentzel 'Changes to South African Transfer Pricing Legislation' available at http://mailstreams.cambrient.com/admin/mailer_instance/view.jsp, accessed on 26 May 2016.
405 Ibid.
406 Section 31(1)*(a)* of the Income Tax Act. See also Olivier & Honiball *International Tax: A South African Perspective* at 662 and Webber Wentzel 'Changes to South African Transfer Pricing Legislation' available at http://mailstreams.cambrient.com/admin/mailer_instance/view.jsp, accessed on 26 May 2016.

The introduction of indirect transactions concept in South Africa was partly influenced by a recent United Kingdom court case on transfer pricing: *DSG Retail Limited v HMRC.*[407] This case is persuasive in the sense that SARS may adjust indirect transactions involving third parties if they deem the transaction not to meet the arm's length standard. In this case, the HMRC successfully argued that DSG had entered into third-party agreements based on the mutual understanding that the third party would reinsure or insure with DISL. The HMRC also succeeded in arguing that had the transaction been entered into between third parties, DISL would have had to compensate DSG for the point of sale advantage. It was reasoned that because DISL benefited from insurance contracts sold within DSG stores, such benefit should be charged for on an arm's length basis.[408] The introduction of indirect transactions to determine the arm's length is a double-edged sword as it gives wide powers to the commissioner whilst it can be exploited to include aspects of the transaction which are not relevant to distort the true nature of taxpayers' transactions.

6.4.3 Connected Persons for Transfer Pricing Purposes

In chapter one it has been mentioned that Transfer pricing takes place between related or connected persons. The connected person's concept in this work is analysed in relation to companies since the research is confined to company transactions. In terms of section 1(d)(i) and section 1(d)(v) a connected person in relation to the company means:

> Any other company that would be part of the same group of companies as that company if the expression 'at least 70 per cent of the equity shares in' in paragraphs (a) and (b) of the definition of 'group of companies' in this section were replaced by the expression 'more than 50 per cent of the equity shares or voting rights in';
>
> Any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company and no holder of shares holds the majority voting rights in the company.

The definition of a connected person as set out in section 1(d) as it relate to a company is a connected person in relation to another company that would form part of the same group of

[407] *DSG Retail Limited v HMRC* [2009] STC (SCD) 397 at 48 para 15-40. See also KPMG 'South Africa-Current Transfer Pricing Trends and Challenges' available at http://www.kpmg.com/global/en/issuesandinsights/articlespublications/taxnewsflash/pages/south-africa-transfer-pricing-trends.aspx, accessed on 26 May 2016.

[408] Section 31(1)*(b)* and section 31(3) of the Income Tax Act.

companies if the expression “at least 70%” with reference to shareholding in the definition of a “group of companies” was replaced by the expression “more than 50%”. To put this in context, the definition of a “group of companies” also has a different meaning depending with which part of the Act one works. The first step is to determine the appropriate definition of a “group of companies”, and then apply the 50% exception to that definition to determine whether or not one complies with the first test of the “connected person” definition. The second test for a company in relation to another company is that company will be a connected person if at least 20% of the equity shares in the company are held by that other company, and no shareholder holds the majority voting rights in the organisation. This seems straightforward to determine but there are exceptions. For transfer pricing purposes, transactions relating to intellectual property and knowledge, the phrase “and no shareholder holds the majority voting rights in the company”, should be disregarded. This has the effect of lowering the threshold of a connected person for purposes of specified transfer pricing provisions. The disregarding of the phrase took effect from 2011 and it applied to all transactions, thus expanding the potential application of transfer pricing provisions. These two tests apply in circumstances where there is a direct shareholding. Where there is no direct shareholding, a company will be a connected person in relation to another entity if such other entity is managed or controlled (more than 50% shareholding) by any person who or which is a connected person in relation to such company. The final twist in this complicated situation is that the connected person test must be applied in converse. Therefore, if company B is a connected person in respect of company A, company A will automatically be a connected person in relation to company B. Before October 2011, this explanation could be depicted by the following illustration:

Company A (A) holds 60% of the shares in company B (B) and 40% of the shares in company C (C). The other 60% of the shares in C are held by one shareholder. We need to establish whether C is a connected person in relation to B. For purposes other than transfer pricing, B will be a connected person in relation to A, as A holds more than 50% of the shares in B. C will not be a connected person in relation to A as, despite A holding more than 20% of the shares in C, the other shareholder in C holds the majority. As A does not control C, C is not connected to B, and B is also not connected to C. after October 2011 the illustration is as follows:

A will be connected to B as it holds more than 50% of the shares in B. A will also be connected to C as it holds more than 20% of the shares in C and the requirement for the lack of majority voting rights must be disregarded. C will not be a connected person in relation to B on account of the joint control provision, as A does not control C. However, this must also be tested conversely. As A is connected to C, and also controls more than 50% of

B, B is a connected person in relation to C on account of the joint control provisions. As B is a connected person in relation to C, C will also be a connected person in relation to B.

Transfer pricing provisions are applied to adjust prices in respect of transactions between resident and non-resident connected persons. Deemed market value proceeds apply in respect of the disposal of assets between connected persons and a deemed dividend with resultant Secondary Tax on Companies (STC) is triggered if any benefit is granted to a connected person in relation to the shareholder. This extremely complicated, clumsy and disjointed legislation can be a good breeding ground for transfer pricing manipulation.

6.4.4 Tax Benefit

The result of transfer pricing manipulation is to derive an unwarranted tax benefit. It makes sense to conclude that one of the features of the South African transfer pricing practice is deriving a tax benefit from the affected transaction. This concept has been used in the previous chapters but it is thoroughly discussed here to give the South African perspective. Section 31(2) provides that any tax benefit derived in terms of paragraph b(ii) must be calculated as if that transaction, operation, scheme, agreement or understanding had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length. In terms of section 1, a tax benefit is defined to:

> Include any avoidance, postponement or reduction of any liability for tax.

The implication of the definition is that for section 31(2) to apply, the transaction, operation, scheme, agreement or understanding that has been entered into on terms or conditions that are different from the terms and conditions that would have been entered into in an arm's length environment must have resulted in a "tax benefit" by any party to that transaction, operation, scheme, agreement or understanding. The language of this definition seem to suggest that the term tax benefit only refers to the avoidance, postponement or reduction of any liability for tax in terms of the Income Tax Act not other tax acts, such as the Value Added Tax Act or the Customs and Excise Act .[409] The liability for tax notion in that definition, implies that section 31(2) only apply to scenarios that lead to an "upward adjustment", i.e. the increase of the taxable income of the person affected, thereby effectively excluding "downward adjustments" from the scope of the rules. Once it is determined that a tax benefit has been derived, the taxable income of each person that is subject to that transaction, operation, scheme, agreement or understanding is calculated as if the transaction,

[409] Value Added Tax Act No.89 of 1991 and Customs and Excise Act No.91 of 1964.

operation, scheme, agreement or understanding had been entered into on an arm's length basis.

6.4.5 Transfer Pricing Adjustment in South Africa

Transfer prices between associated enterprises must be set at arm's length for tax purposes. Where the prices are not at arm's length, such prices must be adjusted to reflect the arm's length.[410] Section 31(1)*(b)* requires that the terms and conditions of all cross-border transactions between connected persons must be concluded as though those terms are between independent persons dealing at arm's length level. Section 31(1)*(b)* provides that:[411]

> Any term or condition of that transaction, operation, scheme, agreement or understanding is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length.

Where the terms and conditions of the affected transaction differ from those that would have existed at arm's length, the taxpayer is required, in terms of section 31(2) to calculate its taxable income as if the terms and conditions of the affected transaction had been at arm's length. If the calculation results in a difference in the taxable income, this amount is referred to as the primary adjustment in tax law parlance. An adjustment is only required if one of the parties derives a tax benefit from the transaction. Section 31(2) subtly introduces the self-assessment principle in transfer pricing as it requires the taxpayer to make the adjustment. This is contrary to the previous dispensation where the Commissioner of SARS was the one obliged to make the primary adjustment. A primary transfer pricing adjustment is a precursor to a secondary adjustment.

In terms of section 31(3) of the Income Tax Act, if the taxpayer is a company, and subject to certain exceptions, the amount of the primary adjustment can be recharacterised by being deemed to be a distribution of a dividend *in specie* declared and paid by the taxpayer. Although this research is confined to transfer pricing practice by companies, section 31(3)(b)(ii) further provides that where the taxpayer is a person other than a company, the amount of the primary adjustment is deemed to be a donation. This re-characterisation is referred to as the secondary adjustment. The rationale behind section 31(3)'s

[410] Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 503; OECD 'Model Tax Convention on Income and Capital' at 27; BD Copping & G Fox *Multistate Tax Guide to Financial Institutions* (2008) at 141; Peroni *International Income Taxation, Code and Regulations* at 1325; Ault & Arnold *Comparative Income Taxation: A Structural Analysis* at 139.
[411] Section 31(1)*(b)* and section 31(3) of the Income Tax Act.

recharacterisation of the primary adjustment is that due to the non-arm's length prices charged between the related parties to the affected transaction, the recipient of the payment would have increased profits, which it would likely have repatriated to the non-resident related payee in the form of a dividend, it is for this reason that the hidden profits that were transferred under the non-arm's length affected transaction should accordingly be re-characterised as a dividend. The deemed dividend imposed under the secondary adjustment should be treated as any other distribution of an asset *in specie* paid by a resident company to a non-resident person. The dividend would be subject to South African dividends tax at a rate of 20% in terms of section 64E of the Income Tax Act. It is important to note that section 31 does not directly refer to recharacterisation but the deeming nature of section 31(3) has some recharacterisation aspects to it as it deems a primary adjustment to be a distribution of a dividend *in specie.* The OECD BEPS Action Plan 10 proposes to develop rules to prevent BEPS by engaging in transactions which would not or would only very rarely occur between third parties. This will involve adopting transfer pricing rules which will clarify the circumstances in which transactions can be recharacterised. Given the fact that section 31 does not directly refer to recharacterisation, it is hoped that this provision will in future be amended to take into account this proposal.

The main concern with transfer pricing adjustments in South Africa is that there are no specific penalties imposed in addition to adjustments which has been made by SARS where a taxpayer has failed to make an adjustment because section 31 seem to suggest that a taxpayer will voluntary comply with the law and make an adjustment at all times. The adjustments are not punitive in nature because a taxpayer is put in the same position they would have been had the adjustment took place. This adjustment has no deterrence effect to an errand taxpayer from repeating the same conduct. Adjustment made under the transfer pricing rules could attract penalties for understatement of tax and penalties for underpayment of tax if there was no differentiation between specific and general anti avoidance rules. The problem is that these are general penalties imposed under the Tax Administration Act 2011. Legislative amendments in 2016 have changed the definition of an understatement to encompass any additional tax arising from an adjustment made by the Commissioner under any general anti-avoidance provision. It has been argued elsewhere in this thesis that general anti-avoidance provisions cannot be used to analyse transfer pricing practice. Logically, this makes it difficult to conclude or suggest that penalties under general anti-avoidance rules should be applied to sanction a failure to make transfer pricing adjustment. If it could hypothetically be argued that the transfer pricing rules are an anti-avoidance provision, a penalty equivalent to 75% of the additional tax due would be imposed on a transfer pricing adjustment. Since there are no transfer pricing penalties to deal specifically with the failure to act according to the arm's length principle, it will help a great deal if section 31 can be amended to cover this aspect since it cannot be covered under section 80A-80L.

The discussion of the transfer pricing adjustment will not be complete without analysing the recent and first ever transfer pricing case in South Africa. The case is *Crookes Brothers Limited v Commissioner for the South African Revenue Service.*[412] This case involves a South African company that advanced loans to its Mozambican subsidiary ("MML"). In its 2015 tax and pursuant to the terms of the loan agreement with its subsidiary, the taxpayer made transfer pricing adjustments to its taxable income. Upon filing their returns the taxpayer requested SARS to issue reduced assessments, claiming that the adjustments were made in error. The basis for the taxpayer's claim was that the terms of the loan are aligned to the requirements of section 31(7) of the Income Tax Act which would exempt the loan from the application of transfer pricing rules. In terms of section 31(7), an interest-free loan advanced by a resident company to a non-resident connected company will not be subject to the arm's length transfer pricing provisions of section 31 where:

(i) The resident company directly or indirectly holds in aggregate at least 10% of the equity shares and voting rights in the non-resident company;

(ii) The non-resident company is not obliged to redeem the debt in full within 30 years from the date the debt is incurred; and

(iii) The redemption of the debt in full by the non-resident company is conditional upon the market value of the assets of the non-resident company not being less than the market value of the liabilities of the non-resident company.

The taxpayer supported their claim by furnishing SARS with the loan agreements. Upon SARS' interpretation of the loan agreements, it concluded that the terms of the loan agreement are contrary to section 31(7) of the Act because there was a clause in the agreement which accelerated the redemption of the loan in the event of bankruptcy, liquidation, business rescue or judgment against MML. Based on that clause, the request for reduced assessments was rejected. The taxpayer made application to the High Court to review and set aside SARS' decision. The court ruled that the inclusion of this clause in the agreement jeopardised the application of the exemption and the taxpayer's application was dismissed with costs and the transfer pricing adjustments were confirmed. Despite the

---

[412] *Crookes Brothers Limited v Commissioner for the South African Revenue Service [2018] ZAGPHC* 311.

parties' intention, the court gave effect to the wording of the agreements. It remains to be seen if the taxpayer is not going to appeal. The correctness of this judgment is questionable because section 31(7)(b) states that a "foreign company is not obliged to redeem that debt in full within 30 years from the date the debt is incurred". This in my view means that the foreign company is not required to redeem the debt at the time that the debt is incurred, it would have been correct if the court ruled that a foreign company should not be required to redeem the debt within the 30 year period, or that the resident company should not have the right, or be able to obtain the right, to require the foreign company to redeem within 30 years at any time.

6.4.6 Integration of Transfer Pricing with Thin Capitalisation

As already mentioned, in South Africa, thin capitalisation and transfer pricing are regulated by the same provision.[413] The arm's length principle is also applied to prevent thin capitalisation where financial assistance between connected parties does not meet the arm's length standard. Financial assistance is described in section 31(1) to include the provision of any loans, advance, debt, security or guarantee.[414] In applying the arm's length principle to thin capitalisation, the taxpayer is expected to use the self-assessment method to determine the amount they would have been able to borrow had the transaction been concluded between independent enterprises.[415]

South Africa introduced thin capitalisation rules in 1995 as a result of the recommendations of the First Interim Report of the Katz Commission.[416] Before the amendment, thin capitalisation was combated by using the arm's length principle and the fixed ratio approach. In terms of section 31(3) of the Income Tax Act,[417] the Commissioner of SARS was empowered to have regard to the international financial assistance rendered by the non-resident (investor) to the resident who is a

[413] Brodbeck 'A New Chapter in Transfer Pricing' (2010) *International Transfer Pricing Journal* at 379.
[414] Section 31(1)*(b)* of the Income Tax Act.
[415] D Pirvu *Corporate Income Tax Harmonisation in the European Union* (2012) at 81; A Arnull & D Chalmers *The Oxford Handbook of European Union Law* (2015) at 825; I Richelle, W Schon & E Traversa *Allocating Taxing Powers within the European Union* (2013) at 92.
[416] Katz *Commission Second Interim Report of the Commission of Inquiry into Certain Tax Structures of South Africa Thin Capitalisation Rules* (1994) at paragraph 1.1.
[417] Section 31(3)*(a)*(i)–(iii) of the Income Tax Act.

connected person as defined.[418] If the financial assistance was considered excessive in proportion to the particular lender's fixed capital in the borrower, the interest and finance charges relating to the excessive financial assistance could be disallowed as a deduction.[419] In other words, where the transaction did not reflect the arm's length price, the excessive portion of the consideration was not deductible for income tax purposes.[420] The old rules allowed the Commissioner of SARS to adjust the consideration paid in respect of the transaction according to his discretion.[421] These rules allowed the Commissioner of SARS to adjust the price of goods or services but not to re-characterise the nature of the goods or services.[422] The excessive amount was therefore taxed as a dividend in terms of section 64C (2)*(e)* of the Income Tax Act and subjected to 20 per cent of the Secondary Tax on Companies (STC).[423]

It should however be noted that the repealed section 31(3) did not directly prescribe how excessive financial assistance was determined.[424] This was determined in terms of SARS 'Practice Note 2'.[425] The SARS 'Practice Note No 2' provided that where the debt to equity ratio was less than 3:1,[426] the Commissioner of SARS could decide not to adjust the amount in the transaction.[427] Interest falling below the 3:1 ratio was not considered to be excessive.[428] Where the debt to equity ratio exceeded 3:1, the Commissioner of SARS had the discretion to disallow any interest relating to

[418] D Lermer 'Recent Developments in Transfer Pricing and Thin Capitalisation (2011) 18(2) *International Transfer Pricing Journal* at 150.
[419] Section (31)(3)*(a)*(i)-(iii) of the Income Tax Act.
[420] AW Oguttu 'Curbing Thin Capitalization: A Comparative Overview with Reference to South Africa's Approach–Challenges Posed by the Amended Section 31 of the Income Tax Act 1962' (2013) 67(6) *Bulletin for International Taxation* at 320.
[421] Section 31(2) of the Income Tax Act.
[422] Olivier & Honiball *International Tax: A South African Perspective* at 649.
[423] The Secondary Tax on Companies (STC) was abolished on 31 March 2012 and was replaced by the Dividends Tax (DT) from 1 April 2012, in terms of ss 64D to 64N of the Income Tax Act as amended.
[424] Oguttu *Curbing Thin Capitalization: A Comparative Overview with Reference to South Africa's Approach – Challenges Posed by the Amended Section 31 of the Income Tax Act 1962* at 320.
[425] SARS 'Practice Note No 2 "Determination of Taxable Income where Financial Assistance has been Granted by a Non-Resident of the Republic to the Resident of the Republic"' (1996) at 1.
[426] This was a safe harbour within which taxpayers were allowed to lend and borrow money where the interest below a certain threshold was not subjected to any deduction in the hands of the recipient.
[427] SARS 'Practice Note No 2' at 3.
[428] Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 446; L Kirsch & H Janisch *Business Blue Book of South Africa 2009* (2009) at 416.

the portion of the financial assistance as a deduction in the hands of the resident recipient.[429]

In terms of the current provisions, the 3:1 debt to equity ratio is no longer applicable and SARS 'Practice Note 2' has been withdrawn.[430] The deletion of the 3:1 debt to equity ratio as a safe harbour has made the test for thin capitalisation more strenuous and wide.[431] The interrogation of financial assistance has been widened since there are no set parameters built into the charging section as to exactly how excessive financial assistance has to be determined. The Commissioner of SARS's powers are unlimited in this regard.

The current section 31 requires that the arm's length principle has to be applied to financial assistance in the same way it applies to any other transfer pricing transaction.[432] The practical effect of the provision is that the taxpayer must determine what amount they would have been able to borrow had the transaction been concluded between independent parties.[433] The taxpayer has to determine their lending capacity by taking into account the terms and conditions which would have been applicable between independent parties on arm's length terms.[434] Any difference between the tax liability calculated on non-arm's length terms and the tax liability calculated on arm's length terms will be treated as a non-arm's length loan.[435]

---

429 SARS 'Practice Note No 2' at 3.

430 SARS Draft Interpretation Note 'Determination of the Taxable Income of Certain Persons from International Transactions: Thin Capitalisation' (2013) at 3 available at http://www.bdo.co.za/documents/Draft%20Interpretation%20Note%20-20%Thin20%Capitalisation.pdf, accessed on 27 June 2016.

431 Olivier & Honiball *International Tax: A South African Perspective* at 654. See also SARS 'Practice Note No 7' at 30 which provide that safe harbour is a simple set of rules under which transfer prices would be automatically accepted by the Commissioner. See also OECD 'Transfer Pricing Guidelines' at 160 which provides that a safe harbour is a statutory provision that applies to a given category of taxpayers and that relieves eligible taxpayers from certain obligations otherwise imposed by a tax code by substituting exceptional, usually simpler obligations. In this context the 3:1 ratio was considered as a safe harbour because it made exceptions to financial assistance below the threshold of this ratio not to be subjected to any adjustment.

432 Section 31 of the Income Tax Act.

433 SARS 'Draft Interpretation Note' at 3.

434 Section 31(2) of the Income Tax Act.

435 Section 31(3)*(a)* of the Income Tax Act.

It is worth noting that the application of the arm's length principle to thin capitalisation has proven to be very difficult internationally and is prone to manipulation.[436] The reason for the difficulty and the susceptibility to manipulation is that, just like in transfer pricing, financiers in thin capitalisation transactions do not take only one factor into account when deciding whether or not to grant financial assistance to a connected taxpayer. A myriad of factors such as expected benefits from the transaction, capital investments, geographical risks and limitations, and collaterals relating to the transaction are taken into account to come to such a decision.[437]

On the 11th April 2013, SARS came up with the 'Draft Interpretation Note on Thin Capitalisation' and opened it for public comment until the end of June 2013.[438] The 'Draft Interpretation Note on Thin Capitalisation' attempts to give guidance on how to transact at arm's length. According to the Draft Interpretation Note, it is not enough for the taxpayer to demonstrate that it could have secured the loan at arm's length terms. The taxpayer must in addition to proving that the loan or financial assistance was at the arm's length, demonstrate a business need for the loan.[439] The Draft Interpretation Note further stipulates that SARS may use the so-called risk-based audit approach to deal with thin capitalisation. The ambit of the transaction which may be included under a risk-based audit is wide. Risk may include anything that the Commissioner may deem to be a contravention of the Income Tax Act. The Draft Interpretation Note provides for a new debt to 'EBITDA ratio'.[440] EBITDA ratio is defined as:

> Earnings before interest, taxation, depreciation, amortization and any exceptional items.

---

436 Miller & Oats *Principle of International Taxation* at 471; De Broe *International Tax Planning and Prevention of Abuse* at 509; OECD 'Model Tax Convention on Income and on Capital, Condensed Version' at 1297.

437 Markham *The Transfer Pricing of Intangibles* at 28.

438 SARS 'Draft Interpretation Note' at 3.

439 SARS 'Draft Interpretation Note' at 3.

440 SARS 'Draft Interpretation Note' at 2; WR Lasher *Practical Financial Management* 8 ed (2014) at 94 mentions that EBITDA is an acronym which stands for Earnings Before Interest, Taxes, Depreciation and Amortization, EBITDA is essentially net income with interest, taxes, depreciation, and amortisation added back to it, and can be used to analyse and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions. For a further understanding of this concept see also MS Fridson & F Alvarez *Financial Statement Analysis: A Practitioner's Guide* 4 ed (2011) at 165; MB Timmons, RL Weiss, JR Callister, DP Loucks & JE Timmons *The Entrepreneurial Engineer: How to Create Value from Ideas* (2014) at 202; LD Wilson & RG Wilson *Going Concern Valuation* (2012) at 154; K Lindsey *Leadership Breakthrough* (2013) at 135.

This ratio is not indicative of what constitutes an arm's length position for a particular taxpayer; the ratio is merely used as a potential risk identifier to verify tax due diligence.[441] It therefore implies that SARS may consider transactions in which the debt to EBITDA ratio of the South African taxpayer exceeds 3:1 to be of greater risk, a factor which was not considered when 'Practice Note No 2' was still applicable. There is however no guarantee that a ratio which does not exceed 3:1 may not be considered as a risk by SARS. Since the Draft Interpretation Note is silent about this, it can therefore be inferred that transactions below the 3:1 ratio may also be investigated if they are risky to SARS. It is also uncertain which thin capitalisation transactions may be subjected to an investigation as it appears that transactions will be investigated even if the ratio does not exceed 3:1 provided there is a risk. At the writing of this thesis, the Draft Interpretation Note has not yet been finalised. Until the Draft Interpretation Note is finalised, there will be no certainty for taxpayers as to how thin capitalisation rules are applied to determine excessive interest and this does not augur well for certainty and compliance

6.5 Other Causes of Transfer Pricing Manipulation in South Africa

There may be many other causes of transfer pricing manipulation in South Africa but for the purposes of this research, the discussion is limited to the following challenges**:**

6.5.1 Lack of Advance Pricing Agreements in South Africa

A full discussion of the Advance Pricing Agreements is done in Chapter 7 which deals with the analysis of the US transfer pricing regime. It is however briefly introduced here because the lack of this dispute resolution mechanism is one of the factors perceived to contribute to transfer pricing manipulation in South Africa. According to the OECD Transfer Pricing Guidelines, Advance Pricing Arrangement (APA) is defined as:[442]

---

[441] SARS 'Draft Interpretation Note' at 11. See also Tegova *European Valuation Standards* (2003) 5 ed (2014) at 75; J Pearl & J Rosenbaum I*nvestment Banking: Valuation, Leverage Buyouts and Mergers and Acquisitions* 2 ed (2013) at 208; HK Baker, G Filbeck & H Kiymaz *Private Equity: Opportunities and Risks* (2015) at 303; M Peppitt *Tax Due Diligence* (2009) at 194; PA Gaughan *Mergers, Acquisitions and Corporate Restructuring* (2015) at 473.

[442] OECD *Transfer Pricing Guidelines* at 23. For further definition of this term see also Avi-Yonah *International Tax as International Law: An Analysis of International Tax Regime* at 118; Helminen *EU*

> An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparable and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing of those transactions over a fixed period of time. Advance pricing arrangement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations.

An APA is an agreement between the taxpayer and the tax administration that transfer pricing transactions shall be handled well in advance in a particular manner. APAs ensure that reasonable expectations from both the taxpayers and the tax administrations are clarified in advance to prevent unnecessary transfer pricing audits and protracted litigation. Because of its certainty and openness, it can limit and, in some instances, prevent the temptation by the taxpayer to engage in transfer pricing manipulation. In South Africa, the current SARS' view on the APAs as stated in SARS 'Practice Note No 7' is that APAs will not be made available to South African taxpayers and no reasons have been given by SARS for such a decision.[443] It is presumed that the unavailability of APAs in South Africa is due to the lack of administrative capacity within SARS.[444] South Africa's Advance Tax Rulings System would have been the right platform through which APAs could be introduced,[445] but surprisingly, no advance rulings on transfer pricing matters are currently allowed. Given the fact that one of the administrative challenges facing the South African transfer pricing regime and other developing nations is the lack of skilled personnel, advance pricing will in the long run (because it is costly to initiate the programme) help to alleviate this because the personnel which was supposed to be used to audit MNEs which would be in the APA programme will be utilised to perform other audits.

Tax Law: Direct Taxation at 251; Radaelli *The Politics of Corporate Taxation in the European Union: Knowledge and International Policy Agendas* at 148.

[443] SARS 'Practice Note No 7' at 36. See also Olivier & Honiball *International Tax: A South African Perspective* at 638; Bakker & Levey *Transfer Pricing and Dispute Resolution* at 755; Markham *The Transfer Pricing of Intangibles* at 235.

[444] Oguttu 'Resolving the Transfer Pricing Disputes: Are Advance Transfer Pricing Agreements the way Forward for South Africa' (2006) 18 *SA Merc LJ* at 403; Olivier & Honiball *International Tax: A South African Perspective* at 638.

[445] Sections 75-90 of the TAA deal with Advance Tax Rulings. An advance tax ruling is a formal process used by taxpayers for clarifying and confirming particular taxation arrangements to ensure certainty before engaging in a transaction that has tax implications. A written interpretation of tax laws is issued by tax authorities to corporations and individuals who request clarification of taxation arrangements. An advance tax ruling binds tax authorities and taxpayers to comply with the tax arrangements set out in the ruling.

In this regard, it is advisable to amend section 31 to include the provision of APA programmes within the South African transfer pricing practice, especially given the fact that there are no reasons, whether legal or economical, which have been advanced so far for excluding this important feature in our transfer practice.

6.5.2 Lack of Domestic Transfer Pricing Rules

Currently, section 31 does not regulate domestic transfer pricing. As opposed to international or cross-border transfer pricing, domestic transfer pricing takes place between related enterprises within the same tax jurisdiction, in other words it does not involve the setting of price with non-resident enterprise, it is therefore not a cross-border transaction. Domestic transfer pricing is not as topical as international transfer pricing, yet it is said that South Africa faces the same if not greater domestic transfer pricing challenges than international transfer pricing.[446] In most tax jurisdictions, international transfer pricing rules do not apply to domestic or intra-country transactions.[447] Domestic transfer pricing transactions are actually excluded from regulation by the international transfer pricing rules.[448] This is a serious loophole since domestic transfer pricing is inextricably linked to international transfer pricing because the parties who are involved in international transfer pricing manipulation may be the same as those involved in domestic transfer pricing.

As already mentioned, section 31 doesn't apply to domestic transfer pricing.[449] In the absence of a specific domestic transfer pricing provisions, any domestic transfer pricing transaction is not regulated. Reliance may be placed on section 80A-L which was incorporated into the Act to deal with all general tax avoidance arrangements, it must however be noted that these provisions are too general in application and do not specifically target transfer pricing, let alone domestic transfer pricing which is

[446] International Monetary Fund South Africa 'Technical Assistance Report-Fiscal Regime for Mining and Petroleum: Opportunities and Challenges' (2015) at 67-68. The domestic transfer pricing problem manifest itself in the price fixing rackets by big conglomerates involving bread prices fixing, construction and many others.

[447] Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 17; Harris *Corporate Tax Law: Structure Policy and Practice* at 95; Harris & Oliver *International Commercial Tax* at 224.

[448] International Monetary Fund South Africa 'Technical Assistance Report-Fiscal Regime for Mining and Petroleum: Opportunities and Challenges' at 67.

[449] Russo *The Attribution of Profits to Permanent Establishments: The Taxation of Intra-Company Dealings* at 301 - 302.

currently excluded by the current transfer pricing provisions. The language in those provisions is geared towards international transactions, not domestic transactions. In a recent *Johannesburg Tax Court Case* (no 12262),[450] a taxpayer succeeded in charging a South African subsidiary company service fees which were challenged by SARS on the basis that they were excessive in the circumstances. The court decision has however created some doubt if section 80A-L is an effective means of regulating domestic transfer pricing. In his judgment, Judge Willis stated that:

> Taking advantage of an accumulated assessed tax loss is not an inherent wrong. On the contrary, advantages presented by losses can influence strategic decisions which can save companies and turn them around to obvious benefit of employees and the revenue services, among others.

There may be other rules which regulate the transactions between related persons within a tax jurisdiction but for the purposes of ensuring certainty in transfer pricing, domestic transfer pricing rules are an imperative. Domestic transfer pricing rules will *inter alia* regulate: whether or not the taxpayers carrying on business transactions with related parties made excessive and unreasonable payments or expenditure, in this regard SARS will be empowered to disallow payments to ‘related parties’ which are excessive or unreasonable.[451] Furthermore, in the case of inter-unit transfer of goods and or services, domestic transfer pricing rules will be applied to check whether the profits of the eligible units have made deductions in accordance with the Income Tax Act. Currently, there is no specific valuation methodology (for transfer pricing purposes) prescribed in the Act to determine whether or not the domestic setting of transfer prices is at arm’s length price. Sometimes expenses from a loss-making company may be shifted to a profit-making company within the country in order reduce the group’s tax liability, to prevent issues like this; domestic transfer pricing rules should be promulgated.

[450] *Johannesburg Tax Court Case* No 12262.
[451] There may be other provisions regulating the tax implications of excessive and unreasonable payments or expenditures between connected parties, but such is not in the context of domestic transfer pricing as domestic transfer pricing is not regulated currently.

6.5.3 Lack of Adequate Regulations to Deal with E-Commerce Transactions

A substantial portion of world trade consists of the transfer of goods, intangibles and services within multinational enterprises through the internet or e-commerce.[452] South Africa is not immune to this trend. The necessity to apply the arm's length price on e-commerce transactions cannot be overemphasised. The instantaneous methods of transmission of data through the internet and the lack of physical boundaries in e-commerce have become a significant impediment in regulating transfer pricing in South Africa and the world-over.[453] Currently, there is no legal provision that expressly regulates e-commerce as it relates to transfer pricing. The main reason for this is because the originating place of income in these types of transactions is cannot be ascertained because the transactions take place in the cyber space and section of the Income Tax Act that deals with source rules for tax purposes does not fully consider the impact of the digital economy. This goes to the heart of how income source rules are structured in South Africa. The discussion on source rules and taxpayer residency is not part of this research but the two concepts will be briefly discussed here in the context of transfer pricing. South Africa applies a residence-based of taxation for its residents and a source-based system for non-residents.[454] The application of the two systems was critically analysed in the seminal case of *Kerguelen Sealing & Whaling Co., Ltd v CIR* where it was remarked that:[455]

> In some countries residence (or domicile) is made the test of liability for the reason, presumably, that a resident, for the privilege and protection of residence, can justly be called upon to contribute towards the cost of good order and government of the country that shelters

[452] United Nations 'E-Commerce and Development Report 2002' (2002) at 219; CSR Prabhu *Mobile Computing: A Book of Readings* (2004) at 140; CC Joyner *International Law in the 21st Century: Rules for Global Governance* (2005) at 269; M Burri & T Cottier *Trade Governance in the Digital Age: World Trade Forum* (2012) at 426; BM Hoekman & PC Mavroidis *The World Trade Organisation: Law, Economics and Politics* 2 ed (2016) at 132.
[453] F Cross & R Miller *The Legal Enviroment of Business: Text & Cases* (2009) at 36; World Bank 'The World Bank Legal Review: Law and Justice for Development' (2003) at 14; Becker *Electronic Commerce: Concepts, Methodologies, Tools and Applications* at 1570; AM Alghamdi *The Law of E-Commerce, E-Contracts, E-Business* (2011) at 148; Basu *Global Perspective on E-Commerce Taxation Law* at 204; KL Lynch *The Forces of Economic Globalization: Challenges to the Regime of International Commercial Arbitration* (2003) at 353; D Campbell & S Woodley E-*Commerce: Law and Jurisdiction* (2002) at 2; GA Stobbs *Business Method Patents* 2 ed (2016) at 16-4; H Chander *Cyber Laws and IT Protection* (2012) at 1; C Graham & F Smith *Competition, Regulation and the New Economy* (2004) at 179; D Campbell *The Internet: Laws and Regulatory Regimes* Vol 1 (2009) at 130.
[454] RC Williams *Income Tax and Capital Gains Tax in South Africa: Law and Practice* 3 ed (2001) at 35.
[455] *Kerguelen Sealing & Whaling Co Ltd v CIR* 1939 AD 487, 10 SATC 363.

> him. In others (as in ours) the principle of liability adopted is 'source of income'; again, presumably, the equity of the levy rests on the assumption that a country that produces wealth by reason of its natural resources or the activities of its inhabitants is entitled to a share of that wealth, wherever the recipient of it may live. In both systems there is, of course, the assumption that the country adopting the one or the other has effective means to enforce the levy.

According to the residence-based the worldwide receipts derived by a resident are included in his gross income.[456] South African residents are taxed on a residence-based system of tax. Non-residents are subject to tax receipts derived from sources within South Africa with certain exceptions.[457] The term source is not defined in the Act but Watermeyer CJ in the case of *CIR v Lever Brothers & Unilever Ltd* said:[458]

> [t]he word source has several possible meanings. In this section it is used figuratively, and when so used in relation to the receipt of money one possible meaning is the originating cause of the receipt of the money, another possible meaning is the quarter from which it is received. A series of decisions of this Court and of the Judicial Committee of the Privy Council upon our Income Tax Acts and upon similar Acts elsewhere have dealt with the meaning of the word 'source' and the inference, which I think, should be drawn from those decisions is that the source of receipts, received as income, is not the quarter whence they come, but the originating cause of their being received as income and that this originating cause is the work which the taxpayer does to earn them, quid pro quo which he gives in return for which he receives them. The work which he does may be a business which he carries on, or an enterprise which he undertakes, or an activity in which he engages and it may take the form of personal exertion, mental or physical, or it may take the form of employment of capital either by using it to earn income or by letting its use to someone else. Often the work is some combination of these.

Based on the analysis above, it can be said that the liability for tax is generally dependent on the place of residence of the taxpayer (in the case of a resident) or upon the source of income (in the case of a non-resident). Currently, there are no rules that require non-resident companies doing e-commerce with South African sourced companies to account for income tax through filing of income tax returns.

---

[456] The word resident is widely defined in s 1 of the Income Tax Act.

[457] Stiglingh, Koekemoer, Van Schalkwyk, Wilcocks, De Swardt & Jordaan *Silke: South African Income Tax* at 49. See also Olivier & Honiball *International Tax: A South African Perspective* at 19.

[458] *CIR v Lever Brothers & Unilever Ltd* 1946 AD 441 at 8. For a further study on the concept of originating cause of income, see *Liquidator Rhodesian Metals Ltd v COT* 1938 AD at 379 where the court said: 'source means not a legal concept but something which the practical man would regard as a real source of income. The ascertaining of the actual source is a practical hard matter of fact'.

Currently, non-resident taxpayers can derive tax benefits from transactions with customers located in South Africa, and the current rules cannot ensure a fair allocation of taxing rights on business profits.[459] Section 31(4) of the Income Tax Act does to a little extent address the transfer pricing of intellectual property as defined in section 23I(1) of the Income Tax Act, but that does not specifically address how e-commerce transactions relating to transfer pricing should be handled for tax purposes.

As already mentioned in Chapter 5 above, one of the biggest challenges posed by e-commerce transactions relates to difficulties in identifying the location of taxpayers and their business transactions, a cardinal pillar of any conventional tax system. Currently, the Income Tax Act is not aligned to the provisions of the Electronic Communications and Transactions Act which provide for the detection and identification of electronic transactions.[460] The lack of synergy between the two pieces of legislation is also a catalyst for low or lack of tax compliance by taxpayers involved in e-commerce. Because of its sophistication, e-commerce may significantly contribute to non- compliance issues due to the difficulty in tracing the digital transactions or lack of statutory provisions that deal with e-commerce.

One would have hoped that due to high prevalence of e-commerce, the South African Income Tax Act will by now have a provision that deals specifically with e-commerce as a source of income. However, to this date section 9 of the Income Tax Act which deals with the rules relating to sources of income in South Africa has no specific reference to electronic transactions. Although this section is not a specific anti-avoidance provision, it would have gone a long in attempting to deal with the current problem if it made reference to electronic commerce as one of the sources of income because that will give rise to ways of preventing revenue loss through e-commerce transactions. This legal deficiency renders section 9(2)(e) and (f) inadequate to enable SARS to impose tax on non-resident suppliers of goods and

[459] OECD “Report on Base Erosion and Profit Shifting” (2013) at 36.
[460] Electronic Communications and Transactions Act 25 Of 2002.

services via e-commerce.[461] The reason is that section 9 does not necessarily regulate the manner in which the proceeds derived from the supply of digital goods and services derived from a source in South Africa. Furthermore, section 9 is not a taxing provision; therefore, it cannot be used in the characterisation of the typical income that flows from digital transactions. Section 9 can be amended to consider e-commerce as one of the sources of income as it (e-commerce) neither fall within the residence-based nor worldwide system of taxation due to its lack of physical presence. Software systems are very expensive. It is highly likely that the amendment may result in expensive technological overhaul to match the complexities of the modern technology. In view of this, it would therefore be important to consider financial costs before implementing new taxing provisions as the costs of collection should not outweigh the tax revenue received or anticipated to be raised.[462] Because of the lack of physical presence associated with e-commerce, legislators should also be wary of promulgating a law which will lead to implementing a system which, realistically, cannot be effectively enforced. [463] This problem can be overcome by extending the application of the gross income concept to non-residents involved ecommerce in South Africa. The source of such income should be based on the double taxation agreements entered into by South Africa in terms of section 231 of the Constitution and section 108(2) of the Income Tax Act.[464] Section 9 requires that the non-resident must have some level of physical local presence in South Africa in order to be taxed here. Under normal circumstances the provisions of section 8 would have been a solution but that is not so because source rules in section 9 do not cover electronic transactions. The common law principle of

[461] Section 9(2)(e) provides that an amount is received or accrues to a person from a source within the Republic if that amount: (e) is attributable to an amount incurred by a person that is resident and is received or accrues in respect of the imparting of or the undertaking to impart any scientific, technical, industrial or commercial knowledge or information, or the rendering of or undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information, unless the amount so received or accrued is attributable to the permanent establishment which is situated outside the Republic; (f) is received or accrues in respect of the imparting of or the undertaking to impart any scientific, technical, industrial, or commercial knowledge or information for use in the Republic, or the rendering of or the undertaking to render, any assistance or service in connection with the application or utilisation of such knowledge or information.

[462] Davis Tax Committee 'Interim Report Addressing Base Erosion and Profit Shifting in South Africa' at 29 available at http://www.taxcom.org.za/docs/New_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf, accessed on 2 June 2016.

[463] Ibid.

[464] Davis Tax Committee Interim Report at 28.

originating cause may not work because the principle does not take into account ecommerce transactions within the South African sphere.

6.5.4 Failure to Impose Tax where Value is Created

One of the contributory factors to transfer pricing manipulation is that profits or income is not taxed where economic activities generating the profits are performed. Section 31 aims to ensure that income generated in South Africa is taxed in South Africa but that does not seem to happen all the times otherwise there wouldn't be any transfer pricing manipulation problem. South Africa as a developing country bears the brunt of losing tax revenue through this scheme. To deal with this problem will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. Essentially this means that profits should be taxed where economic activities generating the profits are performed and where value is created.[465] As result of this problem, the OECD crafted the OECD BEPS Action Plan 10 to ensure that profits are taxed where economic activities generating the profits or income are performed. Accordingly, the OECD submits that transfer pricing outcomes must align with value creation.[466] The OECD BEPS Action Plan 10 does not define what is meant by aligning transfer pricing outcomes with value creation. This means that the concept can be interpreted or defined in any number of ways. Value creation may refer to the value added for the generation of the income or profit.[467] Value added is measured by comparing the value of inputs with the value of outputs; the difference between the two is the value added by that step in the value chain.[468] Value created within an MNE may include items such as services, information, technologies, know-how, brand awareness, and ideas.[469] These

[465] OECD, ''About Base Erosion and Profit Shifting,'' available at http://www.oecd.org/ctp/beps-about.htm, accessed on the 18 October 2018.
[466] OECD/G20 Base Erosion and Profit Shifting Project Aligning Transfer Pricing Outcomes with Value Creation, Actions 8 10 2015 Final Reports at 12. Available at https://www.oecd-ilibrary.org/docserver/9789264241244en.pdf?expires=1541675938&id=id&accname=guest&checksum=8F176ED633E3AC54B3E821CC999A3323, accessed on the 21 October 2018.
[467] Glabush *IBFD International Tax Glossary* at 469.
[468] K Mansori and G Sanschagrin Assessing Value Creation for Transfer Pricing, *Tax Notes International* at 1124.
[469] OECD/G20 Base Erosion and Profit Shifting Project Aligning Transfer Pricing Outcomes with Value Creation. Available at https://www.oecd-ilibrary.org/docserver/9789264241244-en.pdf?expires=1541675938&id=id&accname=guest&checksum=8F176ED633E3AC54B3E821CC999A3323, accessed on the 20 October 2018.

attributes are extremely important profit drivers even though they may not be directly quantified in the value chain. Another aspect of the OECD BEPS Action Plan 10 is to ensure that transfer pricing outcomes are in line with value creation as it relate to high risk transactions or commodities. This action plan entails developing rules which will prevent BEPS by discouraging taxpayers from engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to clarify the circumstances in which transactions can be recharacterised. In this regard section 31 is not very clear with regard to circumstances where transactions can be recharacterised. A proper implementation of this action plan will also ensure clarification of transfer pricing methods, in particular, profit split methods in the context of global value chain. It is hoped that this will provide protection against base eroding payments such as management fees and head office expenses.

Another problem encountered when dealing with value creation is on whose perspective is the value measured. The value may be measured on the perspective of customers, shareholders, or some other measure that contributes to the MNE's ability to generate taxable profits. A heavy reliance on the value creation concept may have the unintended consequences of imposing significant burdens on MNEs due to its wide-ranging different interpretations caused by its lack of clarification. Furthermore, to assess value creation where income is generated, BEPS Action Plan 10 is likely to increase costs of doing business to taxpayers through added reporting requirements. Despite the challenges in implementing this Action Plan, In it is suggested that the SARS update their Transfer Pricing Practice Note in line with OECD Transfer Pricing Guidelines to include new guidance on the arms-length principle and an agreed approach to ensure appropriate pricing of difficult to value items like intangibles as envisaged by this Action Plan.

6.5.5 Lack of Supplementary Rules to Section 31

Transfer pricing is a complicated tax practice, yet South Africa's transfer pricing provisions do not contain supplementary statutory regulations to guide taxpayers on how to arrive at an arm's length price.[470] Taxpayers only rely on the Income Tax Act for guidance on transfer pricing issues. It has already been indicated that the arm's length principle has certain inherent weaknesses which makes it complicated and difficult to apply in certain instances. Although the legislature attempted to use ordinary language, section 31 remains difficult to read and interpret due to its high sophistication and wide-ranging nature; the difficulty is compounded by the lack of supplementary rules to simplify application and interpretation. Because of the lack of rules, SARS has over the years produced Practice Notes to assist taxpayers with the application and interpretation of various aspects of transfer pricing. Guidance on the application of transfer pricing is dealt with in SARS 'Practice Note 7' and guidance on thin capitalisation was dealt with in SARS 'Practice Note No 2' (now withdrawn for years of assessment commencing on or after 1 April 2012).[471]

One of the problems with 'Practice Note No 7' is that it has not been updated since the amendment of section 31. As pointed out above, SARS has come up with a Draft Interpretation Note that covers thin capitalisation; it is not clear whether SARS will come up with a new Interpretation Note on transfer pricing in terms of the amended section 31. Unless SARS 'Practice Note No 7' which deals with transfer pricing is formally withdrawn, it is still applicable even though it may not be fully in line with the new section 31. Strictly speaking, SARS Practice Notes cannot be relied upon to substitute statutory guidelines because they lack the force of law.[472] In *ITC 1675*,[473] the court held that SARS Practice or Interpretation Notes are not law, tax disputes must be solved by reliance on the Income Tax Act. The Commissioner of SARS could only use the Practice Notes as a guide and a tool of interpretation, but they are

[470] In the South African context, regulations referred to here are also called rules to the Act or secondary legislation.
[471] SARS 'Draft Interpretation Note' at 3.
[472] Lermer *Recent Developments in Transfer Pricing and Thin Capitalisation* at 149.
[473] *ITC* 1675 62 SATC 219 at 229. See also Olivier & Honiball *International Tax: A South African Perspective* at 629 where it is remarked that 'while still not constituting law, one would ordinarily assume that this particular Practice Note would have carried more weight in a court of law than other Practice Notes based on the fact that there are many different international principles which could be used to determine a particular arm's length price. The problem was that paragraph 3.1 of the Practice Note itself stated-correctly, it is submitted-that it was drafted as a practical guide and was not intended to be neither prescriptive nor exhaustive'.

not legally binding on the taxpayer or the Commissioner unless they both agree to it.[474] Paragraph 3.1 of the SARS Practice Note clearly states that:

> This Practice Note has been drafted as a practical guide and is not intended to be prescriptive or an exhaustive discussion of every transfer pricing issue that might arise.

In the absence of supplementary rules to section 31 to provide clear guidelines on how to arrive at the arm's length price as the legislature intended, both taxpayers and SARS remain in the interpretational and application dire straits. It has been revealed that practice notes do not have any legal force and without undermining their importance, it is imperative that section 31 be amended to include supplementary statutory rules in order give practical guidelines on how to arrive at the arm's length price. These supplementary rules may also be drafted in such a way that they provide examples of transactions on how to determine the arm's length price.

6.5.6 Divergence between Transfer Pricing and Customs Valuation

The lack of convergence or harmony between transfer pricing and customs valuation rules is one of the problems facing many tax jurisdictions, South Africa is no exception because the legal provisions regulating these spheres of tax are not harmonised. The implication of this lack of convergence is loss of revenue and low compliance levels by the traders or taxpayers. A general overview of the customs valuation rules is undertaken and followed by the South African perspective.

6.5.6.1 General Overview of Customs Valuation Rules

Customs valuation is defined as the process where customs authorities assign a monetary value for the purposes of determining customs duty on the imported or exported goods or service.[475] The World Trade Organisation (WTO)'s General

---

[474] Lermer *Recent Developments in Transfer Pricing and Thin Capitalisation* at 149; Olivier & Honiball *International Tax: A South African Perspective* at 629.

[475] Bakker & Obouforibo *Transfer Pricing and Customs Valuation* (2009) at 4. See also Wolfgang & Dallimore The Valuation of Goods for Customs Purposes (2013) at 1; L De Wulf & JB Sokol Customs Modernization Handbook (2004) at 161; S Rosenow & BJ O'Shea A Handbook on the WTO Customs Valuation Agreement (2010) at 177; Bakker & Obuoforibo Transfer Pricing and Customs Valuation at 337; H Pragter & R Van Raan The Valuation of Goods for Customs Purposes (1981) at 64-66.

Agreement on Trades and Tariff (GATT) Article VII,[476] has laid down the general principles for an international system of custom valuation.[477] Member countries of the WTO typically harmonise their internal legislation dealing with the customs valuation with the WTO Agreement on Customs Valuation.[478] In appropriate circumstances, the documented custom valuation may be used for justifying the transfer prices of imported goods in international transactions between associated enterprises.[479] The arm's length principle is applied by many customs administrations as a principle of comparison between the value attributable to goods imported by associated enterprises and the value of similar goods imported by independent enterprises to

[476] General Agreement on Tariffs and Trade (GATT) was a multilateral agreement regulating international trade. According to its preamble, its purpose was the 'substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis'. It was negotiated during the United Nations Conference on Trade and Employment and was the outcome of the failure of negotiating governments to create the International Trade Organization (ITO). GATT was signed by 23 nations in Geneva on 30 October 1947 and took effect on 1 January 1948. It lasted until the signature by 123 nations in Marrakesh on 14 April 1994 of the Uruguay Round Agreements, which established the World Trade Organization (WTO) on 1 January 1995. The original GATT text (GATT 1947) is still in effect under the WTO framework, subject to the modifications of GATT 1994. For more information about GATT and its history you may also see, The World Trade Organization Secretariat from GATT to the WTO: The Multilateral Trading System in the New Millennium (2000); DA Irwin, PC Mavroidis & AO Sykes *The Genesis of the GATT* (2008), M Benitah *The Law of Subsidiaries under the GATT/WTO System* (2001) at 35; S Rai *Recognition and Regulation of Safeguard Measures under GATT/WTO* (2011).

[477] The World Trade Organization (WTO) is the global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business. The WTO was born out of negotiations, and everything the WTO does is the result of negotiations. The bulk of the WTO's current work comes from the 1986–94 negotiations called the Uruguay Round and earlier negotiations under the General Agreement on Tariffs and Trade (GATT). The WTO is currently the host to new negotiations, under the 'Doha Development Agenda' launched in 2001. For more information about the WTO see C van Grasstek *The History of the World Trade Organisation* (2013); RRF Yearwood *The Interaction between World Trade Organisation (WTO) Law and External International Law* (2012); RU Das, P Edirisuriya & A Swarup *Regional Trade and Economic Integration: Analytical Insight and Policy Options* (2012) at 178; PC Mavroids *Trade in Goods* (2012) at 96; PC *Mavroids The Regulation of International Trade: GATT* (2016) at 170; MB Hoekman, A Mattoo & P English *Development, Trade and the WTO: A Handbook* Vol 1 (2002) at 128.

[478] Rosenow & O'Shea *A Handbook on the WTO Customs Valuation Agreement* at 170; P Stoll & F Schorkpf *WTO: World Economic Order, World Trade Law* (2006) at 62-4; I Feichtner *The Law and Politics of WTO Waivers: Stability and Flexibility in Public International Law* (2012) at 68; Hoekman, Mattoo & English *Development, Trade and the WTO: A Handbook* at 128.

[479] Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 117; S Rosenow and BJ O'Shea *A Handbook on the WTO Customs Valuation Agreement* at 85.

determine the correct customs value.[480] Generally, customs administrations engage in this process as a means of protecting tariff concessions, collecting revenue and implementing the country's trade policy.[481] The reverse of customs valuation is under-valuation of customs values on imported goods. Transfer pricing manipulation can be equated to customs under-valuation. There is no definition of this concept, but in common customs practice customs under-valuation is defined as a form of customs fraud,[482] where the actual price paid or payable is negligently and or intentionally under-declared to customs authorities at importation by the importer with the sole purpose of evading payment of customs duties and other related taxes.

Under-valuation of customs values is a form of tax evasion.[483] Value for customs purposes derives from a sale or offer of sale in the ordinary course of business under fully competitive conditions.[484] Just like transfer pricing manipulation, large-scale customs undervaluation stratagems take place between related or connected parties who are mostly big conglomerates monopolising a specific industry.[485] The non-

---

480 OECD *Transfer Pricing Guidelines* at 83; Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 18. For a determination of customs value on imported goods see: De Wulf & Sokol *Customs Modernization Handbook* at 176; Van den Bossche & Zdouc *The Law of the World Trade Organisation: Texts, Cases and Materials* at 434; Keen *Changing Customs: Challenges and Strategies for the Reform of Customs Administration* at 89; Mavroidis *Trade in Goods* at 96.

481 C Truel *A Short Guide to Customs Risk* (2010) at 22; M Fabio *Customs Law of the European Union* 2 ed (2010) at 248; M Keen *Changing Customs: Challenges and Strategies for the Reform of Customs Administration* (2003) at 6-9; De Wulf & Sokol *Customs Modernization Handbook* at 5; C Herrmann, M Krajewski & JP Terhechte *European Yearbook of International Economic Law* (2013) at 383; K Christopher *Port Security Management* 2 ed (2015) at 16; South African Revenue Services 'Customs Valuation Guide' (2002) at 6.

482 M Keen *Changing Customs: Challenges and Strategies for the Reform of Customs* (2003) at 83; De Wulf & Sokol *Customs Modernization Handbook* at 63; M Robinson *Corruption and Development* (2006) at 145; Schaffer, Agusti & Dhooge *International Business Law and its Environment* at 337; LM Salinger *Encyclopaedia of White-Collar and Corporate Crime* Vol 1 (2005) at 788.

483 HP Gray *Transnational Corporations and International Trade and Payments* Volume 8 (1993) at 38-9; ME Beare *Encyclopedia of Transnational Crime and Justice* (2012) at 392; Stiglingh, Koekemoer, Van Schalkwyk, Wilcocks, De Swardt & Jordaan *Silke: South African Income Tax* (2013) at 773 defines tax evasion as illegal activities deliberately undertaken by a taxpayer to free him/herself from a tax burden. In South Africa, tax evasion is punishable in terms of ss 234 and 235 of the Tax Administration Act (TAA) 28 of 2011.

484 Article 1(1) of the Agreement, A Van de Heerkamp & R Tusveld *Origin Management: Rules of Origin in Free Trade Agreements* (2011) at 97; AF Lowenfeld *International Economic Law* (2003) at 76; LA Glick *Guide to United States Customs and Trade Laws* 3 ed (2008) at 110; P Low *Preshipment Inspection Services* (1995) at 44; ES Lee W*orld Trade Regulation: International Trade under the WTO Mechanism* (2012) at 99.

485 Glick *Guide to United States Customs and Trade Laws* at 39-40; Rosenow & O'Shea *A Handbook on the WTO Customs Valuation Agreement* at 85-86. In South Africa the term related party for

exhaustive examples of undervaluation practices include: under-invoicing of goods between related and unrelated parties,[486] entering or clearing imported goods under a tariff item which pays less customs duty when the goods actually pay a higher rate.[487]

The customs valuation rules establish a hierarchy of six valuation methodologies.[488] The importance of hierarchy was emphasised in the panel report of the *Thailand-Cigarettes* dispute.[489] Customs administrations require importers to declare goods according to the price paid or payable for customs purposes.[490] The 'price actually paid or payable' principle is the primary standard which is used to determine the values declared at importation.[491] If the information is not available to utilise this

---

customs purposes is defined in terms of s 66(2)*(d)* of the Customs and Excise Act 91 of 1964 to mean that 'two persons shall be deemed to be related if they are officers or directors of one another's businesses; they are legally recognized partners in business; the one is employed by the other; any person directly or indirectly owns, controls or holds five per cent or more of the equity share capital of both of them; one of them directly or indirectly controls the other; both of them are directly or indirectly controlled by a third person; together they directly or indirectly control a third person; or they are members of the same family'.

486 The concept of related parties is articulated in art 15 of the World Customs Organisation Valuation Agreement. For a South African definition of related persons see s 66(2) of the Customs and Excise Act 91 of 1964.

487 Truel *A Short Guide to Customs Risk* at 39.

488 Low *Preshipment Inspection Services* at 45; Feichtner *The Law and Politics of WTO Waivers: Stability and Flexibility in Public International Law* at 68; International Business Publications Inc. *Trade and Investments Agreements: African, Caribbean and Pacific Group of States* (2015) at 280. In South Africa the customs valuation methods are regulated in ss 65 to 69 of the Customs and Excise Act 91 of 1964 and ss 112 to 150 of the Customs Duty Act 30 of 2014 although the latter Act is yet to come to effectivity at a date to be determined by the state president of the Republic of South Africa.

489 WTO Panel Report WT/DS371/R Thailand- Customs and Fiscal Measures on Cigarettes from the Philippines at paragraph 7.134, available at https://www.wto.org/english/tratop_e/dispu_e/371abr_e.pdf, accessed on 25 April 2016. Briefly, in this case, the Philippines lodged a complaint to the WCO that Thailand violated the hierarchical set up of the Valuation Agreement by rejecting the first method of valuation being the transaction value method but instead applied the deductive method (the sixth and last method of valuation) in relation to cigarettes imported into that country (Thailand). See also PD Gavier and F Pierola 'Related Parties and Customs Valuation: Guidance Derived from the Panel Report Thailand-Cigarettes' (2012) 7(1) *Global Trade and Customs Journal* at 8.

490 MJ Trebilcock *Advanced Introduction to International Trade Law* (2015) at 34; G Franceschin & F Misuraca *India: Commercial Law, Customs and Taxation* (2011) at 133; J Phyper, P Ducas & PJ Baish *Global Materials Compliance Handbook* (2004) at 239; EG Hinkelman, M Manley & KC Shippey *Importers Manual USA: The Single Source Reference Encyclopedia for Importing to the United States* (2004) at 293; International Business Publications *US Customs Border Handbook, Regulations, Procedures, Opportunities* Vol 1 (2013) at 244; C Aniebonam *Hidden Treasure Book: Saving More of Your Money* (2006) at 211.

491 TK Giannakopoulos *A Concise Guide to the EU Anti-Dumping/ Anti Subsidies* (2006) at 42; International Monetary Fund *A Guide to Direction of Trade Statistics* (1993) at 3; V Thuronyi *Tax Law Design and Drafting* Vol 1 (1996) at 251; In the USA, the concept of price paid or payable is the total payment made or to be made by the buyer to or for the benefit of the seller of imported goods. See art

methodology, then customs valuation must be based on an alternative series of methodologies on an elimination basis based on their statutory hierarchy.[492] Thus, if the transaction value is not viable, customs may invoke the alternative methods which are transaction value of identical or similar merchandise, deductive value, computed value, or adjusted value based on these alternatives (i.e. 'fallback method'), in that hierarchical order.[493] In this regard, customs valuation rules are more rigid than the transfer pricing methods as they do not allow any deviation from the hierarchy.[494]

6.5.6.2 Customs Valuation Rules in South Africa

Customs and excise matters are currently administered by the Customs and Excise Act 91 of 1964 herein referred to as the Act. Once the Customs Duty Act 30 of 2014 is put into effect, customs valuation will be dealt with in terms of chapter 7 of the that Act. As it has already been mentioned in chapter above, South Africa is a signatory to the WTO Valuation Agreement (herein referred to as the Agreement). Article VII of the WTO Valuation Agreement is part of South African law in terms of the Geneva General Agreement on Tariffs and Trade Act 29 of 1948. Customs valuation in South Africa is primarily governed by sections 65, 66 and 67 of the Act. The provisions of these sections are based on the Agreement on Implementation of Article VII of the General Agreement on Tariffs (GATT) and the Interpretative Notes thereto. The interpretation of these three sections is also subject to the Agreement, Notes, the Advisory opinions, commentaries and case studies issued under the Agreement.

Section 74A of the Act specifically deals with the interpretation of sections 65, 66 and 67. It was held in the case of *International Business Machines SA (Pty) Ltd v*

---

1 of the World Customs Organisation Valuation Agreement and also the South African Revenue Service *Customs Valuation Guide* (2002) at 7.

[492] BL Bade *Export Import Procedures and Documentation* (2015) at 304; R Bhala *Modern GATT Law: A Treatise on the General Agreement on Tariff and Trade* (2005) at 513; S Inama *Rules of Origin in International Trade* (2011) at 288.

[493] Bakker & Obuoforibo *Transfer Pricing and Customs Valuation at 68,US Customs and Border Protection Customs Valuation Encyclopaedia* (2004) at 434; ES Lee *World Trade Regulation: International Trade under the WTO Mechanism* at 99; JM Grieco *Cooperation Among Nations: Europe, America and Non-Tariff Barriers to Trade* (1993) at 71; DE Gaines, BE Olsen & KE Sorensen *Liberalising Trade in the EU and the WTO: A Legal Comparison* (2012) at 398; JE Farrell *The Interface of International Trade Law and Taxation* (2013) at 96.

[494] Rosenow & O'Shea *A Handbook on the WTO Customs Valuation Agreement* at 125; Fabio *Customs Law of the European Union* 4-32; A Bakker *Transfer Pricing and Business Restructurings: Streamlining All the Way* at 203.

Commissioner for Customs and Excise that sections, 65, 66 and 67 should be interpreted in conformity with and not contrary to these instruments.[495] The interpretation of these international valuation instruments receive due consideration except where a manifest deviation from or an irreconcilable conflict with the provisions 65-67 is identified in which case the provisions of the latter shall prevail.[496] The first 17 Articles of the Agreement have been incorporated in the Act. The sections can be categorized in the following manner: section 65 deals mainly with customs value and other related matters. Section 66 deals mainly with all valuation methods and how they are applied.[497] Section 67 deals with customs value adjustments.

6.5.6.3 Related Parties in Customs Valuation

Transactions between related or connected parties present a unique problem in that such transactions may potentially not have been conducted at arm's length, i.e. conditions may have been imposed that differ from those that would have been present had the transaction taken place between independent parties. Custom's perception is that related parties can easily manipulate their profits and prices to ensure the most favourable tax and customs treatment for their transactions.[498] Consequently, when the inter group calculation of prices and valuation of goods do not reflect market forces, the tax and customs liabilities of the related parties, and the tax and customs revenues of the host countries, could be distorted.[499] A low customs value does not necessarily mean undervaluation because prices may be determined for legitimate considerations. Some of the non-exhaustive considerations which may have a bearing in the determination of prices between related persons are the desire to reduce tax liability using legitimate tax avoidance schemes.[500] Relationship alone is not ground for rejecting the transaction value but it is only a reason for further

---

[495] *International Business Machines SA (Pty) Ltd v Commissioner for Customs and Excise* 1985 4 SA 852(A) at 864C.
[496] Cronje (2010) *Customs and Excise Service* Issue 29 at 9-26.
[497] Section 66(1), (4), (5), (7), (8) and (9).
[498] Sherman & Glashoff *Customs Valuation Commentary on the GATT Customs Valuation Code* at185.
[499] Sherman & Glashoff *Customs Valuation Commentary on the GATT Customs Valuation Code* at 185.
[500] Stiglingh *et al South African Income Tax* at 717. See also AW Oguttu "Transfer Pricing and Tax Avoidance: Is the Arm's Length Principle Still Relevant in the E-Commerce era?"(2006)18 *SA Mercantile Journal* (*SA Merc LJ*) at 138.

inquiry departure from the transaction value is only permitted when it can be proven that the relationship influences the price.[501] A classic example of a case or transactions which involves related parties is the so-called Thailand Cigarettes dispute, where transactions between a company called Philip Morris Thailand (buyer) and Phillip Morris Philippines (seller) who were related within the meaning of Article 15(4) (f) of the Agreement because they were both directly and indirectly controlled by a third party called Phillip Morris International.[502] The definition of the term related parties in the Valuation Agreement is analogous to section 66(2) (a) of the Act.[503] Article 15(4) provides that two persons shall be deemed to be related only if:

> (i)they are officers or directors of one another's businesses;(ii)they are legally recognized partners in business;(iii)the one is employed by the other;(iv)any person directly or indirectly owns, controls or holds five per cent or more of the equity share capital of both of them;(v)one of them directly or indirectly controls the other;(vi)both of them are directly or indirectly controlled by a third person;(vii)together they directly or indirectly control a third person; or(viii)they are members of the same family.

Section 66(2) (b) further stipulates that:

> Persons who are associated in business with one another in that the one is the sole agent, sole distributor or sole concessionary, however described, of the other shall be deemed to be related only if they are so deemed in terms of paragraph (a).

In terms of subsections quoted above, two persons usually the buyer and the seller are deemed to be related if their relationship can be characterized by one of the following factors: family, affiliated business enterprises, legal control, directorship of one's other business, employment and business partners.[504] Section 66 (2)(b) provides that if two traders' conduct is such that it can be attributed to one of the relationships mentioned here above, then they will be deemed to be related.

The Customs Value Agreement (CVA) provides for two tests to determine whether the related party transaction value is accepted. The tests relate to "circumstances

[501] Article (1) (2) of the Agreement.
[502] WTO Panel Report, "Thailand – Customs and Fiscal Measures on Cigarettes from the Philippines" at 2, Available from http://www.wto.org/english/tratop_e/dispu_e/371abr_e.pdf , accessed on the 14 June 2018.
[503] Article 15(4) and (5) of the Agreement.
[504] SARS *Customs Valuation Guide* (2002) at 32.

surrounding the sale test" and the "test values assessment."[505] According to the circumstances surrounding the sale test, customs must investigate all the surrounding circumstances to determine whether the relationship has influenced the price.[506] Customs has to take an overall view of the transaction and if the circumstances are such that the parties conduct business as if they were not related, the declared transaction must be accepted. This test operates on the premise that the fact that the relationship should not influence the price does not necessarily mean that the parties may not freely set the prices low. It further means that unrelated parties may also set low prices due to other market factors like buying in bulk, paying in cash or the fact that the buyer is a regular customer. The pitfall of this test is that it is wide ranging and will therefore result in uncertainty on the part of the importer as anything may be considered to have influenced the price.

The test value assessment is an alternative test that can be initiated by the importer.[507] This test compares the declared value with any values cited in Article 1(2) (b) of the CVA. If the declared value closely approximates one of the values cited in Article1 (2) (b),[508] then the declared value must be accepted by customs.[509] According to this test, customs must consider whether the differences in value, if any, are commercially significant. To determine the commercial significance may be difficult and subjective with unintended results because sometimes a small difference in value on one type of goods may be unacceptable while a large difference on another type of goods may be acceptable.[510] The relationship between buyer and seller must not be used as a ground to reject declared but as a basis for scrutiny.[511]

[505] Article 1 (2)(a) –(b) of the Agreement.
[506] Gavier & Pierola (2012) Related Parties and Customs Valuation: Guidance Derived from the Panel Report Thailand Cigarettes Global Trade and Customs Journal at 9.
[507] Gavier & Pierola Related Parties and Customs Valuation at 10.
[508] SARS Customs and Border Management: External Policy Customs Valuation on Imports at 33 Available at http://sarsportal/ProdQMS/OpsDocs/Policies/SC-CR-A03 last accessed on the 11 of April 2013.
[509] Section 66 (3) of the Act.
[510] Interpretative Note to Article 1 paragraph 2.
[511] Gavier & Pierola Related Parties and Customs Valuation at 10.

6.5.6.4 Divergent Objectives of the Rules

Transfer pricing rules and customs valuation rules have different objectives.[512] The tax objective is to allocate income to reflect overall taxable income. The customs objective is to determine the value of a specific imported item.[513] A lower value for imported goods results in higher potential profit and income tax revenue from the resale of such goods to unrelated customers. In contrast to this, the higher the dutiable value of the imported goods, the greater the customs duty revenue on the goods for the customs authorities.[514] Thus, income tax administrations will generally insist on a low transfer price and customs administrations on a high import price. The end result is that the importer/taxpayer could be clasped in the middle if these departments do not collaborate to avoid working in silos.[515] In most instances, customs legislation does not provide for transfer pricing and the opposite is true for cross-border income tax legislation in relation to customs valuation issues. Despite the clear differences between transfer pricing and customs valuation,[516] the law can be developed so that the two can be applied in a harmonious manner to achieve the tax revenue objective.[517]

---

[512] Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 174; JE Farrell *The Interface of International Trade Law and Taxation* at 96, where it is provided that 'two different set of rules exist for valuation of cross-border transactions: on the one hand, the valuation of imported goods for customs duties is dealt with under article VII of the GATT and Agreement on the Implementation of Article VII of the GATT (Customs Valuation Agreement), and these rules are administered by the WTO, the World Customs Organisation (WCO) and domestic customs authorities (which are often separate from tax authorities), while on the other hand, the valuation of the sale or purchase of goods (plus, interalia, services and intangibles) for income tax purposes is dealt with under the OECD transfer pricing guidelines and administered by domestic tax authorities'.

[513] Jovanovich *Customs Valuation and Transfer Pricing Is It Possible to Harmonise Customs and Tax Rules* at xvi; Herrmann, Krajewski & Terhechte *European Yearbook of International Economic Law* at 408; M Lang *Procedural Rules in Tax Law in the Context of European Union and Domestic Law* (2010) at 470.

[514] Rosenow & O'Shea *A Handbook on the WTO Customs Valuation Agreement* at 84; R Carbough *International Economics* at 109.

[515] Levey, Wrappe & Chung *Transfer Pricing Rules and Compliance Handbook* at 130; M Butani *Transfer Pricing: An Indian Perspective* (2007) at 150.

[516] Herrmann, Krajewski & Terhechte *European Yearbook of International Economic Law* at 407; Pfeiffer, Ursprung & Steindl *Global Trends in VAT/GST and Direct Taxation* at 299; Spies K & R Petruzzi *Tax Policy Challenges in the 21st Century* at 333; Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 39; Truel *A Short Guide to Customs Risk* at 60.

[517] Farrell *The Interface of International Trade Law and Taxation* at 96 points out that The Customs Valuation Agreement does not explicitly mention the arm's length principle or associated enterprises

The dichotomy is that tax and customs administrations within one country often have different approaches regarding revenue collection and compliance in general: tax administration regulates intra-group sales prices that may be perceived as higher than they should be whereas customs authorities are concerned with customs values which appear to be lower than the market price which would be set between independent parties.[518] While administrations seek to achieve the arm's length pricing, the revenue collection interest in the transaction may be compromised and the impasse may be used by the MNEs to manipulate the prices avoid or evade the payment of taxes or import duties.[519] In order to deal with this problem, both the customs and tax legislation must be crafted in such a way that it takes into account the complementary roles played by each of them. In the South African context, for instance, section 65 of the Customs and Excise Act which deals with the determination of value for customs purposes may need to be amended to the effect that subject to certain conditions, the transaction value method of appraisement will not be precluded when a related party sale price is subject to post-importation adjustments that are made pursuant to formal transfer pricing audit as it relates to the declared value of the imported goods. These adjustments, whether upward or downward, are to be taken into account in determining transaction value. This will ensure that the transfer price, where fully supported with appropriate transfer pricing documentation, may be used as the basis of the 'price' for the customs transaction value method.

6.6 Transfer Pricing Document Requirements in South Africa

Generally, documentation requirements for tax purposes are dealt with in chapter 4 of the TAA. The South African transfer pricing legislation does not have specific provisions dealing with transfer pricing documentation requirements. Guidance on transfer pricing documentation is set out in the SARS Practice Note 7. South Africa does not specify a comprehensive pre-defined set of documentation requirements

---

as presented in the OECD Guidelines but recognises in Article 1 that customs administrations should consider the relationship between related parties and its influence on the transaction value. Both customs valuation and transfer pricing rules maintain the same objective of ensuring that the valuation reflects an arm's length price.

[518] Jovanovich *Customs Valuation and Transfer Pricing Is It Possible to Harmonise Customs and Tax Rules* at 3.

[519] Farrell *The Interface of International Trade Law and Taxation* at 96.

that meet the requirements of all taxpayers, because appropriate documentation depends on each taxpayer's specific facts and circumstances.[520] Documents generated in the ordinary course of business and of setting a transfer price suffice for transfer pricing purposes. Such documentation will usually address issues such as:

(i) Identification of transactions in terms of international agreements entered into with connected persons and the extent of any other commercial or financial relations with connected persons which fall within the scope of section 31.

(ii) Copies of the international agreements entered into with connected persons and a description of the nature and terms (including prices) of all the relevant transactions (including a series of transactions and any relevant off-setting transactions).

(iii) The method that has been used to arrive at the nature and terms of the relevant transactions (including the functional analysis undertaken and an appraisal of potential comparables) and the reasons why the choice of method was considered to be the most appropriate to the relevant transactions and to the particular circumstances.

(iv) An explanation of the process used to select and apply the method used to establish the transfer prices and why it is considered to provide a result that is consistent with the arm's length principle and information relied on in arriving at the arm's length terms such as commercial agreements with third parties, financial information, budgets, forecasts etc.

(v) Details of any special circumstances that have influenced the price set by the taxpayer.

The practice note further provides that Taxpayers may be asked to provide the Commissioner with relevant documentation created when the international agreement was contemplated and at the time when the agreement was entered into. Where there is inadequate contemporaneous documentation of arm's length international dealings, between connected parties, it will clearly be more difficult for

[520] SARS 'Practice Note' 7 at 22.

companies to convince the Commissioner that the dealings took place on an arm's length basis.

The Act does not impose specific penalties in respect of non-arm's length pricing practices; any contravention of document related provisions in the South African Income Tax is dealt with in terms of chapter 15 and 16 of the TAA.

On the 23 June 2017, the SARS released guidance with respect to CbC Reporting. The release is in accordance with section 25 of the TAA. Subsequently on the 20 October 2017, the SARS released a final public notice requiring CbC Reporting as well as Master File and Local File documentation to be submitted. The South African CbC Reporting only applies to multinational entities where the group has total consolidated group revenue of more than R10 billion during the fiscal year immediately preceding the reporting fiscal year. The CbC Reporting must be filed no later than 12 months after the last day of each reporting fiscal year of the group beginning on or after 1 January 2016. On 11 May 2018, SARS released a Public Notice, extended by Government Gazette No. 41621; to advise multinational entities that are required to file CbC reports in South Africa that non-compliance will result in a fixed amount penalty in accordance with section 210(1) and 211 of the TAA. Amendments are effective as of 11 May 2018.

6.7 Conclusion

The legislative amendments effected on section 31 so far are lauded but it is clear that much still needs to be done to ensure that this provision is effective enough to deal with most of the transfer pricing problems. It is the finding in this chapter that section 31 in its current form is not an effective tool to fight transfer pricing manipulation. This finding is supported by the fact that section 31 does not expressly prohibit transfer pricing manipulation except to say that all international transactions must meet the arm's length requirements. Section 31 does not refer to the transfer pricing methods, Currently, section 31 requires compliance with the arm's length principle only on international transactions; this can be interpreted to mean that domestic transfer pricing transactions need not be based on the arm's length principle as they are expressly excluded by this provision. It was also the finding in this chapter that despite the exponential growth of e-commerce, South Africa is yet to have effective regulations that govern e-commerce transactions in transfer pricing.

Section 31 does not provide for any penalty where transfer pricing adjustments have been made and this does not deter taxpayers from manipulating transfer prices because they will be put in the position they would have been had the transaction been at arm's length. Given all these problems, there is no doubt that section 31 needs to be amended to make it more effective in deterring transfer pricing manipulation. Some of the measures that can be taken to achieve this include, but are not limited to: the amendment of section 31 to provide for penalties for transfer pricing adjustments, , introduction of domestic transfer legislation to have a balanced view of both domestic and international transfer pricing transactions, introduction of Advance Pricing Agreements, align transfer pricing and customs valuation rules, introduction of supplementary rules to section 31 and introduction of e-commerce provisions within the Income Tax Act and align these with the Electronic Communication Act to combat transfer pricing manipulation by taking into account OECD BEPS Action Plan 1 and 7.

CHAPTER 7

REGULATION OF TRANSFER PRICING IN THE UNITED STATES (US)

7.1 Introduction

The aim of this chapter is to determine if the US transfer pricing regime can provide solutions to some of the problems (which have been identified from chapter one to six) contributing to transfer pricing manipulation, particularly in South Africa. The US transfer pricing practice is very broad; it will therefore be impractical to comprehensively analyse all aspects of the system in this thesis. It is for this reason that this comparative analysis is focused only on selected aspects of the United States (US) transfer pricing regime which is considered to be relevant for the purposes of improving section 31 of the Income Tax Act and other related provisions where possible. The main aim is to draw lessons from its legislative approach as enshrined in section 482 of the Internal Revenue Code (IRS) and the experiences of the US authorities in dealing with transfer pricing manipulation. To achieve this, both the positive and negative aspects of the US transfer pricing will be considered. The negative aspects will be considered in order to avoid repetition in South Africa. The positive aspects of the US transfer pricing will be emphasised in order to draw lessons which will be used to improve section 31 whilst taking into account the economic situation of a developing country like South Africa.[521]

The comparative analysis will *inter alia* focus on the following aspects of the US transfer pricing: brief historical background of the transfer pricing regime in the US, legal framework of the US transfer pricing: section 482, the arm's length principle as it is applied in the US in relation to the research problem, the application of transfer pricing methods in the US, the analysis of the weaknesses of section 482 and a discussion on the role played by the Advance Pricing Agreements (APAs) in the US. The analysis will conclude by giving a summary of the lessons drawn from the US transfer pricing system.

[521] Such economic situations include the fact that as a developing country, South Africa is in dire need of foreign direct investment. The improvement or development of a transfer pricing legislation like s 31 need not be done in such a way that will frustrate or discourage MNEs who would want to set up their businesses here or trade with the South African economic players.

7.2 Historical Background of the US Transfer Pricing System

The US has had transfer pricing provisions since the 1910s.[522] The first US transfer pricing regulation was enacted through the War Revenue Act of 1917.[523] Through this Act, the IRS was given authority to consolidate and verify whether or not the accounts of related trades or businesses were concluded at market-related prices.[524] The War Revenue Act came as result of The US lawmakers being sceptical about the transfer of profits between the US parent companies and foreign subsidiaries after the First World War. In 1921, the Revenue War Act was amended by inserting section 240*(d)*. It is said that this provision (section 240*(d)*) is the first predecessor of section 482 of the Internal Revenue Code (IRC).[525] The aim of section 240*(d)* was to prevent income shifting to foreign (associated) companies. In 1928, section 240*(d)* was re-enacted into the Revenue Act of 1928 as section 45 of the Revenue Act of 1928 and its wording remained unchanged until 1986 and it provided that:

> In any case of two or more trades or businesses (whether or not incorporated, whether or not organised in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorised to distribute, apportion, or allocate gross income or deductions between or among such trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such trades or businesses.

The main purpose of section 45 was to place a controlled taxpayer on tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true net income from the property and business of a controlled taxpayer. Section 45 also required the IRS to make adjustments by reallocating income between associated companies. Although not expressly stated, section 45 had the hallmark of the arm's length principle. Until 1934, there were no detailed guidelines regarding the manner in which income allocation should be made in order to accurately reflect an income. In 1934, section 45 regulations were issued

---

[522] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 39. See also DR Right 'Announcements and Report Concerning Advance Pricing Agreements: A Comment' (2001) *International Bureau of Fiscal Documentation* at 417; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 5.
[523] AM Heimert & M Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* (2010) at 5.
[524] Regulation 41, arts 77 and 78 of the War Revenue Act of 1917.
[525] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 32.

in terms of the Revenue Act of 1934. The significance of these regulations is that the term 'arm's length' was used for the first time in the US transfer pricing legislation.[526] The regulation provided that:

> The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

The birth of the term 'arm's length' was a turning point in the history of transfer pricing in the US and other countries as it ultimately became the cornerstone of transfer pricing to this day.

In 1939 the US tax statutes were re-codified by an Act of Congress as the 'Internal Revenue Code' (later known as the 'Internal Revenue Code of 1939').[527] The 1939 Code was published as volume 53, Part I, title 26 of the United States Code. In 1954, the IRC was substantially overhauled and expanded by the 83rd United States Congress.[528] The code was published in volume 68A of the United States Statutes. The new version was thereafter referred to as the 'Internal Revenue Code of 1954' and the prior version was known as the 'Internal Revenue Code of 1939'.[529] The arm's length principle in the US was however only affirmed in 1966. In that year, the classic case of *Oil Base Inc v Commissioner* was heard regarding the application of the arm's length standard in relation to sales commissions paid by a U.S. corporation to its Venezuelan marketing affiliate.[530] The provisions of the regulations to s 45 were put to the test.

In 1968, the IRS issued regulations that provided procedural rules for applying the arm's length standard and specific pricing methods for testing the arm's length character of transfer pricing results.[531] These regulations gave rise to the transfer pricing methods which were later to be adopted by the OECD. These transaction-based methods, i.e. the comparable uncontrolled price (CUP) method, the resale

---

[526] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 32. See also Eden Taxing *Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 448.
[527] EJ Barr *Valuing Pass Through Entities* (2014) at 19.
[528] Barr *Valuing Pass Through Entities* at 19.
[529] Ibid.
[530] *Oil Base, Inc v Commissioner* 362 F.d 212, 214 (9th Circuit 1966).
[531] Treasury Regulation 1.482(1)*(d)* and 1.482-2.

price method, and the cost plus method, gradually gained broad international acceptance.

The 1954 Code was renamed the Internal Revenue Code of 1986 by s 2 of the Tax Reform Act of 1986.[532] The 1986 Act contained substantial amendments, but no formal re-codification was done on it.[533] The 1986 Code retained the basic structure of the 1954 Code because most of the same lettering and numbering of subtitles, chapters, subchapters, parts, subparts and sections as the 1954 Code remained intact.[534] The 1986 Code is still published as title 26 of the United States Code and is amended from time to time. The latest additions to the Code being the tax provisions of the American Tax Payer Relief Act of 2012 and the Protecting Americans from Tax Hikes of 2015.[535]

7.3 Section 482 of the Internal Revenue Code (IRC)

Section 482 is contained in the IRC. Section 482 regulates transfer pricing in the US. It authorises the Internal Revenue Service (IRS) to adjust the income, deductions credits or allowances of commonly controlled taxpayers to prevent tax evasion.[536] Section 482 provides that:

> In any case of two or more organisations, trades, or businesses (whether or not incorporated, whether or not organised in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organisations, trades or businesses, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organisations, trades or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B) the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

[532] Kobetsky *International Taxation of Permanent Establishments: Principles and Policy* at 281.
[533] WH Hoffman Jr, WA Raabe, JE Smith & DM Maloney *Corporations Partnerships, Estates and Trusts* (2008) at 1-17.
[534] WH Hoffman Jr, WA Raabe, JE Smith & DM Maloney *Corporations Partnerships, Estates and Trusts* (2017) at 1-16 Mason.
[535] Ibid.
[536] Section 482 of the IRC. See also Ponniah & Glaize *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* at 527; T Pogge & K Mehta *Global Tax Fairness* at 159; CCH 'Tax Editors US Master Tax Guide' (2008) at 531; Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 386; J Pratt & W Kulsrud *Corporate, Partnership, Estate & Gift Taxation* (2013) at 8-12.

The main purpose of section 482 is to prevent tax evasion using transfer pricing manipulation. In the US tax evasion is also referred to as prohibited tax avoidance, this was held in the case of *Merck & Co v United States*.[537] The wording of section 482, which is a principal transfer pricing provision in the US suggest that this section considers transfer pricing manipulation or its transgression as tax evasion or prohibited tax avoidance. The fact that the application of section 482 is meant to prevent tax evasion is indicative of the fact that although section 482 does not expressly provide that transfer pricing manipulation is illegal, it can however be inferred from the language of the legislature. If section 482 was aimed at treating failure to act in arm's length as tax avoidance instead of tax evasion, the legislature should have used tax avoidance in which case transfer pricing manipulation would not have been illegal. This reasoning is supported by the definition of tax evasion in chapter 2 above. Based on this, it is contended by the author that transfer pricing manipulation in the US is illegal. Apart from the prevention of tax evasion, the other main purpose of section 482 is to ensure that taxpayers clearly and correctly reflect the income attributable to controlled transactions.[538] The purpose of section 482 was appositely emphasised by the Court of appeal in the *Xilinx v Commissioner* where it was held that:[539]

> [s]ignificantly, achieving an arm's length result is not in itself the regulatory regime's goal, rather, its purpose is to prevent tax evasion by ensuring taxpayers accurately reflect taxable income attributable to controlled transactions.

The US transfer pricing regulations provide the scope of section 482 as follows:[540]

---

[537] *Merck & Co v United States* (1991) C1. Ct 73 at 24.
[538] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 54; RJ Peroni, CH Gustafson and RC Pugh *International Income Taxation: Code and Regulations* at 1214; Rugman *The Oxford Handbook of International Business* at 602; Muchlinski *Multinational Enterprises and the Law* at 280; RD Wiegley & MJ Levitin *Export & Trade Finance* (2000) at 85; JA Miller & JA Maine *The Fundamentals of Federal Taxation: Problems & Materials* (2010) at 522; RF Reilly & RP Schweibs *Valuing Intangible Assets* (1999) at 455; SM Jones *Federal Taxes and Management Decisions* (1996) at 257; MZ Iqbal *International Accounting: A Global Perspective* (2002) at 408; GE Coven, RJ Peroni & RC Pugh *Taxation of Business Enterprises: Cases and Materials* (2002) at 669.
[539] *Xilinx v Commissioner* (2009) F.3d 482 at 567.
[540] Treasury Regulation 1.482-1*(a)*(1). See also Peroni, Gustafson & Pugh *International Income Taxation: Code and Regulations* at 1214; Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 54; Rugman *The Oxford Handbook of International Business* at 602; P Muchlinski *Multinational Enterprises and the Law* at 220; Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 427.

> The purpose of section 482 is to ensure that taxpayers clearly reflect income attributable to controlled transactions and to prevent the avoidance of tax with respect to such transactions.

Having concluded that section 482 is aimed at tax evasion, it appears that the law seem to use the term evasion and avoidance interchangeably to mean one and the same thing for transfer pricing purposes. According to the analysis conducted in chapter two of this work these concepts do not mean one and the same thing. For the purpose of this research, the provisions of the main section are preferred because regulations are secondary legislation published and interpreted by the IRS not Congress. Treasury Regulation 1.482-1*(a)*(1) provides that transactions between one controlled taxpayer and another will be subject to special scrutiny to ascertain whether common control is being used to reduce, avoid, or escape taxes. In determining the true taxable income of a controlled taxpayer, the Service is not restricted to the case of improper accounting, to the case of a fraudulent or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income of a controlled taxpayer is other than it would have been had the taxpayer, in the conduct of his affairs, been dealing at arm's length with an uncontrolled taxpayer.

Section 482 does not apply to uncontrolled transactions (usually concluded by or between independent parties) but is restricted to controlled transactions, and the latter is described as:

> Any transaction or transfer between two or more members of the same group of controlled taxpayers. The term uncontrolled transaction means any transaction between two or more taxpayers that are not members of the same group of controlled taxpayers.

Just like in other tax jurisdictions, the US courts have also accepted that taxpayers are entitled to minimise their tax liabilities within the confines of the law. In the case of *Merck & Co v United States*,[541] (which among other things also highlight the application of section 482 in relation to allocation of income and evasion of taxes) it was argued by the IRS that an allocation was justified both as a result of tax

[541] *Merck & Co v United States* (1991) C1. Ct 73 at 24.

avoidance and the quest to correctly reflect the income.[542] The court disagreed with the notion that tax avoidance can justify allocation of income (in this case) on the following reasons:

> Defendant's contention that the allocation may be justified on the section 482 prong to prevent evasion of taxes is not persuasive. The fact that Merck's management was diligent and creative, and used sophisticated tax planning to reduce its overall tax liabilities, in itself does not constitute prohibited tax avoidance or evasion. Merck's decision to locate production facilities in Puerto Rico, and its decision to position its sales efforts in foreign markets in local companies, was based on sound business reasons. A second production supply source was needed. Puerto Rico offered an adequate supply of labour and potentially appropriate sites. Other competing pharmaceutical firms had located to Puerto Rico, and any resulting lower tax rates could give such companies competitive edge. A Puerto Rican facility permitted Merck to take advantage of congressionally sanctioned tax incentives to encourage American business investments there, as well as Puerto Rican tax exemptions. It is well established that taking advantage of tax benefits made available by Congress does not constitute tax avoidance or erosion under section 482. Defendant's insinuations of impropriety in Merck's use of sophisticated tax planning do not diminish the valid business purposes established by the facts in this case. Tax considerations obviously, were a significant factor in Merck's decision in structuring group operations to supply methyldopa and LAAN to foreign marketing affiliates from MSDQ production. These tax considerations do not overcome Merck's sound business reasons so as to justify the use section 482 to prevent tax evasion. A taxpayer that does not take the tax laws into consideration when structuring complex transactions not only is naïve but probably is out of business. Accordingly, if the allocation is to be justified, it must be on the 'clearly to reflect income' prong of section 482.

The judgment highlights the parameters within which s 482 can be applied. The essence of this judgment is that even though section 482 empowers the authorities to ensure that all transactions reflect the correct income for tax purposes, such power cannot be exercised arbitrarily and must take into account the business considerations of the taxpayer. This means that despite the fact that section 482 is aimed at combating tax evasion perpetuated through transfer pricing manipulation and ensuring compliance with the tax laws, its execution by the IRS should not undermine the long-standing practice of providing taxpayers with the right arrange their business affairs in a manner that enables them to incur less tax liabilities within the confines of the law. For the purpose of this research, there are three pillars or

---

[542] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 55.

legal conditions upon which the application of section 482 is based. The pillars are taxpayer, control and transactions. These three pillars are contextualised as follows:

7.3.1 Taxpayers

A closer scrutiny of section 482 reveals that this provision apply to all types persons i.e. natural and juristic persons. The use of the phrase 'whether or not incorporated' demonstrate that all persons who are carrying on business with transfer pricing implications are governed by this provision even if they are not incorporated according to US company laws. Section 482 defines an organisation as an organisation of any kind, whether a sole proprietorship, a partnership, a trust, an estate, an association or corporation.[543] The definition is wide ranging in order to include any person who may be involved in cross-border trade. Section 482 applies to both the resident and non-resident entities. The statement 'whether or not organised in the United States' clearly illustrate that the legal personality of an entity and the location of the taxpayer is irrelevant as long as the taxpayer has derived a tax benefit which has the effect of transgressing the US transfer pricing regulations. It also does not make any difference even if the trade, organisation or business is incorporated in the US or elsewhere, the most important consideration is the effect that the taxpayer's conduct has on the US tax base.

It is also not relevant whether the taxpayer is an exempt organisation or a member of the affiliated group that files a consolidated income tax return pursuant to section 1501, as long as the taxpayer is subject to the US taxation laws, then section 482 becomes applicable to the taxpayer. Section 482 is applicable to trade or business. Trade or business is defined as a trade or business activity of any kind regardless of whether or where organised, whether owned individually or otherwise and regardless of the place of operation.[544] The carrying on of business is wide ranging in the US

---

[543] Treasury Regulation 1.482-1*(i)*(1). See also P Harris *Corporate Tax Law: Structure Policy and Practice* at 86; Campbell *International Taxation of Low –Tax Transactions [2009] – High Tax Jurisdictions* at 83.

[544] Treasury Regulation 1.482-1*(i)*(2). See also Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 385; Peroni, Gustafson & Pugh *International Income Taxation: Code and Regulations* at 385; A Johnson *US Transfer Pricing Sourcebook* at 8; CCH *Editors Income Tax Regulations* (2008) at 364.

tax law, for instance, a holding company that merely owns shares in subsidiaries is deemed to be carrying on business or trade and if the subsidiary carries on business activities, the tax implications of such trade or business can be attributed to the holding company.[545] In the case of *Whipple v Commissioner*,[546] it was held that s 482 does not apply to an individual in their capacity as shareholder in the company because investing in shares does not normally qualify as a trade or business. In the *Foglesong v Commissioner*, section 482 was found not to apply to the shareholder who worked exclusively for his company.[547] In this case, the court held that:

> We believe that … an individual who does not work exclusively for his personal service corporation may have the income earned by it allocated to him under section 482. The section should not apply, however, to one who does work exclusively for his corporation. This interpretation of section 482 satisfies both the terms of the statute-one who does not work exclusively for his corporation may rightly be said to be engaging in a separate business-and the policy that legitimate personal service corporations should be recognised.

If an individual loans money to the company, that activity does not qualify as business and it is therefore not subject to section 482; however, if an individual leases assets to the company, this activity is considered to be carrying on a business or trade and it is subject to section 482.[548] The wording of section 482 does not seem to exclude transactions between a head office and a permanent establishment because a permanent establishment falls within the ambit of organisation, trade or business of the MNE group.[549]

7.3.2 Control

The second pillar of section 482 is the control that two or more taxpayers are exercising among or over each other. The guiding principle in section 482 is found in the use of the phrase ‘owned or controlled directly or indirectly by the same interests. This phrase denotes that there must be a connection between the entities which are engaged in a transfer pricing transaction. It is important to bear in mind that the entities must not only be connected but there must be some kind of control exercised over or by one or more of the taxpayers to the other. It is also important to note that

545 Wittendorff *Transfer Pricing and the Arm’s Length Principle in International Tax Law* at 63.
546 *Whipple v Commissioner* (1963) US 193 at 373.
547 *Foglesong v Commissioner* (1982) F.2d 848 at 691.
548 *Fegan v Commissioner* (1979) TC 791 at 71.
549 Wittendorff *Transfer Pricing and the Arm’s Length Principle in International Tax Law* at 63.

being connected does not necessarily mean that the taxpayers control each other. The US tax law does not contain any guidance or detail for assessing whether there is control between two taxpayers. In the absence of any strict guideline, control can therefore take any form but it must be legally possible to verify the existence or the non-existence of such control. Although the guidelines on control are not provided but the word control is broadly defined in section 482 regulations to include:[550]

> any kind of control, direct or indirect, whether legally enforceable or not and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

In order to ensure effective transfer pricing adjustment, the definition above allows for any type of control. In this regard, control may be direct, indirect, vertical or horizontal. In order to ensure that control is not used as an instrument for tax evasion purposes section 482 is also applicable to the control which may not be legally enforceable due to physical (factual) or legal impossibility. Section 482 is based on the *de facto* control or what is commonly known as the reality of control.[551] An important consideration here is whether a taxpayer in fact has the power to dictate the transfer price of a transaction based on their relationship with the other taxpayer. Control can be based on various aspects. The most common of those are ownership of capital, control of voting rights, group affiliation and other factors which may be taken into account to prove both the connection and control between two or more taxpayers.[552]

It was held in the *Bransford v Commissioner* that ownership of more than 50 per cent of the capital or control of more than 50 per cent of the voting rights normally fulfils the requirements of control but it was further noted in that case that the 50 per cent

[550] Treasury Regulation 1.482-1*(i)*(4). See also JC Amico *Introduction to the US Income Tax System* (1993) at 175; Johnson *US Transfer Pricing Sourcebook* at 9; Feinschreiber *Transfer Pricing Handbook* at 5-5.
[551] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 65. See also CD Wallace *The Multinational Enterprise and Legal Control* (2002) at 924; Feinschreiber *Transfer Pricing Methods: An Application Guide* at 247; Feinschreiber *Transfer Pricing Handbook* at 52-7.
[552] Treasury Regulation 1.482-1*(i)*(4).

threshold does not apply if the company is controlled by other interests.[553] For control to be proven to exist it appears that even the minority shareholding will be sufficient to meet the requirements if it gives them effective control of the company. It was held in the *Dallas Ceramic Co v United States* that in instances where control cannot be readily ascertained, there will be a presumption of control if it can be proven by the IRS that profit shifting or transfer pricing manipulation has taken place.[554]

The burden to prove that there is no control which will obviate the legal consequences of section 482 lies with the taxpayer.[555] Conditions for control can still be fulfilled for transactions between companies that are controlled by the same group of otherwise unrelated shareholders.[556] For section 482 to be applicable, the taxpayers should act with a common purpose to avoid taxes but the regulations are not applicable where unrelated taxpayers acted in concert to shift the profits and make arbitrary deductions unless those unrelated companies are exercising a joint control over another company.[557] A view was held in the *US Steel Corp v Commissioner* that a dominant market position is not a legal basis upon which control in terms of section 482 can be derived.[558] This is so because market dominance does not automatically translate to effective control over another taxpayer. The existence of an unrelated intermediary in the transaction that involves two or more taxpayers does not in itself neutralise the element of control if profit shifting can be proven between the controlled persons.[559] Another important consideration is that control must be clearly identifiable at the time of concluding the transaction. In the *DHL Corp v Commissioner,* it was held that:[560]

> The conditions for control were satisfied in a situation where a US company sold a trademark to a foreign company, even though at the time of the transaction the companies were owned and controlled by different interests. However, the sale took place in accordance with an option agreement which had been entered into at a time when the companies were owned

[553] *Bransford v Commissioner* (1977) TCM 1977-314.
[554] *Dallas Ceramic Co v United States* F.2d 1382 (5th Cir.1979) at 598.
[555] *Hall v Commissioner* F.2d 82 (5th Cir.1961) at 294.
[556] *Grenada Industries Inc v Commissioner* F.2d 873 (5th Cir 1953) at 202.
[557] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 66.
[558] *US Steel Corp v Commissioner* F.2d 942 (2nd Cir 1980) at 617.
[559] *First Security Bank of Utah v Commissioner US* 394 (1972) at 405.
[560] *DHL Corp v Commissioner* 285 F.3d 1210 (9th Cir 2002).

and controlled by the same interests. According to the Court of Appeals, the conditions for control should be assessed at the time when the option agreement was entered into and the transfer price determined (transactional approach). A transaction between independent companies can therefore be adjusted under section 482 if the transfer price is agreed at a time when they were subject to common control.

7.3.3 Prevention of Tax Evasion

The purpose of section 482 is to assist in the correct reflection of income and prevention of tax evasion. In terms of section 482, the income of each enterprise in the group of companies must be clearly reflected in relation to the risk assumed in making that income. Section 482 is however silent on how tax evasion can be prevented within the context of transfer pricing. It can however be deduced from the definition that this is achieved by preventing a company from hiding its taxable income in a subsidiary or a separate company. Despite a lack of details on how tax evasion should be prevented, it is however important to note that there is a willingness by the US tax authorities to combat tax evasion related to transfer pricing by the express proscription of tax evasion in the provision.

It is interesting to note that section 482 does not provide for ‘prevention of impermissible tax avoidance’ within transfer pricing but the prevention of tax evasion. This is an indirect indication that the US transfer pricing rules consider the contravention of section 482 so serious to an extent of considering such conduct as constituting tax evasion. It also means impermissible allocation of income which results in the loss of tax revenue or non-compliance with this provision is taken in the same light as tax evasion. This in a way supports the finding in Chapter 2 that impermissible tax avoidance in the form of transfer pricing manipulation is best classified as tax evasion. This is a far cry when compared to the South African transfer pricing provisions as they only prescribe that the setting of transfer prices between connected parties must be at arm’s length but does not go further to address tax evasion or so-called impermissible tax avoidance schemes used in the perpetuating transfer pricing manipulation.

7.3.4 Transactions

The taxable income between related parties must be determined on the basis of data used in each individual transaction.[561] Section 482 does not prescribe the nature of transactions which can be subjected to transfer pricing adjustment save to say that the transactions should relate to the setting of transfer prices and or the transference or shifting of profits to foreign tax jurisdiction. According to the IRS Treasury Regulations, the term transaction is defined as:[562]

> any sale, assignment, lease, loan, advance, contribution, or any other transfer of any interest in or a right to use any property (whether tangible or intangible, real or personal) or money, however such transaction is effected and whether or not the terms of such transaction are formally documented. A transaction also includes the performance of any services for the benefit of, or on behalf of another taxpayer.

The definition above is non-exhaustive and wide ranging. This provision is applicable to tangible, intangible assets, financial assets and services regardless of form of transfer. The phrase 'performance of any services for the benefit of, or on behalf of another taxpayer' demonstrates that section 482 does not exclude the possibility of omission as well. It can however be deduced that the obligation to act (commission) is clearly covered and articulated by section 482 when one takes into account the phrase 'performance of any services for the benefit of, or on behalf of another taxpayer'. Section 482 is rather silent when it comes to omission. The US case law fortunately deals with what would have been an undesirable state of affairs because in the case of *Bausch & Lomb Inc. v Commissioner* the court supported the view that, in principle section 482 may be applicable to omissions.[563] The wide-ranging nature of section 482 in this regard is seen by the use of the phrase 'whether or not the terms of such transaction are formally documented'. This means that section 482 is also applicable to transactions which are not formally documented. The provision does not give guidance on what is meant by formal documentation; this may cause interpretational issues. In the previous chapters, particularly Chapter 5, it was

[561] PR McDaniel, HJ Ault & JR Repeti *Introduction to United States International Taxation* (2005) at 148. See also Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 477; Lang *Tax Compliance for Companies in an Enlarged European Community* at 167.
[562] Treasury Regulation 1.482-1*(i)*(7).
[563] *Bausch & Lomb Inc. v Commissioner* F.2d 1984 (Cir.1991) at 933.

mentioned that lack of comparable data was a problem; informal documentation may prove very difficult to access.

7.4 The Arm's Length Principle in the US

The general overview of the arm's length principle has been fully discussed in Chapter 2 of this research, only the US perspective of the arm's length concept will be briefly discussed here. The discussion in this paragraph will have minor variations from the discussion in Chapter 2; in any case, the discussion there is based on the US's approach to the concept. The arm's length price has been part of the provisions of section 482 for over 60 years.[564] The application of section 482 is based on the arm's length principle; the arm's length principle is in fact the nub of the section 482 regulations.[565] It is for this very reason that any conflict between the arm's length principle and other rules must be resolved in favour of section 1.482-1*(b)*(1).[566] The US transfer pricing system considers the arm's length principle to be a principle of equality that places a controlled taxpayer on tax parity with an uncontrolled taxpayer.[567] The reasons for the adopting the arm's length principle as a US tax policy under section 482 was eloquently articulated in the following paragraph:[568]

> The use of the arm's length standard is a natural reaction. Tax administrators do not question transactions that are governed by the market place. If company A sells goods to unrelated company B at a certain price or furnishes services at a particular price, the income of both companies is determined by using that price.one company may be large and the other may be small; one may be a monopoly; one may be financially strong and the other in a weak condition. But these and other factors which may affect the price at which the transaction occurs arte not the concern of the tax administrator. His tasks are not to correct the injustices or unfairness of the market place nor to turn bad bargains into fair arrangements…given this acceptance of the market place, a tax system and tax administrators working within it-when faced with intra-group transactions not governed by that marketplace but instead by the

[564] Markham *Transfer Pricing of the Intangibles* at 19.
[565] Section 1.482-1*(b)*(1).
[566] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 295.
[567] Heimert & Johnson Gu*ide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 6; McLure *The State Corporation Income Tax: Issues in Worldwide Unitary Combination* at 18; Rugman *The Oxford Handbook of International Business* at 602; Bakker & Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 528.
[568]SS Surrey 'Reflections on the Allocation of Income and Expenses among National Tax Jurisdictions' (1978) 10 *Law and Policy in International Business* 409-460. See also Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* at 84; Richelle, Schon & Traversa *Allocating Taxing Powers within the European Union* at 96.

> policies and goals of the overall enterprise, naturally seeks to replace the intragroup arrangement with the norm of the marketplace. Presumably most transactions are governed by the general framework of the market place and hence it is appropriate to seek to put intra-group transactions under the general framework. Thus, the use of the arm's length, both to test the arrangements and to adjust that allocation if it does not meet such standard, appears in theory to be a proper course.

In 1988, the study of intercompany pricing published by the US Treasury Department also stated that:[569]

> The arm's length standard is embodied in all US tax treaties; it is in each major model treaty, including the US Model Convention; it is incorporated into most tax treaties to which the United States is not a party; it has been explicitly adopted by international organisations that have addressed themselves to transfer pricing issues; and virtually every major industrial nation takes the arm's length standard as its frame of reference in transfer pricing cases… [T]he United States should continue to adhere to the arm's length standard.

This defence and exclusive endorsement of the arm's length drew much criticism from its detractors as they claimed that the US wanted to maintain the *status quo* (upholding the arm's length principle as the dominant or sole mechanism of arriving at a correct transfer price at the exclusion of other methods) as the principle does not have any merit to be singled out in the midst of other alternative methods like the global formulary apportionment.[570]

As already mentioned in the previous chapters, the arm's length principle states that the amount charged by one related party to another for a given product must be the same as if the parties were not related. An arm's length price for a transaction is therefore what the price of that transaction would have been on the open market. For commodities, determining the arm's length price can sometimes be as simple as looking up comparable pricing from non-related party transactions, but when dealing with proprietary goods and services or intangibles, arriving at an arm's length price can be a more complicated exercise. Unlike in South Africa, the US defines most of the important concepts within transfer pricing. The US definition of the arm's length standard is found in section 1.482-1*(b)* of the transfer pricing regulations and it provides that:

[569] IRS Notice 88-123, 1988-2 C.B. 458,475 (The White Paper).
[570] Markham *The Transfer Pricing of the Intangibles* at 20.

> Arm's length standard determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result). However, because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances.

The arm's length price is determined by means of the arm's length test. An arm's length test refers to the verifying whether or not the transfer price of a controlled transaction complies with the arm's length principle.[571] There are two types of arm's length tests in the US transfer pricing practice and they are: an empirical arm's length test and a hypothetical arm's length test.[572] An empirical arm's length test is based on prices in transactions which have actually taken place between parties which are independent of each other.[573] In other words, this is as a result of a *posteriori* finding. The nub of section 482 regulations is the empirical arm's length test because it takes into account the comparison with unrelated parties.[574] The correct application of the empirical arm's length test was suggested by the court in the case of *Lufkin Foundry and Machine Co v Commissioner*.[575] In this case, the taxpayer in defence of his pricing strategy in the controlled transaction simply referred only to internal data which was never compared to uncontrolled transactions under similar circumstances. The idea that internal data cannot be used in the place of empirical data was also confirmed in the *Eli Lily & Co v Commissioner* case.[576] The gist of *Lufkin Foundry and Machine Co v Commissioner* in relation to transfer pricing comparability was captured as follows:

---

[571] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 18; Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* at 332; Bakker & Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 99; Kuan *Global Transfer Solutions* at 78; R Feinschreiber *Transfer Pricing Handbook* at 10-2.

[572] Markham *The Transfer Pricing of the Intangibles* at 19.

[573] Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* at 95; IBFD *Bulletin for International Taxation* Vol 3 (2009) at 123 and 127.

[574] Treasury Regulation 1.482-1*(c)*(2) and Treasury Regulation 1.482-3*(e)*.

[575] *Lufkin Foundry and Machine Co v Commissioner* F2.d 805 (5th Cir 1972) at 468.

[576] *Eli Lily & Co v Commissioner* F.2d (7th Cir.1988) at 856.

> No amount of self-examination of the taxpayer's internal transactions alone could make it possible to know what prices or terms unrelated parties would have charged or demanded. We think it palpable that, if the standard set by these unquestioned regulations is to be met, evidence of transactions between uncontrolled corporations unrelated to Lufkin must be adduced in order to determine what charge would have been negotiated for the performance of such market services.

The second arm's length test is the hypothetical arm's length test. The hypothetical arm's length test is based on the conjectural prices in a controlled transaction. According to this test, an assumption is made that parties would have agreed in a transaction which has taken a certain form even though such a transaction did not take place; this is usually evidence of a prior finding based on reasoning and deduction.[577] There are many instances where hypothetical arm's length test is applied. One example of such instance is in the case of cost sharing arrangements where the parity between taxpayers in uncontrolled transactions and taxpayers in controlled transactions was in question.[578] The case in point is the *Xilinx Inc* v *Commissioner* where the IRS argued that the cost pool (sharing) should be determined without regard to the existence of uncontrolled transactions. The tax court held that internal data could not override empirical data on market transaction and this decision was upheld in the court of appeal where judge Noonan of the majority held:

> Purpose is paramount. The purpose of the regulations is parity between taxpayers in uncontrolled transactions and taxpayers in controlled transactions. The regulations are not to be construed to stultify that purpose. If the standard of the arm's length is trumped by s 7*(d)*(1), the purpose of the statute is frustrated. If *Xilinx* cannot deduct all its stock options costs, *Xilinx* does not have tax parity with an independent taxpayer.

In terms of section 482, the arm's length principle seeks to ensure that enterprises reflect their true taxable income from inter-affiliate transactions. If the Commissioner is of the opinion that a foreign related party overcharged its related company in the US, he may adjust the transfer price downwards, thus increasing the US taxable income. The revenue authority in the foreign country may agree that the transfer price was too high and make a corresponding adjustment thereby decreasing the income of the foreign related company. Since the arm's length principle is

[577] Markham *The Transfer Pricing of the Intangibles* at 19.
[578] Treasury Regulation 1.482-7T*(a)*(1) and Treasury Regulation 1.482-9*(b)*(7)(ii)(B).

considered to be the universal method of determining the transfer price between connected parties, the US transfer pricing system is also not immune to all the weaknesses (experienced by other countries) of this principle as mentioned in Chapter 2 and other relevant chapters.

7.5 The Best Method Rule

The nature and characteristics of the transfer pricing methods discussed in chapter 3 are the same as those applied in the US with very minor variations. The methods are thus fully discussed in Chapter 3 of this research and will not be repeated here. It is however important to briefly discuss the best method rule and the application of the global formulary method within the US transfer pricing practice as these were not discussed in the general discussion of the transfer pricing methods because they fit more within the US transfer pricing practice. The reason for that is that not all tax jurisdictions apply these methods, although not unique to the US but they are predominantly applied there. The best method rule will be analysed first. Since 1993, the selection of the appropriate method in the US is made by applying the best method rule.[579] In terms of Treasury Regulation 1.482-1*(c)*, the arm's length result of a controlled transaction must be determined under the method that, given the facts and circumstances, provides the most reliable measure of an arm's length result.[580] This method advocates that the selection of a transfer pricing method must be based on the comparability between the controlled transaction and the reference transactions; rather than on the internal hierarchy of the methods. This means that there is no strict prioritisation of the methods and that there is no method which is considered to be more reliable than other methods.[581] In determining the most

---

579 Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 702; AM Heimert & M Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 16; Levey, Wrappe & Chung *Transfer Pricing Rules and Compliance Handbook* at 11; Feinschreiber *Transfer Pricing Handbook* at 9-16; McDaniel, Ault & Repeti *Introduction to United States International Taxation* at 143; King *Transfer Pricing and Corporate Taxation, Problems, Practical Implications and Proposed Solutions* at 110.

580 Treasury Regulation 1.482-1*(c)*. For a further and comprehensive analysis of the determination of the arm's length using the best method rule see also Dunning *Multinational Enterprises and the Global Economy* at 631; Keuper & Kleug *Finance Bundling and Finance Transformation: Shared Services Next Level* at 494; Markham *The Transfer Pricing of Intangibles* at 91; Ault & Arnold *Comparative Income Taxation: A Structural Analysis* at 421; BL Brady *Essentials of International Marketing* (2011) at 264; Avi-Yonah *International Tax as International Law: An Analysis of International Tax Regime* at 114.

581 OECD *Transfer Pricing Guidelines* at 97-98; Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 269; D Deak *Hungary in International Tax Planning* (2003) at 104; Heimert & Johnson

reliable measure of an arm's length result, the degree of comparability between controlled and uncontrolled transactions and the quality of data and assumptions used need to be considered.[582] It is therefore not a requirement that the inapplicability or irrelevance of the other methods should be established, if it can be shown that a particular method will produce more reliable results. The method considered to be best in comparison to the others must be applied. This means that if two or more applications of a single method provide inconsistent results, the arm's length results must be determined by using the application that provides the most reliable measure of an arm's length result in the circumstances.[583] Code of Federal Regulations (CFR) number 26 under section 1.482-8 explains that:

> In accordance with the best method rule of section 1.482-1(c), a method may be applied in a particular case only if the comparability, quality of data, and reliability of assumptions under that method makes it more reliable than any other available measure of the arm's length result. The following examples illustrate the comparative analysis required to apply this rule. As with all of the examples in these regulations, these examples are based on simplified facts, are provided solely for purposes of illustrating the type of analysis required under the relevant rule, and do not provide rules of general application. Thus, conclusions reached in these examples as to the relative reliability of methods are based on the assumed facts of the examples and are not general conclusions concerning the relative reliability of any method.

CFR number 26, section 1.482-8 also provides examples of how each of the methods, can be picked on as the best method. The example below as quoted from this regulation explains and demonstrates reasons why the CUP method would be picked on as the best method:

> Preference for comparable uncontrolled price method: Company A is the US distribution subsidiary of Company B, a foreign manufacturer of consumer electrical appliances. Company A purchases toaster ovens from Company B for resale in the U.S market. To exploit other outlets for its toaster ovens, Company B also sells its toaster ovens to Company C, an unrelated U.S. distributor of toaster ovens. The products sold to Company A and Company C

Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies at 15; Rathore *International Accounting* at 308.

[582]CCH Editors *Income Tax Regulations* (2009) at 389; Bullen *Arm's Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* at 398; OECD 'Export and Import Price Index Manual: Theory and Practice' (2009) at 285; Schaffer, Agusti & Dhooge *International Business Law and its Environment* at 522.

[583] Treasury Regulation 1.482-1*(c)*(2)(iii).

are identical in every respect and there are no material differences between the transactions. In this case application of the CUP method, using the sales of toaster ovens to Company C, generally will provide a more reliable measure of an arm's length result for the controlled sale of toaster ovens to Company A than the application of any other method.

As already mentioned in Chapter 3 above, the selection of a method should be based on the following criteria: the degree of comparability between the transactions and the quality of data and the assumptions used. The degree of comparability is assessed by taking into account the factors and rules applicable for each of the methods.[584] Generally, the factors which are taken into consideration are: the functions undertaken by the relevant entities, the contractual terms, risks borne by the relevant entities, economic conditions and the nature of goods and service provided.[585] The quality of data and the assumptions used are relevant for the evaluation of comparability.[586] In turn, the following factors must be taken into account when the evaluation of comparable data is being conducted: the completeness and accuracy of the data, the reliability of the assumptions and the sensitivity of the results in relation to the deficiencies in the data.[587] The completeness and accuracy of the data are important in the comparability analysis because it affects the ability to identify and quantify any material differences that might occur between the transactions.[588] The reliability of the assumptions is also critical because the application of a method depends on the quality of the assumption made.[589] The sensitivity of the results to deficiencies in the data and assumptions may have a greater effect on some methods than others.[590] For example, differences regarding property transferred may be more important for CUP

[584] Treasury Regulation 1.482-1*(c)*(2)(i).
[585] See also RF Reilly & R Scheihs *The Handbook of Business Valuation and Intellectual Property Analysis* (2004) at 570; J Kuan *Global Transfer Solutions* at 50; Schon & Konrad *Fundamentals of International Transfer Pricing In Law and Economics* at 100; OECD 'OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Aspects of Intangibles' (2014) at 88; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 21.
[586] Treasury Regulation 1.482-1*(c)*(2)(ii). See also Panayi *Advanced Issues in International and European Tax Law* at 158; Markham *The Transfer Pricing of Intangibles* at 197; Feinschreiber *Transfer Pricing Methods: An Application Guide* at 89.
[587] C Devonshire-Ellis, A Scot & S Woollard *Transfer Pricing in China* at 32; Juta Statutes Editors *SAIT Compendium of Tax Legislation* at 504; DM Weber & S Van Weeghel *The 2010 OECD Updates Model Tax Convention and Transfer Pricing Guidelines: A Critical Review* (2011) at 153; A Bakker & MM Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 493.
[588] Treasury Regulation 1.482-1*(c)*(2)(ii)(A).
[589] Treasury Regulation 1.482-1*(c)*(2)(ii)(B).
[590] Treasury Regulation 1.482-1*(c)*(2)(ii)(C).

than for CPM. Conversely, differences regarding management efficiency may be more important for the CPM than for CUP.[591]

The OECD Guidelines also state that no one method is suitable in every possible situation. The guidelines provide that where one approach is not conclusive or appropriate for a particular transaction, a more flexible approach which allows the evidence of various methods is advocated by the OECD.[592] It may thus be concluded that the OECD Guidelines are based on a multiple method approach while the US regulations are based on a single best method approach.[593] The best method approach accords with decisions of the courts in some developed countries. For instance, the German Federal Fiscal Court noted that:[594]

> It is the responsibility of the Fiscal Court to determine the most appropriate method in each individual case. In each case this is the one with which the arm's length price can be determined with the highest probability of correctness.

In the *Smithkline Beecham Animal Health Inc v Canada*,[595] it was held that:

> In this regard, it must be recalled that the Crown, based on the OECD Guidelines, has chosen to employ the CUP method for determining an arm's length price for cimetidine. However, the OECD Guidelines also describe alternative pricing methods that the Crown has chosen not to employ. The choice of method depends upon finding appropriate comparators, which in turn depends upon analysis of points of difference and similarity between the structure, operations and activities of Smithkline and the various candidates for comparison (in this case, potentially all other Canadian pharmaceutical manufacturers) that might, at least in theory, include such things as profit margins and profitability.

The application of the best method rule establishes an arm's length range of prices or financial returns against which to test the controlled transactions. If the tested party financial results fall within the middle 50 per cent of that range, known as the interquartile range, then the controlled transaction is considered to be arm's length.

---

591 Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 703.

592 OECD *Transfer Pricing Guidelines* at 97. See also Weber & Van Weeghel *The 2010 OECD Updates Model Tax Convention and Transfer Pricing Guidelines: A Critical Review* at 176; M Kobestsky *International Taxation of Permanent Establishments, Principles and Policy* at 345; Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 244.

593 Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 702.

594 *Federal Fiscal Court decision* of 17 October 2001, IR 103/00(BStB1 II2004 171).

595 *Smithkline Beecham Animal Health Inc. v Canada* 2002 FCA 229(2002) para 32.

7.6 Global Formulary Apportionment Method (GFA) in the US

As already mentioned in paragraph 3.1 of this work, the global formulary method is applied in certain states like California and Massachusetts in the US. This method can act as an alternative to the OECD transfer pricing methods. The global formulary apportionment is defined by the OECD Transfer Pricing Guidelines as:[596]

> [a]n approach to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined formula.

Although the arm's length principle is universally considered to be the basis of transfer pricing, it also has certain weaknesses as shown in the previous paragraphs.[597] The global formulary apportionment method is discussed here to determine if it can offer an alternative to the arm's length principle. The global formulary apportionment is a complex concept which may be a subject of research on its own, a full exposition of this method will not be conducted here. Its discussion will only be limited to its basic principles just to illustrate that the arm's length principle is not the only standard that can be used to deal with transfer pricing issues. In the global formulary apportionment system, the MNE group is viewed as a single unit (unitary taxation applied) where formulary apportionment is applied to attribute tax to different jurisdictions in which the entity transacts. Accordingly, the share of profits of a multinational group that each country may tax is determined not by looking at the accounts of companies operating in each country but by dividing out the total global profits of the group according to a predetermined formula.[598] In other words, affiliated entities engaged in a common enterprise are taxed as if they were a single corporation.

---

[596] OECD *Transfer Pricing Guidelines* at 26. See also Arnold & McIntyre *International Tax Primer* at 77 where it is mentioned that the GFA is an alternative to the arm's length principle. It is further mentioned that in the formulary apportionment system, associated parties engaged in a common enterprise are taxed by means of a predetermined formula as if they were a single corporation. For further analysis of the GFA see also J Li 'Global Profit Split: An Evolutionary Approach to International Income Allocation' (2002) 50(3) *Canadian Tax Journal* at 843.

[597] Arnold & McIntyre *International Tax Primer* at 77. See also Schon & Konrad *Fundamentals of International Transfer Pricing in Law and Economics* at 73; J Monsenego *Taxation of Foreign Business Income within the European International Market* Vol 2 (2012) at 332.

[598] Miller & Oats *Principles of International Taxation* at 243. See also RM Hammer *Will the Arm's Length Test stand the Test of Time? The Spectre of Apportionment* (1996) 24; Intertax at 2; J Owens 'Should the Arm's Length Principle Retire?' (2005) 12 *International Transfer Pricing Journal* at 99-101. See also PB Musgrave 'Sovereignty Entitlement and Cooperation in International Taxation' (2001) 26(4) *Brooklyn Journal of International Law* at 1335.

There is no standard way of determining how the formula is established but it is mostly based on a combination of costs, assets, proportion of turnover, payroll and sales.[599] In the case of an MNE engaged in the manufacture and sale of goods, an apportionment might be used that would allocate some fraction of the income in accordance with sales which took place in those countries. The remaining portion may be allocated to the taxpayers in whose countries manufacturing took place which may be based on the total of the manufactured goods or payroll of the enterprise or a combination of the two.[600] The manner of allocation actually leaves very little room for income to be apportioned to any tax haven corporation forming part of the MNE group unless the tax haven was part of the activities of the group.

It is important to note that the global formulary apportionment system differs from the arm's length principle with regard to the treatment of income from intangible property. Under the global formulary apportionment system, all income including income derived from the intangibles is apportioned to the country which carried out that particular function. In contrast, the arm's length principle apportions the income derived from the intangibles to the country which has ownership of the intangible; this makes ownership rights less important for the other members of the MNE group without ownership rights. The other difference between the global formulary apportionment system and the arm's length principle is that in the case of the latter, functional analysis is undertaken to assign risks borne by different entities of the group, whereas in the GFA, no functional analysis is undertaken, risks are apportioned equally among all the entities.[601] By its apportionment nature, the global formulary apportionment system does not require the presence of a comparable uncontrolled transaction. To a certain extent, the global formulary apportionment is similar to the profit split method.

[599] A Ting 'Multilateral Formulary Apportionment Model-A Reality Check' (2010) 25 *Australian Tax Forum* at 102. See also JJA Burke 'Re-Thinking First Principles of Transfer Pricing Rules' (2011) 30(3) *Virginia Tax Review* at 620.
[600] Arnold & McIntyre *International Tax Primer* at 77. See also SC Morse 'Revisiting Global Formulary Apportionment' (2010) 29 *Virginia Tax Review* at 599.
[601] Sing & Bagchi *Transfer Pricing Regulations for India* at 76.

7.6.1 Advantages of GFA

There are various arguments advanced in favour of the global formulary apportionment system. The method has been extolled for providing greater administrative convenience and certainty for taxpayers.[602] The exponents of the method also take the view that it is more in keeping with the economic reality of the enterprises. According to the GFA, an MNE group must be considered on a group-wide or consolidated basis to reflect the business realities of the relationships among the associated enterprises in the group.[603] This method provides that the separate accounting method is inappropriate for highly integrated groups because it is difficult to determine what contribution each associated enterprise makes to the overall profit of the MNE group. The use of the GFA arguably reduces compliance costs for taxpayers since only one set of account for the group is required for domestic purposes.

7.6.2 Disadvantages of GFA

Most countries who are members of the OECD do not consider the global formulary apportionment as a realistic alternative to the arm's length principle. The most serious concern with the global formulary apportionment system is the difficulty of implementing the system in a manner that both protects against double taxation and ensures a single taxation system.[604] To overcome this difficulty would require substantial international coordination and consensus on the predetermined formulae to be used and on the composition of the group in question. According to the OECD,[605] to avoid double taxation there would have to be common agreement to adopt the approach in the first place, followed by agreement on the measurement of the tax base of an MNE group, on the use of a common accounting system, on the factors that should be used to apportion the tax base among different tax jurisdictions (including non-member countries) and how to measure and weigh those

[602] OECD *Transfer Pricing Guidelines* at 39. See also RS Avi-Yona 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation" (2010) 2(1) *World Tax Journal* at 10.
[603] Feinscreiber & Kent *Transfer Pricing Handbook* at 64.
[604] Sing & Bagchi *Transfer Pricing Regulations for India* at 78.
[605] OECD *Transfer Pricing Guidelines* at 40.

factors.[606] It is further argued that even if some countries were willing to accept the global formulary apportionment system, there would be disagreements because each country would want to emphasise or include different factors in the formula based on the activities or factors that positively predominate in its jurisdiction.[607]

It goes without saying that each country would devise a formula or weighting that is favourable in maximising its revenue collection. This will have an added burden that tax administrations would have to consider jointly how to address the potential of artificially shifting the production factors used in the formula. The risk of transfer pricing manipulation is high because the components of the relevant formula can be easily manipulated by entering into unnecessary financial transactions or by deliberately moving mobile assets or by requiring that particular companies within the MNE group maintain inventory levels in excess of what normally would be encountered in an uncontrolled company of the same size.

The transition to GFA would present enormous political and administrative complexities and would require a level of international cooperation, which is unrealistic expectation in the field of international taxation.[608] The unintended consequences of those political and administrative complexities are that such multilateral coordination would require the inclusion of all major countries where MNEs operate and if all the major countries fail to agree to move to the global formulary apportionment system, MNEs would be faced with the burden of complying with two totally different systems. In other words, for the same set of transactions they would be forced to calculate the profits accruing to their members fewer than two completely different standards. Such a situation would create a potential for double taxation and transfer pricing manipulation will be used to escape these risks.

Another concern is that the predetermined formulae will be arbitrary because it will inherently disregard market conditions, the particular circumstances of the individual enterprises and management's own allocation of resources and this will result in an

[606] J Roin 'Can the Income Tax be Saved? The Promise and Pitfalls of Adopting Worldwide Formulary Apportionment' (2008) 61 *NYU Tax Law Review* at 171.
[607] Sing & Bagchi *Transfer Pricing Regulations for India* at 78.
[608] OECD *Transfer Pricing Guidelines* at 40. See also RH Cutler 'Formulary Apportionment-is this Alternative to the Arm's Length Standard Possible and Practical under the Unites States' Current Tax Treaties' (1997) 3(3) *International Trade and Business Law Annual* at 165.

allocation of profit that bears no sound relationship with the facts and circumstances of the transaction.[609] The nature of the formulae will implicitly impute a fixed rate of profit per currency unit of each component to every member of the MNE group in every tax jurisdiction regardless of differences in assets, risks and efficiencies of the different members of the MNE group. This will result in the assignment of profits to an entity that would naturally incur losses if it were an independent enterprise.[610]

Another problem with the GFA approach is with regard to the exchange rate movements. The effects of the exchange rates movements on the GFA is that rate movements may lead to increasing the profits of the associated enterprise operating with the stronger currency whereas in the long run a strengthening currency makes exports less competitive and leads to a downward pressure on profits which will result in loss of tax revenue.

Contrary to the assertions of its advocates, the GFA may in fact present high compliance costs and data requirements because information would have to be gathered about the entire MNE group and presented in each jurisdiction on the basis of the currency and accounting rules of that particular jurisdiction.[611] It can therefore be contended that the documentation and compliance requirements for an application of the GFA would generally be more burdensome than under the separate entity approach of the arm's length principle. Difficulties would also arise in determining the sales of each member and in the valuation of assets, especially in the valuation of intangible property.[612] To mitigate all these costs and risks, MNEs will seek ways to manipulate before-tax income in order to pay less tax or shift profits to tax havens. The GFA has the effect of taxing an MNE group on a consolidated basis and thereby abandoning the separate entity approach in terms of the arm's

[609] Avi-Yona *Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation* at 10.

[610] SB Nielsen, P Raimondos-Møller and G Schjelderup 'Tax Spillovers under Separate Accounting and Formula Apportionment' at 13 available at http://www.nhh.no/Files/Filer/institutter/sam/Discussion%20papers/2001/dp09.pdf, accessed on the 31 March 2016.

[611] OECD *Transfer Pricing Guidelines* at 41. See also O Oldman & JJS Brooks 'The Unitary Method and the Less Developed Countries: Preliminary Thoughs' (1987) 45(1) *International Business Law Journal* at 61.

[612] JM Weiner 'It's Time to Adopt Formulary Apportionment' (2009) *Tax Analysts* at 106. Weiner points out that the GFA is not without its own problems as he correctly points out that Just like under the current arm's length system, intangible property creates difficulties of transfer price valuation.

length principle.[613] For this reason, it is argued that the GFA approach cannot as a practical matter recognise the important geographical differences, separate company efficiencies and other factors which are inherently peculiar to an individual company within an MNE.[614] The arm's length principle takes into account that an associated enterprise is a separate entity from the group and may be earning a profit even when the rest of the MNE group is incurring a loss. It is argued that the GFA does not have the flexibility to properly account for this contention. The antagonists of the GFA maintain that one of the biggest disadvantages of the approach is that it does not provide a complete solution to the allocation of profits of an MNE group.[615]

7.7 Selected Weaknesses of Section 482

Section 482 may have many weaknesses, but this discussion is confined only to the weaknesses which are viewed to be relevant to the problem at hand. For the purposes of this research, the following are considered to be section 482's weaknesses: lack of parameters in relation to the control element, lack of allocation formula and wide discretionary nature of section 482. These weaknesses are briefly discussed as follows:

7.7.1 Lack of Parameters in Relation to the Control Element

Section 482 is one of the most powerful and progressive pieces of legislation applied to fight tax evasion and ensure the correct allocation of income within transfer pricing in the US. Despite its erudition, section 482 has certain weaknesses which have a direct impact on the very purpose for which it has been enacted. In the early days of its enactment, it was remarked that:[616]

> In fact, its very simplicity makes it appear ridiculous, sitting as it does in the midst of the much more elaborate sections of the Code. It has no subsections, no definitions, no cross references, no exceptions and no mysterious effective date.

[613] Sing & Bagchi *Transfer Pricing Regulations for India* at 78.
[614] E Baistrocchi *The Transfer Pricing Problem: A Global Proposal for Simplification* (2006) 51(4) *Tax Lawyer* at 976. See also H Ordower 'Utopian Visions toward a Grand Unified Global Income Tax' (2013) 14(9) *Florida Tax Review* 361-418.
[615] DA Osborne 'Deterring Transfer Pricing Abuse: Changing Incentives as a Practical Alternative to a Global Tax Regime' (2011) 10(4) *Washington University Global Studies Law Review* at 829. See also P Wilson & E Coffill 'Keeping Business at Arm's Length' (1994) 5(2) *International Tax Review* at 27.
[616] C Murdoch *The Scope of the Power of the Internal Revenue Service to Reallocate Under Section 482 6 B.C.L. Rev. 717* (1965) available at http://lawdigitalcommons.bc.edu/bclr/vol6/iss4/2, accessed on 17 May 2016.

The first criticism deals with the application of the term control as enunciated in the section. The control element for the purposes of this section is captured in the phrase: 'owned or controlled directly or indirectly by the same interests'. The quoted statutory language is extremely wide. In one hand, the wide application of section 482 may be beneficial as it allows the tax authorities more powers and a wide spectrum within which such powers can be exercised. On the other hand, the wide discretionary nature of this part of the statute may result in the Treasury (through its regulations) to include or categorise (within section 482) businesses or a combination of businesses which may not necessarily be under the control of the MNE group. The fact that such businesses may not necessarily have the same business interests may cause problems in transfer pricing comparative analysis because it is easier to compare data for businesses or taxpayers with the similar business interests. The other problem with the control element is that it may not be aligned with other provisions within the IRC. For instance, the common control aspect of section 482 is not tied, by cross-reference or otherwise, to the stock attribution rules of section 318. It is also not linked to the definition of controlled groups found in section 1563, or to the related taxpayers' provisions of section 267.

The application of section 482 in relation to ownership and control is so wide that there is actually no line of demarcation within which this provision can be applied. In the General Counsel Memorandum 2856, it was stated (in considering the early ancestors of section 482) that the Board of Tax Appeals had aptly described the terms 'owned or controlled directly or indirectly by the same interests' as 'doubtful' and 'impossible of a strict definition'.[617] In *Cedar Valley Distillery Inc.,*[618] the Tax Court expressed doubt that there was sufficient common control for purposes of section 45 of the 1939 Code (section 482 of 1954 Code) as between a partnership and a corporation. The wide-ranging nature of the provision may be draconian and thereby prompting taxpayers to find creative ways of circumventing the rules.

[617] IRS General Counsel Memorandum 2856 of 1928.

[618] *Cedar Valley Distillery Inc. v Commissioner* 16 T.C. 870 (1951). In this case 52 stockholders owned 46 per cent of the corporate stock and owned no interests in the partnership; the individual who owned 54 per cent of the corporation's stock had a 30 per cent interest in the partnership; and another 30 per cent partner had no interest of any kind in the corporation. The court held that even if there were common control of the partnership and the corporation, the circumstances did not warrant allocation of the partnership income to the corporation.

7.7.2 Lack of Allocation Formula

The basis of section 482 application lies in the fact that the Commissioner must make a reallocation of income if he is of the opinion that the transaction between related or connected parties is not at arm's length. One of the weaknesses of section 482 is that there is actually no statutory allocation formula which the Commissioner must use to ensure that an accurate reallocation has been made. The lack of a prescribed allocation formula means that there is no wrong or right way of arriving at an arm's length price. This may create an impression that the taxpayer's allocation is inherently incorrect and that the Commissioner's reallocation is always correct,[619] and this may not always be the case. If the parent corporation determines that a particular expense item is one that should be allocated among the related taxpayers in the worldwide business organisation, then an allocation according to some reasonable formula should be made in the first instance. If the Commissioner subsequently challenges this allocation, the taxpayer will prevail in proving that his accounting is fair and reasonable and clearly reflects his income. It is also better for the taxpayer initially to make an allocation, since he is not at liberty subsequently to invoke section 482 because it grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions.[620]

7.7.3 Wide Discretionary Powers of Section 482

The discretionary powers are displayed in the regulations which provide that the Commissioner or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organisations, trades, or businesses.[621] Although the Commissioner may not create income on transactions between related taxpayers where none was actually earned, it was seen that due to the wide-ranging powers of section 482, the Commissioner does overstep the line in some cases. In the case of *Smith-Bridgman & Co v. Commissioner,*[622] a subsidiary loaned money to a parent corporation without interest. The Commissioner required the subsidiary to accrue interest income at 4 per cent. The Tax Court held that the

[619] *Commissioner v Smith* 285 F.2d 91, 95 (5th Cir. 1960).
[620] Treasury Regulation 1.482-1*(b)*(3).
[621] Treasury Regulation 1.482-1*(a)*(3).
[622] Smith-*Bridgman & Co v Commissioner* 16 T.C. 287 (1951).

Commissioner improperly created income where none existed. There is a school of thought which also considers section 482 to be subjective in nature. A portion of the subjective character of the Code lies in the difficulty of determining an applicable foreign law in order to determine an arm's length price.[623] Another element that adds the wide-ranging element to the Code is the existence of multiple tests for allocating the arm's length standard price.[624] The wide discretion enjoyed by the Commissioner also has the makings of subjective standards as he may reallocate an income if he deems it to be in the interest of tax collection.[625] Wide discretionary powers have a tendency to create policy uncertainty, a factor which may play a significant role in transfer pricing manipulation and non-compliance with the law in general.

7.8 Domestic Transfer Pricing in the US

Since the US is a federal state, each of the 51 states enacts their own corporate income tax rules, which include the power and authority to regulate transfer pricing. These rules aim to prevent the shifting of income and deductions from a high-tax state to lower-tax states. The emphasis is mostly on the compliance with the (IRS) but the state-by-state approach to transfer pricing methodologies is also taken in serious light considering the impact that it may have on the tax base. Each state is a sovereign taxing jurisdiction with the authority to disregard the conclusions reached by the IRS with respect to the appropriateness of a particular transfer pricing method.

The investigation into state taxable income in many states is inadequacies in federal taxable income. If the IRS audits a multinational business and proposes changes to federal taxable income, these changes have a direct impact on the state income tax returns for the business for each of the affected years. Most states have a law requiring a business to amend filed state returns to reflect federal income, for example, the Massachusetts General Law Chapter 62C section 30 requires a taxpayer to report changes in the federal taxable income within one year of the date of notice of the federal government's final determination. If the federal determination

[623] MM Levey & JP Clancy '482 Allocation Barred in "Aramco Advantage" Cases' (1994) 5 *Journal of International Tax* at 206.
[624] Treasury Regulation 1.482-1*(c)*(1).
[625] SS Surrey 'Treasury's Need to Curb Tax Avoidance in Foreign Business Through the Use of 482' (1968) 28 *Journal of Taxation* at 75-76.

increases the federal taxable income, failure to file an amended state return results in additional penalties and interest. While any change resulting from an adjustment to the transfer pricing methodology of a business will require the filing of amended state tax returns, it does not follow that just because the IRS agreed with the transfer pricing methodology of a business, that the state is bound to follow the federal determination. This means that to a certain extent, the state is autonomous in so far as these matters are concerned. It is important to note that for domestic purposes, the OECD Guidelines do not provide support and would not be directly relevant to the application of any pricing methods.

States apply various methods to challenge the transfer pricing methodologies of multinational enterprises. Generally, their main concern is the payment of deductible expenses from a business in the state to an affiliated company outside the state. These deductible expenses are the subject of almost every transfer pricing arrangement and relate to payments for royalties, interest and management fees. States may question or audit a transfer pricing arrangement under one of several well-known tax doctrines, including but not limited to the business purpose, economic substance and sham transaction doctrines. Each of these approaches looks to the substantive aspects of the transaction.

Given the above analysis it can thus be inferred that the US tax legislation and the structure of their federal government makes provision for domestic transfer pricing although the structure is different from the Indian Domestic transfer pricing as it will be seen in chapter 8 below.

7.9 Transfer Pricing Documentation in the US

There is no statutory or regulatory requirement to maintain transfer pricing documentation in the US, but the failure to maintain contemporaneous documentation could result in the imposition of IRC section 6662(e) (titled Substantial and Gross Valuation Misstatement Penalty) transfer pricing penalties on any underpayment of tax attributable to a transfer pricing adjustment. Transfer pricing documentation also provides taxpayers an opportunity to explain and affirmatively advocate their transfer pricing methodologies to the IRS and other tax authorities. In many cases, robust, persuasive transfer pricing documentation can help narrowly focus a transfer pricing audit, or even convince a tax authority not to conduct such an audit.

The documentation must adhere to the US tax rules and must be prepared in English. It must contain certain principal documents such as market share strategies under Treas. Reg. ' 1.482(d)(4)(i), unspecified transfer pricing methods under Treas. Reg. '' 1.482-3(e) and 1.482-4(d), profit split methods under Treas. Reg. ' 1.482-6, cost sharing agreements under Treas. Reg. ' 1.482-7, exceptions to adjustments for transfers of intangibles and lump sum payments under Treas. Reg. ' 1.482-4(f)(5). Part of the documentation must include the description of the transfer pricing method selected and the reasons for its selection. This can be established from the economic analysis and projections relied upon in developing the method.

The documentation must establish that the taxpayer reasonably concluded that, given the available data and the applicable pricing methods, the method (and its application of that method) provided the most reliable measure of an arm's-length result under the principles of the best method rule, set forth under the IRC section 482 regulations. In addition to the principal documents, to avoid penalties the taxpayer must also maintain any background documents that support the assumptions, conclusions and positions of the principal documents.

To avoid penalties, a taxpayer must also submit the description of any relevant data that was obtained after the end of the tax year and before filing a tax return, and which would help determine if a specified method was selected and applied in a reasonable manner. Apart from the required principal documents a US taxpayer is also required to submit background documentation to avoid penalties. Background documents are those documents that are used to support the assumptions, conclusions and positions taken in the principal documents. The documents are the research and primary sources needed to prepare the principal documents. They may include but are not limited to documents listed in Treas.Reg.' 1.6032A-3(c) of the IRC.

US taxpayers are not specifically required to maintain a 'master file' or 'local file', although the required 'principal documents' are similar to the local file requirement. In terms of the Treasury Regulations 1.6038-4, the US Treasury Department has however issued final regulations implementing country-by-country reporting (CbCR) requirements for certain US parent companies of multinational enterprises with annual revenue of $850 million or more. The final regulations are generally consistent with the consensus framework of BEPS Action 13. However, the US rules require that the country-by-country reports be filed by the due date (including extensions) of the taxpayer's federal income tax return (generally 15 October for calendar year taxpayers), rather than the 31 December (of the following year) deadline contemplated by Action 13.

7.10 Advance Pricing Agreements in the US

As already explained in Chapter 6 above, an APA is an arrangement that determines, in advance,[626] an appropriate set of criteria for the determination of the transfer pricing transactions over a fixed period of time.[627] The USA transfer system is known for its use of APAs which have proven to bring certainty and curtail arbitrary application and interpretational issues associated with transfer pricing legislation.[628] From the IRS' perspective, the APA process:[629]

> Lessens the burden of compliance by giving taxpayers greater certainty regarding their transfer pricing methods, and promotes the principled resolution of these issues by allowing for their discussion and resolution in advance before the consequences of such resolutions are fully known to taxpayers and the IRS.

There are three types of APAs that a taxpayer can request in the USA: bilateral agreements, multilateral agreements or unilateral agreements.[630] A unilateral APA involves an agreement only between the taxpayer and the IRS. A bilateral or multilateral APA includes other foreign tax authorities beyond the IRS. Bilateral or

---

[626] K Spencer & M Kelleher 'Are Advance Pricing Agreements Binding Commitments?' (2013) 20 (2) *International Transfer Pricing Journal* at 116. See also M Markham *Advance Pricing Agreements, Past Present and Future* (2012) at 39.

[627] OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and Transfer Features of Selected Countries* at 23. See also S Allen, R Tomar & DR Right 'Comments on 2006 Annual Report on Advance Pricing Agreement Programme' (2007) 14(4) *International Transfer Pricing Journal* at 257.

[628] PG Lewis 'What's New? What's Missing? The IRS Updates APA Procedures' (2004) *Tax Executive* at 56.

[629] IRS Revenue Proclamation 2006-09, 2006-1, C.B. 278. See also Heimert & Johnson *Guide to International Transfer Pricing* at 67 of Chapter 13.

[630] Spencer & Kelleher *Are Advance Pricing Agreements Binding Commitments* at 117; FDS Choi *International Finance and Accounting Handbook* 3 ed (2003) at 12; D Hansen & M Mowen *Cost Management: Accounting and Control* 5 ed (2006) at 460; MR Kinney & CA Raiborn *Cost Accounting: Foundations and Evolutions* (2011) at 572; MD Sherman, JS Jarreau & JB Brew *US Customs: A Practitioner's Guide to Principles, Processes and Procedures* (2009) at 74.

multilateral APAs may include a request for mutual agreement between the various competent authorities involved in the agreement.

The IRS launched the APA programme in 1991 with the issuance of Revenue Proclamation number 1991-1.[631] The procedure was intended as a dispute resolution mechanism to supplement the Mutual Agreement Procedures (MAP).[632] The procedure is aimed at encouraging US taxpayers to engage in it in order to reduce administrative costs associated with transfer pricing audits.[633] The APAs limit the compliance burden of the taxpayer by giving taxpayers greater certainty and simplicity regarding their transfer pricing affairs for a specified period.[634] This in turn may minimise the chances of engaging in transfer pricing manipulation due to the openness of the process. APAs are not compulsory but once agreed upon and signed by both the taxpayer and the IRS,[635] it becomes a binding contract. The IRS then agrees not to seek a transfer pricing adjustment for a specific period covering specific transactions.[636] The taxpayer, on the other hand, agrees to file timely tax returns and submit required documentation according to the APA contract.[637] The APA terms are determined on a case-by-case basis, but unless there are compelling reasons for a shorter term, the general term for an APA in the US is at least five years.[638]

---

631 IRS Revenue Proclamation 1991-1. See also Markham *The Transfer Pricing of Intangibles* at 232; Allen et al 'Comments on 2006 Annual Report on Advance Pricing Agreement Programme' (2007) *International Transfer Journal* at 257; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 67.

632 RYW Tang *Intrafirm Trade and Global Transfer Pricing Regulations* at 93. See also T Rixen *The Political Economy of International Tax Governance* (2008) at 146; Butani *Transfer Pricing: An Indian Perspective* at 1165.

633 RE Ackerman 'Resolution of Transfer Pricing Disputes for Large & Small Businesses Using APAs' (2000) *Ernest and Young International Tax Services: Transfer Pricing* at 2.

634 DR Wright 'Announcements and Report Concerning Advance Pricing Agreements: A Comment' (2001) 8(4) *International Transfer Pricing Journal* at 112; Markham *The Transfer Pricing of Intangibles* at 297; Abdallah *Critical Concerns in Transfer Pricing and Practice* at 97.

635 Spencer & Kelleher 'Are Advance Pricing Agreements Binding Commitments?' (2013) *International Transfer Pricing Journal* at 116. See also Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 470.

636 OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and Transfer Features of Selected Countries* at 768. See also J Dasgupta, J Porta & DR Right 'An Assessment of APA Fee Increases' (2006) 13(3) *International Bureau of Fiscal Documentation* at 158.

637 Spencer & Kelleher *Are Advance Pricing Agreements Binding Commitments* at 116.

638 OECD *Transfer Pricing Guidelines and Transfer Pricing Features of Selected Countries* at 739.

The taxpayer usually approaches the IRS by proposing a method that they deem to be the best for their purposes.[639] The proposed transfer pricing method must be in accordance with the arm's length standard; this is in line with the requirement of s 4 of Revenue Procedure (Rev.Proc) 2004-40 which provides that the taxpayer must provide the suitability of the method in terms of section 1.482-1*(c)*.[640] A complete APA request should contain all factual, legal and analytical information as well as critical assumptions that would be necessary in evaluating the proposed transfer pricing method. Revenue Procedure 2004-40 provides that the taxpayer must provide a detailed description not only of the transactions it intends to cover under requested APA, but also explain how the proposed covered transactions relate to other related party transactions that will not be covered.[641]

Each APA request must be accompanied by a user fee made payable to the US treasury. The applicable amount is revised time again by the Treasury department but the current fee structure is $50 000 for large businesses for an initial request and $35 000 for a renewal. Small businesses as defined in IRS Revenue Procedure 2006-9 pay $22 500 to file an APA request.[642] Once payment is made, the taxpayer must thereafter furnish data that supports the fact that the method is indeed the best under the given facts and circumstances.[643] The US tax law allows both US and foreign comparables to be utilised depending on factors such as relevant market, the type of transaction being evaluated and the result of functional and risk analysis.[644]

---

[639] OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and Transfer Features of Selected Countries* at 749.

[640] In some cases, the proposed method can be applied to years prior to those in the APA term. Some of the reasons which can be advanced to apply the procedure retrospectively (roll-backs) are: consent by the tax administration and the taxpayer and where appropriate, and the consent of the treaty partner. In this regard, the IRS's preferred policy is to use roll-backs if there are reliable facts and records from those previous years. The option to request a rollback of the APA methodology to prior years was initiated in terms of Revenue Procedure 96-53 of 1996.

[641] Rev.Proc. 2004-40, s 4.01. See also Johnson *US Transfer Pricing Sourcebook* at 113; C Wankel *Encyclopaedia of Business in Today's World* at 23; Eden *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* at 520.

[642] Ibid.

[643] Rev Proc. 2008-31, 2008-C.B.1133.

[644] Rev.Proc. 2004-40, section 521*(b)*(2)(D)(v), (vi) and (vii).

Once the APA is in place, the IRS monitors if the taxpayer complies with the terms of the APA. The monitoring is carried out in two ways.[645] The first way is to require the taxpayer to submit annual reports which will provide evidence that the terms and conditions of the APA have been complied with, and that the critical assumptions remain relevant.[646] Secondly, the IRS may continue to examine the taxpayer's transfer pricing affairs as part of the regular audit activities of the IRS except that the APA transfer pricing method is exempted from the audit. The audit is thus limited to verifying the initial data relevant to the APA proposal in order to determine whether or not the taxpayer has complied with the terms and conditions of the APA.[647] There is nothing in the US tax law which prevent the IRS from cancelling an APA, even with retrospective effect if it is found that the taxpayer has violated the terms and conditions of the APA. Some of the common reasons which can be advanced for such cancellation are fraud or misrepresentation of information during an APA negotiation.

7.10.1 Advantages of Using Advance Pricing Arrangements

APAs eliminate transfer pricing uncertainties by enhancing the predictability of tax treatment in international transactions.[648] APAs are by their nature non-adversarial.[649] APAs provide an opportunity for both tax administrations and taxpayers to consult and interact, with a view to achieving an amicable solution to a transfer pricing dispute. APAs also improve cooperation between taxpayers and tax

---

645 OECD 'Transfer Guidelines *for Multinational Enterprises and Tax Administrations and Transfer Features of Selected Countries*' at 749. See also Markham *The Transfer Pricing of Intangibles* at 245; OECD/G20 'Base Erosion and Profit Shifting Project Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance' (2014) at 42.

646 Section 10.06(1) and (2) of the Rev. Proc. 2004-40.

647 OECD *Transfer Guidelines for Multinational Enterprises and Tax Administrations and Transfer Features of Selected Countries* at 749; Johnson *US Transfer Pricing Sourcebook* at 110; Markham *Transfer Pricing of the Intangibles* at 245; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 74; Hufbauer & Assa *US Taxation of Foreign Income* at 156; King *Transfer Pricing and Valuation in Corporate Taxation: Federal Legislation v Administrative Practice* at 65.

648 OECD *Transfer Pricing Guidelines* at 219; Abdallah *Critical Concerns in Transfer Pricing and Practice* (2004) 201; Lymer & Hasseldine *The International Taxation System* at 170; Markham *The Transfer of Intangibles* at 291.

649 C Read & GN Gregoriou *International Taxation Handbook Policy, Practice, Standards and Regulation* at 125; Abdallah *Critical Concerns in Transfer Pricing and Practice* (2004) 201; Muchlinski *Multinational Enterprises and the Law* at 293; Spies & Petruzzi *Tax Policy Challenges in the 21st Century* at 224.

administrations.[650] This can result in a more objective review of submitted data than in a transfer pricing audit or examination which is characterised by a confrontational approach.[651] As already mentioned APAs also reduce costly and protracted audits and litigation between taxpayers and tax administrations.[652] Although APAs might appear to be expensive in the beginning but administrative costs are minimised in the long run. The advantage lies in the fact that fewer resources are needed to conduct audits because much is already known about the taxpayer through the APA programme.[653] The advance disclosure of information also assists tax authorities in gaining insight into the complex international transactions undertaken by multinational groups of companies.[654] The introduction of APAs may also result in the development of specialist skills and access to useful industry data and analysis of transfer pricing methodologies.[655]

7.10.2 Disadvantages of APAs

Despite the above advantages of APAs, it has been noted that APAs may not assist much in deterring tax evasion as a taxpayer may still evade tax even in the presence of APAs.[656] In other words, APAs only bring about certainty in transfer pricing issues and may not be relied upon as tax evasion deterrence. APAs do not have the same legal force as legislation and taxpayers can opt out of the programme as they wish.[657] The length of time it takes to conclude an APA may also be an impediment

---

[650] Read & Gregoriou *International Taxation Handbook Policy, Practice, Standards and Regulation* at 140; Heimert & Johnson G*uide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 16; Pfeiffer, Ursprung & Steindl *Global Trends in VAT/GST and Direct Taxation* at 666; Markham *The Transfer Pricing of Intangibles* at 249.
[651] OECD *Transfer Pricing Guidelines* at 220. See also A Miller & L Oats *Principle of International Taxation* at 464; R Feinschreiber *Transfer Pricing Handbook* at 7-23; Devonshire-Ellis, Scot & Woollard *Transfer Pricing in China* at 50; Bakker & Levey *Transfer Pricing and Dispute Resolution* at 277.
[652] Oguttu *Resolving Transfer Pricing Disputes* at 469. See also Christians, Donaldson & Postlewaite *United States International Taxation* para 20.17; Abdallah *Critical Concerns in Transfer Pricing and Practice* (2004) 200; M Butani *Transfer Pricing: An Indian Perspective* at 1077.
[653] OECD *Transfer Pricing Guidelines* at 220.
[654] OECD *Transfer Pricing Guidelines* at 220. See also Markham *The Transfer Pricing of Intangibles* at 249.
[655] OECD *Transfer Pricing Guidelines* at 221.
[656] Oguttu *Resolving Transfer Pricing Disputes* at 470. See also Feinschreiber *Transfer Pricing Methods: An Application Guide* at 218; Spies & Petruzzi *Tax Policy Challenges in the 21st Century* at 295; JA Sale *Advances in International Accounting* Vol 18 (2005) at 204.
[657] Feinschreiber *Transfer Pricing Methods: An Application Guide* at 218.

to their use.[658] On average, it takes about 18 months to complete one APA and another 18 months to renew it.[659] The agreement may thus be outdated by the time it is finalised especially if there are any tax legislative amendments that may have a bearing in the application of the APA.[660] The fact that APAs are entered into for a number of years may lead to inflexibility which may affect the taxpayer's business decisions.[661] APAs may also initially put a strain on transfer audit resources because tax administration may be forced to divert resources earmarked for other purposes to the APA programme.[662] APAs may not be accessible to small enterprises due to high costs especially if one takes into account the cost of expert advice that may be required in these types of cases.

Despite the above disadvantages, APAs are still an effective programme used in many countries. Some notable examples of countries using APAs are:[663] Belgium, Canada, United Kingdom, and the United States. Through APAs, the chances of transfer pricing manipulations are low because of the openness and certainty brought by the programme. In the interest of certainty and predictable dispute resolution mechanism, APAs may be a viable option in the South African transfer pricing landscape especially because there is no legal impediment against it. Section 31 should be amended to accommodate its inclusion in the law.

7.11 The Use of Regulations to Provide Transfer Pricing Certainty

Section 482 of the IRC is supplemented by regulations that work as enforcement guidelines to ensure compliance with the charging section.[664] The regulations are divided into two main categories, the interpretative regulations and the legislative

[658] OECD *Transfer Pricing Guidelines* at 221. For a further study on this see also Lang *Tax Compliance for Companies in an Enlarged European Community* at 412; Levey, Wrappe & Chung *Transfer Pricing Rules and Compliance Handbook* at 108; Bakker & Obuoforibo *Transfer Pricing and Customs Valuation* at 659; Markham *The Transfer Pricing of Intangibles* at 249.
[659] Heimert & Johnson *Guide to International Transfer Pricing* at 68 of Chapter 3. See also Bakker & Levey *Transfer Pricing and Dispute Resolution* at 501.
[660] Ibid.
[661] A Joseph 'Transfer Pricing Comparability; Perspectives of OECD, Australia and United States' (2007) 14(2) *International Transfer Pricing Journal* at 91.
[662] OECD *Transfer Pricing Guidelines* at 221.
[663] MN Jovanovic *International Economic Integration: Monetary, Fiscal and Factor Mobility Issues* Vol 2 (1998) at 432; Shenkar, Luo & Chi *International Business* at 516; Shome *Tax Policy Handbook* at 224; K Susarla & A Glaize *OECD Transfer Pricing for Multinational Enterprises and Tax Administrations* (2010) at 402.
[664] Wittendorff *Transfer Pricing and the Arm's Length Principle in International Tax Law* at 26.

regulations. The interpretative regulations are intended to explain and illustrate the rules of the statute. Interpretative regulations are binding on the IRS but not on the courts and taxpayers.[665] Legislative regulations have the same binding effect as legislation and they may be issued in three forms, namely the proposed, temporary and final form. It is the final legislative regulations which have the effect and force of law. Temporary regulations are binding for a period of three years. Proposed regulations have no legal effect whatsoever. The binding effect of s 482 regulations has been demonstrated in the case of *U.S. Steel Corp. v Commissioner* where it was held that:[666]

> the Treasury Regulations provide a guide for interpreting this section's broad delegation of power to the Secretary and they are binding on the Commissioner.

Section 482 regulations provide clarity in interpreting the working of the transfer pricing provisions in ways that ensure that any uncertainty that could arise as a result of the application of section 482 is ameliorated. For instance, the regulations set out the definitions of various terms used in section 482. For example, regulation 1.482*(b)*(1) explains the term 'arm's length standard' as follows:

> In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. Controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realised if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).

Regulation 1.482-1(8) defines 'controlled transaction' and 'uncontrolled transactions' as follows:

> Controlled transaction or controlled transfer means any transaction or transfer between two or more members of the same group of controlled taxpayers. The term uncontrolled transaction means any transaction between two or more taxpayers that are not members of the same group of controlled taxpayers.

---

[665] Ibid.

[666] *U.S. Steel Corp v Commissioner* 617F.2d 942 (2nd Cir.1980) para 24. See also the US Treasury Regulation 1.482-1*(b)* of the IRC.

Regulation 1.482-9(1)(3)(i) defines the term 'benefit' for the purposes of the transfer pricing provisions as follows:

> [A]n activity is considered to provide a benefit to the recipient if the activity directly results in a reasonable identifiable increment of economic or commercial value that enhances the recipient's commercial position, or that may reasonably be anticipated to do so. Any activity is generally considered to confer a benefit if, taking into account the facts and circumstances, an uncontrolled taxpayer in circumstances comparable to those of a recipient would be willing to pay an uncontrolled party to perform the same or similar activity on either fixed or contingent – payment basis, or if the recipient otherwise would have performed for itself the same activity or a similar activity.

Apart from clearly explaining the meaning of terms that are used in the transfer pricing provisions, the regulations also provide guidelines as to how the transfer pricing methods are applied.

The regulations are structured in such a way that they provide detailed examples of specific transfer pricing issues based on various transfer pricing methods.[667] Effort has been made to make the law clear to such an extent that it even specifies which specific class of methods must be used for particular kinds of property. For example, CFR number 26 under section 1.482-3 (a) clearly sets out how the transfer pricing methods can be used to determine taxable income in connection with the transfer of tangible property. Taxpayers are referred to where each of the transfer pricing methods is described in the section. This regulation states that:

> The arm's length amount charged in a controlled transfer of tangible property must be determined under one of the six methods listed in this paragraph (a). Each of the methods must be applied in accordance with all of the provisions of section 1.482-1, including the best method rule of section 1.482-1(c), the comparability analysis of section 1.482-1(d), and the arm's length range of section 1.482-1(e). The methods are:
>
> (i) The comparable uncontrolled price method, described in paragraph (b) of this section;
> (ii) The resale price method, described in paragraph (c) of this section;
> (iii) The cost plus method, described in paragraph (d) of this section;
> (iv) The comparable profits method, described in section1.482-5;

[667] A Stroud & C Masters *Transfer Pricing* (1991) at 108.

(v) The profit split method, described in section 1.482-6; and

(vi) Unspecified methods, described in paragraph (e) of this section.

In the same vein, regulation 26 CFR 1.482-4 makes it clear to a taxpayer involved in a cross-border transfer of intangible property how such transaction will be regulated. Because of the fact that the ambit and the application of the regulation are specific, if an adjustment were to be made the taxpayer would know exactly which method and procedures are going to be applicable in their transaction. The Tax Administration Act does not categorically state that Interpretation Notes or Practice Notes are statutory regulations. This matter needs to be clarified. It is therefore recommended that in addition to making interpretation Notes binding to the Commissioner and the taxpayers, Practice Notes should also have the force of law that provides practical guidance in the application of section 31.

7.12 E-commerce and Transfer Pricing in the US

The US does not have a special tax regime for electronic commerce. The IRS imposes tax on income from electronic commerce by applying rules and principles applicable to taxation generally. Section 1.861-8 provide specific rules for determining the source of income from computer software and related activities but these provisions are subject to the general principles of taxation. Section 1.863 which deals with the taxation of international communication income is also based on the general principles espoused in the IRC. Tax rules differ from state to state with the result that each state has its own rules to regulate e-commerce.

Since 1992 the general law on ecommerce was formulated in the case of *Quill v Heitkamp*.[668] The ruling in this case prevented states from collecting any sales tax from retail purchases made over the Internet or other e-Commerce route unless the seller had a physical presence in that particular state. The ruling was based on the Dormant Commerce Clause,[669] which prevent states from interfering with interstate

[668] *Quill Corp. v. North Dakota*, 504 US 298 (1992).

[669] The Dormant Commerce Clause, or Negative Commerce Clause, in American constitutional law, is a legal doctrine that courts in the United States have inferred from the Commerce Clause in Article I of the US Constitution. The Dormant Commerce Clause is used to prohibit state legislation that discriminates against interstate or international commerce.

commerce unless authorized by the United States Congress. The case resulted from an attempt by North Dakota seeking to collect sales tax on licensed computer software offered by the Quill Corporation, an office supply retailer with no North Dakota presence, that allowed users to place orders directly with Quill. In essence the court stipulated that ecommerce stores only had to collect sales taxes in the states where they had a “nexus," or a physical location. There was no obligation to collect or withhold tax where there was no nexus. Clearly, the ruling caused discrimination between conventional retailers and online retailers because it handed e-commerce vendors a competitive advantage over their counterparts. The decision had unintended consequences of creating a tax loophole. Due to this, the South Dakota state felt the need to take Supreme Court decision on judicial review. In October 2017, the state of South Dakota filed a petition for in the U.S. Supreme Court urging it to "abrogate *Quill*'s sales-tax-only, physical-presence requirement". In the petition South Dakota noted that advances in computer technology have made it easier to determine appropriate sales tax based on the purchaser's location and contending that such "poses a minimal obstacle" in an era where retailers can easily tailor their online marketing based on customers' IP addresses. South Dakota argued that *Quill* should be overturned and that the case met the Supreme Court's criteria for declining to overturn its previous ruling under the doctrine of *stare decisis*. The Court agreed to hear the case in January 2018, with arguments heard in April 2018. The Court ruled in June 2018 that the physical presence aspect of *Quill* was "unsound and incorrect" with the state of current technology, and overturned *Quill* decision. Justice Anthony Kennedy wrote the majority opinion, in which he stated that:

> The Internet’s prevalence and power have changed the dynamics of the national economy. The expansion of e-commerce has also increased the revenue shortfall faced by States seeking to collect their sales and use taxes. [The Quill decision] creates rather than resolves market distortions. In effect, it is a judicially created tax shelter for businesses that limit their physical presence in a State but sell their goods and services to the State’s consumers, something that has become easier and more prevalent as technology has advanced. Each year the physical presence rule becomes further removed from economic reality and results in significant revenue losses to the States. These critiques underscore that the physical presence rule, both as first formulated and as applied today, is an incorrect interpretation of the Commerce Clause.

For the minority opinion, Justice John Roberts warned that the decision could disrupt a successful part of the U.S. economy:

> E-commerce has grown into a significant and vibrant part of our national economy against the backdrop of established rules, including the physical-presence rule. Any alteration to those rules with the potential to disrupt the development of such a critical segment of the economy should be undertaken by Congress.

This ruling overturned a 26-year-old precedent, established in *Quill Corp v North Dakota*, when the court ruled that Quill, a catalog retailer, did not have to collect sales tax in North Dakota because it had no physical presence in the North Dakota. The implication is that the US tax law now requires internet retailers to collect sales tax on purchases by South Dakota buyers, even if the retailer lacks a physical presence in the state. This is in line with the value creation principle espoused by the OECD BEPS Action Plan 10.

7.13 Lessons Learnt from the Us Transfer Pricing Regime

The analysis above reveals that there are positive and negative lessons that can be drawn from the US transfer pricing practice. The positive and negative aspects of the US transfer pricing have already been demonstrated throughout this chapter but they are summarily restated here in order to provide a context for possible solutions to the transfer pricing manipulation problem and a connection with the transfer pricing challenges which have been identified in Chapter 6. The negative lessons are also highlighted to help to avoid a repeat of section 482's deficiencies in the improvement of the South African transfer pricing system.

In paragraph 7.6.3 it was concluded that one of the significant negative aspects of section 482 is that it gives the Commissioner too much discretionary powers to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organisations, trades, or businesses. The wide discretionary powers are prone to abuse by the Commissioner and in turn may lead to manipulation by the taxpayers since the application of the terms may include or exclude transactions in a manner that was not intended by the legislature. The use of these words (distribute, apportion, or allocate) may cause interpretational issues which may further complicate the law. What makes matters worse is that in as much as section 482 provides for the distribution, apportionment, or allocation of the gross income, there is however no statutory formula that the Commissioner must adhere to when making the allocation, the distribution or the apportionment.

Section 482 is supplemented by rules and regulations which ought to give practical guidance to both the taxpayers and the IRS on transfer pricing issues but the rules are so voluminous that they tend to lose their simplicity and render an otherwise simple and straightforward provision with application and interpretational quagmire. These weaknesses demonstrate that no country is immune to the transfer pricing scourge as the well-intended rules are circumvented to perpetuate impermissible tax avoidance or tax evasion. Every effort must be made to ensure that legislative weaknesses such as these are avoided in any endeavour meant to amend or improve section 31 of the South African Income Tax Act.

Despite the negative conclusions that have been drawn, there are positive lessons that can be drawn from the US transfer pricing system. Some of the recommendations in Chapter 9 of this research will be based on these positive attributes of the system. One of the most important attributes of section 482 is that it proscribes tax evasion. The distribution, apportionment, or allocation of gross income, deductions, credits, or allowances between or among such organisations, trades or businesses, is done in order to prevent the evasion of taxes. This is a clear indication that the US legislature intended for this provision to be a specific anti-evasion or avoidance rule. An important lesson that can be learnt in this regard is that the power to combat transfer pricing abuse or manipulation is expressly articulated in the transfer pricing provision. This is in stark contrast to section 31 of the South African Income Tax Act which only provides that tax payable in respect of international transactions must be based on the arm’s length principle. It is therefore important that section 31 be amended to provide for severe penalties where the arm’s length principle is transgressed because transfer pricing adjustments do not deter taxpayers from engaging in transfer pricing manipulation.

It appears that the existence of the supplementary rules in the US transfer pricing system has both positive and negative connotations. As already mentioned, the US has voluminous supplementary rules on transfer pricing which may sometimes cause application and interpretational problems but that is a necessary evil meant to deal with transfer pricing manipulation problems. The rules (voluminous as they may be) are a far cry from the South African situation where there are no supplementary rules at all for such a complicated aspect of the tax law. By and large, the disadvantages are far outweighed by the advantages. As indicated in Chapter 6 South Africa relies on the outdated SARS Practice Notes with no legal force to interpret one of the most complicated provisions (section 31) of the Income Tax Act. The South African transfer pricing legislation can be improved by adding supplementary rules which will have legal force to obviate the current reliance on the outdated practice notes. When promulgating the supplementary rules care must be taken that they are not too voluminous and overly complicated (like the US) but be simple and written in plain language to ensure practical application and easy interpretation in time of disputes.

Another important lesson that can be drawn from the US transfer pricing regime is that it has one of the effective dispute resolution mechanisms in the form of APAs. Despite the fact that APAs can be expensive and time-consuming in the beginning, it has been proven that they have long-term benefits for both the taxpayer and the tax administration as demonstrated in paragraph 7.8.1. Despite APAs having been adopted in many countries, South Africa does not have APAs and as already mentioned, there is no known reason for the lack of APAs, it can however be assumed that it is due to capacity constraints within SARS. A lesson that South Africa should learn from the US practice is to amend section 31 in order to accommodate APAs within its transfer pricing legislation. The manner and the procedures which must be followed in the application of APAs should be accommodated in chapter 7 of the TAA, which deals with advance rulings involving any tax provision in South Africa.

7.14 Conclusion

The analysis of the US transfer pricing regime shows that there are no clear-cut answers to the transfer pricing problem even in developed countries like the US. There are however positive sentiments which can be adapted to specific South African situations without being seen to be engaging in a slavish copying exercise. Some of the lessons learnt are the deterrence nature of section 482 in that it gives the Secretary to adjust taxpayer income to reflect correctly in order to prevent tax evasion. The instructive and deterrence nature (prevention of tax evasion) of the US transfer pricing legislation is something that can be imported into section 31 of the

South African Income Tax Act to give it a deterrence effect. This will in turn cement section 31 as an effective specific anti-avoidance rule as it is supposed to be. Some of the transfer pricing problems in the US are alleviated by the use of APAs. The introduction of APAs will help to reduce the audit workload of the transfer pricing officers and thereby giving them an opportunity to concentrate on unknown taxpayers. Supplementary rules to section 482 play an important role in simplifying transfer pricing procedures. It has been mentioned that excessive rules may complicate the law; it is thus recommended that simplified rules must be introduced in order to align with the South African economic conditions. The US transfer pricing regime also has a domestic component which helps to alleviate manipulation in transaction taken place between MNEs located within different states. These measures are not problem-free but their introduction is a step in alleviating the transfer pricing manipulation problem.

CHAPTER 8

TRANSFER PRICING IN INDIA

8.1 Introduction

The previous chapters, particularly Chapter 6 have shown that there are various factors that contribute to transfer pricing manipulation in South Africa. One way of searching for solutions is through a comparative analysis. The first comparative analysis was done with the US in the previous chapter. The second analysis is undertaken in this chapter with India. The aim is to compare and determine whether there are lessons to be learnt from the Indian experiences that can be applied to deal with the South African situation. As already mentioned, one of the reasons for choosing India for a comparative analysis is that the Indian tax authorities have rigorously and aggressively applied and interpreted transfer pricing rules to multinationals doing business there.[670] It is no wonder that India tops the list of nations in aggressive application of transfer pricing rules.[671] Similar socio-economic conditions between these two jurisdictions were another reason for a comparative analysis.

This chapter will primarily deal with: the historical background of the Indian transfer pricing regime, the arm's length principle as it is applied in India, the impact of the existence of domestic transfer pricing within the transfer pricing landscape, the transfer pricing challenges in India. For the purposes of this chapter transfer pricing methods and APAs will not be discussed here as they have already been discussed in the previous chapters, particularly Chapter 7. It is important to note that India's transfer pricing methods and the APAs are aligned to the OECD transfer pricing

---

[670] Asian Countries Top Aggressive Tax Authority Poll *TPWeek* 16 June 2010; 'Top 10 toughest tax authorities for transfer pricing.' *TPWeek* 6 December 2007 available at http://www.thesait.org.za/news/110252/Transfer-Pricing-In-Africa.htm, accessed on 19 February 2016. According to this poll in 2015 India was second toughest tax authority in relation to transfer pricing. In terms of this poll the countries were ranked from one to ten as follows: (1) Japan, (2) India, (3) China, (4) Canada, (5) U.S., (6) France, (7) Germany, (8) Australia, (9) Korea, (10) United Kingdom.

[671] Kuan *Global Transfer Solutions* at 158.

guidelines and will therefore not be discussed in detail in this chapter. Only selected issues will be discussed for the purposes of this research.

8.2 Historical Background to Transfer Pricing in India

In 1999, the Indian government commissioned an inquiry which was also known as the Expert Group to study global transfer practices and examine the need for a legislation to deal with the transfer pricing problem in India.[672] The aim of the study was to provide a detailed statutory framework aimed at ensuring the computation of reasonable, fair and equitable transfer prices between resident and non-resident connected parties in India. The outcome of that study led to the introduction of transfer pricing in India. The Transfer Pricing Regulations (TPR) were introduced in India through the Finance Act of 2001, this culminated in the amendment of the then existing section 92 by the introduction of new sections 92A to 92F in the Income Tax Act ('Act') and relevant rules 10A to 10E in the Income Tax Rules (ITR) 1962. These rules are meant to curb tax evasion by laying down norms for computation of income arising from both international transactions and specified domestic transactions (SDT) through the arm's length principle.

The memorandum explaining the Finance Bill which preceded the Finance Act of 2000 stated the intention for introducing the new sections as follows:

> The increasing participation of multinational groups in economic activities in the country has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same multinational group. The profits derived by such enterprises carrying on business in India can be controlled by the multinational group, by manipulating the prices charged and paid in such intragroup transactions, thereby, leading to erosion of tax revenues.

Sections 92A to 92F were introduced and deal primarily with the computation of income from an international transaction having regard to: the arm's length price, meaning of associated enterprise, meaning of international transaction, computation of arm's length price, maintenance of information and documents by persons entering into international transactions and definitions of certain expressions within

---

[672] E Baistrocchi & I Roxan *Transfer Pricing Disputes: A Global Analysis* (2012) para 15.2; OECD 'Transfer Pricing Guidelines' at 511; Dhar *New Age Marketing: Emerging Realities* at 226; Bakker & Levey *Transfer Pricing and Dispute Resolution* at 365; A Kapila & U Kapila *Economic Development in India* (2001) at 192.

the transfer practice in India. The legislative intention, underlying the TPR, is to prevent the shifting of profits by manipulating prices charged or paid in international transactions, thereby eroding India's tax base. The explanatory memorandum of Finance Bill, 2001 explains that the TPR was introduced to curb transfer pricing abuse which results in tax evasion.

India is currently not a fully-fledged member of the OECD but she has an observer status with enhanced engagement.[673] India endorses the OECD 'Transfer Pricing Guidelines' to the extent that such guidelines are not inconsistent with their domestic legislation.[674] The Indian transfer pricing regulations are largely based on the OECD Transfer Pricing Guidelines but they have also incorporated certain aspects of legislation from other countries like China and the Korea Republic.[675] Where there are inconsistencies between the OECD Guidelines and the Indian TPR, The Indian TPR supersedes the OECD Transfer Pricing Guidelines. Due to its alignment with the OECD Transfer pricing guidelines, section 92C of the Indian Income Tax read with rule 10C of the ITR provides the use of the comparable uncontrolled method, resale method, cost plus method, profit split method, transactional net margin method and any other method. These rules need not be discussed here because they have already been discussed in chapter 3 above. The rules allows the taxpayer to use any other method in addition to the above mentioned methods for the determination of the ALS provided the method takes into account the price which has been paid, or the price that would have been paid for the same or similar uncontrolled transaction between non-associated enterprises under similar circumstances.[676] The nature and character of the 'any other method" is more in line with the requirements of the arm's length principle. It does not seem that the Indian legislature intended for the application of the global formulary apportionment method

[673] G Kofler, MP Maduro & P Pistone *Human Rights and Taxation in Europe and the World* (2001) at 194; E Kemmeren, DS Smit & P Essers *Tax Treaty Case Law Around the Globe* at 198; TC Schaffer *India and the United States in the 21st Century: Reinventing Partnership* (2009) at 194; AO Krueger *WTO as an International Organisation* (1998) at 127.
[674] S Ramesh *Indian Economy: For Civil Services* 7 ed (2015) at 16-8; P Carroll & A Kellow *The OECD: A Study of Organisational Adaptation* (2011) at 122; OECD 'Globalisation and Emerging Economies: Brazil, Russia, India, Indonesia, China, and South Africa' (2008) at 436.
[675] VV Sople *Supply Chain Management* (2012) at 428; G Shailaga *International Finance* (2008) at 308; C Devonshire-Ellis *Doing Business in India* 3 ed (2012) at 66; Butani *Transfer Pricing: An Indian Perspective* at 41; V Sharan *International Financial Management* (2002) at 490.
[676] OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and Transfer Features of Selected Countries* at 522.

where the five OEDC transfer pricing methods are not applicable. There is nowhere in the Indian tax law where the application of the global formulary method is intimated. It can thus be concluded that the global formulary apportionment method does not form part of the Indian transfer pricing law in particular or Indian tax law in general.

8.3 The Legal Framework of Transfer Pricing in India

Transfer pricing in India is regulated by the Income Tax Act of 1961, herein referred to as the Income Tax Act. The Indian tax authority is empowered by sections 92, 92A-92F to regulate international transactions. There are three important concepts underpinning the Indian transfer pricing landscape. The concepts are: international transaction, associated enterprise and the arm's length price. Based on the observations of the Supreme Court in the case of *CIT v Glaxo Smithkline Asia (P) Ltd*,[677] the Finance Act of 2012 introduced transfer pricing provisions relating to domestic transactions with effect from 2013. This has been done with a view to providing objectivity in the determination of income from domestic related parties. To avoid overlapping between international and domestic transfer pricing, the definition of specified domestic transaction excludes from its scope all international transactions.

8.3.1 Features of the Indian Transfer Pricing

For the purposes of this research, only the following features of the Indian transfer pricing system are briefly discussed. The features are: associated enterprises, international transaction, specified domestic transactions, wide auditing powers of the transfer pricing officers. These features are analysed as follows:

8.3.1.1 Associated Enterprise

One of the important concepts that must be analysed within the Indian transfer pricing practice is the term associated enterprise (AE). The term associated enterprise is defined as follows in sections 92A (1) of the Indian Income Tax Act of 1961:

---

[677] *CIT v Glaxo Smithkline Asia (P.) Ltd* [2010] 195; *Taxman* 35.

> For the purposes of this section and sections 92, 92B, 92C, 92D, 92E and 92F, "associated enterprise", in relation to another enterprise, means an enterprise (a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

The definition considers AE to comprise of: management, control and capital of an enterprise. The courts have however on various occasions made pronouncements on the definition of this concept. In *CIT v Nandlal Gandalal,*[678] it was held that the associate enterprise means an enterprise which has the ability to influence the policy or management or functioning of another entity to derive maximum tax benefits. In *CIT v United Breweries*,[679] the court held that if one company has the right and power to exercise functional control, in addition to capitalist control over the other company, the existence of the other company as a separate and distinct entity could not prevent the business of that company being treated as part of the controlling company. The Supreme Court has in case of *Ceylon v CIT*,[680] defined control and management as the controlling and directing power. The court further observed that control and management must be practically shown and not merely theoretically portrayed. It must be the *de jure* and *de facto* display of power actually exercised in the management and control of the AE. In *CIT v VRNM Subhiah Chettiar,*[681] it was held that the expression "control and management" means *de facto* control and management and not merely the right or the power to control and manage.

In the case of *Diageo India Pvt. Ltd v ACIT,*[682] it was decided that if one enterprise controls the decision making of the other or if the decision making of two or more enterprises is controlled by the same person, these enterprises are required to be treated as 'associated enterprises'. Though the expression used in the statute is 'participation in control or management or capital', essentially all these three ingredients refer to *de facto* control on decision making. The use of the three primary

[678] *CIT v Nandlal Gandalal* (1960) 40 ITR 1 (SC).
[679] *CIT v United Breweries* [1973] 89 ITR 17.
[680] *Ceylon v CIT* (34 ITR 001)**.**
[681] *CIT v VRNM Subhiah Chettiar* (1947) 15 ITR 502.
[682] *Diageo India Pvt. Ltd v ACIT* 47 SOT 252.

concepts (management, control and capital) in section 92A (1) is in line with the provisions of article 9(1) of the OECD's Model Tax Convention.[683] The interpretation of article 9(1) reveals that the cross-border transaction between associated enterprises must meet the conditions which would have existed had such transaction been concluded between independent enterprises. The transaction must meet the arm's length requirements, failing which; an adjustment will be made to ensure that correct tax is paid.[684]

In order to cover as many entities as possible, section 92A lists circumstances under which two enterprises are deemed to be associated enterprises.[685] the wide-ranging nature of section 92A have led to disputes and the courts of India have assisted in settling some those disputes whilst at the same time providing certainty in the law. One notable case that dealt with the associated enterprises in India was the *Vodafone India Services Private Limited v UOI*.[686] The issue before the court was whether the Indian transfer pricing (TP) provisions are applicable to the taxpayer's issue of shares to its AE and whether the Indian tax authorities have jurisdiction under the Indian Tax Laws (ITL) to tax a shortfall between the alleged fair market value (FMV) of the shares and the issue price of the equity shares. It was held that no amount was received, accrued or arising on capital account transaction that can be subjected to tax as income. This notion was also echoed in the *Cadell Weaving Mill Co. v CIT*.[687]

Another important aspect of the Indian transfer pricing in relation to associated enterprises is the deeming fiction set out in section 92A(2) of the Income Tax Act of 1961. This is a typical example of a provision which spells out circumstances which may be taken into account when a tax authority needs to decide if an enterprise must be classified as an associated enterprise. This may be considered to be too restrictive as taxpayers may structure their tax arrangements in a manner which is

[683] Article 9(1) of the Model Tax Convention.
[684] Article 9(2) of the Model Tax Convention.
[685] For a comprehensive list of all those circumstances see s 92A(2) of the Income Tax Act of 1961.
[686] *Vodafone India Services Private Limited v UOI* (WP No.871 of 2014, Bombay HC).
[687] *Cadell Weaving Mill Co. v CIT* [2011] 249 ITR. The court in the *Cadell* case *inter alia* observed that: 'It is well settled that all receipts are not taxable under the Income Tax Act. Section 2(24) defines "income". It is no doubt an inclusive definition. However, a capital receipt is not income under section 2(24) unless it is chargeable to tax as capital gains under section 45'.

not consistent with this subsection but the provision is important in ensuring that there is certainty for both taxpayers and the Indian Tax administration.

8.3.1.2 International Transaction

Section 92B of the Indian Tax Act defines the term international transaction as any transaction between two or more associated enterprises situated in different countries in terms of a property that is tangible or intangible, a service offered by the company, or any form of lending of money.[688] It is compulsory that at least one of the participants involved in the transaction is a non-resident of India. However, a transaction that has been carried out by two non-resident Indians; where one of them has a permanent establishment in India and whose income is taxable from India, is also considered to be an international transaction. A PE also qualifies as an associated enterprise in India. The legislature has in terms of section 92B(2) of the Finance Act 2012 also introduced what is called a ‘deemed international transaction’. In terms of section 92B(2) a transaction is deemed to be an international transaction if the following requirements are met:

(i) There should be an AE, and an unrelated party;

(ii) There should be a transaction between an enterprise and an unrelated party;

(iii) There should exist a prior agreement in relation to the relevant transaction; or terms of the relevant transaction should be determined in substance between such unrelated party and the AE of the enterprise.

8.3.1.3 Domestic Transfer Pricing

The Indian transfer pricing system is also characterised by the regulation of the domestic transfer pricing. Section 92BA defines Specified Domestic Transaction (SDT) as follows:

[688] Section 92B of the Income Tax of India.

For the purposes of this section and sections 92, 92C, 92D and 92E, specified domestic transaction in case of an assessee means any of the following transactions, not being an international transaction, namely:—any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;any transaction referred to in section 80A; any transfer of goods or services referred to in sub-section (8) of section 80-IA; any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA; any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or any other transaction as may be prescribed, and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of 5 crore.

Before 2013 the Indian tax legislation did not contain a specific provision regulating domestic transfer pricing issues. This issue was suggested by the court in the case of *CIT v GlaxoSmithKline Asia (p) Ltd*.[689] In this case, the court observed that:

The larger issue is whether Transfer Pricing Regulations should be limited to cross-border transactions or whether the Transfer Pricing Regulations to be extended to domestic transactions. In domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage such as where one of the related entities is (i) loss making or (ii) liable to pay tax at a lower rate and the profits are shifted to such entity. The CBDT should examine whether Transfer Pricing Regulations can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act. The AO can be empowered to make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties and can apply any of the generally accepted methods of determination of arm’s length price, including the methods provided under Transfer Pricing Regulations.

The court further remarked that:

Though the Court normally does not make recommendations or suggestions, in order to reduce litigation occurring in complicated matters, the question of extending Transfer Pricing regulations to domestic transactions require expeditious consideration by the Ministry of Finance and the CBDT may also consider issuing appropriate instructions in that regard.

The court decision laid the foundation for Domestic Transfer Pricing (DTP) law in India. In terms of this verdict, some of the reasons for advocating for the domestic transfer pricing rules were: lack of prescribed methods to determine the

[689] *CIT v GlaxoSmithKline Asia (P) Ltd.* (SLP 18121/2007).

reasonableness of expenditure to re-compute the income in related party transactions. There was also a need to provide objectivity in the determination of income and reasonableness of expenditure in domestic transfer pricing transactions. DTP was introduced because there was also a need to create a legally enforceable obligation on assessee to maintain proper documentation in relation to domestic transfer pricing transactions.

The Indian Domestic Transfer pricing rules have some similarity with the disallowance provisions under s 40A(2) of the Indian Income Tax Act with respect to payments made in excess of the arm's length price. The Tribunal in *Aztec Software and Technology Services Ltd v ACI*[690] held that Chapter X of the Income Tax Act is a complete code in itself applicable in respect of transaction with a non-resident associate in excess of arm's length price. In terms of section 40A(2), any expenditure by way of payment to the persons [mentioned in sub-clause (b)], is liable to be disallowed in computing business profit to the extent that such expenditure is considered to be excessive or unreasonable having regard to the fair market value of goods, services and facilities.[691]

Section 92BA seeks to regulate matters covered in various provisions including section 40A(2) which deal with payments to related parties. Section 40A(2) covers excessive or unreasonable payment made to related parties. For this purpose, section 40A(2) has also been amended to the effect, that no disallowances would be made under this section in respect of specified domestic transactions, if such transactions are not at arm's length as defined under section 92F.

Some examples of specified domestic transactions covered in the section 40A(2) which are regulated by section 92BA are: payment for purchase of semi-finished goods; transfer of machinery, sharing of common cost; payment of interest or royalty charge; transfer of goods from one unit to another (in specific cases); payment made to key personnel or relatives; and rent charged. Basically, the transactions covered by section 92BA are transactions referred to in section 80A and transactions related

[690] *Aztec Software and Technology Services Ltd v ACIT* [2007] 294 ITR (AT) 32 (BANG) [SB].
[691] In terms of s 80-IA (8) and (10) of the Income Tax Act.

to businesses eligible for profit-linked tax incentives, for example, infrastructure facilities (section 80-IA) and Special Economic Zones (SEZ) units (section 10AA).The above transactions will be regarded as SDT only if the aggregate value of all the above-specified transactions exceeds the threshold limit of 5 *crore*.[692] If the threshold limit is exceeded, the taxpayer will be required to comply with TP requirements with reference to all the transactions regardless of the fact that that the value of the transactions under one of the limbs may be very small or nominal.

8.3.1.4 Some Judicial Pronouncements on Domestic Transfer Pricing

The Indian tax courts have made pronouncements on the domestic transfer pricing concept even before the rules were officially promulgated into law in 2013. In the *KR Motilal v CIT*,[693] the assessee engaged in the business of manufacturing of three-wheel cycles. The dispute was about the payment of remuneration and commission to brothers of the assessee for providing technical and supervisory services. The assessing officer (AO) disallowed the payments by holding that such payments were excessive and unreasonable in terms of section 40A(2). The ITAT held that part of the remuneration or commission paid to brothers is excessive and unreasonable and thus to be disallowed because the assessee was unable to justify possession of technical qualifications or technical skill by the brothers required to handle the job.

In the case of *Mangal Chand Tubes Pvt. Ltd. v CIT*,[694] payments were made to two directors for managing the operations for the same area. The AO disallowed part of the payments made to one of the directors under section 40A(2). The matter was brought before the Rajasthan High Court. The court upheld the AO's order and the reasons for the court's decision was that the disallowance made by the AO is justified since one of the directors who was permanently stationed in the same region (Delhi) was looking after the day to day functions of the company and

[692] The threshold in terms of s 92A is 26%. But under s 40A(2)*(b)* of the Act, the threshold is 20 per cent of the voting power. Even under s 40A(2) of the Act, it is not necessary that both entities should be resident. Accordingly, even a transaction between one resident and other non-resident or both non-residents could be covered under the ambit of s 40A(2). Where one of the entities is a non-resident and voting power hold by any of the entity is above 20 per cent but less than 26 per cent, then it will be covered under domestic transfer pricing if aggregate value of transactions exceed five crores.
[693] *KR Motilal v CIT* (1999) (240 ITR 810) (Mad).
[694] *Mangal Chand Tubes Pvt. Ltd. v CIT* (1994) 208 ITR 729 (Raj).

payments to the other director were not justifiable. The assessee was unable to justify the commercial rationale of making payments to both directors and how it benefited its operations.

8.4 The Arm's Length Principle in India

As it is the case with most tax jurisdictions, transfer pricing in India is based on the arm's length principle. The arm's length principle is dealt with in section 92C of the Income Tax Act. The underlying intention of these specific anti-avoidance rules is to prevent the shifting of profits through manipulation of prices charged or paid in international or specified domestic transactions in order to alleviate eroding the Indian tax base.[695] The phrase arm's length principle is not defined in the Indian tax statutes but the phrase arm's length price is expressly defined in section 92F to mean:

> A price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

Section 92(1) provides that any income arising from an international transaction shall be computed having regard to the arm's length price. The reading of this provision further denotes that income may include expense or interest relating to an international transaction. It is provided in that section that that allowances for any expense or interest arising from an international transaction shall also be determined to have regard to the arm's length price. The implications of this provision are illustrated by means of the following example:[696]

Suppose there are two associated enterprises, A in USA and B in India. The two enterprises conclude a mutual agreement whereby A would carry out some research in the USA for the benefit of both the enterprises and the research expenses which would be incurred will be apportioned between A and B in the ratio of 3:2 respectively. In line with this provision, B's share in the research expenses would be

---

[695] ECD 'Transfer Pricing Guidelines' at 513. See also A Lemgrubber & S Shelton *Revenue Administration: Administering Revenues from Natural Resources-A Short Primer* (2014) at 7; Pogge & Mehta *Global Tax Fairness* at 157.

[696] Section 92(1) of the Income Tax Act, as amended by the Finance Act of 2010. See also KK Agrawal *Direct Tax Planning and Management, Incorporating: Corporate Tax Planning, Business Tax Procedure and Management* 5 ed (2006) at 203; KK Agrawal *Corporate Tax Planning* Vol 1 6 ed (2007) at 248; BB Lal & V Vashisht *Direct Taxes: Income, Wealth Tax and Tax Planning* 29 ed (2008) at 17-3; PG Apte *International Financial Management* 5 ed (2008) at 672; Kuan *Global Transfer Solutions* at 143.

calculated with regard to the arm's length price of the research expenses and not on the basis of the actual research expenses incurred. This means that if B incurs expenses that an independent enterprise would not have incurred under similar circumstances, the expenses cannot be considered to be at arm's length.

In terms of section 92B there are three main factors which must be taken into account when determining the arm's length price of an international transaction.[697] The first consideration is that there must be an income or expense or interest; secondly, the income must arise out of an international transaction; and thirdly, there must be computation in line with the arm's length methods. In terms of section 92F(ii) an arm's length price:

> is the price applied or proposed to be applied when two unrelated persons enter into a transaction in uncontrolled conditions.

The arm's length principle is applied in instances where there are mutual agreements or arrangements in an international transaction which produce a service, a facility or tax benefit for parties to such agreement. In other words, the consideration or arm's length price relating to an international transaction shall be determined by having regard to the arm's length of such benefit service or facility. In this regard, section 92(1) provides that:

> Where in an international transaction, two or more associated enterprises enter into a mutual agreement or arrangement for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises, the cost or expense allocated or apportioned to, or, as the case may be, contributed by, any such enterprise shall be determined having regard to the arm's length price of such benefit, service or facility, as the case may be.

Where more than one arm's length price is determined by applying the most appropriate transfer pricing method, the arithmetic mean (average) of such prices shall be the arm's length price of the international transaction or specified domestic

[697] C Campbell *Legal Aspects of Doing Business in Asia and the Pacific* (2009) at HS-53; R Millar *Doing Business with India: A Guide to Investment Opportunities and Business Practice* 2 ed (2007) at 98; M Antani & G Gokhale *Contract Research and Manufacturing Services(CRAMS) in India* (2012) at 55; J Kuanpoth *Patent Rights in Pharmaceuticals in Developing Countries: Major Challenges for the Future* (2010) at 140; S Dewan & K Singh *Doing Business in India: India Commercial Laws* (2016) at 107; BS Chimni, M Masahiro & T Li-Ann *Asian Yearbook of International Law* Vol 14 (2011) at 154.

transactions. In the Indian context, the arm's length principle is not applicable where the computation of income or the determination of the allowance for any expense or interest or the determination of any cost or expense allocated or apportioned as the case may be, has the effect of reducing the income chargeable to tax or increasing the loss of tax revenue.[698] An inference which can be drawn from the wording of section 92(3) is that the arm's length principle may not be applied if it is prejudicial to the collection of revenue by the Board. For the sake of brevity section 92(3) provides that:

> The provisions of this section shall not apply in a case where the computation of income under sub-section (1) or the determination of the allowance for any expense or interest under that sub-section, or the determination of any cost or expense allocated or apportioned, or, as the case may be, contributed under subsection (2), has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account in respect of the previous year in which the international transaction was entered into.

The determination of the arm's length price must take into account all relevant factors concerning the controlled and uncontrolled transactions. These sentiments are illustrated in the case of *M/s. Bharti Airtel Limited v Assessee* where all relevant factors of the case were considered by the court.[699] This case relates to issues arising from the issuance of a corporate guarantee to secure loans to associated enterprise and contribution to share capital. The taxpayer, an Indian company, provided a guarantee to a third-party bank on behalf of its foreign subsidiary for which the taxpayer did not charge a fee. The taxpayer contended that as it did not incur any costs in providing the guarantee that there was no requirement for it to charge a fee to the subsidiary under the transfer pricing provisions. During audit proceedings, the Transfer Pricing Officer (TPO) imputed an arm's length guarantee fee by applying the comparable uncontrolled price (CUP) method and considered the commission charged by independent banks as a benchmark. The Tribunal, considering the facts of the case, held that the corporate guarantee provided by the taxpayer, which does not involve cost to the taxpayer, does not have a bearing on profits, incomes, losses or assets of the taxpayer and for that reason the transaction

---

[698] Section 92(3) of the Indian Tax Act.
[699] M*/s. Bharti Airtel Limited v Assessee* ITA No 80to 83/coch/2013.

does not fall within the definition of ‘international transaction’ in terms of Indian tax law. The Tribunal accordingly ruled that transfer pricing provisions do not apply to the terms of the guarantee and therefore the TP adjustment imputing an arm’s length guarantee fee is not warranted. With regard to interest on the loan provided by the taxpayer to its associated enterprises, the Tribunal rejected the TPO’s approach of determining the arm’s length interest rate. The Tribunal ruled that the arm’s length interest rate should be determined based on rates prevailing with respect to the currency in which the loans are made. With regard to the capital contribution made by the taxpayer to its AEs, the Tribunal rejected the TPO’s approach of determining the arm’s length interest rate by treating these payments partly as an interest-free loan. The Tribunal ruled that an arm’s length price adjustment based on that hypothesis was not legally sustainable on merits as the TPO has not brought on record anything to show that an unrelated share applicant would be paid any interest for the period between making the share application payment and allotment of shares.

8.5 Wide Audit Powers Held by the Transfer Pricing Officers

As already mentioned, the Indian transfer pricing regime is said to be one of the aggressive in the world. The reason for this is partly due to the comprehensive transfer pricing legislation which includes practical rules which assist in the regulation of the transfer pricing processes. It is also due to the wide powers conferred to the Indian Transfer Pricing Officers (TPO) to deal with transfer pricing audits.[700] The powers of the TPO in India are encapsulated in section 92CA of the Income Tax Act, 1961. The primary powers of the TPO involve the determination of the arm’s length principle of international and specified domestic transactions in India.[701] The transfer pricing audit in India is initiated by the assessing officer (OA) who then refers the matter to the TPO.[702] Until 2011, the power to determine the

---

[700] In terms of s 92CA Transfer Pricing Officer – TPO means a Joint Commissioner, Deputy Commissioner or Assistant Commissioner, authorized by the board to perform all or any of the functions of an assessing officer specified in s 92C-D in respect of any person or class of persons.

[701] A covered transaction refers to either an international transaction or a specified domestic transaction.

[702] In terms of s 2(7A) of the Income Tax Act, 1961, unless the context otherwise requires, the term “assessing officer” means the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under subsection (1) or subsection (2) of s 120 or any other provision of

arm's length principle was limited to transactions referred to the TPO by the OA. Sections 92CA(2A) and 92CA(2B) widened the powers of the TPO to adjudicate both international and specified domestic even if those audits were not referred to by the AO. The powers of the AO were asserted in the case of *Cushman & Wakefield (India) Pvt v ITA*.[703] The TPO may adjudicate the covered transactions even though the taxpayer did not disclose the transaction in the Account's Report filed with the tax return in terms of section 92E.

When conducting the transfer pricing audit, the TPO has the power to summon or call for information in order to conduct a transfer pricing audit. One of the controversial powers that the TPO is having is the power to conduct on-the-spot enquiry and verification. In this regard section 92CA(7) was amended in order to allow the TPO to exercise the power of survey conferred upon the Indian tax authority in terms of section 133A. These powers are limited in terms of section 133(1)(a)-(d) and section 133(6). If such powers were to be conferred to the South African officials such would on face value infringe on the rights of the taxpayers but such infringement would be reasonable and justifiable in terms of section 36 of the Constitution.

The fact that there is a dedicated provision that spells out the powers and duties of the TPO shows the willingness by the Indian tax authority to fight transfer pricing manipulation. Some of the provisions like section 133A which gives the TPO the power to conduct surveys may be draconian if there are no checks and balances but that is also an indication that the Indian government is serious about eradicating transfer pricing manipulation and impermissible tax avoidance. In South Africa, there is no provision that gives specific powers to the transfer pricing assessors (auditors) the power to perform their duties in a legally specified manner. Considering that transfer pricing is a specialised function, it would be best if the powers and duties of transfer pricing officers are expressed in the law. The first step would be to amend section 1 of the TAA to include the definition of an auditor in the list of definitions.

---

this Act, and the Additional Commissioner or Additional Director or Joint Commissioner or Joint Director who is directed under clause (b) of subsection (4) of that section to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer under this Act.

[703] *Cushman & Wakefield (India) Pvt v ITA* 475/2012/Del.

Supplementary rules should be promulgated to prescribe the powers and duties of SARS officials including transfer pricing assessors.

8.6 Transfer Pricing Methods in India

Indian transfer pricing methods are based on the OECD transfer pricing guidelines. Section 92C(1) provides that the arm's length price in relation to an international transaction shall be determined by any of the transfer pricing methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe.[704] Transfer pricing methods are part of the tax law in India. Transfer pricing methods are provided for in section 92C read with rules 10A, 10AB, 10B and10C of the same section. It must also be borne in mind that in India, just like in other parts of the world, no particular method has been accorded a greater or lesser priority or hierarchical status. This notion was emphasised in the case of *Serdia Pharmaceuticals (India) (P) Ltd v CIT,*[705] where the court held that there is no particular order or priority of methods which the assessee must follow. No method can invariably be considered to be more reliable than the others.

8.6.1 The Most Appropriate Method

Section 92C read with rule 10C(2) provides that the most appropriate method must be used to arrive at a transfer price. It is not known what is meant by most appropriate as it is not defined in the law but section 92C provides that where more than one price is determined by the most appropriate method, the arm's length price shall be taken to be the arithmetical mean of such prices.[706] Regrettably, the phrase 'arithmetical mean of such prices' is also not defined anywhere in this provision or elsewhere in the Act but it can be interpreted to mean that if the variation between the arm's length price so determined and price at which the international transaction

[704] Section 92C (1) of the Indian Tax Act.
[705] *Serdia Pharmaceuticals (India) (P) Ltd. v CIT* [2011] 44 SOT 391.
[706] In mathematics and statistics, the arithmetic mean or simply the mean or average is the sum of a collection of numbers divided by the number of numbers in the collection. The collection is often a set of results of an experiment, or a set of results from a survey. For a further reading on this see: U Kohler & F Kreuter *Data Analysis Using Stata* (2005) at 153; A Francis *Business Mathematics and Statistics* 6 ed (2008) at 96; J Medhi *Statistical Methods: An Introductory Text* (2005) at 55.

has actually been undertaken does not exceed five per cent of the latter,[707] the price at which the international transaction has actually been undertaken shall be deemed to be the arm's length price. The difficulty of arriving at a most appropriate method can be best illustrated by the case *Fulford (India) Limited v Assessee* discussed.[708]

In the above case, the taxpayer imported Active Pharmaceutical Ingredients (APIs) for secondary manufacturing of formulations. The Transfer Pricing Officer (TPO) rejected the TNMM analysis undertaken by the taxpayer and considered the CUP method as the most appropriate method. The TPO compared the purchase price of APIs imported by the taxpayer from an AE with the price for which generic APIs were purchased by the taxpayer's competitors. The taxpayer contended that the CUP method requires stringent comparability and any differences in the third-party price and the international transaction price which could materially affect the price in the open market, warrant appropriate adjustment to such third-party prices. In the pharmaceutical world, APIs may have similar properties but still could be different on quality, efficacy and levels of impurities present in the drug amongst other things. Therefore, the two products cannot be compared. Even though the matter was referred back to the officer for fresh adjudication, this case illustrates the difficulty that occurs in choosing the most suitable method for transfer pricing adjustment purposes.

8.7 Supplementary Transfer Pricing Regulations in India

Just like in the US transfer pricing regime, most of the principal transfer pricing regulations (sections 92 TO 94b) are supplemented by rules. These supplementary regulations have the same binding effect as legislation because they are incorporated in the income Tax Act. Typically, these provisions are aimed at simplifying the complicated sections of the law because they are written in simple language and provide guidance on how to apply the principal act. The regulations are structured in such a way that they provide detailed aspects of specific transfer pricing issues based on various transfer pricing methods. For an example, rule 10B(d) under section 92C deals with the determination of the arm's length principle by means of the profit split method and to demonstrate the clarity and simplicity of

[707] Words 'such percentage of the latter, as may be notified by the Central Government in the Official Gazette in this behalf' shall be substituted for 'five per cent of the latter' by the Finance Act, 2011, with effect from 01-April-2012.
[708] *Fulford (India) Limited v Assesee I.T.A.* No 8312/Mum/2010.

language required to tone down the often-complicated principal legislation, the rule is quoted as follows:

> profit split method, which may be applicable mainly in international transactions [or specified domestic transactions] involving transfer of unique intangibles or in multiple international transactions [or specified domestic transactions] which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which—
>
> (i) the combined net profit of the associated enterprises arising from the international transaction [or the specified domestic transaction] in which they are engaged, is determined;
>
> (ii) the relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
>
> (iii) the combined net profit is then split amongst the enterprises in proportion to their relative contributions, as evaluated under sub-clause (ii);
>
> (iv) the profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction [or the specified domestic transaction] :
>
> Provided that the combined net profit referred to in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction [or specified domestic transaction] in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction [or the specified domestic transaction]

8.8 Dealing with E-Commerce in India

The taxation of e-commerce has assumed great importance. As a result, in many countries, including India, Finance Act, 2016 has introduced a new levy called the Equalisation Levy, 2016 as a self-contained code to tax digital e-commerce transactions under sections 165 to 180 of Chapter VIII of the Finance Act 28 of 2016. This is in line with India's action on Base Erosion Profit Sharing (BEPS) agenda relating to the impact of the digital economy on tax collection. India has incorporated some tax options of the Action Plan such as this in its national legislation. The so-called equalisation rules were promulgated by the Central Government of India in terms of section 179 of the Finance Act. According to these provisions the equalisation levy has been made applicable only to certain specified services, which include online advertising, any provision for digital advertising space or any other facility or service for the purpose of online advertisement.[709] It is hoped that in future there will be an inclusion of further services within the ambit of this levy. It is further provided that no income tax is payable in respect of income on which equalisation levy is chargeable. In terms of section 166 of the Finance Act a levy of 6% (prescribed in terms of section 165) is to be withheld by the payer who makes the payment to a non-resident who provides the specified services. Apart from protecting revenue, the other rationale behind the imposition of the above levy seems to be that the Indian tax authorities are trying to create a level playing field between multi-national companies who do not have a PE in India and those who have a PE in India.[710] The *Income Tax Officer vs. Right Florists Pvt Ltd* is a typical example of a situation where the equalisation levy would have been applied to level the plain field between an MNE who have a PE in India and the one that does not have[711]. This case is briefly discussed as follows:

The taxpayer who was a florist used the online advertising services of two US based entities, namely Google Ireland Limited (Google Ireland) and Overture Services Inc USA (Yahoo USA), on their search engines Google and Yahoo, to market their services and generate business. The taxpayer made payments amounting to Rs 30, 44,166/- (Rupees Thirty Lakhs Forty-Four Thousand One Hundred and Sixty-Six

[709] Section 165(2)(b) of the Finance Act of 2016.
[710] Section 165 of the Finance Act of 2016.
[711] *Income Tax Officer v Right Florists Pvt Ltd I.T.A*. No.: 1336/Kol/2011.

Only) in respect of online advertisements without withholding taxes from those payments. The Assessing Officer (A.O) disallowed the deduction claimed by the taxpayer under section 40(a) of the Indian Income Tax Act since no tax was withheld by the taxpayer on the said payments as required by section 195 of the Act. Aggrieved by the A.O's decision, the taxpayer filed an appeal before the Commissioner of Income Tax Appeals (CIT-A), who subsequently ruled against the A.O. in turn, the aggrieved A.O. filed an appeal before the Tribunal.

The tribunal held that since the taxpayer had no access the portal of either of the search engines, the payment could not be claimed as royalty because there was no positive act of utilization, application or employment of the equipment (search engine) by the taxpayer. The tribunal held further that since the services were provided by Yahoo USA and Google Ireland by automated systems without any human intervention, the payment for same cannot be brought to tax as fees for technical service. the tribunal further ruled that since the recipients were foreign companies having no (PE) in India during the year under consideration, the taxpayer was not liable to deduct tax at source from the payment for such services and thereby ruling that the tax could not be disallowed by invoking the provisions of section 40(a)(i) for non-deduction of tax.

The imposition of the equalisation levy helps to correct some of the controversial judicial decisions like the *Income Tax Officer vs. Right Florists Pvt Ltd* where it was erroneously held that 'payments made for online advertisement on search are not subject to withdrawal tax when in fact the converse is the truth.

8.9 Thin Capitalisation in India

Many countries have incorporated specific thin capitalisation rules in their tax jurisdictions to deter erosion of the tax base through unscrupulous financial assistance between connected parties.[712] Many other countries do not have thin capitalisation rules, India is among those countries. Indian tax legislation does not have separate rules for thin capitalisation; in fact, it does not directly recognize the

[712] AJ Easson *Tax Incentives for Foreign Direct Investment* (2004) at 44; MZ Brooke & PJ Buckley *Handbook of International Trade* (2016) at 245; J Blouin, H Huizinga, L Laeven & G Nicodeme *Thin Capitalisation Rules and Multinational Firm Capital Structure* (2014) at 14-16; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 26.

concept. In the case of *Besix Kier Dabhol, SA v DDIT*,[713] it was held that thin capitalisation rules have not yet been introduced in India but the Direct-tax Code Bill, 2010 does contain a gist of such rules as a part of General Anti-avoidance Rule. Until the rules are introduced in India, it is not open to tax authorities to re-characterise the debt capital as equity capital and make interest payment as non-deductible. The court held that in the absence of thin capitalisation rules interest paid to shareholders for loans cannot be disallowed despite a capital-structure tax-planning resorted to by the taxpayer. One of the aims of the thin capitalisation rules is to regulate cross-border financial transactions, more particularly the provision of loans between related persons.

The provision of loans on an interest-free basis generally points to a non-arm's length transaction because under normal course of events, a financier would not extend a loan for no return.[714] One of the common challenges with interest-free loans in India and elsewhere is whether the transfer pricing provisions can impute interest income artificially, when in reality there is no income.[715] Section 4 of the Indian Income Tax provides that income is considered to be real only if it accrues, arises or received. The section further stipulates that income is considered to be real if it is deemed to accrue, arise or received by a person in terms of the Income Tax and not otherwise. A moot point in this regard is whether the recipient of an interest-free loan cannot be deemed to have some kind of income in relation to the interest-free loan. In the case of *Ed Sassoon v CIT*,[716] the court held that the words "accrues", "arises" or "received" as applied in s 4, indicate the right to receive. In view of this reasoning, the court held that what is sought to be taxed must be the income, not some fictitious arrangement. It further held that strictly speaking, an amount cannot be taxed unless it has reached a stage where in reality, it can be called income. In the case of *CIT v*

[713] *Besix Kier Dabhol, SA v DDIT* [131 ITD 299].
[714] Baker & Levey *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* at 281. *See also* BR Hopkins *The Law of Tax–Exempt Organisations* 10 ed (2011) at 522; Choi *International Finance and Accounting Handbook* at 14; Avi-Yonah, Santori & Marian *Global Perspectives on Income Taxation Law* at 74.
[715] Baker & Levey *Transfer Pricing and Intra-Group Financing* at 282. See also McDaniel, Ault & Repeti *Introduction to United States International Taxation* at 140.
[716] *ED Sassoon India Pvt Ltd v CIT* (26 ITR 27). See also RC Williams *Capital Gains Tax: A Practitioner's Manual* 2 ed (2005) at 369; WH Hoffman, JC Young, WA Raade, DM Maloney & A Nellen *South-Western Federal Taxation 2016: Individual Income Taxes* (2016) at 4-21.

Ajax Products,[717] the Supreme Court of India held that the taxpayer is not to be taxed unless the charging provision clearly imposes the obligation to pay the tax.

8.9.1 Judicial Pronouncements on Thin Capitalisation Issues

Over the years the Indian courts have made rulings on disputes involving interest-free loans between connected persons albeit not based on any specific thin capitalisation rule. Two examples of those cases are briefly analysed. In the case of *Ainthent Technologies Pvt Ltd*,[718] the taxpayer granted an interest-free loan to its subsidiary. The taxpayer claimed that the transaction was at arm's length because its net margins from the software development business were computed using the TNMM. The taxpayer further maintained that even if a notional interest towards the loan is included in the revenue from the software services, the net margin would still be at arm's length. The tribunal considered various factors such as creditworthiness of the borrower, estimation of credit rating, period of loan, amount, currency, convertibility of the loan, and interest rate applied. Based on the consideration of these factors, the Tribunal came to the conclusion that CUP would be the most appropriate method to compute the arm's length price of the interest receivable on the loan.

In the *Perot Systems TSI* case,[719] the Indian taxpayer granted interest-free loans to two of its associated enterprises. It was also claimed by the taxpayer that the loans were granted in quasi-equity form.[720] The Revenue authority rejected the nil rate of interest by stating that no third person or independent person would extend such kind of loan if the transaction took place in the open market. It was further held that based on the facts and circumstances of the case, the intercompany agreement was silent on the treatment of the loan as quasi-equity.

---

[717] *CIT v Ajax Products* (1965) (55 ITR 741).
[718] *Ainthent Technologies Pvt Ltd* (Delhi ITAT) (unreported).
[719] *Perot Systems TSI (India) Limited v DCIT* ITA No 2320, 2321 & 2322/Del/2008.
[720] Quasi-equity is a category of debt taken on by a company that has some traits of equity, such as having flexible repayment options or being unsecured. Examples of quasi-equity include mezzanine debt and subordinated debt. For a comprehensive analysis of this concept see also: GE Peterson & PC Annez *Financing Cities: Fiscal Responsibility and Urban Infrastructure in Brazil, China, India, Poland and South Africa* (2007) at 257; H Beale, M Bridge, L Gullifer & E Lomnicka *The Law of Security and Title Based Financing* (2012) at 2047.

8.10 Comparability Analysis within the Indian Context

The comparison between the controlled and uncontrolled transaction is the key factor in determining the arm's length price of an international transaction. Comparability analysis of the controlled transaction for the enterprises participating in the controlled transactions provides a basis for characterisation of the controlled transaction to be benchmarked or the characterisation of the tested party. Such characterisation provides the parameters for searching the potential comparables or the selection and application of the most appropriate method.

Thus, the first stage of comparability analysis in a transfer pricing benchmarking exercise is to gather all the relevant facts and circumstances surrounding the controlled transactions under review. The functional analysis involves the evaluation of comparability factors of uncontrolled comparables for establishing comparability with the controlled transactions. Comparability analysis is part of the functional analysis. The use of the comparability analysis was emphasised in the case of *Mentor Graphics (Noida) (P) Ltd v DCT*.[721] The determination of arm's length price of a controlled transaction involves functional analysis at two stages, *viz:* characterisation of the international transaction and establishing comparability between the controlled and uncontrolled transactions. In the case of *E-Gain Communication (P) Ltd. v ITO,*[722] it was held that:

> It is clear that even when TNMM method is applied to determine arm's length price as per OECD guidelines, functional profile, assets, assumed risks of controlled and uncontrolled transaction are to be seen while screening. Besides, it is not possible to ignore specific Indian regulations on the subject. We have already noted the relevant rule (2) and (3) 10B of I.T. Rules, which specifically require to consider for comparison "the functions performed assets employed ... and risks assumed by respective parties" In Rule 10(B)(1)(c) of I.T. Rules providing for determination through TNMM, it is clearly provided in clause (iii) "the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the difference if any.

[721] *Mentor Graphics (Noida) (P) Ltd v DCT* 109 ITD.
[722] E-*Gain Communication (P) Ltd. v ITO* 118 TTJ 354 para 36-37.

Given the above, any material difference in the market value must be given serious consideration. The degree of comparability between the tested party and the uncontrolled taxpayer must be taken into account when making a comparative analysis.

8.10.1 Use of Secret Comparables in India

One of the controversial aspects of Indian transfer pricing practice within the comparability space is the use of secret comparables by the tax authorities. It is important to note that Indian tax legislation currently does not provide guidelines on the use of foreign comparables. India does not frown from using secret comparables. Under Indian legislation, the general provisions regarding the disclosure of any information are contained under section 138 of the Income Tax Act of 1961 as well as section 124 of the Indian Evidence Act, 1872. Section 124 of the Indian Evidence Act confers privileges against disclosure in respect of any official communication made to a public officer in their official capacity when the public officer considers that the public interest would suffer by the disclosure. Furthermore, the current provisions of section 138 of the Act do not specifically provide for adequate secrecy of the information produced by an assessee in the course of any proceeding under the Act. The Indian tax authority is empowered to use any information at its disposal to determine the arm's length price. The tax authority may also use secret comparables to make adjustments.[723] The powers under these provisions are so wide that they may also cause one taxpayer to furnish data to determine the arm's length price of other taxpayers. This is one of the reasons for concluding that Indian transfer pricing rules are wide ranging.

8.10.2 Use of Ranges to Determine a Transfer Price

In a case where more than one price is determined by the most appropriate method, the arm's length price will be the arithmetical mean of such prices.[724] The use of

[723] A few other countries such as Japan, France, China, and Germany permit use of secret comparables. Mexico also specifically allows such use.

[724] Mo *Tax Avoidance and Anti- Avoidance Measures in Major Developing Economies* at 113; A Bakker & B Obuoforibo *Transfer Pricing and Customs Valuation* at 427; KK Agrawal *Direct Tax Planning and Management, Incorporating: Corporate Tax Planning, Business Tax Procedure and Management* at 205; C Campbell *Legal Aspects of Doing Business in Asia and the Pacific* at HS-55. In summary, the arithmetic mean, also called the average or average value, is the quantity obtained by summing two or more numbers or variables and then dividing by the number of numbers or variables. The arithmetic mean is important in statistics. When there are only two quantities involved, the arithmetic mean is obtained simply by adding the quantities and dividing by two.

arithmetic mean is unique to India and is opposed to an interquartile approach.[725] Further, the transfer pricing regulations permit an allowable variation where there is a deviation from arm's length price. No adjustment can be made to the taxpayer's price within the range of $1 million.[726] This is a safe-harbour provision which helps to ensure some degree of certainty unlike in South Africa where the determination of the arm's length price is risk based with no legislated threshold.

8.11 Transfer Pricing Documentation Requirements in India

Unlike in the US where transfer pricing documents are not mandatory, in India, taxpayers are required to maintain, on an annual basis, a set of extensive information and documents relating to international transactions undertaken with associated enterprises or specified domestic transactions. Section 92D of the ITA requires every person who has entered into an international transaction or specified domestic transactions to maintain such information and documents as required by law. Rule 10D of section 92D of ITA prescribes detailed information and documentation that has to be maintained by the taxpayer. Information required in terms of this rule primarily deals with the profile of the taxpayer's organisation and relevant business activities. The documents must be held for a period of 8 years from the relevant assessment year. Some of the documents include but not limited to:

(i) A description of the ownership structure of the taxpayer's enterprise with particulars of shares or other ownership interest held therein by other enterprises.

---

725 Levey, Wrappe & Chung *Transfer Pricing Rules and Compliance Handbook* at 75; Heimert & Johnson *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* at 12; King *Transfer Pricing and Corporate Taxation, Problems, Practical Implications and Proposed Solutions* at 13. For a scientific description of this term see SL Weinberg *Data Analysis for Behavioural Sciences Using SPSS* (2002) at 73; F Gravetter & L Wallnau *Essentials of Statistics for the Behavioural Science* 6 ed (2008) at 88; A Rubin *Statistics for Evidence-Based Practice and Evaluation* 3 ed (2013) at 67. In descriptive statistics, the interquartile range (IQR), also called the mid-spread or middle fifty, or technically H-spread, is a measure of statistical dispersion, being equal to the difference between the upper and lower quartiles, $QR = Q_3 - Q_1$. In other words, the IQR is the 1st quartile subtracted from the 3rd quartile; these quartiles can be clearly seen on a box plot on the data. It is a trimmed estimator, defined as the 25 per cent trimmed range, and is the most significant basic robust measure of scale. The interquartile range (IQR) is a measure of variability, based on dividing a data set into quartiles. Quartiles divide a rank-ordered data set into four equal parts. The values that divide each part are called the first, second, and third quartiles; and they are denoted by Q1, Q2, and Q3, respectively.

726 Finance Act, 2014.

(ii) A profile of the multinational group in which the taxpayer's enterprise is a part along with the name, address, legal status and country of tax residence of each of the enterprises included in the group with whom the specified transactions have been pursued.

(iii) The nature and terms of the international transaction pursued with each associated enterprise, details of property transferred or services provided as well as the quantum and value of each of the transactions or class of such transaction.

(iv) A description of the operations, risks assumed and assets utilized or to be utilized by the taxpayer.

(v) Any assumptions, policies and price negotiations which have significantly affected the determination of arm's length price.

(vi) Details of any adjustments made to transfer prices to align them with arm's length prices determined under these rules and the resulting adjustments applied to the total income for tax purposes.

(vii) Any other information, data or document which may be relevant for determining the arm's length price.

Further, it is mandatory for all taxpayers, without exception, to obtain an independent accountant's report in respect of all international transactions between associated enterprises or specified domestic transactions. The report has to be furnished by the due date of the tax return filing (i.e. on or before 30 November) to avoid stringent penalties prescribed for noncompliance with the provisions of the transfer pricing code.

If the assessee is non-compliant with any of the following regulations relating to disclosure of any information, he or she will be penalized with a sum which is equal to 2% of the value of each international transaction or specified domestic transaction:

(i) Keep and maintain information and documents in respect of international transaction or specified domestic transaction.

(ii) Report the international transaction or specified domestic transaction as per the requirement.

(iii) Submitting false information or document in respect of international transaction or specified domestic transaction.

On the other hand, if an assessee or taxpayer who is a constituent entity of international group and who fails to furnish information and documents in respect of an international group, will receive a penalty to the amount of Rs 5, 00,000. Furthermore a 50% penalty of tax on transfer pricing adjustment is imposed where no documentation maintained and 200% of tax on TP adjustment where transaction not declared or facts undisclosed.

It is worth mentioning that India has integrated the recommendations of OECD BEPS Action Plan 13 into its national legislation. The Indian government, through Finance Act, 2016, amended the Income Tax Act to introduce provisions for additional transfer pricing documentation and CbCR to give effect to the guidance contained in Action 13. In a nutshell, the Maintenance and filing of the Master File is done in terms of section 92D (1) read with its applicable rules. Section 286 deals with the filing of country by country reporting. Detailed rules for implementation were also released on 31 October 2017 on CbCR and furnishing of the master file. While the master file and local file would be filed the by MNEs locally, the local CbC report filing requirements would arise in a case: (i) where the parent entity of an MNE or the alternate reporting entity is resident in India; or (ii) where the home jurisdiction of the MNE group to which the Indian constituent entity is affiliated, neither has an arrangement for exchange of the CbCR with India nor is exchanging information with India even though there is an agreement and this fact has been communicated to the constituent entity by the Indian Tax Administration. In all other cases, every constituent entity resident in India should file a CbCR notification in India given that the CbC reports would be filed in the jurisdiction of tax residence of the ultimate parent entity and shared between jurisdictions through the automatic exchange of CbCR information pursuant to government-to-government mechanisms under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, bilateral tax treaties or Tax Information Exchange Agreements (TIEAs).

8.12 Advance Pricing Agreements in India

The rules governing APA i.e. Advance Pricing Agreement Scheme, was notified on 30th August 2012 by Central Government through notification No. 36/2012 of the Indian government Gazette. Section 92CC of the Income Tax Act regulates Advance pricing Agreements in India. APA scheme has been finally notified by the government by amending the Income-tax Rules, 1962 ('Principal Rules') by inserting Rules 10F to 10T and 44GA in the Principal Rules. The Indian APAs are also aligned to the OCED transfer pricing guidelines. Rule 10F to section 92CC define an Advance Agreement as an advance agreement entered into between the Board and the applicant with the approval of the Central government, as referred to in subsection (1) of section 92CC of the Act.

8.12.1 Types of APA'S in India

Just like anywhere else where there are APAs, the kinds of APA depend on the number of parties who are concluding the agreement. Accordingly, there are three kinds of APA in India and they are bilateral, multilateral and unilateral:

Unilateral APA, rule 10F defines this agreement as an "agreement between the board and the applicant which neither a bilateral nor multilateral agreement" this is the type of an agreement between CBDT and the applicant and does not involve any other party. As no other party is involved, such an agreement is binding only on the CBDT and the applicant entity. It is extremely important to mention that Unilateral APA is not binding on the other country of residence of the other party of the International Transaction.

A Bilateral APA is defined in rule 10F(c) as:

> an agreement between the board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authority in the other country regarding the most appropriate transfer pricing method or the arm's length price.

This is the APA which involves more than one country. The parties involved in this type of agreement are CBDT, the applicant and the competent authority of the other country. These parties through a Mutual Agreement Procedure (MAP) negotiate and reach a mutual agreement on how to handle the tax affairs of the taxpayer involved.

The negotiated agreement is therefore binding on all of the parties involved including the Indian government and the other country.

According to rule 10F (h) to section 92CC a multilateral agreement means:

> an agreement between the Board and the applicant, subsequent to, and based on, any agreement referred to in rule 44GA between the competent authority in India with the competent authorities in other countries regarding the most appropriate transfer pricing method or the arm's length price.

Multilateral APA involves the participation of many parties. Generally, the CBDT and the applicant along with all the competent authority of other countries are the parties in these types of agreements. These parties through Mutual Agreement Procedure (MAP) negotiate and reach at a mutual agreement. Hence, such a negotiated agreement is binding on all of the parties involved.

Section 92CC (1) provides that an APA can be applied for various international transactions, like purchase or sale of raw materials, finished goods, providing services, financing arrangements, transfer and use of tangible/intangible assets, etc. However, considering the time and resources required for concluding an APA, it is generally preferred to enter into an APA in respect of complex/high value transactions. Applying for an APA for transactions is generally left to the discretion of the taxpayer. Though it is not the statutory obligation for a taxpayer to cover all the related party or inter-company transaction in an APA, however, considering the scope of APA it is generally recommended to disclose all the inter-company transactions proposed to be entered into by the taxpayer to the relevant tax authorities so that both the parties may discuss and come to a consensus to include such transactions. This is more due to the fact that the APA proposals are independent in nature and binding only on the person in whose case the agreement has been entered into and only in respect of the transaction in relation to which the agreement has been entered into. The scope of an APA also states the time period for which the APA shall remain in force, in terms of section 92CC (4) an APA is valid for duration not exceeding five years and in terms of rule 10S it may be renewed/re-negotiated upon completion of the originally agreed term.

Key characteristic features of APA as proposed in India are as under:

In terms of section 92CC (1) provides that the board with the approval of the central government may enter into an advance agreement with any person in relation to an international transaction. The emphasis on an international transaction presupposes that APAs may not be applicable to domestic transfer pricing. Rule 10G amplifies section 92CC in that it provides that any person who has undertaken an international transaction or is contemplating to undertake an international transaction is eligible to enter into an agreement under these rules.

In terms of rule 10H Pre Filing Consultation is a requirement for the taxpayer in the process. Rule 10H(2) provides that the request for prefilling consultation shall be made to the director general of income tax (DGIT). Additionally, it involves a mandate of providing a lot of detailed information, with an option to keep the name of the taxpayer and its related entities 'anonymous'. Taxpayers/ representatives can request for a pre-filing consultation with the DGIT. While the pre-filing consultation is neither binding on the Board nor the taxpayer to enter into an APA.

The application for an advance pricing agreement in India is made in terms of rule 10-I. Application for APA. Companies desirous of entering into an APA need to file an application with the DGIT for Unilateral APA and with Competent Authority ('CA') of India for bilateral and multilateral APAs. Although the number of years can be proposed by the applicant, it cannot exceed 5 years as suggested in the Finance Act, 2012. Rule 10-I further provides that every application shall be accompanied by the proof of payment of fees as specified in sub rule (5) which deals with a threshold of fees payable for this process.

8.12.2 Steps taken to conclude an APA

8.12.2.1 Feasibility Study

As part of the prefilling consultation process, a feasibility study in terms of rule 10-H (5) must be conducted with the aim of objectively and rationally uncovering the strengths and weaknesses of the existing business model or proposed venture, evaluate the opportunities and threats and ultimately draw up the prospects for success. The feasibility study should also aim to analyse which transaction or group of transaction the taxpayer should cover while entering into an APA. In its simplest terms, the feasibility study should encapsulate the objective, type of transaction to be covered, cost-benefit (economic) analysis and the risk threshold. This will enable a company to decide if an APA is feasible or not. As mentioned above, the feasibility study should detail the primary objective for entering into an APA. The objective could be to determine certainty in case of high risk / high value transfer pricing issue or ensure certainty before starting a new line of business; expansion etc. or another objective could be to eliminate risk of double taxation (bilateral/multilateral APA). The next step would be to determine the economic benefit for entering into an APA vis-à-vis the current litigation options available. The economic analysis would entail undertaking a cost benefit- risk analysis. The taxpayer will have to determine an appropriate threshold limit in terms of time, resource and money that it would want to invest in an APA process.

8.12.2.2 Pre-filing Consultation (PFC)

In terms of rule 10H Pre Filing Consultation is a requirement in the provided to the taxpayer in the process. Rule 10H (2) provides that the request for prefilling consultation shall be made to the director general of income tax (DGIT. According to rule 10H (5)(iii) PFC allows taxpayers to discuss the suitability of an APA before deciding to pursue it. The PFC would be fruitful if the taxpayer is given a chance to discuss the case directly with the Board personnel who would be processing the case. It is understood that, the pre-filing conferences can be held on a named or anonymous basis also. An anonymous pre-filing conference provides the taxpayers the opportunity to discuss the facts and issues of the case with the board. During the discussion, the taxpayer can determine the openness of the Board to the issues of the taxpayer, without the fear of inviting an audit if the taxpayer decides not to proceed with an APA. According to rule 10-H(6)(i), the pre filing discussions however do not bind a taxpayer or the tax administration to the APA process.

8.12.2.3 APA Application

Once the preliminary consultation has been finalised, the third phase is to process the application. The application for an advance pricing agreement in India is made in terms of rule 10-I. This is done by filing a written APA application. The APA Rules prescribe that the APA application should be made in Form CED. The information to be submitted in this form includes general information which among other things cover the name of the applicant, profile of the business which may include background and description of the business and products involved, the application must also contain prefilling details such as type of application, fee details and proposed period of APA.

The application should also contain transactional details which include functional analysis of the applicant and all relevant entities with respect to the covered transactions. This may also include business strategies and forecasts. The application should also include financial details such as relevant marketing and financial studies, detailed industry analysis and the market analysis for all countries involved and copies of all relevant intercompany agreements. Financial details must also include financial operating information, corporate annual reports & financial statement for the prior five years, accounting and costing system, policies, procedures, and practices, including any significant financial and tax accounting differences, segment financials as well as Income tax returns and related supporting schedules for the prior three years At the heart of the application is the transfer pricing methodology which essentially relate to transfer pricing background and discussion of transfer pricing method, policies, and practices used by the applicant and AE for the for past, discussion and analysis of each TPM, applied or rejected, for each covered transaction. In particular provide details on accepted or rejected internal comparables. Method, terms and conditions, and critical assumptions, Details Primary and Secondary Transfer Pricing Methodology and Impact of proposed TPMs. All this information will be used for preliminary screening purpose to determine the viability of the application. Once the authorities are satisfied that the application is viable, then the actual APA negotiation commences. RULE 10-I further provides that every application shall be accompanied by the proof of payment of fees as specified in sub rule (5) which deals with a threshold of fees payable for this process.

8.12.2.4 Negotiation

The fourth phase in the APA process is the negotiation of the terms and conditions of the APA between the taxpayer and the tax administration. This is in terms of rule 10K read with rule 10L. In terms of rule 44G and in cases involving unilateral APAs, the tax administration will arrange negotiations and discussions with the taxpayer.

For bilateral APAs, the tax administration will first arrange negotiations with the taxpayer and then enter into discussion rounds with the relevant competent authorities. In the negotiation phase which is in terms of rule 10L (2)(i) the tax administration and the taxpayer would mutually reach to a conclusion on the transfer pricing of the covered transactions. In complex transactions, the negotiation meetings could be more than one meeting. The tax administrator should share with the taxpayer its findings after the negotiations. Once the negotiation proceedings are done the next step in the APA process would be drafting of an APA.

8.12.2.5 Draft and Execute APA

Once the negotiations are concluded and an agreement is reached, the Indian tax authorities shall in terms of rule 10L (7) draft the formal agreement in a manner consistent with the laws of that country relating to contractual arrangements. In terms of section 92CC (a) and (b) the formal agreement will be binding on both the taxpayers and tax authorities. If any tax demand is raised as a result of the normal TP audit process on any subject matter of the APA, the same should not be enforced till the execution of the APA.

8.12.2.6 Annual APA Compliance Report

Once the APA is concluded and execute, the taxpayer is required in terms of rule 10-O to prepare and file an annual compliance report in relation to the implementation of the APA to the tax authority for each year of the APA. This report may cover issues such as details of covered transactions including nature, amount, agreed TPM, actual result achieved, adjustment required etc. the report may also cover details of any changes in the functional and risk profile of the taxpayer and the associated enterprises.

8.12.2.7 Compliance Audit for APAs

It is also a requirement in terms of rule 10-O that the Indian tax authorities, in particular the TPO conduct compliance audit for each of the covered years of the agreement. The TPO shall submit the compliance audit report, for each year covered in the agreement, to the DGIT in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assesse with terms of the agreement. The

DGIT shall forward the report to the Board in a case where there is finding of failure on part of assesse to comply with terms of agreement and cancellation of the agreement is required.

8.12.2.8 APA Renewal

Rule 10-S requires that when an existing APA is drawing to a close of its term, the parties may agree to enter into further discussions or negotiations with a view to extending the APA beyond the period originally provided. Any such extended arrangement is considered to be a new APA in terms of rule 10-H.

Within the Indian context, an APA may be discontinued due to critical assumptions. According to rule 10F, critical assumptions mean significant factors and assumptions that if changed would lead to the annulment of the APA. This is the most crucial aspect in an APA and needs to be carefully agreed and drafted. In terms of section 92CC (6) an APA would not be binding in case of any changes in critical assumptions or failure in meeting conditions set under APA. Also, the binding effect of APA would cease in the following cases:

(i) change in law

(ii) changes in critical assumptions or failure to meet conditions by the applicant or by the Board

Rule 10N allows for the amendments to the application: rule 10(1) of the APA scheme provides for the amendment of the application by the taxpayer at any time before the finalization of the agreement. Rule 10N (2) stipulate that the DGIT may allow the amendment of the application if such amendment does not have the effect of altering the nature of the application as originally filed and payment of additional fees if required.

In terms of rule 10Q (1) an APA can be revised under any of the following circumstances:

(i) change in critical underlying assumptions

(ii) change in such law other than that which renders it non-binding

(iii) request from CA in the other country

Rule 10Q (2) provides that an agreement may be revised by the board either suo motu or on request of the assessee or the competent authority in India or the DGIT. Rule 10Q(5) provides that in case the board is not in agreement with the request of the assessee to for revision of the agreement, the board shall reject the request in writing giving reasons for such rejection.

Rule 10R provides for the Cancellation of APA and it can be cancelled in case of the following:

(i) negative findings of the compliance audit by the TPO

(ii) failure in timely filing of annual compliance report or filing with material errors

(iii) non-agreement by the taxpayer on the proposed revisions may result in cancellation of the APA

(iv) on account of fraud or misrepresentation of facts

In terms of rule 10R (4) the order of cancellation is required to have the following essential features:

(i) in writing with reasons and be able to provide the taxpayer with an opportunity to heard

(ii) formal communication to the concerned Assessing Officer and the TPO shall be made in terms of rule10R (7).

8.12.2.9 Criticism of the APAs in India

There are certain aspects which are not adequately covered under the Indian APA regime. While the overall regime adapts most of the global best practices, the following are concerns raised in terms of the Indian APAs:

Lack of confidentiality clause within the APA rules to protect taxpayer information. The information shared by a tax-payer while negotiating an APA may be confidential relating to the group policy, pricing policy, future business predictions, revenue model which are of strategic importance to the MNE group. The income tax act does protect taxpayer information from being shared in the public domain. However, if an

APA is not concluded then whether the information would be shared with the regular audit team is a concern to be addressed because the rules are silent on this issue. There is nothing preventing tax authorities from using any such information for subsequent audit processes especially if the APA was not concluded or it was cancelled.

Lack of flexibility, in terms of section 92CC (4) an APA is valid for a period not exceeding five years. While an APA provides a high degree of certainty over the APA a maximum of 5 years, it means that a taxpayer has no flexibility for that period. Once concluded, an APA takes away the ability to make fundamental changes to the transfer pricing method. Making any material changes on the key assumptions underlying the APA would make the APA subject to annulment by the Board in terms of rule 10R.

Just like all APAs in other jurisdictions, time and cost are always critical disadvantages against APA, India is no exception. The APA process is a time-consuming process and takes long to conclude time. Mature APA jurisdictions like USA also take a minimum of 14 months going all the way up to 3 years in some cases to conclude a unilateral APA. Bilateral / Multilateral APAs would take even longer given the level of complexity just by virtue of having more than two tax administrations involved. While on one hand it can take a long time to conclude an APA, on the other, it might be a better option considering the timelines involved in pursuing normal channels of dispute resolution (litigation) in India.

8.13 Lessons Learnt from the Indian Transfer Pricing System

Just like the US comparative analysis, the Indian transfer pricing system contains both positive and negative attributes that can be applied or avoided (as the case may be) to help in the improvement and development of the South African transfer pricing legal framework. Lessons from the negative aspects of the system are considered first. The aim is to use the experience as a learning curve in order to avoid similar mistakes. The Indian transfer pricing provision gives very wide powers to transfer pricing assessing officers. These provisions even go to an extent of giving officers the power to conduct surveillance on the suspected taxpayers. Although this may be applicable in India, the extent of the powers would not be allowed in South Africa as this has the potential to encroach upon the constitutional rights of taxpayers. These wide powers may also lead to abuse of power which does not augur well for good governance. Another negative aspect of the Indian transfer pricing system is that it does not contain thin capitalisation rules. One of the aims of the thin capitalisation rules is to regulate cross-border financial transactions, more particularly the provision of financial assistance between related persons. The absence of the thin capitalisation rules means that Indian tax authorities cannot adequately deal with financial assistance which does not meet the arm's length standard. Although s 31 contains thin capitalisation rules, more can still be done to improve and simplify the rules. Lastly, the Indian transfer pricing regime does not frown against the use of secret comparables, a practice that is not allowed in South Africa.

Apart from the negative aspects of the Indian transfer pricing rules, there are positive sentiments that can be drawn from the analysis. The Indian transfer pricing provisions are wide ranging but the powers and duties of transfer pricing assessors are clearly articulated in the law. This means that the delegation of authority in relation to transfer pricing practice is clearly stipulated in the law. As already mentioned, the law gives too much power to the transfer pricing assessors; however, such power is necessary (if in moderation) if it is exercised within the confines of the law. Transfer pricing is a very serious issue for South Africa and a specialised field of tax practice that needs special attention. South Africa can emulate India by expressly providing for the powers and duties of the transfer pricing assessors. In order to achieve this, rules must be promulgated to enable the Commissioner to set out the powers, duties of transfer pricing assessors. This will also help in setting out the minimum requirements that must be met for one to be eligible for appointment as a transfer pricing assessor.

Another lesson that can be drawn from the Indian transfer pricing regime is that it regulates both international and domestic transfer pricing transactions which help to determine the reasonableness of expenditure and to re-compute the income in related party transactions within a domestic set up. Domestic transfer pricing rules also provide objectivity in the determination of income and reasonableness of expenditure in domestic transfer pricing transactions. Domestic transfer pricing is not regulated in South Africa. In order to combat transfer pricing manipulation on all fronts, it is desirable to seriously consider regulating the transfer pricing process in our domestic sphere. This can be achieved by amending section 31 to incorporate the tax payable in respect of domestic transactions to be based on the arm's length principle.

8.14 Conclusion

The Indian transfer pricing legislation is arguably one of the most aggressive in the world. This does not mean however that the system is without any flaws. It is important to note that even with those flaws, the Indian tax authority has made significant strides in dealing with transfer pricing issues in the short space of time that it has been in existence. The success of the Indian transfer pricing is owed to clear legislative guidelines which are regularly updated in line with prevailing transfer pricing trends around the world. The introduction of domestic transfer pricing legislation also contributes immensely in ensuring that MNEs are circumspect when setting transfer prices within the MNE group. The successful introduction of dispute resolution mechanisms like APA is also one of the contributory factors in ensuring that there is certainty bestowed to the taxpayers within the transfer pricing realm. Certainty in transfer pricing in India has also been brought by the judicial pronouncements which have been made in transfer pricing disputes.

CHAPTER 9

FINDINGS, RECOMMENDATIONS AND CONCLUSION

9.1 Summary of Findings

9.1.1 Introduction

The literature analysis in this research shows that transfer pricing manipulation is caused by many factors which can be attributed to the conduct of the taxpayers which may in turn be attributed to the deficiency of the transfer pricing provision. Through this analysis, an attempt was made to provide solutions which can help to control or combat this problem. Since the problem is largely based on the legal deficiency of the transfer pricing provisions, an attempt has been made to provide legal solutions which will enhance the transfer pricing and related provisions in South Africa. There are many research findings which have been recorded in this research. A repetition of each finding in this chapter will be superfluous; however, a brief summary of the most critical findings is provided here to link with the suggested recommendations. Some of the most critical findings of this research are summarised as follows:

9.1.2 Transfer Pricing Manipulations Leads to the Loss of Tax Revenue

One of the critical findings of this research is that the manipulation of transfer prices and the shifting of income and profit result in the loss of tax revenue. The extent of the loss is not known but the figures in Chapter 1 paint a very gruesome picture of a monumental revenue loss amounting to billions of dollars every year.

9.1.3 The Arm's Length Principle is Not the Panacea of Transfer Pricing Problems

It is also one of the findings of this research that the arm's length principle is one of the internationally accepted methods to determine the transfer price between connected persons. It was also acknowledged that despite its positive attributes, the arm's length principle also has inherent weaknesses which make it inapplicable in certain circumstances. For this reason, it was concluded in Chapter 2 that the arm's length principle is not the panacea for all transfer pricing problems. For this reason, it was also concluded that the global formulary apportionment method should be adopted and applied in South Africa as an alternative method to deal with the transfer pricing problems where the arm's length principle is inadequate. The adoption of the global formulary apportionment method may result in a hybrid transfer pricing system in South Africa.

9.1.4 Section 31 Deficiencies Contribute to the TP Manipulation Problem

It is also a finding of this research that section 31 contains certain deficiencies which directly or indirectly contribute to the loss of revenue through transfer pricing manipulation. It was concluded in this research that issues like: lack of important definitions, lack of simplified guidelines, lack of adequate and transfer pricing-specific dispute resolution mechanisms like APAs contribute significantly to uncertainty which then becomes a breeding ground for manipulation. A detailed discussion on how to tackle each of these issues is undertaken in the various paragraphs dealing with recommendations below. Furthermore, it was this research's finding that section 31 transfer pricing is not illegal hence there are no set penalties when the Commissioner conduct secondary transfer pricing adjustments. This research found that this is not a deterrent measure if one takes into account the devastating effects of transfer pricing manipulation. The research also found that South Africa has no provisions that regulate domestic transfer pricing and interestingly no reason could be found for this statutory deficiency. The divergence between customs valuation rules and transfer pricing rules was also found to be contributing to the problem

9.1.5 E-commerce Transactions Remain a Significant Contributory Factor

It was also found that despite the rapid growth of e-commerce; from a tax point of view, South Africa is not legislatively ready to deal with issues relating to detection and monitoring of e-commerce for tax or transfer pricing purposes. It was found that due to the instantaneous nature of e-commerce and the fact that it takes place in the virtual world with no paper or audit trail, South Africa like many other countries across the globe, cannot quantify or measure the volumes and monetary impact of e-commerce although it is feared that revenue is lost through this. Importantly, it was found that currently, there is no tax provision that specifically targets and regulates e-commerce; even section 9 which deals with income source rules in South Africa does not specifically target e-commerce transactions and the exact source of those transactions. It was also found that there is no synergy between the Income Tax and the Electronic Communications and Transactions Act.

9.1.6 Lessons Drawn from the Comparative Analysis: US and India

The comparative analysis of selected issues relevant to the South African situation was conducted in order to draw lessons from these countries and avoid mistakes that they may have been committed in the past by these countries. Some of the lessons drawn from the comparative study include: the aggressive execution of transfer pricing rules, sorting out definitional issues and provision of clear guidance on how to determine the arm's length price, the use of APAs, and the application of the arm's length principle on specified domestic transfer pricing transactions. It was found that the introduction of these measures is not a magic wand to eradicate all the causes of transfer pricing manipulation problems but will go a long way in bringing certainty because transfer pricing manipulation thrives in uncertainty and secretive environments.

9.2 Recommendations

The purpose of this research is to find lasting solutions which can be applied to prevent transfer pricing manipulation. For the purpose of this research, the recommendations which may help to solve the transfer pricing manipulation problem are:

(i) Promulgation of transfer pricing supplementary rules;

(ii) Introduction of legislative definitions of transfer pricing concepts;

(iii) Amendment of the income tax act to adequately provide for e-commerce transactions;

(iv) Introduction of domestic transfer pricing legislation;

(v) Alignment of transfer pricing legislation with customs legislation;

(vi) Introduction of non-adversarial dispute resolution mechanism like advance price agreement within the South African transfer pricing system; and

(vii) Promulgation of tax provisions which will lead to the introduction of the alternative transfer pricing method to supplement the arm's length principle.

The above-mentioned recommendations are fully discussed in no particular order as above:

9.2.1 Introduction of APAs in South Africa

The benefits of APAs have been set out in Chapters 7 and 8 above. These benefits can be achieved if APAs can be made part of South African tax law. Section 80(1)*(a)*(iii) of TAA clearly provides that SARS may reject any application of an advance ruling relating to the pricing of goods or services supplied by or rendered to a connected person in relation to the applicant. The discretionary powers are signified by the use of the word "may" in that provision. For South African taxpayers to benefit from the APAs that are very instrumental in alleviating transfer pricing uncertainties, it is recommended that section 80(1)*(a)*(iii) be amended so that tax ruling applications relating to the pricing of goods and services are not administered on a discretionary basis by SARS, rather, a legal obligation should be placed on SARS to consider such applications on their merit based on the facts and circumstances of each case. Section 31 can also be amended to provide that transfer pricing disputes can be resolved by reference to the APAs provisions in the TAA. In order to deal effectively with the introduction of APAs in South Africa, a new chapter in the TAA must be inserted to deal with this suggestion.

For the sake of expediency, it is not critical to elaborate on the technical details of this proposed chapter but save to say that the envisaged chapter may be crafted to look more like chapter 7 of the TAA that deals with Advance Rulings but with a specific emphasis on Advance Pricing Arrangements. It will also help with the convergence with the customs valuation rules if this chapter can also make reference to Customs Advance Rulings found in chapter 10 of the Customs Duty Act.

9.2.2 Amendment of the ITA to Regulate E-Commerce Transactions

It has been noted in Chapter 6 that section 9 of the Income Tax Act has no specific reference to electronic transactions. In other words, e-commerce is not one of the sources found in section 9. In order to align the law with the modern methods of trading, the current source rules under section 9 should be amended to regulate prices or proceeds or income that have been derived or earned from the supply of digital goods and services (e-commerce) which have been generated from a source outside the Republic of South Africa.[727] The rules should dictate that digital goods or services should be taxed where the recipient is, which would be where the South African tax resident physically resides at the time of supply.[728] This recommendation will be in line with the value creation principle as articulated in chapter 6 above. This recommendation is also echoed by the Davis Tax Commission who remarked that:

> The current scope of the source rules under section 9 of the Income Tax Act needs to be expanded to include rules that cover proceeds derived from the supply of digital goods and services derived from a source in South Africa. The new rules should be based on where consumption takes place. The rules could for instance provide that digital goods or services are sourced where the recipient is, which would be where the South African tax-resident; physically present in South Africa, is at time of supply. The rules should also aim to clarify the characterisation of the typical income flows from digital transactions. Enacting of such rules would create the basis from which South Africa can apply the OECD recommendations on the taxation of the digital economy.

The instantaneous methods of transmission of data through the Internet and the effective removal of all physical and territorial boundaries have become a significant impediment in dealing with transfer pricing in South Africa and elsewhere. In order to remove this hurdle, it is recommended that the Income Tax Act be amended to align with the provisions of the Electronic Communications and Transactions Act for the purposes of detection, monitoring and investigation of taxpayers involved in e-commerce transactions on a risk basis especially as it relates to transfer pricing transactions. Given the complications associated with e-commerce taxation, it is also suggested that the Income Tax Act should be amended to provide for a separate tax category for e-commerce transactions in order to fully regulate this aspect of tax practice in line with the recommendations suggested in the OECD BEPS Action Plan 1 and 7. To achieve this, section 9 of the Income Tax Act may be amended to read as follows:

> An amount will be deemed to have been received or accrued to a person from a source within the Republic if that amount is:
>
> (i) as a result of an e-commerce transaction which took place between a connected resident and non-resident within the Republic, or

[727] Davis Tax Commission, Addressing Base Erosion and Profit Shifting in South Africa' at 28.
[728] Davis Tax Commission, Addressing Base Erosion and Profit Shifting in South Africa' at 28.

(ii) the transaction was concluded in the digital world as defined, or

(iii) the internet server used to conclude the transaction is located within the Republic, or

(iv) the consumption or the supply of the digital goods or services took place within the Republic.

It is hoped that with all these measures in place, the legislature will be in a position to amend the Act to align it with some of the recommendations of the OECD on the taxation of the digital economy. Some of those recommendations are:[729] modifications to the exemptions from permanent establishment status, a new nexus based on significant digital presence, virtual electronic permanent establishment, mechanism for withholding tax on digital transactions.

9.2.3 Introduction of Domestic Transfer Pricing Legislation

Currently, the South African transfer pricing legislation does not provide for domestic transfer pricing regulation. This is unsatisfactory given the problems encountered with international transfer pricing transactions. Although there is no quantum for revenue loss through domestic transfer pricing, one is convinced that the loss is huge because there is no regulation. It is prudent to ensure the regulation of this part of the tax practice. In order to effectively deal with domestic transfer pricing, section 31 must be amended to specifically make provision for such. In this regard, it is suggested that section 31 be amended to include rules which will be applied to determine the reasonableness of expenditure in order to reflect correct domestic transfer prices between related parties. Another reason for amending section 31 to regulate domestic transfer pricing will create a legally enforceable obligation on the taxpayer involved in domestic transfer pricing to maintain proper documentation.

When regulating domestic transfer pricing, the tax authority must be mindful of the sheer number and volumes of transactions that are going to be affected. In this regard, section 31 must contain a rule which creates a threshold within which taxpayers will be required to report domestic transfer pricing transactions to SARS. A

[729] OECD BEPS Action 1 ‘Address the Tax Challenges of the Digital Economy’ at 64-66 available at https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf, accessed on 5 July 2016.

leaf can be taken from the Indian situation where specified domestic transactions in excess of R50 million are required to maintain extensive documentation (relating to the transaction) in order to ensure that their domestic intra-group dealings are arm's lengths. It is suggested that the proposed provision giving effect to this amendment should be called section 31A and should read as follows:

> Section 31A Tax payable in respect of specified domestic transactions must be based on the arm's length principle. For the purposes of this section:
>
> (i) Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the specified domestic transaction;[730]
>
> (ii) Tax holiday undertakings in relation to specified domestic transactions to be prescribed by the rules to be promulgated by the Commissioner of SARS;
>
> shall, notwithstanding anything contrary to this Act or any other law whether or not administered by the Commissioner be computed having regard to the arm's length price.

The promulgation of domestic transfer pricing rules will strengthen and supplement the current international transfer pricing legislation thereby ensuring the justification of all domestic transfer pricing transactions. The amendment of section 31 to deal with domestic transfer pricing manipulation is justified by the fact that domestic transfer pricing is a specific avoidance scheme which in law can only be regulated by a specific anti avoidance rule in the form of section 31 because section 80A-80L can only applicable to general avoidance schemes.

9.2.4 Alignment of Transfer Pricing Legislation with Customs Legislation

It has been concluded that the transfer pricing and customs valuation provisions in South Africa are not aligned to each other; hence the two departments administering these provisions are not aware of each other's audit activities. Theoretically, the two activities are intertwined and highly dependent on each other to combat manipulation at both ends but there is no synergy in practice. In order to avoid the misalignment, it is recommended that supplementary rules be enacted in both customs and tax provisions to integrate the two concepts and processes to avoid working in silos.

---

[730] Expenditure on buying goods or procurement of services; or expenditure on salary, training services, marketing expenses, interest payments, expenditure on purchase of tangible and intangible property, group charges reimbursements and guarantee fees.

It is suggested that section 31 of the Income Tax Act should be amended to provide that the arm's length principle must also refer to transactions involving customs valuation processes. Sections 65 of the Customs and Excise Act 91 of 1964 and Chapter 7 of the Customs Duty Act 30 of 2014 that deals with customs valuation must also be amended to take into account the provisions of section 31 when processing customs valuation transactions. Both the Customs and Excise Act 91 of 1964 and the Customs Duty Act 30 of 2014 do not contain any anti-avoidance provisions. It is recommended that both these pieces of legislation be amended to contain specific anti-avoidance provisions to combat commercial and invoicing malpractices which directly impact on transfer pricing and customs valuation alike. This may be achieved by amending relevant sections of the Customs Duty Act and Excise Act to read:

> Where the customs or excise value of the goods or services is determined in terms of the Customs Duty Act 30 of 2014, section 31 of the Income Tax or any relevant provision of the tax levying Act administered by the Commissioner will be taken into consideration in order to identify, and verify material information which may affect the determination of the arm's length price of such goods or service.

In order to have the same effects when determining the arm's length price in terms of section 31, this provision may also be amended to read:

> Where the arm's length price of an international transaction is determined in terms of s 31 of the Income Tax Act, Chapter 7 of the Customs Duty Act Tax or any relevant provision of the tax levying Act administered by the Commissioner will be taken into consideration in order to identify, and verify material information which may affect the determination of the arm's length price of such goods or service.

9.2.5 Introduction of Supplementary Transfer Pricing Rules to Section 31

Although section 31 provides that tax payable in respect of international transaction must be based on the arm's length principle, there is however no clarity or guidance in the law on how to determine the arm's length principle. The current section 31 does not specify how the arm's length principle should be applied. It may be argued that the Practice Notes fulfil that role but it has been concluded in Chapter 6 of this research that currently practice notes do not have any legal force and in particular, the current Practice Notes on transfer pricing are outdated and not aligned to the current law. It is strongly suggested that practice notes must be updated and accorded legal status with periodic updates in accordance with the section 31 amendments. South Africa relies heavily on the OECD transfer pricing guidelines but these guidelines only have a persuasive effect, not a binding legal effect because South Africa is not a signatory to the OECD and have not ratified the transfer pricing guidelines; as a result, they are not law. In this regard, South Africa has two choices: either join the OECD in which case the guidelines will be made part of South African law in terms of section 231(4) of the Constitution or incorporate the guidelines into South African law without being a member of the OECD. Taking leaf from the US and Indian comparative analysis made above, the better option would be to enact some aspects of these guidelines like transfer pricing methods and comparability analysis into South African law.

In this regard, it is recommended that section 31 should be amended to provide for supplementary transfer pricing regulations that will clearly explain how the transfer pricing methods are to apply as it is the case with the USA regulations which supplement the provisions of the IRC. Thus from a South African perspective, the regulations should form part of the transfer pricing legislation so that the binding effect on both the taxpayer and the Commissioner of SARS may effectively materialise. Such regulations should be updated regularly in order to prevent the current situation where taxpayers have to rely on outdated Practice Notes which are not aligned to the current law.

Furthermore, the envisaged supplementary regulations should clearly explain the process and give practical examples on how transfer pricing methods are to be applied to a given transaction. It is recommended that the regulations should be adapted to suit South Africa’s economic circumstances as a developing country. It is recognised that the addition of supplementary rules or regulations may lead to a substantial overhaul of the South African transfer pricing landscape but that is considered necessary if South Africa is to win the war against transfer pricing manipulation. In view of this recommendation, sections 107 of the Income Act may be amended to include a new category of rules which may be promulgated by the Minister; the amendment should read as follows:

Rules to facilitate the implementation of section 31 may prescribe:

(i) The categories of transactions which may be subject to this section 31
(ii) Guidelines on how to determine the arm's length price.
(iii) Transfer pricing methods which can be used to determine the arm's length price
(iv) Specific factors to be considered when choosing a transfer pricing methods
(v) Practical examples on how transfer pricing methods are to be applied to specific transactions.
(vi) Transactions which may be exempted from a transfer pricing audit (APAs).
(vii) Any other matter which the Commissioner may deem expedient to ensure the implementation and application of section 31.

9.2.6 Introduction of Legislative Definitions of Transfer Pricing Concepts

One of the biggest problems facing transfer pricing in South Africa is that the most important concepts relating to transfer pricing are not defined in section 31 or elsewhere in Income Tax Act. It may be argued that some of the terms used in South African transfer pricing can be gleaned from the OECD Transfer Pricing Guidelines. It is important to define and clarify these concepts in order to avoid interpretational disputes. important terms like 'transfer pricing', 'arm's length principle', 'arm's length methods' and 'arm's length price, thin capitalisation and other pertinent terms' should be defined for the purposes of section 31. The South African transfer pricing provisions only define three concepts for the purposes of section 31, those concepts are: affected transactions,[731] financial assistance,[732] and connected persons.[733] The problem with some of these definitions (except connected persons) is that they are couched so widely that it is difficult to confine them to a specific ambit in relation to the transaction. For instance, the term affected transaction is defined in section 31 as:

> Any transaction, operation, scheme, agreement or understanding that has been directly and indirectly entered into or effected between or for the benefit of either or both a person that resident and any person that is not a resident.

[731] Section 31(1) of the Income Tax Act.
[732] Ibid.
[733] Section (31)(4) of the Income Tax Act.

The definitional problem of this term is further compounded by referring to other inadequately defined terms such as operation, scheme, agreement or understanding. Unlike the position in South Africa, the discussion in Chapter 7 above shows that in the US, the terms used in the transfer pricing provision (s 482 of the IRC) are clearly defined in regulations 1.482.1 to 1.482.8 to assist in the interpretation and application of the provisions. Concepts such as: 'transaction, scheme, operation, understanding or agreement' entered into 'directly or indirectly' as used in section 31 of the Income Tax Act must be clearly defined within the transfer pricing context in order to bring clarity. Section 31(1) should be amended to accommodate these definitions in line with the definitions transcribed from the *IBFD International Tax Glossary and OECD Tax Glossary.* Some of the definitions of the pertinent concepts may read thus:

For the purpose of section 31:

> An 'Advance pricing agreement is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An advance pricing arrangement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations. [734]
>
> An Arm's length principle is the international standard which states that, where conditions between related enterprises are different from those between independent enterprises, profits which have accrued by reason of those conditions may be included in the profits of that enterprise and taxed accordingly. [735]
>
> A Global Formulary Apportionment Method refers to the transfer pricing method where the profits of each member of a multinational enterprise (MNE) are not calculated on the basis of arm's length dealings, but rather the total profit of the enterprise is allocated to the members of the multinational enterprise on the basis of, for example, the turnover of each member, the expenses incurred by each member or the labour cost of each member.[736]

[734] Glabush *International Tax Glossary* at 9.
[735] Glabush *International Tax Glossary* at 23.
[736] Glabush *International Tax Glossary* at 204.

A transfer price is the price charged by a company for goods, services or intangible property to a subsidiary or other related company. Abusive transfer pricing occurs when income and expenses are improperly allocated for the purpose of reducing taxable income. [737]

'Transfer Pricing Adjustment', means an adjustment made by the tax authorities after making a determination that a transfer price in a controlled transaction between associated enterprises is incorrect or where an allocation of profits fails to conform to the arm's length principle. [738]

Traditional Transaction Methods refer to the traditional methods for determining the arm's length prices for specified transactions. The main types of these methods are the comparable, uncontrolled price method, the resale price method, and the cost plus method. Such methods may be distinguished from other methods such as the profit split method or the global formulary apportionment method. [739]

'Transactional net margin method is a transfer pricing methodology that analyses the net profit of a taxpayer from a controlled transaction relative to a defined base such as costs or assets.[740]

Profit Split Method is a transfer pricing method that allocates the combined operating profit or loss from a transaction to associated enterprises in a manner that reflects the division of profits that would have been expected in an arm's length arrangement. This may include a division based on the relative contribution of each participant to the transaction. The relative value will normally be determined by taking into account the functions performed, risks assumed and resources employed by a participant. Profit split methods include comparable profit split method, residual split method and the total split method.[741]

'Transfer pricing manipulation' refers to trade between related parties at prices meant to manipulate markets or to deceive tax authorities.

A scheme means: any arrangement or any plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.[742]

---

[737] Glabush *International Tax Glossary* at 449.
[738] OECD Glossary of Statistical Terms available at http://www.oecd.org/ctp/glossaryoftaxterms.htm#T, accessed on the 29 October 2018.
[739] Glabush *International Tax Glossary* at 447.
[740] Glabush *International Tax Glossary* at 448.
[741] Glabush International Tax Glossary at 335.
[742] Australian Income Tax Assesment Act 1936.

9.2.7 Introduction of the Alternative Transfer Pricing Regulation

It has been proven throughout this research that there is currently no transfer pricing method which is more suitable than the other, hence the lack of hierarchy in the application of the methods. It has also been established in this research that any of these methods may be successfully applied to determine the arm's length price of a transaction if facts and circumstances of the transaction permit the application of that particular method. In view of this important consideration, there appears to be no impediment in applying other alternative methods to regulate transfer pricing. In this regard, it is therefore recommended that the global formulary apportionment method be adopted as an alternative method to regulate transfer prices where the facts and circumstances are such that the arm's length principle cannot produce the desired results.

To this end, it is recommended that s 31 be amended to include global formulary apportionment method as an alternative regulatory measure in South Africa. Because of its nature, this method should be used as a last resort if the other transfer pricing methods cannot yield positive results in determining the correct transfer prices. Section 31 should also be amended to provide for procedures which should be followed in applying this method. Considering that the global formulary is similar to the profit split method, it shouldn't be problematic to include it in South African tax law.

9.2.8 Improved Capacity Building

To improve the administration of the transfer pricing practice, SARS needs to engage in substantial capacity building and develop appropriate administrative policies and procedures in relation to transfer pricing. Capacity building should encompass training on transfer pricing and related international tax issues including tax treaties, and soft skills where necessary. An introduction of the legal aspect of transfer pricing will supplement the audit skills required in transfer pricing. Ongoing capacity building is required to ensure that the tax administration can address and stay up to date with local and international developments in the field. To avoid staff poaching by private companies' and brain drain, tax administrations like SARS must strive to pay competitive salaries if they are to retain skilled transfer pricing personnel.

9.9 Concluding Remarks

It has been proven in this research that transfer pricing is not an exact science and there are no exact set of solutions that can be applied to the diverse problem areas. It is therefore critical to note that recommendations suggested here are not panaceas for all transfer pricing manipulation problems in South Africa. In order to effectively apply these recommendations, South African economic circumstances must be considered given the fact that South Africa is still a developing country in dire need of foreign direct investment. This means that a mere regurgitation of similar principles applied elsewhere will not bear any fruit and may have disastrous consequences on the economy.

The implementation of some of the recommendations will need a dramatic overhaul of the transfer pricing practice and a paradigm shift in some long-standing practices such as the reclassification of impermissible tax avoidance concept.[743] In other words, these recommendations will remain academic with no pragmatic effect if there is no political will from the lawmakers to make a paradigm shift on controversial issues like the criminalising of the impermissible tax avoidance, introduction of domestic transfer pricing on specified transactions and adoption of alternative transfer pricing methods like the global formulary apportionment method. The MNEs' main aim is to minimise costs and maximise profit, and the aim of SARS is to collect the maximum tax revenue. In the quest of accomplishing these two competing objectives, great circumspection must be exercised to strike a balance (between these objectives) so that these interests do not impede one another. In this regard, taxpayers must make a profit in a legally acceptable way by engaging in permissible transfer pricing practices whilst SARS should guard against introducing rigid and unreasonable laws which will ultimately stifle the economy and result in the very loss of tax revenue that they are intending to protect and collect.

[743] Tax Practices brought about by issues such as the inadequate definition of impermissible tax avoidance which allows illegal tax behaviour to be treated as legal.

BIBLIOGRAPHY

Books

Aaron HJ, Burman L and Steuerle CE *Taxing Capital Income* (2007) Urban Institute Press, Washington DC, USA.

Aaron H and Slemrod J *The Crisis in Tax Administration* (2004) Brookings Institution Press, Washington DC, USA.

Abdallah WM *Critical Concerns in Transfer Pricing and Practice* (2004) Praeger Publishers, Westport USA.

Abdallah WM *International Transfer Pricing Policies: Decision-Making Guidelines for Multinational Companies* (1989) Quorum Books Washington DC, USA.

Abdallah WM *Managing Multinationals in the Middle East: Accounting and Tax* (2001) Greenwood Publishing Group, Westport, USA.

Abrams H and Doernberg RL *Essentials of United States Taxation* (1999) Kluwer Law International, The Hague, the Netherlands.

Adam P *Managing Internationalisation* (2015) UVK Verlag, Munchen, Germany.

Agrawal KK *Corporate Tax Planning* Volume 1, 6th edition (2007) Atlantic Publishers and Distributors (P) Ltd, New Delhi, India.

Agrawal KK *Direct Tax Planning and Management, Incorporating: Corporate Tax Planning, Business Tax Procedure and Management* 5th edition (2006) Atlantic Publishers and Distributors Private Limited, New Delhi, India.

Ahmad E and Stern NH *The Theory and Practice of Tax Reform in Developing Countries* (1991) Cambridge University Press, Cambridge, Great Britain.

Ajani RA, Cool K, Goddard GJ and Khambata D *International Business Theory and Practice* 2nd edition (2006) ME Sharpe Inc New York, USA.

Ajayi SI and Ndikumana L *Capital Flight from Africa: Causes, Effects and Policy Issues* (2015) Oxford University Press, Oxford University Press, UK.

Alberto F and Borego V *Limitations on Benefit Clauses in Double Taxation Conventions* (2006) Kluwer Law International, The Hague, the Netherlands.

Alghamdi AM *The Law of E-Commerce, E-Contracts, E-Business* (2011) Author House, Bloomington, USA.

Aliber RZ and RW Click *Readings in International Business: A Decision Approach* (1999) the MIT Press Cambridge, Massachusetts USA & London UK.

Alink M and van Kommer V *Handbook on Tax Administration* (2011) IBFD Amsterdam, the Netherlands.

Alkhafaji A *Competitive Global Management: Principles and Strategies* (1995) St Lucie Press, Florida, USA.

Allen J *Apartheid South Africa: An Insider's Overview of the Origin and Effects of Separate Development* (2005) iUniverse, Lincoln, USA.

Allen PR and Keen PB *Asset Markets and Exchange Rates: Modelling an Open Economy* (2002) Cambridge University Press, New York, USA.

Allmer T *Critical Theory and Social Media: Between Emancipation and Commodification* (2015) Routledge, Oxon, UK.

Alexander D and Britton A *Financial Reporting* 7th edition (2007) Thomson Learning, London, UK.

Alexandrides CG *International Business Systems Perspectives* (1973) Georgia State University Press, Georgia, USA.

Alonso JA Ocampo JA *Global Governance Rules for the Post 2015-Era: Addressing Emerging Issues in the Global Enviroment* (2015) Bloomsbury Publishing Plc, New York, USA.

Altman ZD *Dispute Resolution under Tax Treaties* (2005) IBFD Amsterdam, the Netherlands.

Altmann J *Grid Economics and Business Models: 5th International Workshop GECON (2008)* Springer Berlin-Heidelberg, Germany.

Althunayan T *Dealing with the Fragmented International Legal Environment: WTO International Tax and Internal Tax Regulations* (2010) Springer, Berlin-Heidelberg, Germany.

Alworth JS and Arachi G *Taxation and the Financial Crisis* (2012) Oxford University Press Inc, New York, USA.

Amatucci A *International Tax Law* (2006) Kluwer Law International, Alphen aan den Rijn the Netherland.

Amico JC *Introduction to the US Income Tax System* (1993) Kluwer Law and Taxation Publishers, Boston, USA.

Aniebonam C *Hidden Treasure Book: Saving More of Your Money* (2006) CTK Publishing Services, Irving, USA.

Anson W and Suchy D *Fundamentals of Intellectual Property Evaluation: A Primer for Identifying and Determining Value* (2005) American Bar Association, Chicago, USA.

Antani M and Gokhale G *Contract Research and Manufacturing Services (CRAMS) in India* (2012) Woodhead Publishing Limited, New Delhi, India.

Apte PG International *Financial Management* 5th edition (2008) Tata McGraw-Hill, New Delhi, India.

Aryya G *Managing Business with Electronic Commerce: Issues and Trends* (2002) Idea Publishing Group, Hershey, USA.

Arnold BJ & McIntyre MJ *International Tax Primer* 2 edition (2002) Kluwer Law International, The Hague.

Arnull A and Chalmers D *The Oxford Handbook of European Union Law* (2015) Oxford University Press, Oxford, UK.

Artaraz K and Hill M *Global Social Policy: Themes, Issues and Actors* (2016) Macmillan Publishers, London, UK.

Ardizzoni M *German Tax and Business Law* (2005) Sweet & Maxwell, London, UK.

Avis J *Performance Management, Managerial Leve*l (2009) CIMA Publishing Burlington, USA.

Avi-Yonah RS Advanced Introduction to International Tax Law (2015) Edward Elgar Publishing Massachusetts, USA.

Avi-Yonah RS, *International Tax as International Law*: *An Analysis of International Tax Regime* (2007) Cambridge University Press, New York, USA.

Bachetta M *Electronic Commerce and the Role of the WTO* (1998) WTO Publications Lausanne, Canada.

Bade BL *Export Import Procedures and Documentation* (2015) AMACOM Publications, USA.

Baiden JE *Exchange Traded Funds* (2012) Xlibris Corporation, New York USA.

Baistrocchi E & Roxan I *Transfer Pricing Disputes: A Global Analysis* (2012) Cambridge University Press, Cambridge, UK.

Baker HK, Filbeck G and Kiymaz H *Private Equity: Opportunities and Risks* (2015) Oxford University Press, New York, USA.

Bakker A *Transfer Pricing and Business Restructurings: Streamlining All the Way* (2009) IBFD, Amsterdam, the Netherlands.

Bakker A & Levey MM *Transfer Pricing and Intra-Group Financing, The Entangled Worlds of Financial Markets and Transfer Pricing* (2012), IBFD, Amsterdam, The Netherlands.

Bakker A & Levey MM *Transfer Pricing and Dispute Resolution* (2011), IBFD, Amsterdam, The Netherlands.

Bakker A & Obuoforibo B *Transfer Pricing and Customs Valuation* (2009) IBFD The Netherlands.

Bakker A and Kloosterhof S Tax Risk Management: From Risk to Opportunity (2010) IBFD Amsterdam, the Netherlands.

Balachandran V and Thothadri S *Taxation Law and Practice* Volume 1(2013) PHI Learning Private Limited, New Delhi, India.

Ball DA and MacCulloch WH *International Business: Introduction and Essentials* 4th edition (1990) Homewood Irwin New York, USA.

Bammans N *The Principle of Non-Discrimination in the International and European Tax Law* (2012) IBFD, Amsterdam, the Netherlands.

Barenfeld J *Taxation of Cross-Border Partnerships: Double Tax Relief in Hybrid and Reverse Hybrid Situation* (2005) IBFD Amsterdam, the Netherlands.

Bartels FL and *Pass* C *International Business: A Competitive Approach* (2000) Prentice Hall, New York, USA.

Basu S *Global Perspective on E-Commerce Taxation Law* (2007) Ashgate Publishing Limited, Hampshire, England.

Beale H, Bridge M, Gullifer L and Lomnicka E *The Law of Security and Title Based Financing* (2012) Oxford University Press, Oxford, UK.

Beare ME *Encyclopedia of Transnational Crime and Justice* (2012) Sage Publishers California, USA.

Becerra JA *Interpretation and Application of Tax Treaties in North America* (2007) IBFD Amsterdam, the Netherlands.

Becker A *Electronic Commerce: Concepts, Methodologies, Tools and Applications* Volume 1 (2008) IGI Global, Hershey, USA.

Bekker J and Blaas W *Strategic Arena Switching in International Trade Negotiation*s (2007) Ashgate Publishing Limited, Hampshire, England.

Belkaoui AR Advanced Management Accounting (20010 Quorum Books, Westport, USA.

Bellan DV *Individuals Income under Double Taxation Conventions: A Brazilian Approach* (2010) Kluwer Law International Alphen aan den Rijn, the Netherlands.

Benitah M *The Law of Subsidiaries under the GATT/WTO System* (2001) Kluwer Law International London, the United Kingdom.

Benke RL and Edwards JD *Transfer Pricing: Techniques and Uses* (1980), National Association of Accountants, New York City, USA.

Bergman M *Tax Evasion and the Rule of Law in Latin America: The Political Culture of Cheating and Compliance in Argentina and Chile* (2009) The Pennsylvania State University Press, Pennsylvania, USA.

Bernadi L, Chandler M and Gandulia L *Tax Systems and Tax Reforms in New EU Member States* (2005) Routledge, New York, USA.

Berson SA *Federal Tax Litigation* (2003) Law Journal Press, Madison Avenue, New York, USA.

Bernstein PW *The Ernst and Young Tax Guide 2004* (2004) John Wiley & Sons, Hoboken, New Jersey, USA.

Bhala R *Modern GATT Law: A Treatise on the General Agreement on Tariff and Trade* (2005) Sweet & Maxwell, New York, USA.

Bidgoli H *Electronic Commerce Principles and Practice* (2002) Academic Press Florida, USA.

Bidgoli H *The Internet Encyclopedia* Volume 3 (2004) Volume 4 John Wiley & Sons Hoken, New Hershey, USA.

Bilgin FZ and Wuhrer G *International Marketing Compact* (2014) Linde Verlag Scheydgasse.

Billet BL *Investment Behaviour of Multinational Corporations in Developing Areas: Comparing the Development Assistance Committee, Japanese and American Corporations* (1991) Transaction Publishers, New Brunswick, New Jersey, USA.

Bird R & Wilkie S *Source vs Resident Based Taxation in the European Union: The Wrong Question*? (1997) International Centre for Tax Studies, Rotman School of Management University of Toronto.

Birts AN *Balance Sheet Structures* (2001) Woodhead Publishing Ltd, Cambridge England.

Blackford MG *The Rise of Modern Business: Great Britain, the United States, Germany, Japan and China* (2008) The University of North Carolina Press, North Carolina, USA.

Blasi RW US *Master Bank Tax Guide* (2009) CCH, New York, USA.

Blouin J, Huizinga H, Laeven L and Nicodeme G *Thin Capitalisation Rules and Multinational Firm Capital Structure* (2014) IMF Washington DC, USA.

Bluestone B, Harrison B and Baker L *Corporate Flight: Causes and Consequences of Economic Dislocation* (1981) Progressive Alliance Books, Washington DC, USA.

Bobo BF *Rich Country: The Multinational as Change Agent* (2005) Praeger, Westport, USA.

Bohan B and McCarthy F *Capital Acquisition Tax* 4th edition (2013) Bloomsbury Professional, West Sussex, United Kingdom.

Bond P *Against Global Apartheid: South Africa Meets the World Bank* 2nd edition (2003) UCT Press, Pty Ltd, Cape Town, South Africa.

Boos M *International Transfer Pricing, The Valuation of Intangible Assets* (2003) Kluwer International, The Hague New York.

Bovard J *Lost Rights: the Destruction of American Liberty* (1995) St Martin’s Press, New York, USA.

Bozyk P *Globalization and the Transformation of Foreign Economic Policy* (2006) Ashgate Publishing Limited, Hampshire, England.

Bullen A *Arm’s Length Transaction Structures: Recognising and Restructuring Controlled Transactions in Transfer Pricing* (2011) IBFD, Amsterdam, the Netherlands.

Bungenberg M, Herrman C, Krajewski M and Terhechte JP *European Yearbook of International Economic Law* (2016) Springer International Publishing, Switzerland.

Burri M & Cottier T *Trade Governance in the Digital Age: World Trade Forum* (2012) Cambridge University Press, New York, USA.

Bush JW and Johnston D *International Oil Company Financial Management in Nontechnical Language* (1998) PennWell, Oklahoma, USA.

Butani *M Transfer Pricing: An Indian Perspective (2007) Lexis Nexis Butterworth, New Delhi, India*.

Butler KC *Multinational Finance* 5th ed (2012) John Wiley & Sons Inc. Hoboken, New Hershey, USA.

Butler KC *Multinational Finance: Evaluating the Opportunities, Costs and Risk of Multinational Operations* 6th edition (2016) John Wiley & Sons, Hoboken, New Jersey, USA.

Braithwaite J *Regulatory Capitalism: How it Works, Ideas for Making it Work Better* (2008) Edward Elgar Publishing Limited, Cheltenham, UK.

Brand R *Fundamentals of International Business Transactions* (2000) Kluwer Law International the Hague, the Netherlands.

Brandstetter P *Taxes Covered: a Study of Article 2 of the OECD Model Tax Conventions* (2011) IBFD, Amsterdam, the Netherlands.

Bradfield G and Lehmann K *Principles of the Law of Sales and Lease* 3rd edition (2013) Juta and Company Ltd, Claremont Cape Town, South Africa.

Brady BL *Essentials of International Marketing* (2011) Routledge, Third Avenue, New York, USA.

Bragg SM *Wiley GAAP Policies and Procedures* 2nd edition (2007) John Wiley & Sons, Hoboken New Jersey, USA.

Brakman S and Garretsen H *Foreign Direct Investment and the Multinational Enterprise* (2008) The MIT Press Massachusetts, USA.

Brimer J and Smith-Porter L *Annual Franchise and Distribution Law Development* (2005) American Bar Association, New York USA.

Brooke MZ and Buckley PJ *Handbook of International Trade* (2016) Macmillan Publishers, New York, USA.

Brown KB *General Reports of the XVIII Congress of the International Academy of Comparative Law* (2012) Springer, Washington DC, USA.

Brundage P and Starchild A *Tax Planning for Foreign Investors in the United States* (1983) Springer Science + Business Media, New York,USA.

Brunori D *The Future of State Taxation* (1998) The Urban Institute Press, Washington DC, USA.

Bryan M and Vann V *Equity and Trusts in Australia* (2012) Cambridge University Press Port Melbourne, Australia.

Calder J *Administering Fiscal Regimes for Extractive Industries; A Handbook* (2014) IMF Multimedia Services Division, Washington DC, USA.

Cameira MA *Legal Studies: Portuguese Perspective* 2nd edition (20015) Andrews UK Limited, London, UK.

Campbell C *Legal Aspects of Doing Business in Asia and the Pacific* (2009) Yorkhill Law Publishing, New York, USA.

Campbell D *International Taxation of Law Tax Transactions* (2009) Yorkhill Law Publishing, Salzburg, Austria.

Campbell D *International Taxation of Low –Tax Transactions [2009]-High Tax Jurisdictions* (2009) Yorkhill Publishing, New York, USA.

Campbell D & Woodley S *E-Commerce: Law and Jurisdiction* (2002) Kluwer Law International, The Hague, the Netherlands.

Campbell D *The Internet: Laws and Regulatory Regimes* Volume 1 (2009) Yorkhill Law Publishing, Salzburg, Austria.

Campbell BK *Modes of Governance and Revenue Flows in African Minin*g (2013) Palgrave MacMillan, Hampshire, UK.

Cao F *Corporate Income Tax Law and Practice in the People's Republic of China* (2011) Oxford University Press, New York, USA.

Carroll P and Kellow A *The OECD: A Study of Organisational Adaptation* (2011) Edward Elgar Publishing Limited, Cheltenham, UK.

Cassim F, Cassim MF, Jooste R, Shev J & Yeats J *Contemporary Company Law* 2nd ed (2012) Juta & Co Claremont, Cape Town South Africa.

Cattaneo O *International Trade in Services: New Trends and Opportunities for Developing Countries* (2010) World Bank Publications, Washington DC, USA.

Caves RE *Multinational Enterprises and Economic Analysis* 2nd edition (1999) Cambridge University Press.

Cavusgil ST, Night G and Riesenberger JR *International Business: The New Realities* (2015) Pearson Australia, Melbourne, Australia.

Carbough R *International Economics* 12th edition (2009) Cengage Learning, Mason, USA.

Carmichael DR and Graham L *Accountants Handbook, Special Industries and Special Topics* 12th edition (2012) John Wiley & Sons, Hoboken New Jersey, USA.

CCH Australia Staff *Australian Master Tax Guide* 50th edition (2012) CCH Australia Limited, Australia.

CCH Australia Staff *International Master Tax Guide* 2009/10 (2009) CCH Australia.

CCH Tax Editors *US Master Tax Guide* (2008) CCH Incorporated Chicago, USA.

CCH Editors *Income Tax Regulations* (2008) CCH, Chicago, USA.

CCH Editors *Income Tax Regulations* (2009) CCH, Chicago, USA.

Cendrowski H, Petro LW, Martin JP *The Handbook of Fraud Deterrence* (2007) John Wiley & Sons, Hoboken, New Jersey, USA.

Cerioni L *The European Union and Direct Taxation: A Solution for a Difficult Relationship* (2015) Routledge New York, USA.

Chan KH and Chow L *International Transfer Pricing in China* (1998) Sweet & Maxwell, Hong Kong.

Chander H *Cyber Laws and IT Protection* (2012) PHI Learning Private Limited, New Delhi, India.

Chapman CS, Hopwood AG, Shields MD *Handbook of Management Accounting Research* (2007) Elsevier Ltd Amsterdam, the Netherlands.

Chen Z and Zhou Y *Income Distribution during System Reform and Economic Development in China* (2005) Nova Publishers, New York, USA.

Chimni BS, Masahiro M and Li-Ann T *Asian Yearbook of International Law* Volume 14 (2011) Routledge, Oxon, UK.

Choi FDS & Meek GK *International Accounting* (7th edition)(2011) Pearson, New Jersey.

Choi FDS *International Finance and Accounting Handbook* 3rd edition (2003) John Wiley & Sons Hoboken, New Jersey, USA.

Chow DCK and Schoenbaum TJ *International Trade Law (2013)* Wolters Kluwer Law and Business, New York.

Christians A, Donaldson SA and Postlewaite PF *United States International Taxation* 2nd edition (2011) Lexis Nexis, Massachusetts, USA.

Christopher K Port *Security Management* 2nd edition (2015) Taylor and Francis Group LLC, Florida, USA.

Clarkson KW, Miller RL and Cross FB *Business Law: Texts and Cases: Legal, Ethical, Global and Corporate Environment* (2012) Cengage Learning, Mason, USA.

Clarkson KW, Miller RL and Cross FB *Business Law: Texts and Cases: Legal, Ethical, Global and Corporate Environment* 8th edition (2012) Cengage Learning, Mason, USA.

Clegg D, Stretch R *Income Tax in South Africa* (2009), LexisNexis Durban.

Cnossen S *Excise Tax Policy and Administration in Southern African Countries (2006)* University of South Africa Press, Pretoria.

Cnossen S and H Sinn *Public Finance and Public Policy in the New Century* (2003) the MIT Press, Massachusetts, USA.

Cockfield AJ *Globalization and its Tax Discontents: Tax Policy and International Investments* (2010) University of Toronto Press Incorporated, Toronto Canada.

Codippilly HMA *Pacific Island Economies: Building a Resilient Economic Base for the Twenty-First Century* (1996) World Bank Publications, Washington DC, USA.

Collier P and Agyei-Ampomah S *Performance Strategy* (2009) CIMA Publishing, Oxford, London, UK.

Colombo MG *The Changing Boundaries of the Firm: Explaining Evolving Inter-Firm Relations* (1998) Routledge London, UK.

Commonwealth Secretariat *Business Guide to the Uruguay Round* (1995) International Trade Centre, Geneva, Switzerland.

Commission of the European Communities, *Report of the Committee of Independent Experts on Company Taxation* (1992), Publications of the European Commission, Luxembourg.

Contractor FJ Valuation *of Intangible Assets in Global Operations* (2001) Quorum Books, Westport, USA.

Cordes JJ, Ebel RD and Gravelle JG *The Encyclopaedia of Taxation and Tax Policy* (2005) The Urban Institute Press, Washington DC, USA.

Correia C, Flyn D, Uliana E and Wormald M *Financial Management* (2011) Juta & Company Cape Town, South Africa.

Cox SA *Managing Information in Organisations: A Practical Guide to Implementing an Information Management Strategy* (2014) Palgrave Macmillan, New York, USA.

Coven GE, Peroni RJ & Pugh RC *Taxation of Business Enterprises: Cases and Materials* (2002) West Group, Minnesota, USA.

Currie-Alder B, Kanbur R, Malone DM and Medhora R *International Development: Ideas, Experience and Prospects* (2014) Oxford University Press, Oxford, UK.

Croome BJ *Taxpayer's Rights in South Africa* (2010) Juta & Company Ltd Claremont, Cape Town, South Africa.

Croome BJ and Olivier L *Tax Administration* (2010) Juta & Company Ltd Claremont, Cape Town, South Africa.

Croome B, Oguttu AW, Muller E, Legwaila T, Kolitz M, Williams RC & Louw C *Tax Law: An Introduction* (2013) Juta Cape Town, South Africa.

Cross F & Miller R *The Legal Environment of Business: Text & Cases* (2009) Cengage Learning, Mason, USA.

Cryer R, Friman H, Robinson D and Wilmshurst E *An Introduction to International Criminal Law and Procedure* 2nd edition (2010) Cambridge University Press, New York, USA.

CTIA *Consolidated Treaties and International Agreements* Volume 1 (2009) Oxford University Press, Madison Avenue, New York, USA.

Cullis J, Jones P and Jones PR *Public Finances and Public Choice: Analytical Perspectives* 3rd edition (2009) Oxford University Press, New York, USA.

Czinkota MR and Ronkainen IA *International Marketing* 10th edition (2003) Cengage Learning, Mason, USA.

Dalberg M *Direct Taxation in Relation to the Freedom of Establishment and Movement of Capital* (2005) Kluwer Law International, The Hague, the Netherlands.

Daniels JD, Hough J, Neuland EW *Global Business: Environments and Strategies* (2000) Oxford University Press, Goodwood, Cape Town South Africa.

Daniel P, Keen M, McPherson C *Taxation of Petroleum and Minerals: Principles, Problems and Practice* (2010) Routledge, Abingdon, Canada.

Das RU, P Edirisuriya and A Swarup regional *Trade and Economic Integration: Analytical Insight and Policy Options* (2012) World Scientific Publishing, Singapore.

Das S, Mourmouras A and Rangazas PC *Economic Growth and Development: A Dynamic Dual Economy Approach* (2015) Springer International Publishing, Switzerland.

Das Mohapatra AK *International Accounting* 2nd edition (2012) PHI Learning Private Limited, New Delhi, India.

DC, US.

Deak D *Hungary in International Tax Planning* (2003) IBFD Publications, Amsterdam, the Netherlands.

De Koker AP *Silke on the South African Income Tax* (2012) LexisNexis, Durban, South Africa.

De Koker AP & Williams RC, *Silke on South African Income Tax* (2012) Butterworths LexisNexis, Cape Town.

De Mestral A and C Levesque *Improving International Investment Agreements* (2013) Routledge Oxon, United Kingdom.

Delta GB and Matsuura JH *Law of the Internet* (2014) Wolters Kluwer & Business, New York, USA.

Devonshire-Ellis C, Scot A and Woollard S *Transfer Pricing in China* 2nd edition (2011) Springer-Heidelberg Berlin, Germany.

Devonshire-Ellis C *Doing Business in India* 3rd edition (2012) Springer, New York, USA.

Dewan S and Singh K *Doing Business in India: India Commercial Laws* (2016) Indian National Bar Association, New Delhi, India.

De Wulf L and Sokol JB *Customs Modernization Handbook (2004)* World Bank, Washington DC.

Dixit S and Sinha AK *E-Retailing Challenges and Opportunities in the Global Marketplace (2016) IGI Global Hershey, New Delhi, India.*

Dochartaigh NO *The Internet Research Handbook: A Practical Guide for Students and Researchers in the Social Sciences* (2002) Sage Publishers, New Delhi, India.

Doernberg RL *International Taxation* (1999) West Group, New York USA.

Doernberg RL, Hinnekens L, Hekkerstein W & Li J *Electronic Commerce and Multi-Jurisdictional Taxation* (2001) Kluwer Law International, The Hague.

Dornseifer F *Corporate Business Forms in Europe* (2005) Sellier European Law Publishers, Munchen, Germany.

Downing D *Apartheid in South Africa: Witness to History* (2004) Heinemann Library, New York, USA.

Douma S *Optimisation of Tax Sovereignty and Free Movement* (2011) IBFD Amsterdam, the Netherlands.

D'Souza J *Terrorist Financing, Money Laundering and Tax Evasion: Examining the Performance of Financial Intelligence Units* (2012) Taylor & Francis Group, Boca Raton, USA.

Duff & Phelps *Guide to International Transfer Pricing, Law, Tax Planning and Compliance Strategies*, 4th Edition (2014) Kluwer Law International, Amsterdam, Netherlands.

Dunning JH *Multinational Enterprises and the Global Economy* (1992) Addison-Wesley New York, USA.

Du Plessis SPJ *International Economics* (1987) Butterworth Durban.

Druica E *Digital Economy Innovations and Impacts on Society* (2012) Information Science Reference, Hershey, USA.

Drury C *Management and Cost Accounting* 7th edition (2008) South-Western Cengage Learning, London, the United Kingdom.

Dziurdz K and Marchgraber C *Non Discrimination in European and Tax Treaty Law: Open Issues and Recent Challenges* (2015) Linde, Vienna, Austria.

Easson AJ *Tax Incentives for Foreign Direct Investments* (2004) Kluwer Law International, The Hague, Netherlands.

Ebrill L, Keen M, Bodin J and Summers V *The Modern VAT* (2001) International Monetary Fund Publication Services, Washington DC, USA.

Ecker T *A VAT/GST Convention Model: Tax Treaties as Solutions for Value Added Tax and Services Tax Double Taxation* (2013) IBFD, Amsterdam, the Netherlands.

Eden L *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (1998) University of Toronto Press, Toronto, Canada.

Eden L *International Taxation, Transfer Pricing and Multinational Enterprises* (2001) Oxford University Press.

Edmunds JC and Marthinsen JE *Wealth by Association: Global Prosperity Through Market Unification* (2003) Praeger Publishers, Westport, USA.

Eicke R *Tax Planning with Holding Companies: Repatriation of US Profit from Europe* (2009) Kluwer Law International Alphen aan den Rijn, the Netherlands.

Ehrhardt M and Brigham E *Corporate Finance: A Focused Approach* (2009) Cengage Learning Mason, USA.

Elliot J and Emmanuel CR *International Transfer Pricing: A Study of Cross-Border Transactions* (2000) CIMA Publishing, London, United Kingdom.

Elliot J *International Transfer Pricing: A Survey of UK and Non-UK Groups* (1998) Chartered Institute of Management Accounting (CIMA) Publishing, London, United Kingdom.

Emmanuel CR and Mehafdi M *Transfer Pricing* (1994) Academic Press, San Diego, USA.

Emmanuel CR, Merchant K and Otley DT *Accounting for Management Control* 2nd edition (2004) Thomson Learning London, UK.

Easson AJ *Tax Incentives for Foreign Direct Investment* (2004) Kluwer Law International, The Hague, the Netherlands.

Eulenpesch T *Attribution of Profits to Permanent Establishments in the OECD-View* (2012) Grin-Verlag, Berlin Germany.

Eun CS & Resnick BG *International Financial Management* (2009) McGraw Hill International Edition, Singapore.

Evans AJ *Markets for Managers: A Managerial Economics Primer* (2014) John Wiley & Sons, West Susses, United Kingdom.

Everett JO, Hennig CJ, Nichols N *Contemporary Tax Practice: Research, Planning and Strategies* (2009) CCH Chicago, USA.

Fabio M *Customs Law of the European Union* 2nd edition (2010) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Fabozzi FJ, Drake PP and Polimeli RS *The Complete CFO Handbook: from Accounting to Accountability* (2008) John Wiley & Sons, Sussex United Kingdom.

Fabozzi FJ *The Use of Derivatives in Tax Planning* (1998) Frank J Fabozzi Inc, Pennsylvania, USA.

Fan X *Communications and Information in China: Regulatory Issues Strategic Implications* (2001) University of America Inc, Maryland, USA.

Fanelli JM and Medhora R *Finance and Competitiveness in Developing Countries* (2001) International Development Research Centre, Ottawa, Canada.

Farrell JE *The Interface of International Trade Law and Taxation* (2013) IBFD Amsterdam, the Netherlands

Feetham N *Tax Arbitrage: The Trawling of the International Tax System* (2011) Spiramus Press Ltd, London, UK.

Feige EL *The Underground Economies: Tax Evasion and Information Distortion* (1989) Cambridge University Press, New York, USA.

Feinschreiber R *Transfer Pricing Methods*: *An Application Guide* (2004) John Wiley & Sons Publications, Canada and USA.

Feinschreiber R *Transfer Pricing Handbook* Volume 1 (2001) John Wiley & Sons, New York, USA.

Feist WR, Heely JA, Lu MH and Nersesian RL *Managing a Global Enterprise: A Concise Guide to International Operations* (1999) Quorum Books, Westport, USA.

Feichtner I *The Law and Politics of WTO Waivers: Stability and Flexibility in Public International Law* (2012) Cambridge University Press, New York.

Feldstein M, Hines JR, Hubbard RG *The Effects of Taxation on Multinational Corporations* (1995) University of Chicago Press, Chicago, USA.

Fellows CM *Microeconomics in a Canadian Setting* (1993) HarperCollins College Publishers, Toronto, Canada.

Fibbe G *EU Law Aspects of Hybrid Entities (*2009) IBFD Amsterdam, the Netherlands.

Finnerty C, Merks P, Petriccione M & Russo R *Fundamentals of International Tax Planning* (2007) IBFD Publications, Amsterdam, the Netherlands.

Fishman JE, Pratt SP, Morrison MJ *Standards of Value: Theory and Applications* 2nd edition (2013) John Wiley & Sons, Hoboken, New Jersey, USA.

Fox WF *International Commercial Agreements: A Primer on Drafting, Negotiating and Resolving Disputes* 4th edition (2009) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Franceschin G and Misuraca F *India: Commercial Law, Customs and Taxation* (2011) Kluwer Law International Alphen aan den Rijn, the Netherlands.

Francis A *Business Mathematics and Statistics* 6th ed (2008) Cengage Learning, London, UK.

Frank HA *Public Financial Management* (2006) Taylor Francis Group, Florida, USA.

Fridson MS and Alvarez F *Financial Statement Analysis: A Practitioner's Guide* 4th edition (2011) John Wiley & Sons New Jersey, USA.

Friedrichs DO *Trusted Criminals: White Collar Crimes in Contemporary Society* 4th edition (2010) Wadsworth Cengage, Belmont, USA.

Gaines DE, Olsen BE and Sorensen KE *Liberalising Trade in the EU and the WTO: A Legal Comparison* (2012) Cambridge University Press, New York, USA.

Gaughan PA *Mergers, Acquisitions and Corporate Restructuring* (2015) John Wiley & Sons New Jersey, USA.

Gaughan PA *Mergers: What Can Go Wrong and How to Prevent It* (2005) John Wiley & Sons Hoboken, New Jersey, USA.

Geach WD & Yeats J Trusts: Law and Practice (2008) Juta Cape Town South Africa.

George AM *Exchange Management and the Multinational Corporation: A Manager's Guide* (1978) Praeger, New York, USA.

Giannakopoulos TK *A Concise Guide to the EU Anti-Dumping/ Anti Subsidies* (2006) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Gillies G *Transnational Corporations and International Production: Concepts, Theories and Effects* 2nd ed (2012) Edward Elgar, Cheltenham, the United Kingdom.

Gillies P *Concise Contract Law* (1988) Federation Press, Sydney, Australia.

Ginsberg A *International Tax Havens* (1990), Butterworth, Durban.

Ginsburg MD, Levin JS and Rocap DE *Mergers, Acquisitions and Buyouts* (2012) Wolters Kluwer Law and Business, New York, USA.

Giovannini A, Hubbard RG and Slemrod J *Studies in International Taxation* (1996) University of Chicago Press, London, the United Kingdoms.

Gottschalk P *Policing White Collar Crime: Characteristics of White Collar Criminals* (2014) Taylor & Francis, Boca Raton, USA.

Govaere I, Quick R, Bronckers M *Trade and Competition Law in EU and Beyond* (2011) Edgar Elgar Publishing Limited, Cheltenham, England

Glabush J *IBFD International Tax Glossary* 6th edition (2009) IBFD Publications.

Glick LA (2008) *Guide to United States Customs and Trade Laws* 3rd ed Kluwer International, Amsterdam.

Gupta P *Transfer Pricing: Practices and Manipulation in India, Basics Concepts Methods Practices and Evidence of Income Shifting* (2010) VDM Verlag Saarbrucken, Germany.

Guzm AT and Sykes AO *Research Handbook in International Economic Law* (2007) Edward Elgar Publishing Ltd, Cheltenham, UK.

Graetz MJ *Follow the Money: Essays on International Taxation (2016)* Lilian Goldman Law Library, Yale Law School.

Graetz MJ and Schenk DH *Federal Income Taxation: Principles and Policies* (1995) Foundation Press, Westbury, New York, USA.

Graham C and Smith F *Competition, Regulation and the New Economy* (2004) Hart Publishing, Oregon, USA.

Gray HP *Transnational Corporations and International Trade and Payments* volume 8 (1993) Routledge, London, UK.

Gray J *International Accounting and Transnational Decisions (1983) Butterworth & Co Publishers, Kent, UK.*

Gray SJ, Coenenberg AG and Gordon PD *International Group Accounting: Issues in European Harmonization* 2nd edition (2014) Routledge, Oxon United Kingdom.

Gravelle G *Tax Havens: International Tax Avoidance and Evasion* (2010) Congressional Report Service, Washington DC.

JG Gravelle The Economic Effects of Taxing Capital Income (1994) The MIT Press Massachusetts, USA.

Gravetter F and Wallnau L *Essentials of Statistics for the Behavioral Science* 6th edition (2008) Thomson Wadsworth, Belmont, California, USA.

Greaves BB *Free Market Economics: A Syllabus* (2007) The Ludwig Von Mises Institute, Alabama, USA.

Green SP *Lying, Cheating and Stealing: A Moral Theory of White Collar Crime* (2006) Oxford University Press, New York US.

Grieco JM *Cooperation among Nations: Europe, America and Non-Tariff Barriers to Trade* (1993) Cornell University Press, New York, USA.

Grimwade N *International Trade: New Patterns of Trade, Production & Investment* (2000) Routledge, London.

Gringas *C The Laws of the Internet (2003) Butterworth London, UK*.

Haccius C *Ireland in International Tax Planning* 2nd edition (2004) IBFD Amsterdam, the Netherlands.

Halliday TC and Shaffer G *Transnational Legal Orders* (2015) Cambridge University Press, New York, USA.

Hampton M *The Offshore Interface: Tax Havens in the Global Economy* (1996) St Martin's Press Inc, New York, USA.

Hansen D & M Mowen M *Cost Management: Accounting and Control* 5th edition (2006) Thomson, Ohio, USA.

Harding BM *The Tax Law of Colleges and Universities* 3rd edition (2008) John Wiley & Sons, Hoboken New Jersey, USA.

Harris P, Oliver D *International Commercial Tax* (2010) Cambridge University Press, New York, USA.

Harris MM *Handbook of Research in International Human Resource Management* (2008) Taylor Francis Group, New York, USA.

Harris P *Corporate Tax Law: Structure Policy and Practice* (2013) Cambridge University Press, New York, USA.

Hartley RD *Corporate Crime: A Reference Handbook, Contemporary Issues (*2008) ABC-CLIO, Santa Barbara, California, USA.

Haseler S *The Super-Rich: The Unjust World of Global Capitalism* (2000) St Martin's Press Inc, New York, USA.

Hayoz N and Hug S *Tax Evasion, Trust and State Capabilities: How Good is Tax Moral in Central and Eastern Europe?* (2007) International Academic Publishers, Bern Switzerland.

Haupt, P *Notes on South African Income Tax* (2018) Hedron Tax Consulting and Publishing CC, Western Cape.

Heimert AM & Johnson M *Guide to International Transfer Pricing: Law, Tax Planning and Compliance Strategies* (2010) Kluwer Law International, Netherlands.

Helminen M *EU Tax Law: Direct Taxation* (2011) IBFD Amsterdam, the Netherlands.

Henderson GD and Goldring SJ *Tax Planning for Troubled Corporations: Bankruptcy and Nonbankruptcy* (2008) CCH, Chicago, USA.

Henderson GV, Trennepohl GL and Wert JE *Introduction to Financial Management* (1984) Addison-Wesley Ontario.

Henderson L *The Taxation of Electronic Commerce* (2001) OECD Publications.

M Helminen *EU Tax Law: Direct Taxation* (2011) IBFD, Amsterdam, the Netherlands.

Hellerstein JR *State Taxation: Corporate Income and Franchise Taxes* (1983) Warren, Gorham and Lamont, Boston, USA.

Hellewitz JA *Basic Contract Law for Paralegals* 6th edition (2010) Aspen Publishers, New York, USA.

Herman ES *Beyond Hypocrisy: Decoding the News in an Age of Propaganda* (1992) South End Press, Boston MA, USA.

Herrmann C, Krajewski M and Terhechte JP *European Yearbook of International Economic Law* (2013) Springer-Verlag Berlin, Germany.

Hiatt S *A Game as Old as Empire: The Secret World of Economic Hitmen and the Web of Global Corruption* Volume 1 (2008) Accessible Publishing Systems, Ltd, London, UK.

Hickey JJB, Matthew R & Rose C *e-Commerce Law, Business and Tax Planning* (2000) at Jordan Publishing Limited, Bristol, Great Britain.

Hickey JJB *Internet Business Commerce and Tax* (2012) Jordan Publishing Limited, Bristol, Great Britain.

Hildreth WB and Richardson JA *Handbook on Taxation* (1999) Marcel Dekker Inc, WB Hildreth, GJ Miller and J Rabin *Handbook of Public Administration* 3rd edition (2007) CRC Press New York,USA New York, USA.

Hinkelman EG *Dictionary of International Trade: Handbook of the Global Trade Community* 6th edition (2005) World Trade Press, California, USA.

Hinkelman EG, Manley M, Shippey KC *Importers Manual USA: The Single Source Reference Encyclopedia for Importing to the United States* (2004) World Trade Press, California, USA.

Hoekman BM, Mattoo A and English P *Development, Trade and the WTO: A Handbook Volume* 1 (2002) The World Bank, Washington DC, USA.

Hoekman BM & Mavroidis PC *The World Trade Organisation: Law, Economics and Politics* 2nd edition (2016) Routledge, Oxon, United Kingdom.

Hoffman WH, Raabe WA, Maloney DM, Young JC and Smith JE *Corporations, Partnerships, Estates and Trusts* 2015 edition (2015) Cengage Learning, Stamford, USA.

Hoffman WH, Young JC, Raade WA, Maloney DM, and Nellen A *South-Western Federal Taxation 2016: Individual Income Taxes* (2016) Cengage Learning, Boston,USA.

Hoffmann E *Interorganisational Operations Management: Performance in Supply Chains* (2013) Springer Gabler, Berlin Germany.

Holmes K *International Tax Policy and Double Tax Treaties: An Introduction to Principles and Application* (2007) IBFD Amsterdam, the Netherlands.

Hoogvelt A, Puxty AG, Stopford JM *Multinational Enterprises: An Encyclopaedia Dictionary of Concepts and Terms (1987)* the MacMillan Press Ltd, London, UK.

Hooper T Uddin S, Tsamenyi M and Wickramasinghe D *Handbook of Accounting and Development* (2012) Edward Elgar Cheltenham, UK.

Hooper P and Richardson D *International Economic Transactions: Issues in Measurement and Empirical Research* (1991) Chicago University Press, USA.

Hopkins BR *The Tax Law of Associations* (2006) John Wiley and Sons, Hoboken, New Jersey, US.

Hornsby AS & Crowther J Oxford *Advanced Learner's Dictionary of Current English* (2000) Oxford University Press, New York.

Hoque Z *Handbook of Cost and Management Accounting* (2005) Spiramus Press, London, the United Kingdom.

Howard M *Public Sector Economies for Developing Countries* (2001) University of West Indies, Kingston, Jamaica.

Horwath C *Master Tax Guide 2009/10* (2009) CCH Australia, New South Wales, Australia.

Hufbauer GC and Assa A *US Taxation of Foreign Income* (2007) Peterson Institute for International Economics, Washington DC, USA.

Hughes J *The Theory, Principles and Management of Taxation: An Introduction* (2015) Routledge New York, USA.

Hyman DN *Public Finance: A Contemporary Application of Theory to Policy* (2014) Cengage Learning Stamford, USA.

IBFD *Bulletin for International Taxation* Volume 62 Issues 1-6(2008) IBFD Publications.

IBFD *Bulletin for International Taxation* Volume 63 (2009) IBFD Amsterdam, the Netherlands.

IBFD *Bulletin for International Taxation* Volume 3 (2009) Amsterdam, the Netherlands.

IBP Inc *Turkey Taxation Laws and Regulations: Corporate Taxation* Volume 1 (2015) International Business Publications, Washington DC, USA.

IMF *Balance of Payment Manual* 5th edition (1997) International Monetary Fund, Washington DC, US.

Inama S *Rules of Origin in International Trade* (2011) Cambridge University Press, New York, USA.

India Ministry of Finance *Report on the High Powered Expert Committee on Making Mumbai an International Financial Centre* (2007) SAGE Publications, New Delhi, India.

Inland Revenue Service *Cumulative Bulletin 2007-1* (2007) Department of the Treasury, USA.

Innes WI, Boyle PJ and Nitikman JA *The Essential GAAR Manual: Policies, Principles and Procedures* (2006) CCH Canadian Limited, Toronto Canada.

International Business Publications Inc *Trade and Investments Agreements: African, Caribbean and Pacific Group of States (2015) International Business Publications, Washington DC*.

International Business Publications Inc US *Customs Border Handbook, Regulations, Procedures, Opportunities* Volume 1 (2013) International Business Publications, Washington DC, USA.

International Monetary Fund (IMF) *Export and Import Price Index Manual: Theory and Practice* (2009) International Monetary Fund Publications, Services, Washington DC, USA.

International Monetary Fund *A Guide to Direction of Trade Statistics* (1993) International Monetary Fund, Washington DC, USA.

International Monetary Fund *South Africa: Technical Assistance Report-Fiscal Regime for Mining and Petroleum: Opportunities and Challenges* (2015) IMF Fiscal Department, Washington DC, USA.

International Monetary Fund *Romania Technical Assistance Report- Improving Compliance Risk Management of Large Taxpayers* (2016) International Monetary Fund, Washington DC, USA.

Iqbal MZ International *Accounting: A Global Perspective* (2002) South-Western / Thomson Learning, Cincinnati, Ohio, USA.

Irwin DA, Mavroidis PC and Sykes AO *The Genesis of the GATT* (2008) Cambridge University Press, New York, USA.

Isenbergh J *International Taxation* 3rd edition (2010) Thomson Reuters, New York, USA.

Ishikawa T *Firms' Location Selection and Regional Policy in the Global Economy* (2015) Springer Tokyo, Japan.

Jacobs V and Duke JR *Legal Ways to Save Taxes Offshore and Onshore: An Annotated Checklist of Tax Reduction Methods Sanctioned by the Tax Law* (2006) Offshore Press Incorporated Kansas City, Missouri, USA.

James M *The UK Tax System: An Introduction* 2nd edition (2009) Spiramus London, UK.

James SR *Taxation: Critical Perspectives on World Economy* Volume 1 (2002) Routledge London, UK.

Javanovic MN *The Economics of European Integration: Limits and Prospects* (2005) Edward Elgar Publishing Limited, Cheltenham, UK.

Jeffery's' A Oxford *Business Group The Report: South Africa 2013* (2013) Oxford Business Group, Pretoria, South Africa.

Jenkins R *Transnational Corporations and Uneven Development* (2013) Routledge, New York.

Jochum H, Essers P & Englisch J *Taxing German-Dutch Cross-Border Business Activities: A Legal Comparison with Particular Focus on the New Bilateral Tax Treaty* (2015) Druckerei Schope, Nordhorn, Germany.

Johnson A *US Transfer Pricing Sourceboo*k (2005) Worldtrade Executive Inc, Concord USA.

Johnson AD *Andean and Southern Cone Regions Tax, Law and Business Briefing* (2006) World Trade Executive, Concord, USA.

Johnson A *Brazil Tax, Law and Business Briefing* 3rd edition (2006) Worldtrade Executive Inc, Concord, USA

Jomo KS *Japan and Malaysian Economic Development: In the Shadow of the Rising Sun* (1998) Routledge, New York, USA.

Jones SM *Principles of Taxation for Business and Investment Planning* (2001) Irwin/McGraw-Hill, Boston Massachusetts.

Jones SM *Federal Taxes and Management Decisions* (1996) Irwin, Chicago, USA.

Jones S *The Decline of the South African Economy* (2002) Edward Elgar Publishing Limited, Cheltenham, England.

Jovanovic MN *International Economic Integration: Monetary, Fiscal and Factor Mobility Issues* Volume 2 (1998) Routledge, London, United Kingdom.

Joyner CC International Law in the 21st Century: Rules for Global Governance (2005) Rowman & Littlefield Publishers, Inc, Lanham, USA.

Juta Statutes Editors *SAIT Compendium of Tax Legislation* (2010) Juta & Company, Claremont Durban, South Africa.

Juta Statutes Editors *SAIT Compendium of Tax Legislation* (2014) Juta & Company, Claremont Durban, South Africa.

Kalmanek CR, Misra S and Yang YR *Guide to Reliable Internet Services and Applications* (2010) Springer, London, UK.

Kamel S *Electronic Business in Developing Countries: Opportunities and Challenges* (2006) Idea Group Publishing, Hershey, USA.

Kanafani A and Kuroda K *Global Competition in Transportation Markets: Analysis and Policy Making* (2005) Elsevier, Tokyo Japan.

Kang D and Mason A *Macroprudential Regulation of International Finance: Managing Capital Flows and Exchange Rates* (2016) Edward Elgar Publishing Limited Cheltenham, UK.

Kapila A & Kapila U *Economic Development in India* (2001) Academic Foundation, New Delhi, India.

Keen M *Changing Customs: Challenges and Strategies for the Reform of Customs Administration* (2003) International Monetary Fund, Washington DC, USA.

Keller A *An Analysis of Adequate Transfer Pricing Methods for Intangible Property (*2015) Grin Verlag Berlin, Germany.

Kemmeren E, Smit DS and Essers P *Tax Treaty Case Law Around the Globe 2014* (2015) IBFD, Amsterdam, the Netherlands.

Kennedy RE and Sharma A *The Services Shift: Seizing the Ultimate Offshore Opportunity* (2009) Pearson Education Inc. New Hershey, USA.

Kettel B *Finance of International Business* (1981) Quorum Books, Westport, USA.

Kerschner I & Sonare M *Taxation in a Global Digital Economy* (2017) Hans Jenlzsch Publications, Wien , Scheydgasse, Germany.

Kersten W Global *Logistics Management: Sustainability, Quality, Risks* (2008) Erich Schmidt Verlag GmbH & Co, Berlin, Germany.

Kerzner DS and Chodikoff DW *International Tax Evasion in the Global Information Age* (2016) Palgrave Macmillan, Cham, Switzerland.

Keuper F and Kleug K *Finance Bundling and Finance Transformation: Shared Services Next Level* (2013) Springer Gabler, Wiesbaden, Germany.

Kim S and Kim S *Global Corporate Finance* (2006) Blackwell Publishing Victoria, Australia.

King E, *Transfer Pricing and Corporate Taxation, Problems, Practical Implications and Proposed Solutions* (2009) Springer Science & Business Media, Brookline, USA.

King E *Transfer Pricing and Valuation in Corporate Taxation: Federal Legislation v Administrative Practice* (2004) Kluwer Law International Boston, Dordrecht & London.

Kinney MR and Raiborn CA *Cost Accounting: Foundations and Evolutions* (2011) South-Western Cengage Learning, Mason, USA.

Kirchler E *The Economic Psychology of Tax Behaviour* (2007) Cambridge University Press, New York, USA.

Knoedler JT and Prasch RE *Thorstein Veblen and the Revival of the Free Market Capitalism* (2007) Edward Elgar Publishing, Cheltenham, UK.

Kofler G, Maduro MP and Pistone P *Human Rights and Taxation in Europe and the World* (2001) IBFD Amsterdam, the Netherlands.

Kobestsky M *International Taxation of Permanent Establishments, Principles and Policy* (2011) Cambridge University Press, New York, USA.

Kohler U & Kreuter F *Data Analysis Using Stata* (2005) Stata Press Publication, Texas, USA.

Kolesnikov O & Hatch B *Building Linux Virtual Private Networks (VPNs)* (2002) New Riders Publishing, Indianapolis, US.

Kontrimas *AR International Expatriate Employment Handbook* (2006) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Kuan JS *Global Transfer Solutions* (2004) World Trade Executive Inc, Concord, USA.

Kuanpoth J *Patent Rights in Pharmaceuticals in Developing Countries: Major Challenges for the Future* (2010) Edward Elgar Publishing Limited, Cheltenham, UK.

Kurukulasuriya L and Robinson NA *Training Manual on International Environmental Law* (2006) UNEP, Hertfordshire, UK.

Kreiser L, Lee S, Ueta K, Milne JE and Ashiabor H Environmental *Taxation and Green Fiscal Reform: Theory and Impact* (2014) Edward Elgar Publishing Limited, Cheltenham, UK.

Krimpmann A *Principles of Group Accounting under IFRS* (2015) John Wiley & Sons West Sussex, United Kingdom.

Krueger AO *WTO as an International Organisation* (1998) University of Chicago Press, USA.

Lal BB and Vashisht V *Direct Taxes: Income, Wealth Tax and Tax Planning* 29th edition (2008) Dorling Kindersley Private Limited, New Delhi, India.

Lanciano JR, Farrell MF, Reed A, and DeBole P *Regulations: Usiness Law and Professional Responsibility* (2007) Lambers CPA, New York, USA.

Lang M *Introduction to the Law of Double Taxation Conventions* 2nd edition (2013) IBFD, Amsterdam, the Netherlands.

Lang M *CFC Legislation, Tax Treaties and EC Law* (2004) Kluwer Law International, The Hague, the Netherlands.

Lang M *Tax Compliance Costs for Companies in an Enlarged European Community* (2008) Kluwer Law International Amsterdam, the Netherlands.

Lang M *Procedural Rules in Tax Law in the Context of European Union and Domestic Law* (2010) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Lang M, Melz P, Kristofferson E, and Ecker T *Value Added Tax and Direct Taxation: Similarities and Differences* (2009) IBFD Amsterdam, the Netherlands.

Lang M, Schuch J and Staringer C *The Dependant Agents as Permanent Establishments* (2014) Hans Jentzsch Scheydgasse, Germany.

Lang M, Pistone P, Rust A, Schuch J and Staringer C *Base Erosion and Profit Shifting BEPS: The Proposals to Revise the OECD Model Convention* (2016) Hans Jentzsch & Co Scheydgasse, Germany.

Lang M, Liu J and Tang G *Europe-China Tax Treaties* (2010) Kluwer Law International Alphen aan den Rijn, the Netherlands.

Lang M, Pistone P & Schuch J *Introduction to European Tax Law: Direct Taxation* 3rd edition (2013) Spiramus Press Ltd, Austria.

Lang M, Herdin J and Hofbauer I *WTO and Direct Taxation* (2005) Kluwer Law International, The Hague, the Netherlands.

Larkins ER *International Applications of US Income Tax Law: Inbound and Outbound Transactions* (2004) John Wiley & Sons, New Jersey, USA.

Laro D & Pratt SP *Business Valuation and Federal Taxes: Procedure, Law and Perspective* 2nd edition (2011) John Wiley & Sons Inc. Hoboken New Jersey.

Lasher WR *Practical Financial Management* 8th edition (2014) Cengage Learning, Boston, USA.

Lathrope DJ *Selected Sections, United States International Taxation* (2008) Foundation Press, New York, USA.

Law J *Oxford Dictionary of Law* 8th edition (2015) Oxford University Press, Oxford, United Kingdom.

Leap TL *Dishonest Dollars: The Dynamics of White Collar Crime* (2007) Cornell University Press, New York, USA.

Lee ES *World Trade Regulation: International Trade under the WTO Mechanism* (2012) Springer-Verlag Berlin, Germany.

Leer AC *Masters of the Wired World: Cyberspace Speaks Out* (1999) Financial Times, London, UK.

Lehr WH and Pupillo L *Internet Policy and Economics: Challenges and Perspectives* 2nd edition (2002) Springer Science + Business Media, New York, USA.

Lehr WH and Pupillo L *Cyber Policy and Economics in the Internet Age* 2nd edition (2002) Springer Science + Business Media, New York, USA.

Leibfied S and Zurn M *Transformations of the State?* (2005) Cambridge University Press, New York, USA.

Lemgrubber A and Shelton S *Revenue Administration: Administering Revenues from Natural Resources-A Short Primer* (2014) IMF, Washington DC, USA.

Lepard BD *Customary International Law: A New Theory with Practical Applications* (2010) Cambridge University Press, New York, USA.

Lessambo F *Fundamentals of Hedge Funds: Alternative Investment Vehicles* (2011) Rosedog Books, Pittsburgh, USA.

Levey MM, Wrappe SC and Chung K *Transfer Pricing Rules and Compliance Handbook* (2006) CCH, Wolters Kluwer International, Chicago, USA.

Levey MM and Wrappe SC *Transfer Pricing Rules Compliance and Controversy* (2001) CCH Chicago, USA.

Lewis A The Cambridge *Handbook of Psychology and Economic Behaviour* (2012) Cambridge University Press, New York USA.

Li J and Paisey A *International Transfer Pricing in Asia Pacific: Perspective on Trade between Australia, New Zealand and China* (2005) Palgrave Macmillan, New York, USA.

Li S *The Legal Environment and Risks for Foreign Investment in China* (2007) Springer + Business Media, Berlin, Germany.

Lindsey K *Leadership Breakthrough* (2013) AuthorHouse Bloomington, USA.

Litan RE and Niskanen WA *Going Digital! A Guide to Policy in the Digital Age* (1998) Brookings Institution Press, Massachusetts, USA.

Liu H, Sung WP and Yao W *Computing, Control, Information and Education Engineering* (2015) Taylor Francis Group, London, UK.

Livingston MA and Gamage DS *Taxation: Law, Planning and Policy* 2nd edition (2010) Matthew Bender & Company Inc (Nexis Lexis), Massachusetts, USA.

Low LA, Drory DM and Norton PM *International Lawyer's Deskbook* 2nd edition (2002) American Bar Association, New York, USA.

Low P *Preshipment Inspection Services* (1995) World Bank, Washington DC, USA.

Lowenfeld AF *International Economic Law* (2003) Oxford University Press, New York, USA.

Luga RHC *Assesment and Recovery of Tax Incentives in the EU and the WTO: a View on State Aid, Trade Subsidies and Direct Taxation* (2003) Intersentia, New York, US.

Lymer A and Hasseldine J *The International Taxation System* (2005) Kluwer Law International, the Netherlands

Lymer A and Hasseldine J *The International Taxation System* (2002) Springer +Business Media, New York USA.

Lynch KL *The Forces of Economic Globalization: Challenges to the Regime of International Commercial Arbitration* (2003) Kluwer Law International, The Hague, the Netherlands.

Lyons T *EC Customs Law* (2001) Oxford University Press, New York, USA.

MacLean RM EU *Trade Barrier Regulation: Tackling Unfair Foreign Trade* 2nd edition (2006) Sweet & Maxwell Limited, London, England.

Madhu VIJ *International Financial Management* 2nd edition (2006) Excel Books, New Delhi, India.

Maelah R *Sustaining Competitiveness in a Liberalised Economy: The Role of Accounting* (2009) Cambridge Scholars Publishing, New Castle, UK.

Maheshwari RP *Principles of Business Studies* Volume 1, 6th edition (2004) Pitambar Publishing Company (P) Ltd New Delhi, India.

Mahon R & Mc Bride S *The OECD and Transnational Governance* (2008) UBS Press, the University of British Columbia, Vancouver, Canada.

Maisto G *The Meaning of Enterprise, Business and Business Profits under Tax Treaties and EU Tax Law* Volume 7(2011) IBFD, Amsterdam the Netherlands.

Maisto G *Taxation of Intercompany Dividends under Tax Treaties and EU Law* Volume 8 (2012) IBFD Amsterdam, the Netherlands.

Maither L *The Canada Income Tax Act: Enforcement, Collection, Prosecution, A Case Compilation* 6th edition (2014) Canadian Revenue Authority.

Malke C *Taxation of European Companies at the Time of Establishment and Restructuring* (2010) Springer Science + Business Media, Wiesbaden, Germany.

Mambi AJ *ICT Law Book: A Sourcebook for Information and Communication Technologies and Cyber Law* (2010) Mkuki na Nyota Publishers Ltd, Dar es Salaam, Tanzania.

Mann RA and Roberts BS *Business Law and the Regulation of Businesses* (2014) Cengage Learning, Boston, USA.

Mann CL, Eckert SE and Knight SC *Global Electronic Commerce: A Policy Primer* (2000) Institute of International Economics, Washington DC, USA.

Marcella AJ Jr and Stucki C *Privacy Handbook: Guidelines, Policy Implementation and International Issues* (2003) John Wiley & Sons, Hoboken, New Jersey, USA.

Marajan M and Prakashan N *Managerial Economics* (2008) Niralli Prakashan Publishers, Pune, India.

Markham M *Advance Pricing Agreements, Past Present and Future* (2012) Kluwer Law International, AH Alphen aan den Rijn, the Netherlands.

Markham M *The Transfer Pricing of Intangibles* (2005) Kluwer Law International, The Netherlands.

Martel A and Klibi W *Designing Value-Creating Supply Chain Networks* (2016) Springer International Publishing, Switzerland.

Martens-Weiner J *Company Tax Reform in the European Union: Guidance from the United States and Canada on Implementing the Formulary Apportionment in* *the EU* (2006) Springer Science + Business Media Inc, Spring Street, New York, USA.

Martinez-Lopez FJ *Handbook of Strategic e-Business Management* (2014) Springer-Verlag, Berlin Germany.

Matheson T, Perry VJ and Veung C *Territorial vs Worldwide Corporate Taxation: Implications for Developing Countries* (2013) International Monetary Fund, New York, USA.

Mavroidis PC *Trade in Goods* (2012) Oxford University, Oxford, United Kingdom.

Mavroidis PC *The Regulation of International Trade: GATT* (2016) Massachusetts, USA.

May C *Global Corporate Power* (2006) Boulder Colorado, USA.

Mayer S *Formulary Apportionment for the Internal Market* (2009) IBFD Amsterdam, the Netherlands.

McCalley RW *Marketing Channel Management: People, Products, Programs and Markets* (1996) Praeger Publishers, Westport, USA.

McDaniel PR, Ault HJ & Repeti JR *Introduction to United States International Taxation* ((2005), Kluwer Law International, the Netherlands.

McGee RW *Ethics of Tax Evasion: Perspectives in Theory and Practice* (2012) Springer + Business Media New York, USA.

McKern B *Transnational Corporations and the Exploitation of Natural Resources* (1993) Routledge, London, United Kingdom.

McLure CE *The State Corporation Income Tax: Issues in Worldwide Unitary Combination* (1984) Stanford University, California, USA.

Medhi J *Statistical Methods: An Introductory Text* (2005) New Age International (P) Limited, Publishers, New Delhi, India.

Meena RL *Textbook on Contract Law Including Specific Relief* (2008) Universal Law Publishers Co Pvt Ltd, New Delhi, India.

Meiners RE, Ringleb ALH and FL Edwards *The Legal Environment of Business* 12th edition (2012) Cengage Learning, Stamford, USA.

Mele D *Business Ethics in Action: Seeking Human Excellence in Organisations* (20090 Palgrave Macmillan Indiana University, USA.

Merchant KA *Modern Management Control Systems: Text & Cases* (1998) Prentice-Hall Inc, Upper Saddle River New Jersey.

Messenger J and Ghosheh N *Offshoring and Working Conditions in Remote Work* (2010) Palgrave MacMillan, New York, USA.

Mikesell J *Fiscal Administration* 10th edition (2016) Cengage Learning, New York, USA.

Milgrom P and Roberts J *Economics, Organization and Management* (1992), Prentice-Hall, Englewood Cliffs, New Jersey.

Millar R *Doing Business with India: A Guide to Investment Opportunities and Business Practice* 2nd edition (2007) GMB Publishing Ltd, Philadelphia, USA.

Miller A & Oats L *Principle of International Taxation* (2006) Tottel Publishing, West Sussex, the United Kingdom.

Miller JA & Maine JA *The Fundamentals of Federal Taxation: Problems & Materials* (2010) Carolina Academic Press, USA.

Miller RL *Economics Today: The Macro View volume* 2 (1999) Addison-Wesley Massachusetts, USA.

Mintz JM *The Role of Allocation in Globalised Corporate Income Tax* (1998) IMF, Washington DC, USA.

Mitchell F, Norreklit H and Jakobsen M *The Routledge Companion to Cost Management* (2013) Routledge, Oxon, Canada.

Mittal DP *Law of Transfer Pricing in India* (2014) Taxman Publications Pvt Ltd New Delhi India.

Mo PLL *Tax Avoidance and Anti- Avoidance Measures in Major Developing Economies* (2003) Praeger Publishers, Westport, USA.

Monteiro J, PMC Swatman, LV Valadares *Towards the Knowledge Society: e-Commerce and Government* (2003) Springer Science + Business Media, New York.

Monsenego J *Taxation of Foreign Business Income within the European International Market* Volume 2 (2012) IBFD Amsterdam, the Netherlands.

Moosa I *Foreign Direct Investment: Theory, Evidence and Practice* (2002) Palgrave Macmillan Hampshire (UK) and New York (USA).

Morgan B and Yeung K *An Introduction to Law and Regulation: Text and Materials* (2007) Cambridge University Press, New York, USA.

Morris AP *Offshore Financial Centres and Regulatory Competition* (2010) AEI Press, Washington DC, USA.

Morris G *Tax Cheating: Illegal, But is it Immoral?* (2012) State University of New York, New York, USA.

Morrison J *Business Ethics: New Challenges in a Globalised World* (2015) Palgrave, London UK.

Muchlinski P *Multinational Enterprises and the Law* 2nd edition (2007) Oxford University Press, New York, USA.

Muhr SL, Sorensen BM and Vallentin S *Ethics and Organisational Practice: Questioning the Moral Foundations of Management* (2010) Edward Elgar Publishing Limited, Cheltenham, United Kingdom.

Muller WH, Kalin CH, & Goldworth JG *Anti- Money Laundering: International Law and Practice* (2007) John Wiley & Sons West Sussex, UK.

Murphy WJ, Orcutt JL and Remus PC *Patent Valuation: Improving Decision Making through Analysis* (2012) John Wiley & Sons Hoboken, New Jersey, USA.

Murphy KE and Higgins M *Concepts in Federal Taxation* (2017) Cengage Learning, Boston USA.

Naidoo R *Corporate Governance: An Essential Guide for South African Companies* (2002) Juta Publishing, Cape Town, South Africa.

Niels GN, H Jenkins and Kavanagh J *Economics for Competition Lawyers* (2011) Oxford University Press, New York, USA.

Negandhi AR *Functioning of Multinational Corporations: A Global Comparative Study* (1982) Pergamon Press Inc, New York, USA.

Noguchi Y and Yamamura K *US- Japan Macro Economic Relations* (1980) University of Washington Press, Washington.

Oberson X & Hull HR *Switzerland in International Tax Law* (2006) IBFD Publications, Amsterdam, the Netherlands.

Oberson X & Hull HR *Switzerland in International Tax Law* 4th ed (2011) IBFD, Amsterdam, the Netherlands.

Oguttu AW *International Tax Law Offshore Tax Avoidance in South Africa* (2015) Juta Cape Town, South Africa.

Okauru IO *Federal Inland Revenue Service and Taxation Reforms in Democratic Nigeria* (2002) Safari Books Ltd, Ibadan, Nigeria.

Organisation for Economic Co-operation and Development (OECD) *Dealing Effectively With the Challenges Of Transfer Pricing* (2012), OECD Publishing.

OECD *Globalisation and Emerging Economies Brazil, Russia, India, Indonesia, China and South Africa* (2008) OECD Publications, Paris France.

Organisation for Economic Co-operation and Development (OECD) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2010), OECD Publishing.

Organisation for Economic Co-operation and Development (OECD) *Model Tax Convention on Income and Capital* (2008) OECD Publishing, Paris, France.

Organisation for Economic Co-operation and Development (OECD) *Model Tax Convention on Income and on Capital, Condensed Version* (2010), OECD Publishing, Paris France.

Organisation for Economic Co-operation and Development (OECD) *Model Tax Convention on Income and on Capital, Condensed Version* (2014), OECD Publishing, Paris France.

OECD *Economic and Social Impact of Ecommerce: Preliminary Findings and Research Agenda*, OECD Publications, Paris, France.

OECD *OECD/G20 Base Erosion and Profit Shifting Project Addressing the Tax Challenges of the Digital Economy (2014) OECD Publications Paris, France.*

OECD/G20 *Base Erosion and Profit Shifting Project Tax Challenges Arising from Digitisation-Interim Report* (2018) OECD Publications, Paris France.

OECD Revised Draft BEPS Action 7: Preventing the Artificial Avoidance of PE Status at 12. Available at http://www.oecd.org/ctp/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf, accessed on the 15 October 2018.

OECD/G20 Base Erosion and Profit Shifting Project Aligning Transfer Pricing Outcomes with Value Creation. Available at https://www.oecd-ilibrary.org/docserver/9789264241244-en.pdf?expires=1541675938&id=id&accname=guest&checksum=8F176ED633E3AC54B3E821CC999A3323, accessed on the 20 October 2018.

OECD/G20 *Base Erosion and Profit Shifting Project Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance* (2014) OECD Publishing, Paris, France.

OECD *OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Documentation and Country by Country Reporting (2014)* OECD Publications, Paris, France.

OECD *OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Aspects of Intangibles (2014)* OECD Publications, Paris, France.

OECD *Export and Import Price Index Manual: Theory and Practice* (2009) IMF Publications, Washington DC, USA.

OECD Meeting of the OECD Council at Ministerial Level 2002: Key Information (2002) OECD Publishing, Paris, France.

OECD *Transfer Pricing Guidelines and Transfer Pricing Features of Selected Countries* (2014) OECD Publishing, Paris, France.

OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2017) OECD Publishing, Paris, France.

OECD *Addressing Base Erosion and Profit Shifting* (2013) OECD Publications, Paris France.

OECD African *Economic Outlook 2010* (2010) OECD Publications, Paris, France.

OECD *Consumption Tax Trends 2006 "VAT/GST and Excise Rates, Trends and Administration Issues* (2006) OECD Publications, Paris, France.

OECD Country by Country Reporting, Handbook on Effective Tax Risk Assessment, available at http://www.oecd.org/ctp/beps/country-by-country-reporting-handbook-on-effective-tax-risk-assessment.pdf, accessed on the 20th October 2018.

OECD *Globalisation and Emerging Economies: Brazil, Russia, India, Indonesia, China, and South Africa* (2008) OECD Publishing, Paris, France.

OECD *OECD Economic Outlook* (2002) OECD Publications, Paris, France.

OECD *Taxation and Electronic Commerce Implementing the Ottawa Taxation Framework Conditions* (2001) OECD Publications, Paris France.

OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes* (2012) OECD Publishing, Paris, France.

OECD *The Taxation of Global Trading of Financial Instruments* (1998) OECD Publishing, Paris France.

OECD *Transfer Pricing and Multinational Enterprises Report of the OECD Committee on Fiscal Affairs* (1979) OECD Publishing, Paris, France.

O'Hara PA *Encyclopaedia of Political Economy* Volume 2 L-Z (2001) Routledge London,UK.

Olsen K *Characterization and Taxation of Cross Border Pipelines* (2012) IBFD Amsterdam, the Netherlands.

Olivier L & Honiball M *International Tax, A South African Perspective* 5 ed (2011) Siber Ink Publishers, South Africa.

Olivier L, Davis DM and Urquhart G *Juta Income Tax* (2009) Cape Town Juta.

Onkvisit S Shaw JJ *International Marketing: Analysis and Strategy* 4th edition (2004) Routledge, New York, USA.

Oxekheim L *International Financial Market Fluctuations* (1985) John Wiley & Sons, New York, USA.

Pagan JC & Wilkie JS *Transfer Pricing in a Global Economy (1993), IBFD Publications, Amsterdam, the Netherlands*.

Paisey A and Li J *Transfer Pricing: A Diagrammatic and Case Study Introduction, with Special Reference to China* (2012) Brown Walker Press Florida, USA.

Palda KF *Tax Evasion and Firm Survival in Competitive Markets* (2001) Edward Elgar Publishing Limited, Cheltenham, UK.

Panayi CHJI *Advanced Issues in International and European Tax Law* (2015) Hart Publishing Ltd, Oxford, United Kingdom.

Park JJ, Stojmenovic I, Choi M and Xhafa F *Future Information Technology* (2104) Springer-Verlag Berlin Germany.

Parr RL and Smith GV *Intellectual Property: Valuation, Exploitation and Infringement Damages* (2008) John Wiley & Sons, Hoboken, New Jersey, USA.

Parry C Grant JP and Barker JC *Parry and Grant Encyclopaedia Dictionary of International Law* 3rd edition (2009) Oxford University Press, New York,USA.

Patel BN *India and International Law* Volume 2 (2008) Martinus Nijhoff, Leiden, the Netherlands.

Paul J *International Marketing: Texts and Cases* (2008) Tata McGraw- Hill Publishing Company, New Delhi, India.

Paulos B *The Legal Architecture for E-commerce in Ethiopia: Lessons from the EU Experiences* (2015) Anchor Academic Publishing, Hamburg, Germany.

Paulos B *Regulating Cross-Border E-commerce by Ethiopia: Prospects and Challenges* (2015) Anchor Academic Publishing, Hamburg, Germany.

Pearl J and Rosenbaum J *Investment Banking: Valuation, Leverage Buyouts and Mergers and Acquisitions* 2n edition (2013) John Wiley & Sons New Jersey, USA.

Peeters M, Sabri N and Shahin W *Financial Integration: A Focus on the Mediterranean Region* (2013) Springer-Verlag, Berlin, Germany.

Peppitt M *Tax Due Diligence* (2009) Spiramus Press Ltd, London, United Kingdom.

Perritt HH *Digital Communications Law* (2015) CCH Inc, New York, USA.

Peroni RJ *International Income Taxation, Code and Regulations* (2008) Wolter Kluwer Business Publication, Chicago, USA.

Peroni RJ, Gustafson CH and Pugh RC *International Income Taxation: Code and Regulations* (2008) Wolter Kluwer Business, Chicago, USA.

Peterson GE and Annez PC *Financing Cities: Fiscal Responsibility and Urban Infrastructure in Brazil, China, India, Poland and South Africa* (2007) Sage Publications India Private Limited, New Delhi, India.

Petruzzi R and Spies K *Tax Challenges in the 21st Century* (2014) Linde Verlag Publications, Vienna, Austria.

Pfeiffer S, Ursprung Steindl M *Global Trends in VAT/GST and Direct Taxation* (2015) Hans Jentzch & Co Scheydgasse, Austria.

Phyper J, Ducas P and Baish PJ *Global Materials Compliance Handbook* (2004) John Wiley & Sons New Jersey, USA.

Piciotto S *International Business Taxation* (1992), Weidenfeld and Nicolson, London, United Kingdom.

Pickhardt M and Prinz A *Tax Evasion and the Shadow Economy* (2012) Edward Elgar Publishing Cheltenham, UK.

Pierce A and Brennan N *Principles of Group Accounts: A European Perspective* (2003) Thomson Learning, London, United Kingdom.

Pieterse JN *Global Futures: Shaping Globalisation* (2000) Zed Books Ltd, New York, USA.

Pinto D *E-Commerce and Source Based Income Taxation* (2003) IBFD Publications Amsterdam, the Netherlands.

Pirvu D *Corporate Income Tax Harmonisation in the European Union* (2012) Palgrave MacMillan, New York, USA.

Pitts GW *The Personal Trainer's Legal Bible: Legalities for Fitness Professionals* (2014) iUniverse LLC, Bloomington, USA.

Plasschaert SRF *Transfer Pricing and Multinational Corporations: An Overview of Concepts, Mechanisms and Regulations* (1979) at 47 Saxon House Teakfield Limited, Hampshire.

Pogge T and Mehta K *Global Tax Fairness* (2016) Oxford University Press, London, the United Kingdom.

Poniachek HA *International Corporate Finance: Markets, Transactions and Financial Management* (2013) Routledge, Oxon, Canada.

Ponniah A & Glaize A *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2009). IBFD, Amsterdam, the Netherlands.

Poterba JM *Tax Policy and the Economy* (1996) National Bureau of Economic Research MIT Press Cambridge Massachusetts, USA.

Poterba JM *Tax Policy and the Economy* Volume 12 (1998) the MIT Press, Cambridge Massachusetts, USA.

Prabhu CSR *Mobile Computing: A Book of Readings* (2004) Universities Press, Hyderabad, India.

Pragter H and Van Raan R *The Valuation of Goods for Customs Purposes* (1981) Springer Science + Business Media LLC, New York, USA.

Pratt J & Kulsrud W *Corporate, Partnership, Estate & Gift Taxation* (2013) Cengage Learning Mason, USA.

PWC *Mergers and Acquisitions: A Global Tax Guide* (2006) John Wiley & Sons Inc Hoboken, New Jersey, USA.

Qin Z *Introduction to E-commerce* (2009) Springer Berlin, Germany
(2008) John Wiley and Sons Hoboken, New Jersey, USA.

Raabe WA, Whittenburg GE, Sanders DL and Sawyers RB *Federal Tax Research* 9th edition (2012) Cengage Learning, Mason USA.

Raczkowski K and Schneider F *The Economic Security of Business Transactions: Management in Business* (2013) Chartridge Books Oxford, Oxford, UK.

Radaelli CM *The Politics of Corporate Taxation in the European Union: Knowledge and International Policy Agendas* (2006) Routledge, Oxon, United Kingdom.

Radin MJ, Rothchild J and Silverman GM *Internet Commerce: The Emerging Legal Framework: Cases and Materials* (2002) Foundation Press New York, USA.

Rajan RS *Economic Globalisation and Asia: Essays on Finance, Trade and Taxation* (2003) World Scientific Publishing Co Pte, Tuck Link, Singapore.

Rai S Recognition *and Regulation of Safeguard Measures under GATT/WTO* (2011) Routledge Oxon, UK.

Riahi-Belkaoui A *Advanced Management Accounting* (2001) Quorum Books, Westport, USA.

Rao MG and Rakshit M *Public Economics: Theory and Policy* (2011) SAGE Publications India Pvt Ltd, New Delhi, India.

Ramesh S *Indian Economy: For Civil Services* 7th edition (2015) McGraw Hill Education (India) Private Limited, New Delhi, India.

Ramsey V, Minogue A, Baster J and O'Reilly M *Construction Law Handbook* (2007) Thomas Telford Publication, London, United Kingdom.

Rendahl P *Cross Border Consumption Taxation of Digital Supplies* (2009) IBFD Amsterdam, the Netherlands.

Rasmussen M *International Double Taxation* (2011) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Rathore S *International Accounting* 2nd edition (2009) PHI Learning Private Limited, New Delhi, India.

Rawal R *The Taxation of Permanent Establishments: An International Perspective* (2006) Spiramus London, United Kingdom.

Razin A and Slemrod J *Taxation in the Global Economy* (1990) University of Chicago Press, Chicago, USA.

Read C & Gregoriou GN *International Taxation Handbook Policy, Practice, Standards and Regulation* (2007) CIMA Publishing, the Netherlands.

Reed C *Internet Law: Texts and Materials* 2nd edition (2004) Cambridge University Press, Cambridge, UK.

Reilly RF and Schweibs RP *The Handbook of Business Valuation and Intellectual Property Analysis* (2004) McGraw Hill, New York, USA.

Reilly RF & Schweibs RP *Valuing Intangible Assets* (1999) McGraw Hill Professional, New York, USA.

Reinert KA and Rajan RS *Encyclopedia of the World Economy* Volume 1 (2009) Princeton University Press, New Jersey, USA.

Riemer E, Urban N, and Schmid S *Permanent Establishments: A Domestic Taxation, Bilateral Tax Treaty and OECD Perspective* (2011) Kluwer Law International Alphen aan den Rijn, the Netherlands.

Rendahl P *Cross-Border Consumption Taxation of Digital Supplies* (2009) IBFD Amsterdam, the Netherlands.

Riccardi L *Vietnam Tax Guide: Domestic Fiscal System and International Treaties* (2014) Springer International Publishing, Switzerland.

Riccardi L *Chinese Tax Law and International Treaties* (2013) Springer International Publishing, Switzerland.

Richelle I, Schon W and Traversa E *State Aid Law and Business Taxation* (2016) Springer- Verlag, Berlin, Germany.

Rixen T *The Political Economy of International Tax Governance* (2008) Palgrave Macmillan, New York, USA.

Robbins SM & Stobaugh RB *Money in the Multinational Enterprise* (1973), Basic Books, New York.

Robinson M *Corruption and Development* (2006) Frank Cass Publishers, New York, USA.

Rogers SC *Marketing Strategies, Tactics and Techniques: A Handbook for Practitioners* (2001) Quorum Books, Westport, USA.

Rogers-Glabush J *IBFD International Tax Glossary* 6th Revised Edition (2009) IBFD, Amsterdam, the Netherlands.

Rohde C & Rossing CP *Transfer Pricing* (2011) Department of Accounting & Auditing Copenhagen Business School.

Rohatgi R Basic *International Taxation* (2002), Kluwer Law International, The Hague, the Netherlands.

Rolfe C *International Transfer Pricing* (1993) CCH International, London.

Romano C *Advance Tax Rulings and Principles of Law: Towards a European Tax Rulings System?* (2002) IBFD Publications, Amsterdam, the Netherlands.

Rose-Ackerman A *Corruption and Government: Causes, Consequences and Reform* (1999) Cambridge University Press, Cambridge, United Kingdom.

Rosenow S and O'Shea BJ *A Handbook on the WTO Customs Valuation Agreement* (2010) Cambridge University Press, New York, USA.

Roth JA and Scholtz JT *Taxpayer Compliance an Agenda for Research Volume 1 (1989)* University of Pennsylvania Press, Pennsylvania, USA.

Roux A *Everyone's Guide to the South African Economy* 8th edition (2005) Zebra Press Cape Town South Africa.

Rubel G and Runge H *Real and Monetary Issues of International Economic Integration* (2000) Duncker & Humblot, Berlin, Germany.

Rubin A *Statistics for Evidence-Based Practice and Evaluation* 3rd edition (2013) Brooks/Cole Belmont, California, USA.

Ruggles ND and Ruggles R *National Accounting and Economic Policy: The United States and UN Systems* (1999) Edward Elgar Publishing Limited, Cheltenham, UK.

Rugman AM *Multinationals in Canada: Theory, Performance and Economic Impact* (1980) Martinus Nijhoff Publishing, Boston USA.

Rugman AM & Eden L *Multinationals & Transfer Pricing* (1985) St Martin's Press, New York, USA.

Rugman AM *International Business Critical Perspectives on Business and Management* (2002) Routledge Taylor & Francis Group, London, the United Kingdoms.

Rugman AM *The Oxford Handbook of International Business* 2nd edition (2008) Oxford University Press, New York, USA.

Russo R *The Attribution of Profits to Permanent Establishments: The Taxation of Intra-Company Dealings* (2005) IBFD, Amsterdam, the Netherlands.

Sadler P *Strategic Management* 2nd ed (2003) Kogan Page Limited, London (UK) & Sterling (US).

Said R, Crowther D and Amran A *Ethics, Governance and Corporate Crime: Challenges and Consequences* (2014) Emerald Group Publishing LTD, Bingley, UK.

Sale JA *Advances in International Accounting* Volume 18 (2005) Elsevier, Amsterdam, the Netherlands.

Salinger LM *Encyclopaedia of White-Collar and Corporate Crime* Volume 1(2005) Sage Publications, California, USA.

Salvatore D *International Economics* 12th edition (2016) John Wiley & Sons, New Jersey, USA.

Salvendy G and Kanwowski W *Introduction to Service Engineering* (2010) John Wiley & Sons, Hoboken, New Jersey, USA.

Sanders MI *Joint Ventures Involving Tax Exempt Organisations* 3rd edition (2007) John Wiley & Sons Hoboken, New Jersey, USA.

Sangtani G *An Analysis of Direct Tax Provisions in the Finance Bill* (2011) CA Pariwar Publication, New Delhi, India.

Saudagaran SM *International Accounting: A User Perspective* (2009) Wolter Business, Chicago, USA.

Sauvant KP and Lim M *Transnational Corporations Volume 14 Number 2 (2005) United Nations Publications UN Plaza, New York, USA*.

Sayde A *Abuse of EU Law and Regulation of Internal Market* (2014) Hart Publishing Ltd, Oxford, UK.

Scarlet R *Management Accounting- Performance Evaluation* (2005) CIMA Publishing, Burlington, USA.

Schafer A *International Company Taxation in the Era of Information and Communication Technolog*y (2006) Springer Science + Business Media Wiesbaden, Germany.

Schaffer R Agusti F and Dhooge LJ *International Business Law and its Environment* 9th edition (2015) Cengage Learning, Stamford, USA.

Schaffer TC *India and the United States in the 21st Century: Reinventing Partnership* (2009) The CSIS Press, Washington DC, USA.

Schneider GP *Electronic Commerce* 10th edition (2013) Cengage Learning, Boston, USA.

Schreiber U *International Company Taxation: An Introduction to the Legal and Economic Principles* (2013) Springer-Verlag Berlin, Germany.

Schon W & Konrad KA *Fundamentals of International Transfer Pricing In Law and Economics* (2011) Springer Heidelberg Dordrecht, Munich Germany.

Schon W, Schreiber U, Spengel C *A Common Consolidated Corporate Tax Base for Europe* (2008) Springer-Verlag Berlin, Germany.

Scott MD *Scott on Outsourcing: Law and Practice* (2010) Aspen Publishers, New York, USA.

Schuster P *Transfer Prices and Management Accounting* (2015) Springer International Publishing AG Switzerland.

Schulze GG *The Political Economy of Capital Controls* (2000) Cambridge University Press, Cambridge, Great Britain.

Sears JH *Trust Estates as Business Companies* 2nd edition (1998) The Lawbook Exchange Ltd, New Jersey, USA.

Seidi-Hoheneldem I *International Economic Law* (1999) Kluwer Law International, Dordrecht, the Netherlands.

Seiler M *GAARs and Judicial Anti-Avoidance in Germany, the UK and the EU* (2016) Linde Verlag, Scheydgasse, Germany.

Senift S, Gallegos F and Davis A *Information Technology Control and Audit* 4th edition (2013) Taylor and Francis, Boston, USA.

Seyoum B *Export-Import Theory, Practices & Procedures* 3rd edition (2014) Taylor & Francis, New York, USA.

Shailja D *E-Retailing Challenges and Opportunities in the Global Market Place* (2016) IGI Global, Hershey, USA.

Shailaga G *International Finance* (2008) Universities Press (India) Private Limited, New Delhi, India.

Sharan V *International Financial Management* (2002) PHI Learning Private Limited, New Delhi, India.

Sharma V *Information Technology Law and Practice* 3rd edition (2011) Universal Law Publishing Company Private Limited, New Delhi, India.

Shaviro DN *Fixing US International Taxation* (2014) Oxford University Press, New York, USA.

Shenkar O, Luo Y and Chi T *International Business* 3ed (2014) Routledge New York, USA.

Sherman MD, Jarreau JS and Brew JB *US Customs: A Practitioner's Guide to Principles, Processes and Procedures* (2009) ABA Publishing, Chicago, Illinois, USA.

Shilling D *Lawyer's Desk Book* (2017) Wolters Kluwer New York, USA.

Shome P *Tax Policy Handbook* (1995) International Monetary Fund Washington DC, USA.

Shtub A *Enterprise Resource Planning (ERP): The Dynamics of Operations Management* (2002) Kluwer Academic Publishers, Dordrecht, Germany.

Simpson AF and Kinsella NS *World Online Business Law* Volume 1 (2003) Oceana Publications, New York, USA.

Simpson M, Johnson A, Ford P, Jarvis T and McGhee H *Tax Aspects of the Purchase and Sale of Private Company's Shar*e 22nd edition (2013) Bloomsbury Professional Ltd, West Sussex, United Kingdom.

Singh BD *Compensation and Reward Management* (2007) Excel Books, New Delhi, India.

Singh J *Regulation, Institutions and the Law* (2007) Social Science Press, New Delhi, India.

Singh SP, Bagchi A & Bajaj RK *Transfer Pricing and Regulations for India, Approvals and Alternatives* (2002) UBS Publishers' Distributors, New Delhi India.

Slorach JS & Ellis J *Business Law 2017-2018* (2017) Oxford University Press, Oxford, UK.

Snyman CR *Criminal Law* 5th edition (2008) Lexis Nexis Durban, South Africa.

Somanath VS *International Financial Management* (2011) IK International Publishing House, Private Limited, New Delhi, India.

Sommer C *Separate Accounting or Unitary Apportionment?: The Fairytale of the Arm's Length Pricing and General Equilibrium Analysis of Multinational Enterprise Behaviour under the Formulary Taxation Alternative* (2010) Josef Eul Publications, Berlin, Germany.

Sood V *Cyber Law Simplified* 4th edition (2008) Tata McGraw-Hill Publishing Company Limited, New Delhi, India.

Sople VV *Supply Chain Management* (2012) Dorling Kindersley (India) Private Limited, New Delhi, India.

Smit PC *Economics: A Southern African Perspective* (2007) Juta & Company, Cape Town South Africa.

Smith DG and Macpherson A *Hong Kong Taxation: Law and Practice* (2008) Chinese University Press, Sha Tin, Hong Kong.

Smith GJH *Internet Law and Regulation* 4th edition (2007) Sweet & Maxwell, London, UK.

Smith GV, Parr RL *Intellectual Property: Valuation, Exploitation and Infringement Damages* (2005) John Wiley & Sons.

Smith S *Taxation: A Very Short Introduction* (2015) Oxford University Press, Oxford, London.

Smullen J *Transfer Pricing for Financial Institutions* (2001) Woodhead Publishing Limited, Cambridge England.

Spencer P *Property Tax Planning* 13th edition (2013) Bloomsbury Professional Ltd, West Sussex, UK.

Spenke G and de Vries M *Taxation in the Netherlands* 4th edition (2011) Kluwer Law International, the Netherlands.

Spitz B *International Tax Havens Guide* (2003) Aspen Publications, New York, USA.

Stiftung H and Schonenberg R *Transnational Organised Crime: Analyses of a Global Challenge to Democracy* (2014) Verlag, Berlin, Germany.

Stiglingh M, Koekemoer AD, Van Schalkwyk L, Wilcocks JS, de Swardt RD & Jordaan K *Silke: South African Income Tax* (2013) LexisNexis, South Africa.

Stobbs GA *Business Method Patents* 2nd edition (2016) Wolters Kluwer International, New York, USA.

Stoll P and Schorkpf F WTO*: World Economic Order, World Trade Law* (2006) Martinus Nijhoff Publishers, Leiden the Netherlands.

Streissler EW *Exchange Rates and International Finance Markets* (2002) Routledge, New York.

Strik P *Shaping the Single European Market in the Field of Foreign Direct Investment* (2014) Hart Publishing Limited, Oxford, UK.

Stroud A & Masters C *Transfer Pricing* (1991) Butterworth & Co (Publishers) Ltd, Edinburgh, United Kingdom.

Summers LH *Tax Policy and the Economy* Volume 1 (1987) The MIT Press Ltd, London, the United Kingdom.

Sury N *Foreign Direct Investment: Global and Indian Aspects* (2004) New Century Publications, New Delhi, India.

Susarla K & Glaize A *OECD Transfer Pricing for Multinational Enterprises and Tax Administrations* (2010) IBFD, Amsterdam, The Netherlands.

Swart N *Personal Financial Management* 2nd edition (2002) Juta Publishing Cape Town South Africa.

Tally M *Practical Experiences with the OECD Transfer Pricing Guidelines* (1999) Kluwer Law International, New York, USA.

Tang RYW *Intrafirm Trade and Global Transfer Pricing Regulations* (1997) Quorum Books, Westport.

Tang ZS *Electronic Consumer Contracts in the Conflict of Laws* Volume 1 (2009) Hart Publishing, Portland, USA.

Tanzi V *Globalisation, Technological, Developments and the Work of Fiscal Termites* (2000) IMF, Washington DC, USA.

Tassabehji R Applying *E-Commerce in Business* (2003) Sage Publications, London, UK.

Taylor P *Consolidated Financial Reporting* (1996) Paul Chapman Publishing Limited, London, UK.

Tegova *European Valuation Standards 2003* 5th edition (2014) Routledge Oxon, UK.

Terra BJM and Wattel PJ *European Tax Law* 4th edition (2005) Kluwer Law International, The Hague, the Netherlands.

Terterov M *Doing Business with Ukraine: A Guide to Investment Opportunities and Business Practice* 3rd edition (2005) GMB Publishing Ltd, London, UK.

Tiley J and Loutzenhiser G *Revenue Law: Introduction to UK Law, Income Tax, Capital Gains Tax, Inheritance Tax* 7th edition (2012) Hart Publishing Limited, Oxford, UK.

Timmons MB, Weiss RL, Callister JR, Loucks DP and Timmons JE *The Entrepreneurial Engineer: How to Create Value from Ideas* (2014) Cambridge University Press, New York, USA.

The World Trade Organization Secretariat *from GATT to the WTO: The Multilateral Trading System in the New Millennium* (2000) Kluwer Law International, The Hague, the Netherlands.

Thirsk WR *Tax Reform in Developing Countries* Volume 235 (1999) Washington DC, USA.

Thompson SC *US International Tax Planning and Policy: Including Cross-Border Mergers and Acquisitions* (2007) Carolina Academic Press, Durham, North Carolina, USA.

Thorson A *A Legal Guide to Doing Business in the Asia Pacific* (2010) American Bar Association, Chicago, USA.

Thuronyi V *Tax Law Design and Drafting* Volume 1(1996) International Monetary Fund Publication Services, Washington DC, USA.

Trebilcock MJ *Advanced Introduction to International Trade Law* (2015) Edward Elgar Publishing Cheltenham, England.

Truel C *A Short Guide to Customs Risk (2010)* Gower Publishing Limited, Surrey England.

United Nations *Improving Resource Mobilization in Developing Countries and Transition Economies (2002)* United Nations Publications, New York, USA.

United Nations *World Investment Report 2007 Transnational Corporations (2007)* United Nations, New York, USA.

United Nations *E-Commerce and Development Report 2002* (2002) UN Publishers, Washington DC, USA.

US Customs and Border Protection *Customs Valuation Encyclopedia* (2004) US Customs.

Vaidya AK *Globalization: Encyclopaedia of Trade, Labour and Politics* Volume 1 (2006) ABC Clio California, USA.

Valente P, Della Revere A and Schipani P *Analisi di Comparabilita nel Transfer Pricin*g (2013) Wolters Kluwer, Strada, Italy.

Van den Bossche P and Zdouc W *The Law of the World Trade Organisation: Texts, Cases and* Materials 3rd edition (2013) Cambridge University Press, New York, USA.

Van den Bossche P and Prevost D *Essentials of WTO Law* (2016) Cambridge University Press, Cambridge, UK

Van den Bossche P *The Law and Policy of the World Organisation: Text, Cases and Materials* 3rd edition (2013) Cambridge University Press, Cambridge, UK.

Van de Heerkamp A and Tusveld R *Origin Management: Rules of Origin in Free Trade Agreements* (2011) Springer-Verlag Berlin, Germany.

Van de Vijver A *The New US-Belgian Double Tax Treaty: A Belgian and EU Perspective* (2009) Group de Boeck, Brussels, Belgium.

Van Grasstek C *The History of the World Trade Organisation* (2013) World Trade Organisation, Geneva, Switzerland.

Van Hoose D *E-commerce Economics* 2nd edition (2011) Routledge, Oxon, United Kingdom.

Van Niekerk PG & Schulze WG *The South African Law of International Trade: Selected Topics* 2nd Ed (2006) SAGA Legal Publications, Pretoria South Africa.

Van K Raad *Model Income Tax Treaties* (1983) Springer Science + Business Media, The Hague, the Netherlands.

Vermulst EA *Customs and Trade Laws as Tools of Protection: Selected Essays* (2005) Cameron May LTD, London, England.

Vernon H and Wortzel LH *Global Strategic Management* (1991) John Wiley & Sons, New Jersey, USA.

Vlcek W *Offshore Finance and Small States: Sovereignty Size and Money* (2008) Palgrave Macmillan, New York, USA.

Vob S and Woodruff DL *Introduction to Computational Optimization Models for Production Planning in a Supply Chain* (2003) Springer Verlag Berlin Germany.

Vogel K *Interpretation of Tax Law and Treaties and Transfer Pricing in Japan and Germany* (1998) Kluwer Law International, The Hague, Netherlands.

Vogel K and Kirchhoff P *International and Comparative Taxation: Essays in Honour of Klaus Vogel* (2002) Kluwer Law International Ltd, London, the United Kingdom.

Waincymer J "The Australian Tax Avoidance Experience and Responses: A Critical Review" in GS Cooper *Tax Avoidance and the Rule of Law* (1997) International Bureau for Fiscal Documentation, Amsterdam.

Walden I & Hornle J *E-Commerce Law and Practice in Europe* (2001) Woodhead Publishing Limited, Cambridge, England.

Wallace CD *The Multinational Enterprise and Legal Control* (2002) Kluwer Law International, The Hague, the Netherlands.

Walker F *Double Taxation in the United States* (2004) The Lawbook Exchange, New Jersey, USA.

Walton P and Aerts W *Global Financial Accounting and Reporting: Principles and Analysis* (2008) Thomson Learning, London, UK.

Wankel C *Encyclopaedia of Business in Today's World* Volume 1 (2009) Sage Publications, California, USA.

Warren CS, Reeve JM and Duchac J *Financial and Management Accounting* (2008) South-Western Cengage Learning, Mason, USA.

Watson C *Watson's Tax Procedure and Tax Fraud in a Nutshell* 4th edition (2012) Thomson Reuters, ST Paul, Minnesota, USA.

Weber DM *European Direct Taxation: Case LAW and Regulation 2010* 2nd edition (2010) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Weber DM *Europe Direct Taxation: Case Law and Regulation* 2010 2nd edition (2010) Kluwer Law International Alphen aan den Rijn, the Netherlands.

Weber DM and Van Weeghel S The *2010 OECD Updates Model Tax Convention and Transfer Pricing Guidelines: A Critical Review* (2011) Kluwer Law International, Alphen aan den Rijn, the Netherlands.

Webley P *Tax Evasion: An Experimental Approach* (1991) Cambridge University Press, Cambridge, UK.

Wendt C *A Common Tax Base for Multinational Enterprises in the European Union* (2009) Springer Science + Business Media, Wiesbaden, Germany.

Weiner JM *Company Tax Reform in the European Union from the United States and Canada on Implementing Formulary Apportionment in the European Union* (2006) Springer Science + Business Media Inc, New York, USA.

Weinberg SL *Data Analysis for Behavioural Sciences Using SPSS* (2002) Cambridge University Press, West Street, New York, USA.

Wiegel DR *Foreign Direct Investment* (1997) International Finance Corporation, Washington DC, USA.

Wiegley RD & Levitin MJ *Export & Trade Finance* (2000) Oceana Publications, New York, USA.

Williams RC *Income Tax and Capital Gains Tax in South Africa: Law and Practice* 3rd edition (2001) Butterworth Publishers, Durban, South Africa.

Williams RC *Capital Gains Tax: A Practitioner's Manual* 2nd edition (2005) Juta & Co Ltd, Lansdowne, Cape Town, South Africa.

Williams R *Unjust Enrichment and Public Law: A Comparative Study of England, France and the EU* (2010) Hart Publishing, Portland, USA.

Wilson LD & Wilson RG *Going Concern Valuation* (2012) I Universe, Bloomington, USA.

Winters AP *International Economics* 4th edition (1999) Routledge, London, The United Kingdom.

Wittendorf J *Transfer Pricing and the Arm's Length Principle in International Tax Law* Volume 35 (2010) Kluwer Law International, Amsterdam, The Netherlands.

Wolfgang HM and Dallimore C *The Valuation of Goods for Customs* (2013) *Purposes* Springer-Verlag, Berlin Germany.

World Bank *The World Bank Legal Review: Law and Justice for Developme*nt Volume 1 (2003) The World Bank, Washington DC, USA.

World Bank Group *International Trade* (2001) World Bank Publications, Washington DC, USA.

World Trade Organisation *Dispute Settlement Reports* Volume XIII (2005) Cambridge University Press, New York, USA.

Wright KK *California Income Tax Manual* (2008) CCH Pearson Avenue, Chicago, USA.

Wundisch K *International Transfer Pricing in the Ethical Pharmaceutical Industry* 2nd edition (2003) *International Bureau of Fiscal Documentation*, Amsterdam, the Netherlands.

Yearwood RRF *The Interaction between World Trade Organisation (WTO) Law and External International Law* (2012), Routledge, Oxon, UK.

Yutaka K *Global Information Technology and Competitive Financial Alliances* (2006) Idea Group Publishing, Hershey, USA.

Zuckerman A and Bierderman D (1998) *Exporting and Importing, Negotiating Global Markets* Warren Gorham and Lamont, New York, USA.

Printed Articles

Abdallah WM & Maghrabi AS Do Multinational Companies have Effective Transfer Pricing Systems of Intangible Assets and e-Commerce? (2009) Vol 19 Iss: 2 International *Journal of Commerce and Management* 115-126.

Abdallah WM “How to Motivate and Evaluate Managers with International Transfer Pricing Systems” (1989) *Management International Review* 65-71.

Ackerman RE “Resolution of Transfer Pricing Disputes for Large & Small Businesses Using APAs (June 2000), Ernest and Young International Tax Services: Transfer Pricing” 1-9.

Ackerman A and Chorvat E “Modern Financial Theory and Transfer Pricing” (2002) Volume 10 Issue No 4 *George Mason Law Review* 637-674.

Allen S, Tomar R & Right DR “Comments on 2006 Annual Report on Advance Pricing Agreement Programme” (2007) Vol 14 Issue No 4 *International Transfer Pricing Journal* 257-260.

Allen S, Tomar R & Wright DR “Section 482 Service Regulations: Implications for Multinationals” *(2006)*, Volume 13 No 6 *International Transfer Pricing Journal* 279-290.

Avi-Yona RS “The Rise and Fall of Arm’s Length Principle: A Study in the Evolution of U.S. International Taxation” (2007) *University of Michigan Law School Scholarship Repository* 1-62*.*

Avi-Yona RS ‘Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation” (2010) Volume 2 No 1 *World Tax Journal* 3-18.

Baistrocchi E “The Transfer Pricing Problem: A Global Proposal for Simplification” (2006) Volume 51 Issue No 4 *Tax Lawyer* 943-980.

Baldenius T, Melumad ND and Riechelstein S “Integrating Managerial and Tax Objectives in Transfer Pricing” (2004) Volume 79 Number 3 *the Accounting Review*, 591-615.

Bateman CR, Herndon Jr. NC and Fraedrich JP “The Transfer Pricing Decision Process for Multinational Corporations"(1997) Volume 7 Issue No 3/4 *International Journal of Commerce and Management* 18 – 38.

Bartlesman EJ & Beetsma RMWJ, “Why Pay More?: Corporate Tax Avoidance Through Transfer Pricing in OECD Countries”, (2003) Volume 87 *Journal of Public Economics* 2225-2252.

Bernard JT and Weiner RJ Multinational Corporations, “Transfer Pricing and Taxes: Evidence from the US Petroleum Industry” (1990), *Chicago University Press* 123-154.

Boldman N “International Tax Avoidance” (1981) 35 *Bulletin For International Fiscal Documentation* 441-459.

Brauner Y “Transfer Pricing in BEPS: First Round –Business Interests Win but not in Knock Out” (2015) 43 *Intertax* 72-84.

Brinker E The Purpose Requirement of the General Anti- Avoidance Provision in South African Fiscal Law, *TSAR* 158-169.

Brodbeck J “A New Chapter in Transfer Pricing?” (2010) Vol 17 Issue No 4 *International Transfer Pricing Journal* 377-380.

Burke JJA “Re-Thinking First Principles of Transfer Pricing Rules” (2011) Volume 30 Issue No 3 *Virginia Tax Review* 613-620.

Cassidy J ‘The Holy Grail: The Search for the Optimal GAAR” (2009) Vol 26 Issue 4740 South *African Law Report 740*-779.

Campos G “Transfer Pricing for Major Trading Nations” (1996) 50 *Bulletin for International Fiscal Documentation* 212-222.

Chand V and Wagh S The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan (2014) *International Transfer Pricing Journal* 402-408.

Ching-Wen Lin Hsiao-Chen Chang Motives of Transfer Pricing Strategies – Systemic Analysis (2010) Vol. 110 Issue No 8 *Industrial Management & Data Systems* 1215 – 1233.

Clausing KA “Tax Motivated Transfer Pricing and US Intrafirm Prices” (2003) Volume 87 No’s 9&10, *Journal of Public Economics* 2207-2223.

Cools M, Emmanuel C and Jorissen A (2008)" Management Control in the Transfer Pricing Tax Compliant Multinational Enterprise" (2008) 33(6), *Accounting, Organizations and Society* 1-48.

Cottani G "Transfer Pricing" (2014) *IBFD* 1-183.

Cutler RH "Formulary Apportionment-is this Alternative to the Arm's Length Standard Possible and Practical under the United States' Current Tax Treaties (1997) Volume 3 Issue 3 *International Trade and Business Law Annual* 153-174.

Cravens KS "Examining the Role of Transfer Pricing as a strategy for Multinational Firms" (1997) Volume 6No 2 *International Business Review* 127-145.

Dasgupta J, Porta J & Right DR "An Assessment of APA Fee Increases" (2006) Vol 13 Issue No 3 *International Bureau of Fiscal Documentation* 158-161.

Dressel A & Goulder R, "IFA Asia Regional Conference Focuses on E-commerce and International Taxation" (2000) Vol no 21 *Tax Notes International 2331*-35.

Dunning, J.H. and Lundan, S.M. "Institutions and the OLI paradigm of the multinational enterprise", (2008) Vol. 25 No. 4, *Asia Pacific Journal of Management* 573-93.

Eden L "The Internalization Benefits of Transfer Price Manipulation" George Bush School of Government and Public Service (2003), *A&M University* 1-40.

Feinschreiber R and Kent M "What You Need to Know about OECD's Transactional Profit Split Methods" (2011) Volume 1 Issue No 5 *Corporate Business Taxation Monthly* 29-44.

Feinschreiber R and Kent M OECD Examines Intra-Group Service Arrangements Ordinarily (2011) Volume 13 Issue No 2 *Corporate Business Taxation Monthly* 23-44.

Fleming Jr JC, Peroni RJ, SE Shay SE "Formulary Apportionment in the US International Income Tax System: Putting Lipstick on a Pig?"(2014) Volume 36 Issue 1 *Michigan Journal of International Law* 1-57.

Forst DL, "Old and New Issues in Taxation of Electronic Commerce" (1999) Vol 14, No. 2 *Berkeley Technology Law Journal* 711-719.

Gavier PD and Pierola F "Related Parties and Customs Valuation: Guidance Derived from the Panel Report Thailand-Cigarettes" (2012) Volume 7 Issue 1 *Global Trade and Customs Journal* 7-13.

Gianni MB "Transfer Pricing and Formulary Apportionment" (1996) Volume 74 Taxes 169-182.

Grubert H & Mutti J "Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making" (1991) Vol. 73, No. 2 *The Review of Economics and Statistics* 285-293.

Hamaekers H "Arm's Length- How Long?" (March/ April 2001) 8 *International Transfer Pricing Journal* 30-41.

Hammer RM Will the Arm's Length Test stand the Test of Time? The Spectre of Apportionment (1996) 24 *Intertax* 2-5.

Hamel G and Prahalad C "Do You Really Have a Global Strategy? (1985) *Harvard Business Review* 139-148.

Hay D, Horner F & Owens J "Past and Present Work in the OECD on Transfer Pricing and Selected Issues (1994) 10 *Intertax* 423-439.

Hellerstein JR "The Basic Operations Independence Requirement of a Unitary Business: A Reply to Charles E McLure Jr" (1983) 18 *Tax Notes* 723-731.

Higginbotham & CW Yi "International Transfer Pricing: Practical Solutions for Intercompany Pricing-Part II" (2003) 29 *International Tax Journal* 1-23

Holtzman Y and Nagel P "An Introduction to Transfer Pricing" (2014) Volume 33 Issue No 1 *Journal of Management Development* 57-61.

Horak W "Transfer Pricing and Thin Capitalization (1995) 8 *SA Tax Review* 48-51.

Horner F & Owens J "Past and Present Work in the OECD on Transfer Pricing and Selected Issues" (1994) 10 *Intertax* 423-439.

Jones CS "Transfer Pricing and its Misuse: Some Further Considerations"(1981) Volume. 15 Issue No 7 European *Journal of Marketing* 43-51.

Joseph A "Transfer Pricing Comparability; Perspectives of OECD, Australia and United States" (2007) Vol 14 Issue No 2 *International Transfer Pricing Journal* 90-91.

Knowles LL and Mathur I "Designing International Transfer Pricing Systems"(1985) Volume 11 Issue No 2 *Managerial Finance* 21-24.

Kotarba CJ "Better than the Best: Transfer Pricing Methodology in the Wake of Roche" (2009) Volume 48 Issue No 1 *Columbia Journal of Transnational Law* 140-173.

Lermer D "Recent Developments in Transfer Pricing and Thin Capitalisation" (2011) Vol 18 Issue No 2 *International Transfer Pricing Journal* 149-155.

Lester EE “International Transfer Pricing Rules: Unconventional Wisdom” (1995) Volume 2 Issue No 283 *Journal of International and Comparative Law* 284-306.

Levey MM “Inbound Transfer Pricing” (1989) Volume 15 Issue No 2 *International Tax Journal* 107-140.

Lewis PG “What’s New? What’s Missing? The IRS Updates APA Procedures (JLU/Aug2004) *Tax Executive* 310-317.

Li J “Global Profit Split: An Evolutionary Approach to International Income Allocation” (2002) Volume 50 No 3 *Canadian Tax Journal* 823-883.

Lin TM, Chen YL and Lin B “A Research on Transfer Pricing Strategies and Management Performance of MNEs” (2010) Vol. 8 No. 2 *International Journal of Management and Enterprise Development* 117-34.

Lin CW and Chang HC "Motives of Transfer Pricing Strategies – Systemic Analysis"(2010) Volume 110 Issue No 8 *Industrial Management & Data Systems* 1215 – 1233.

Loof G *A Critical Analysis of the Requirements of the South African General Anti Avoidance (2013) Post Graduate Diploma Thesis, University of Cape Town 1-42.*

Lucas-Mas MO “Section 1059A: An Obstacle to Achieving Consistent Legislation?”(2008) Vol 15 Issue No 1 International *Transfer Pricing Journal* 3-13.

Manyaka PO “Prescriptiveness of the South African Transfer Pricing Tax Legislation in Providing Guidance on How to Transact at Arm’s Length” (2010) LLM Dissertation, University of the Witwatersrand 1-213.

McAlonan D et al *“Rev.Proc.2204-40: Streamlining the APA Process* (Nov 2004) 45 Tax Management Memorandum, Washington 437-453.

McLure Jr CE. “Opinion and Analysis: US Federal Use of Formula Apportionment to Tax Income from Intangibles” (1997) Vol 14 *Tax Notes International* 859-871.

Mehta N “Formulating an Intra-Group Management Fee Policy” (2005) Volume 12 No 5 *International Transfer Pricing Journal* 253 -274.

Milewska M & Hurtado de Mendoza M Increasing Importance of Intangible Assets and the Rise of Profit Split Methods (2010) volume 17, No 2 *International Transfer Pricing Journal* 160-165.

Miller K & Lermer D “Practical Application of Transactional Profit Methods” (2000) Vol 7 Issue No 5 *International Transfer Pricing Tax Journal* 193-197.

Miesel VH, HH Higinbotham CW Yi “International Transfer Pricing: Practical Solutions for Intercompany Pricing-Part II” (2003) Volume 29 Issue No 1 *International Tax Journal* 1-40.

Misey Jr RJ “A Primer on Transfer Pricing”(1999) Volume 77 Issue No 8 *Taxes-The Tax Magazine* 43-46.

Morse SC “Revisiting Global Formulary Apportionment”(2010) Volume 29 *Virginia Tax Review* 593-644.

Musgrave PB “Sovereignty Entitlement and Cooperation in International Taxation (2001) Volume 26 Issue No 4 *Brooklyn Journal of International Law* 1335-1345.

Nielsen SB, Raimondos-Moller P, Schjelderup G “Formula Apportionment and Transfer Pricing under Oligopolistic Competition” (2003) Volume 5 No 2 *Journal of Public Economic Theory*, 417-435.

Norregaard J & Khan TS “Tax Policy: Recent Trends and Coming Challenges” (2007) WP/07/274 *IMF Working Paper* 1-59.

OECD “Report of the Committee on Fiscal Affairs” Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations” (1994) 172 *Intertax* 318-330.

Oguttu AW “Curbing Thin Capitalization: A Comparative Overview with Reference to South Africa’s Approach –Challenges Posed by the Amended Section 31 of the Income Tax Act 1962” (2013) Vol 67 Issue No 6 *Bulletin for International Taxation* 311-326.

Oguttu AW “Resolving the Transfer Pricing Disputes: Are Advance Transfer Pricing Agreements the way Forward for South *Africa”* (2006) 18 *SA Mercantile Law Journal* 460-485.

Oguttu AW “Transfer Pricing and Tax Avoidance: Is the Arm’s Length Principle still relevant in the E-commerce era?” (2006) *18 SA Mercantile Law Journal 138-158.*

Oyelere PB and Turner JD, A Survey of Transfer Pricing Practices in UK Banks and Building Societies" (2000) Vol. 12 Issue No 2 *European Business Review* 93-99.

Oldman O and Brooks JJS "The Unitary Method and the Less Developed Countries: Preliminary Thoughts" (1987) Volume 45 Issue No 1 *International Business Law Journal* 45-62.

Olivier L "Tax Avoidance Options Available to the Commissioner for Inland Revenue" (1997) 4 *SA Law Journal* 1-3.

Ordower H "Utopian Visions Toward a Grand Unified Global Income Tax" (2013) Volume 14 Issue No 9 *Florida Tax Review* 361-418.

Osborne DA "Deterring Transfer Pricing Abuse: Changing Incentives as a Practical Alternative to a Global Tax Regime" (2011) Volume 10 Issue 4 *Washington University Global Studies Law Review* 813-836.

Owens J "Should the Arm's Length Principle Retire?" (2005) 12 *International Transfer Pricing Journal* 99-101.

Pantelidaki P, Opara P & Hickman "A CUPs and Profit Split: When and How to Use" (2011) *International Transfer Pricing Journal* 1-7.

Pastukhov O "International Taxation of Income Derived from Electronic Commerce: Current Problems and Possible Solutions" (2006) Vol 12 No 2 *Boston University Journal of Science & Technology Law* 256-277.

Pendse SJ International Transfer Pricing: A Review of Non-Tax Outlook (2012) Volume 37 *Procedia Social & Behavioural Sciences* 337-343.

Pfeiffer T, Schiller U and Wagner J Cost-based Transfer Pricing (2011) *Review Accounting Studies* 219-246.

Plasschaert SFR "The Multiple Motivations for Transfer Pricing Modulations in Multinational Enterprises and Governmental Counter Measures: An Attempt at Clarification" (1994) Volume 34 Issue No 1 *Management International Review* 36-50.

Prysuski M, Lalapet S and Swaneveld H "Transfer Pricing Method Selection in the United States and Canada" (2004) Volume 5 Issue *Corporate Business Taxation Monthly* 11 7-15.

Prysuski M "OECD Transfer Pricing of Intra-Group Services" (2005) Volume 6 Issue No 8 *Corporate Business Monthly* 21-28.

Rohde C & Rossing CP "Transfer Pricing" (2011) *Department of Accounting & Auditing Copenhagen Business School* 1-47

Roin J "Can the Income Tax be Saved? The Promise and Pitfalls Of Adopting Worldwide Formulary Apportionment (2008) Volume 61 *NYU Tax Law Review* 169-240.

Rosenberg JB, McLennan BN, Mohamed AH, McInnes AD "Transfer Pricing Comparability: Concepts, Methods and Applications" (2003) *Corporate Business & Taxation Monthly* 4-30.

Smallman A & Adrien H "Inter-Divisional Transfer Pricing" (1987) Volume 25 Issue No 2 *Management Decision* 27 – 30.

Toshio T "Japanese Transfer Pricing Taxation" (2008) Volume 34 Issue No 4 *International Tax Journal* 21-52.

Wilson P and E Coffill "Keeping Business at Arm's Length (1994) Volume 5 Issue 2 *International Tax Review* 22-27.

Rahmanov A Transfer Pricing (2015) Volume 2 Issue 1 *Baku State University Law Review* 107-117.

Read C and Gregoriou GN *International Taxation Handbook: Policy, Practice, Standards and Regulations* (2007) CIMA Publishing, Burlington, USA.

Right DR "Transfer Pricing in the United States: Recent Events and Expectations for the Future" (2001) Vol 55 Issue No 9 *International Bureau of Fiscal Documentation* 417-426.

Roseberg JB, McLennan BN, Mohamed AH & McInnes AD "Transfer Pricing Comparability: Concepts and Applications" (2003) Volume 5 Issue 3 *Corporate Business Taxation Monthly* 4-30.

Schwartz JS "Transfer Pricing and Electronic Commerce" (1999) *Bulletin for International Fiscal Documentation* 286-311.

Scott C, *OECD Unveils Progress Report on Harmful Tax Regimes (2004)*, 33 *Tax Notes International* 1151- 1153.

Sheng LF Wang and Chin Wang Y "Brand Proliferation and Inter-Brand Competition" (2016) Vol 35 Issue No 3, *Journal of Economic Studies* 278-292.

Sheppard LA "Is Transfer Pricing Worth Salvaging?" (2012) 65 *Tax Notes International* 467-476.

Spencer K & Kelleher M "Are Advance Pricing Agreements Binding Commitments?" (2013) Vol 20 Issue No 2 *International Transfer Pricing Journal* 116-119.

Stewart JC "Transfer pricing Some Empirical Evidence from Ireland" (2001) Volume 16 Number 3 *Journal of Economic Studies* 40-56.

Stotsky J & WoldeMariam A "Central American Tax Reform: Trends and Possibilities" (2007) WP/02/227 *IMF Working Paper* 1-41.

Surrey SS, Treasury's Need to Curb Tax Avoidance in Foreign Business Through the Use of 482*(1968)* 28 *Journal of Taxation* 75-79.

TEI "Comments on United Nations Transfer Pricing Manual" (2014) Volume 66 Issue No 2 *Tax Executive* 107-112.

Tremblay, R. and Suarez, S "The OECD discussion draft on transfer pricing aspects of business restructurings Canadian considerations" (2009), Vol. 38 No. 2,*Tax Management International Journal* 98-105.

Ting A "Multilateral Formulary Apportionment Model-A Reality Check" (2010) Volume 25 *Australian Tax Forum* 95-139.

Van Blerck M "Transfer Pricing and Thin Capitalization, the Basics" (1995) 8 *SA Tax Review* 41-49.

Wagenaar L "The Effects of the OECD Base Erosion and Profit Shifting Action Plan on Developing Countries" (2015) 69 *Bulletin for International Taxation* 84-92.

Warren N "Internet Challenge to Tax System Design" (2002) *International Taxation System* 61-82.

Weiner JM "It's Time to Adopt Formulary Apportionment" (2009) *Tax Analysts* 103-107.

Wilkie JS "Intangibles and Location Benefits -Customer Base" (2014) 68 *Bulletin for International Taxation* 352-360.

Wrappe SC, Milani K and Joy J "The Transfer Price is Right…or is it?" (1999) *Strategic Finance* 38-40.

Wright DR "Announcements and Report Concerning Advance Pricing Agreements: A Comment" (2001) Vol 8 Issue No 4 *International Transfer Pricing Journal* 111-115.

Yi CW *"International Transfer Pricing: Practical Solutions for Inter-Company Pricing Part II*" (2003) 29 *International Tax Journal* 1-23.

Yonah RS and Tittle MB "The New United States Model Income Tax Convention" (2007) *Bulletin for International Taxation* 224-234

Ziegler PA "Transfer Pricing: A problem Seeking Solution" (1989) Volume 6 Issue 4 *Australian Tax Forum* 455-494.

Zollo TM, Bowers CP, and Cowan Jr JP "Transfer Pricing for Services: The Next Wave (2003) Volume 81 Issue 3 *Taxes – The Tax Magazine* 17-402.

Electronic Articles

APA Critical Assumptions by Joseph P. Baniewicz available at https://www.irs.gov/pub/irs-apa/critical_assumptions.pdf accessed on the 04 February 2015.

Armitage J How does Facebook Avoid Paying Tax, and what will the Changes Mean? Available at http://www.independent.co.uk/news/business/news/how-does-facebook-avoid-paying-tax-and-what-will-the-changes-mean-a6912731.html accessed on the 27 January 2017.

Avi-Yonah RS, *Clausing KA*, *Durst MC* "Allocating Business Profits for Tax Purposes: A Proposal to Adopt A Formulary Profit Split". Available at http://www.sbs.ox.ac.uk/centres/tax/conferences/Documents accessed 29 May 2016.

Baniewicz JP APA Critical Assumptions available at https://www.irs.gov/pub/irs-apa/critical_assumptions.pdf accessed on the 04 February 2015.

Barford V & Holt G Google, Amazon, Starbucks: The Rise of 'Tax Shaming' available at http://www.bbc.com/news/magazine-20560359 accessed on the 26 January 2017.

BBC Starbucks 'paid just £8.6m UK tax in 14 years', available at http://www.bbc.com/news/business-19967397 accessed on the 27th January 2017.

Bloomberg BNA Transfer Pricing Forum Examines Treatment of Secret Comparables available at https://tax.thomsonreuters.com/blog/onesource/transfer-pricing-global-tax-compliance/bloomberg-bna-transfer-pricing-forum-examines-treatment-of-secret-comparables/. accessed on the 13 August 2016.

Bond-Graham D How Google Became one of America's Biggest Tax Dodgers, available at http://www.counterpunch.org/2014/01/07/how-google-become-one-of-americas-biggest-tax-dodgers/ accessed on the 26 January 2017.

Brodbeck J "Postponement of Amendments to the South African Transfer Pricing Legislation" (August 2011)."Available at http://www.ens.co.za/news/news_article.asp?iID=496&iType=4 accessed 30 September 2016.

Budget Speech 2010 at 15 available at http://www.treasury.gov.za/documents/national%20budget/2010/speech/speech2010.pdf accessed on the 30 May 2016.

Christian Aid in South Africa, available at http://www.christianaid.org.uk/whatwedo/africa/south_africa.aspx accessed 30 January 2017, accessed on the 30th January 2017.

Christian Aid 2009, The True Cost of Tax Dodging in Africa. Available at http://www.christianaid.org.uk/ActNow/trace-the-tax/resources/zambian-copper-tax.aspx. Accessed 30 January 2017.

Cristea AD and Nguyen DX "Transfer Pricing by Multinational Firms: New Evidence from Foreign Firm Ownerships" at 3. Available at http://pages.uoregon.edu/cristea/Research_files/transfprice.pdf accessed on the 19 March 2016.

Davids E & Ashleigh A "Mergers and Acquisitions Review" (2011) Available at http://www.bowman.co.za/FileBrowser/ArticleDocuments/Mergersand Acquisitions-Review-2012.pdf accessed 31 May 2016.

Davis Tax Committee Interim Report Addressing Base Erosion and Profit Shifting in South Africa at 29 available at http://www.taxcom.org.za/docs/New_Folder/2%20DTC%20BEPS%20Interim%20Report%20on%20Action%20Plan%201%20-%20Digital%20Economy,%202014%20deliverable.pdf accessed on the 02nd June 2016.

Dennis TJH **"**Unitary Formulary Apportionment as a Solution to the Conundrum of Source" Available at http://www.jmls.edu/academic/taxeb/pdf/Faherty_1pdf accessed 29 May 2015.

ENS The New South African Transfer Pricing Rules-Latest Development Available at https://www.ensafrica.com/news/the-new-South-African-transfer-pricing-rules-latest-developments?Id=563&STitle=tax%20ENSight accessed on the 10 May 2016.

Desai MA, Foley CF and Hines JR "Chains of Ownership, Tax Competition and Foreign Direct Investment at 26 available at http://dev.wcfia.harvard.edu/sites/default/files/578__Chains_of_Ownership.pdf accessed on the 11th April 2016.

Edward Nathan Sonnenbergs "International Tax: Transfer Pricing" (2010). Available at http://www.saica.co.za/integritax/2010/1901._transfer_pricing.htm accessed 11 September 2016.

Grassley C Press Release: Grassley, Baucus Launch Review of Whether Certain Multinationals Pay Fair Share of Taxes, Monday December 22, 2003 Available at http://grassley.senate.gov/releases/2003/p03r12-22.htm accessed on the 27 November 2015.

India Advance Pricing Agreements: Providing Transfer Pricing Certainty, available at http://www.ey.com/Publication/vwLUAssets/EY-India-Advance-PricingAgreements/$FILE/EY-India-Advance-Pricing-Agreements-providing-transfer-pricing-certainty.pdf, accessed on the 04th of February 2015.

Investopedia Double Irish with a Dutch Sandwich, available at http://www.investopedia.com/terms/d/double-irish-with-a-dutch-sandwich.asp#ixzz4Wxt0X4wM accessed on the 27 January 2016.

Katz Commission "The Interim Report of the Commission of Inquiry into Certain Tax Structures of South Africa" (1994). Available at http://www.info.gov.za/view/DownloadFileAction?id=70508 accessed on 20 June 2016.

KPMG "South Africa-Current Transfer Pricing Trends and Challenges" (August 2011). Available at http:// www.kpmg.com/global/en/issuesandinsights/articlespublications/taxnewsflash/pages/south-africa-transfer-pricing-trends.aspx accessed 26 October 2016.

Lent RN *New Importance for Section 482 of the Internal Revenue Code*, 7 Wm. & Mary L. Rev. 345 (1966) at 347, available at http://scholarship.law.wm.edu/wmlr/vol7/iss2/12, accessed on the 20th November 2016.

Murdoch C, *The Scope of the Power of the Internal Revenue Service to Reallocate Under Section 482*, 6 B.C.L. Rev. 717 (1965), available at http://lawdigitalcommons.bc.edu/bclr/vol6/iss4/2,acessed on the 17th December 2016.

Nielsen SB, Raimondos-Møller P and Schjelderup G ”Tax Spillovers under Separate Accounting and Formula Apportionment” at 13 available at http://www.nhh.no/Files/Filer/institutter/sam/Discussion%20papers/2001/dp09.pdf accessed on the 31 March 2016.

OECD BEPS ACTION 1: Address the Tax Challenges of the Digital Economy at 64-66 available at https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf accessed on the 05th July 2016.

OECD ACTION 1. Addressing the Tax Challenges of the Digital Economy. Available at http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf.accessed on the 18 October 2018.

OECD “Defining and Measuring Electronic Commerce: OECD Workshop on 21st April 1999” available on http://www1.oecd.org/dsti/sti/ec/act/agenda_ECworkshop.htm,acessed on the 24th July 2015.

OECD/G20 Base Erosion and Profit Shifting Project 2015 Final Reports, available at http://www.oecd.org/tax/beps/beps-actions.htm .accessed on the 10 October 2018.

OECD/G20 Base Erosion and Profit Shifting Project Executive Summaries 2015 Final Reports, available at http://www.oecd.org/ctp/beps-reports-2015-executive-summaries.pdf , accessed on the 16 October 2018.

OECD/G20 Base Erosion and Profit Shifting Project Aligning Transfer Pricing Outcomes with Value Creation, Actions 8 10 2015 Final Reports. Available at https://www.oecd-ilibrary.org/docserver/9789264241244en.pdf?expires=1541675938&id=id&accname=guest&checksum=8F176ED633E3AC54B3E821CC999A3323, accessed on the 21 October 2018.

OECD “Global Relations” Available at http://www.oecd.org/globalrelations/keypartners accessed 01 July 2016.

OECD Glossary of Statistical Terms. Available at http://stats.oecd.org/glossary/detail.asp?ID=4721 accessed on the 05 July 2016.

OECD Glossary of Statistical Terms available at http://www.oecd.org/ctp/glossaryoftaxterms.htm#T, accessed on the 29 October 2018.

OECD "History of the OECD", Available at www.oecd.org/.../03746,en_2649_201185_1876671_1_1_1_1,00 accessed May 2015.

OECD Implementation Issues for Taxation of Electronic Commerce at 3 available at http://www.oecd.org/tax/consumption/5594899.pdf accessed on the 05th of June 2016.

OECD "Report of the Committee on Fiscal Affairs Electronic Commerce: A Discussion Paper on Taxation Issues (1998) "Available at http://www.oecd.org/ctp/treaties/1923272.pdf, accessed on the 10 June 2016.

OECD "What is Thin Capitalisation" Available at http://www.oecd/ctp/tax-global/5%20Thin_Capitalization_Background.pdf accessed 3 June 2015.

Pak SJ & Zadnowicz S, U.S. Trade with the World: An Estimate of 2001 Lost U.S. Federal Income Tax Revenues Because of Over-Invoiced Imports and Under-Invoiced Exports 2-6 (2002), available at http://dorgan. senate.gov/newsroom/extras/pak-zdan.pdf accessed on the 2 December 2015.

OECD Report: Are the Current Treaty Rules for Taxing Business Appropriate for E-commerce at 59 available at http://www.oecd.org/ctp/treaties/35869032.pdf accessed on the 01 April 2016.

Press Release, Dep't of the Treasury, Internal Revenue Service (IRS), IRS Accepts Settlement Offer in Largest Transfer Pricing Dispute (Sept. 11, 2006), available at http://www.irs.gov/newsroom/article/0,,id=162359, 00.html, accessed on the 2 December 2015.

PWC "International Transfer Pricing" Available at http://www.pwc.com/gx/en/international-transfer-pricing/assets/united-states.pdf accessed 10 November 2016.

Report on Royal Commission on Taxation: Implications of the proposed tax reforms (1966) available at *https://books.google.co.za/books?id=B1VxenZtvU8C* accessed on the 06th January 2017.

Rose M and Labbé C Investigators Raid Google Paris HQ in Tax Evasion Inquiry, available at http://www.reuters.com/article/us-google-france-investigation-idUSKCN0YF1CV accessed on the 26 January 2017.

SAICA Transfer Pricing 2044, New Rules available at https://www.saica.co.za/integritax/2012/2044._New_rules.htm accessed on the 10th of May 2016.

SARS "Discussion Paper on a Proposed System for Advance Tax Rulings" (2003). Available at www.sars.gov.za/home.asp?pid=5981 accessed 20 January 2016.

SARS "Discussion Paper on Tax Avoidance" (November 2005). Available at www.sars.gov.za accessed 20 March 2016.

SARS Draft Interpretation Note "Determination of the Taxable Income of Certain Persons from International Transactions: Thin Capitalisation" (2013) at 3. Available at http://www.bdo.co.za/documents/Draft%20Interpretation%20Note%20-20%Thin20%Capitalisation.pdf accessed 27 June 2016.

SARS "Practice Note No 7: Determination of Taxable Income of Certain Persons from International Taxation". (August 1999). Available at http://www.ftomasek.com/pn0499.html accessed 20 March 2016.

SARS "Practice Note No 2: "Determination of Taxable Income where Financial Assistance has been granted by a Non-Resident of the Republic to a Resident of the Republic." (May 1996). Available at http//:www.acts.co.za/tax/pn_2 of 1999 accessed 20 March 2016.

Sheppard L "Transfer Pricing" (August 2012) Available at http://www.taxjustice.net/cms/front_content.php?idcatart=2&changelang=139 accessed 3 June 2013. The Katz Commission "The Interim Report of the Commission of Inquiry into Certain Tax Structures of South Africa." (1994). Available at http://www.info.gov.za/view/DownloadFileAction?id=70508 accessed 6 January 2015.

Substance over form Available at http://dictionary.cambridge.org/dictionary/english/substance-over-form accessed on the 12 January 2017.

Transfer Pricing Methods available at http://www.un.org/esa/ffd/tax/2011_TP/TP_Chapter5_Methods.pdf accessed on the 2nd of March 2016.

Troskie J & Buttrick D "SARS to Increase Tax Revenue from Transfer Pricing." (2009) Available at www.engineeringnews.co.za/.../sars-to-increase-tax-revenue-from-tra accessed 10 January 2016.

United Nations Practical Manual on Transfer Pricing for Developing Countries available at http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf accessed on the 06th of April 2016.

Van der Merwe C *Transfer Pricing and Exchange Control Approval (2009)*. Available from:https://taxmanagementconsulting.deloitte.co.za/upload/At%20arms 0length%20January%202009.pdf, accessed 16 March 2016.

Webber Wentzel "Changes to South African Transfer Pricing Legislation."(October 2010). Available at http://mailstreams.cambrient.com/mailstreams/admin/mailer_instance/view.jsp accessed 26 October 2015.

WTO Panel Report WT/DS371/R Thailand- Customs and Fiscal Measures on Cigarettes from the Philippines at paragraph 7.134, available at https://www.wto.org/english/tratop_e/dispu_e/371abr_e.pdf accessed on the 25th April 2016.

Table of Cases

Australia

FCT v Peabody (1994) 94 ATC

Palser v Grinling 1948 AC 291

R v Mears (1997) 37 ATR 321.

Canada

Canada v GlaxoSmithKline Inc. 2012 SCC 52, [2012] 3 S.C.R.3.

Smithkline Beecham Animal Health Inc. v Canada 2002 FCA 229(2002).

Stubart Investments Ltd. v. The Queen, [1984] 1 S.C.R 536, 84 D.T.C

Germany

Federal Fiscal Court decision of 17 October 2001, IR 103/00(BStb1 II 2004 171).

India

Ainthent Technologies Pvt Ltd (Delhi ITAT) (unreported).
Aztec Software and Technology Services Ltd v ACIT [2007] 294 ITR (AT) 32 (BANG) [SB].
Besix Kier Dabhol, SA v DDIT [131 ITD 299].
Cadell Weaving Mill Co. v. CIT [2011] 249 ITR.
Ceylon v. CIT (34 ITR 001).
Cheil Communication India Private Ltd v Assessee I.T.A. No. 5890/Del/2012.
CIT v Ajax Products (1965) (55 ITR 741).
CIT v. United Breweries [1973] 89 ITR 17.
CIT v. VRNM Subhiah Chettiar (1947) 15 ITR 502.
CIT v. Nandlal Gandalal (1960) 40 ITR 1 (SC).
CIT v. Quark Systems (P.) Ltd. [2010] 38 SOT 307/4 ITR (Trib.) 606/132 TTJ 1 (Chd.)(SB).
Coca-Cola India Inc v Assistant Commissioner of Income Tax CWP No 16681/2005.
Commissioner of Income Tax v Amadeus India Pvt Ltd ITA 938/2011.
Diageo India Pvt. Ltd v ACIT 47 SOT 252.
Director of Income Tax (International Taxation) v Morgan Stanley and Co Ltd [2007].
ED Sassoon India Pvt Ltd v CIT (26 ITR 27).
E-Gain Communication (P) Ltd. vs. ITO: 118 TTJ 354.
Income Tax Officer v Right Florists Pvt Ltd I.T.A. No.: 1336/Kol/2011.
Kaybee Private Limited v Assessee ITA No 3749/Mum/2014.
KR Motilal v CIT (1999) (240 ITR 810) (Mad).
LG Electronics India Pvt. Ltd v Assesee ITA5140/Del/2001.
Mangal Chand Tubes Pvt. Ltd v CIT (1994) 208 ITR 729 (Raj).
Mentor Graphics (Noida) (P) Ltd v DCT 109 ITD.
M/s. Bharti Airtel Limited v Assesee ITA No 80to 83/coch/2013.

M/s Visual Graphics Computing Services (India) Pvt. Ltd vs. ACIT (2012-TII-55-ITAT-MAD-TP).
Perot Systems TSI (India) Limited v DCIT, ITA No.2320, 2321 & 2322/Del/2008.
Ranbaxy Laboratories Limited v Commissioner of Income Tax [2008] 114 TTJ 1(Del) 110: ITD 428.
Sapient Corporation (P.) Ltd. v. Dy. CIT [2011] 11 taxmann.com 69 (Delhi – ITAT).
Serdia Pharmaceutical v Assesee ITA No 2469/Mum/2006.
Sony India v. Dy. CIT [2008] 114 ITD 448 (Delhi).
Swarnandhara IJMII Integrated Township Development Co. Pvt. Ltd v. DCIT (ITANo.53/Hyd/2014.
Vodafone India Services Private Limited v. UOI (WP No.871 of 2014, Bombay HC).

South Africa

Cape Brandy Syndicate v CIR 1921) 12 TC 358 1KB 64.
CIR v Conhage (19990(40) SA 1194 SCA.
CIR v Estate Kohler and Others 1953 (2) SA 584.
CIR v King 1947(2) SA 196 A.
CIR v Estate Kohler and Others 1953(2) SA 584 (A)
CIR v Lever Brothers & Unilever Ltd 1946 AD 441.
CIR v Nemojim (Pty) Ltd 1983 (4) SA 935 (A), 45 SATC 241
CIR v Sunnyside Centre Pty Ltd 1997(1) SA.
Crookes Brothers Limited v Commissioner for the South African Revenue Service [2018] ZAGPHC 311.
Hicklin v SIR 1980(1) SA 481 (A), 41 SATC 179
ITC 1178(1972) 35 SATC 29 (C) 33
ITC 1496(1990) 53 SATC 229(T)
ITC 1675 (1998) 62, SATC 219
Johannesburg Tax Court Case No 12262
Kerguelen Sealing & Whaling Co., Ltd v CIR, 1939 AD 487, 10 SATC: 363).
7095/2008,4-6-2009)
Mankayi v AngloGold Ashanti Limited 2011 (3) SA 237 (CC).
Meyerowitz v CIR 1963 (3) SA 863 (A), 25 SATC 287
SBI v Lourens Erasmus (Edms) Bpk 1966(4) SA 434(A) 28 SATC 233.

SIR v Downing 1975 (4) SA 518 (A).

SIR v Geutstyn Forsyth and Joubert.

SIR v Hicklin 1980 (1) SA 481(A), 41 SATC.

United Kingdom

Ayrshire Pullman Motors Services and DM Ritchie v IRC (1929)14 TC 75

CIR v Willoughby[1997] 4 All ER 65.

DSG Retail Limited v HMRC [2009] STC (SCD) 397

Limited v HMRC [2009] STC (SCD) 397.

Levene v IRC [1928] AC 21.

Salomon v Salomon & Co Ltd [1897] AC 22.

United States

Bausch & Lomb, Inc. v. Commissioner, 933f2d 1984(2nd Cir.1991).

Cedar Valley Distillery, Inc. v Commissioner 16 T.C. 870 (1951).

Commissioner v. Smith, 285 F.2d 91, 95 (5th Cir. 1960).

Dallas Ceramic Co.v. United States, 598 F.2d 1382(5th Cir.1979)

DHL Corp. v. Commissioner, 285 F.3d 1210(9th Cir 2002).

Fegan v Commissioner, 71TC 791(1979).

Gregory v Helvering 69 F2d 809(1934).

Hall v Commissioner, 294 F.2d 82(5th Cir.1961).

United States v Isham 84 U.S. (17Wall) 496 (1873).

U.S. Steel Corp v Commissioner, 617F.2d 942 (2nd Cir.1980)

Oil Base, Inc v Commissioner, 362 F.d 212,214(9th Circuit 1966).

Pauline W. Ach, 42 T.C. 114, 125 (1964).

Polak's Frutal Works, Inc v Commissioner 21 TC 953(1954).

Smith-Bridgman & Co v Commissioner 16 T.C. 287 (1951).

South Tex. Rice Warehouse Co. v Commissioner 43 T.C. No. 44 (Jan. 29, 1965).

Sundstrand Corporation v Commissioner 199/91

Vesty's (Lord) Executors v IRC (1949) 1 All ER 1108(HL).
Whipple v Commissioner, 373 US 193(1963).
Xilinx, Inc. v Commissioner, 567 F.3d 482 (9th Circuit 2009).

Legislation

Australia
Taxation Administration Act of 1953.

Canada
Income Tax Act of 1985.

India
Income Tax of 1961
Finance Act of 2012

South Africa
Currency and Exchanges Act 9 of 1933.
Electronic Communications and Transactions Act 25 Of 2002.
Explanatory Memorandum to the Taxation Laws Amendment Bill of 2010.
Income Tax Act 31 of 1941.
Income Tax Act 58 of 1962 (as amended).
Tax Administration Act 28 of 2011.
Taxation Laws Amendment Act 7 of 2010.
Taxation Law Amendment Act 24 of 2011.

United States
General Explanation of the Tax Reform Act of 1986.
Internal Revenue Code of 1986.
IRS Revenue Proclamation 2006-1.
IRS Revenue Proclamation 2006-09.
The Omnibus Budget Reconciliation Act of 1990.

The War Revenue Act of 1917.