

# Transfer Pricing Adjustments: The Different Types, Practical Challenges and Recommended Approaches—A South African Perspective

**Annet Oguttu**

<https://orcid.org.0000-0003-1795-6669>

Department of Taxation, Faculty of Economic and Management Sciences  
Employment

University of Pretoria

[annet.oguttu@up.ac.za](mailto:annet.oguttu@up.ac.za)

## Abstract

This article concerns the tax policy and practical challenges that arise from applying the various transfer pricing adjustments. The lack of clear international guidelines on how to address some issues regarding transfer pricing adjustments and the diverging policy positions that some countries have taken, pose uncertainties for taxpayers and tax disputes which can impede international trade. These challenges are addressed in the article by focusing on the South African position and providing recommendations on how to resolve some of them. The explanation of the murky issues regarding transfer pricing adjustments will be found instrumental for developing countries where the legislation, administration and practice of transfer pricing are not yet well developed. The article's focus is on South Africa, an emerging economy on the African continent, which is used as a base for many MNEs that invest in the rest of Africa. It will be useful for foreign investors to gain an understanding of South Africa's position on transfer pricing adjustments.

**Keywords:** Transfer pricing; primary adjustments; secondary adjustments; corresponding adjustments; economic double taxation; mutual agreement procedure

## Introduction

‘Transfer pricing’ is a general term used for the pricing of cross-border, intra-firm transactions between associated or related businesses, such as multinational enterprises (MNEs).<sup>1</sup> Associated enterprises often manipulate transfer prices in the network of internal payments of goods and services they supply to each other,<sup>2</sup> since such prices are not negotiated in a free and open market.<sup>3</sup> Countries often enact transfer pricing legislation to ensure that the prices charged by associated enterprises do not deviate from normal market prices (arm’s length prices).<sup>4</sup> However, the process of finding arm’s length prices is generally complex.<sup>5</sup> Transfer pricing is one of the main contentious international tax issues that is at the centre of competing tax policy objectives of three parties: the revenue-maximising objective of domestic tax authorities, the revenue-maximising objectives of foreign tax authorities, and the tax-minimising objectives of taxpayers.<sup>6</sup> This is because, transfer pricing is not an exact science, it requires the exercise of judgment and interpretation of facts by tax administrations and taxpayers when analysing a company’s transfer pricing position.<sup>7</sup> Given the uncertainty in an enterprise’s ability to sustain its transfer-pricing positions, transfer pricing often puts MNEs in an uncertain tax position, particularly when ‘transfer pricing adjustments’ impact on the profits of associated enterprises.<sup>8</sup> However, the process of carrying out appropriate adjustments can be quite complicated, unclear and contentious. Clarity on these matters and the effective resolution of the inevitable tax disputes is very important for MNEs for which transfer pricing adjustments pose some of most costly audit experiences. Such clarity is equally important for countries which have increased their scrutiny of transfer pricing issues when faced with the risks of tax base erosion and profit shifting (BEPS).<sup>9</sup>

- 
- 1 UN, *Practical Manual on Transfer Pricing for Developing Countries* (New York, UN 2017) para B.1.1.6.
  - 2 Sylvain RF Plasschaert, *Transfer Pricing and Multinational Cooperation: An Overview of Concepts, Mechanisms and Regulations* (Farnborough, Saxon House 1979) 4.
  - 3 Diane Hay, Francis Horner and Jeffrey Owens, ‘Past and Present Work in the OECD on Transfer Pricing and Selected Issues’ (1994) *Intertax* 424.
  - 4 Brian Arnold and Michael J Mclntyre, *International Tax Primer* (The Hague, Kluwer Law International 2002) 55; OECD, *Issues in International Taxation No 2 Thin Capitalisation: Taxation of Entertainers, Artists and Sportsmen* (OECD Publishing 1987) 17.
  - 5 SARS, ‘Practice Note: No 7 Section 31 of the Income Tax Act 1962: Determination of Taxable Income of Certain Persons from International Taxation: Transfer Pricing’ (6 August 1999) para 11.1.1.
  - 6 John Mckinley and John Owsley, ‘Transfer Pricing and its Effect on Financial Reporting’ (1 October 2013) *Journal of Accountancy* para 1. <<https://www.journalofaccountancy.com/issues/2013/oct/20137721.html>> accessed 24 March 2023.
  - 7 SARS ‘Practice Note’ (n 5) para 7.6; OECD, ‘Review of Comparability and of Profit Methods: Revision of Chapters I-III of The Transfer Pricing Guidelines’ (2010) para 1.13 <<http://www.oecd.org/tax/transfer-pricing/45763692.pdf>> accessed 5 November 2018.
  - 8 OECD, ‘Model Tax Convention on Income and on Capital’ (Commentary on Article 9) (2017) para 2 (hereinafter OECD MTC).
  - 9 OECD/G20 BEPS Project *Aligning Transfer Pricing Outcomes with Value Creation: Actions 8-10* (2015 OECD Publishing) 9.

This article addresses the following tax policy and practical problems regarding transfer pricing adjustments:

- The main cause of uncertainties and disputes regarding whether transfer pricing adjustments have been carried out appropriately, emanates from conceptual misunderstandings of the three types of transfer pricing adjustments (i.e. primary, secondary and corresponding adjustments).
- These conceptual misunderstandings are compounded by the fact that some countries question the policy rationale of granting some adjustments and in practice, some tax administrations extend the boundaries of how some adjustments are carried out.
- These matters are further compounded by the fact that in certain situations, there is no clear international guidance on how to address these challenges. Thus, countries have adopted different approaches of addressing them, which creates further uncertainties and tax disputes due to the potential for double taxation.

The purpose of this article is to:

- Clarify the conceptual misunderstanding of the above-mentioned transfer pricing adjustments, by making it clear that they are not linked (even though they all derive from transfer pricing issues). The only commonality between them is the term 'adjustments.' The role and purpose of each of these adjustments is explained by contextualising why and how they arise, thereby clarifying their often-misunderstood policy rationale.
- The author also discusses the international guidance in addressing the various challenges of the different transfer pricing adjustments, while pointing to the gaps in such guidance.
- In the absence of clear international guidance, the practices applied by some countries in addressing the challenges and uncertainties that diverging approaches pose for taxpayers are set out. Since transfer pricing is international in nature, examples are given of diverging approaches from a broad range of countries, as MNEs can have associated enterprises in any country in the world.<sup>10</sup> The examples will be found instructive for taxpayers and tax authorities globally in developing a general understanding of the various approaches countries take on transfer pricing adjustment issues, for which there is no clear international guidance. Special focus is, however, placed on the legal and administrative practices on transfer pricing adjustments in South Africa which will be beneficial for MNEs based in South Africa or those based elsewhere that have associated enterprises in South Africa.

The explanation of the murky issues regarding transfer pricing adjustments, the discussion of the various challenges that arise and the recommendations provided will be found especially instrumental for tax administrators, tax policy makers, tax practitioners, researchers and academics in developing countries where the legislation,

---

<sup>10</sup> Mckinley and Owsley (n 6) 7.

administration and practice of transfer pricing are not yet well developed. The article is focused on South Africa, an emerging economy on the African continent, which is a base for many MNEs that invest in Africa.<sup>11</sup> It could be useful for foreign investors in understanding South Africa's position on the transfer pricing adjustments and how this could impact their finances.

## Primary Adjustments

### Contextualising Why and How Primary Adjustments Arise

The first category of transfer pricing adjustments is 'primary adjustments.' As indicated above, when associated enterprises manipulate the transfer prices of the goods and services they supply to one another, countries normally enact transfer pricing legislation to ensure that the prices charged are at arm's length, in that they should not deviate from normal market prices charged by independent enterprises participating in similar transactions, conditions and economic circumstances.<sup>12</sup> The Organisation for Economic Co-operation and Development (OECD) explains that associated enterprises, are those where 'same persons participate directly or indirectly in the management, control or capital of both enterprises,' in that both enterprises are under common control.<sup>13</sup> Internationally, countries apply the OECD 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (OECD TPG),<sup>14</sup> which set out certain transfer pricing methods<sup>15</sup> to establish whether the conditions imposed in the commercial or financial relations between associated enterprises are consistent with the arm's length principle. Although the OECD TPGs are not binding on non-OECD member countries, they have become a globally accepted standard that is applied internationally in order to ensure proper allocation of taxing rights among the jurisdictions a MNE operates.<sup>16</sup> The United Nations also developed a *Practical Manual on Transfer Pricing (UN Practical Manual)*,<sup>17</sup> which is instrumental in addressing transfer pricing issues from a developing country perspective.

When applying the transfer pricing methods, taxpayers are required to carry out a 'comparability analysis' (discussed fully in 2.1.2 ahead) by comparing a controlled

---

11 Annet Oguttu, 'Developing South Africa as a Gateway for Foreign Investment in Africa: A Critique of South Africa's Headquarter Company Regime' (2011) 36 SAYIL 61–93.

12 Arnold and Mclntyre (n 4) 55.

13 OECD, 'Glossary of Terms' <<https://www.oecd.org/ctp/glossaryoftaxterms.htm>> accessed 15 November 2022; Brian J Arnold, *International Tax Primer* (3rd edn, Wolters Kluwer 2016) 106.

14 OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations Paris*, (OECD Publishing 2017) para 2.1 (herein after OECD TPG).

15 The 'comparable uncontrolled price' method, the 'resale price method', the 'cost plus method' and the 'profit split method'. Details on the operation of these methods are set out in OECD TPG (n 11) Ch II. These methods are also applied in the UN, *Practical Manual* (n 1) B 4.1.1.

16 Annet Oguttu, 'Challenges of Applying the Comparability Analysis in Curtailing Transfer Pricing: Evaluating the Suitability of Some Alternative Approaches in Africa' (2020) *Intertax* 48(1) 83.

17 UN, *Practical Manual* (n 1).

transaction between two associated enterprises<sup>18</sup> and an uncontrolled transaction between two independent parties.<sup>19</sup> Essentially this is an external comparable but internal comparable can also be applied. Where the comparability analysis shows that the prices charged are not at arm's length, then countries are entitled to carry out a 'primary adjustment' on the price charged so that it corresponds with an arm's length price. A 'primary adjustment' is defined in the OECD TPG 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.'<sup>20</sup>

The concept of 'primary adjustments' was first introduced in double tax agreements (DTAs) under Article 5 of the 1933 League of Nations Model, which referred to the arm's length principle as follows:

When an enterprise of one contracting State has a dominant participation in the management or capital of an enterprise of another contracting State, or when both enterprises are owned or controlled by the same interests, and as the result of such situation there exists, in their commercial or financial relations, conditions different from those which would have been made between independent enterprises, any item of profit or loss which should normally have appeared in the accounts of one enterprise, but which has been, in this manner, diverted to the other enterprise, shall be entered in the accounts of such former enterprise, subject to the rights of appeal allowed under the law of the State of such enterprise.<sup>21</sup>

Although this initial article alluded to the arm's length principle, it did not specifically use the words primary adjustment. The phrase 'subject to the rights of appeal allowed under the law of the State of such enterprise' indicated that domestic law had to be referred to, to ensure an arm's length price. Currently, the arm's length principle as imbedded in Article 9(1) of the OECD Model Tax Convention on Income and on Capital (OECD MTC), that provides:

where 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.<sup>22</sup>

---

18 OECD TPG (n 14) Glossary 24.

19 *ibid* Glossary 25, 31.

20 *ibid* Glossary 28.

21 League of Nations Taxation of Foreign and National Enterprises: Vol IV, Methods of Allocating Taxable Income Document No C425(b) M 217(b)1933.II.A (1933); Jens Wittendorf, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (Kluwer Law International 2010) 213; Ramon SJ Dwarkasing, 'Associated Enterprises: A Concept Essential for the Application of the Arm's Length Principle and Transfer Pricing' (LLD dissertation, Tilburg University 2011) 77.

22 OECD MTC (n 8) Art 9(1).

Article 9(1) is intended to place associated and independent enterprises on an equal footing for tax purposes, thereby eliminating any economic distortions that differential tax treatment may create.<sup>23</sup> Thus in terms of the OECD TPG, ‘two enterprises are associated enterprises with respect to each other if one of the enterprises meets the conditions of article 9(1) of the OECD MTC with respect to the other enterprise.’<sup>24</sup> Article 9(1) is not self-supporting, it depends on the domestic law of the treaty partners for its application since tax is levied at domestic level.<sup>25</sup> Article 9(1) permits national tax authorities to make an adjustment to the profits of one enterprise where the terms of transactions between associated enterprises differ from terms that would be agreed between unrelated enterprises in similar circumstances.<sup>26</sup> Thus, ‘the taxation authorities of a Contracting State may, for the purpose of calculating tax liabilities of associated enterprises, re-write the accounts of the enterprises if, as a result of the special relations between the enterprises, the accounts do not show the true taxable profits arising in that State.’<sup>27</sup> Thus the taxable income between two related parties is adjusted to more accurately reflect the income earned by each party.

Example: Assume that a South African company had provided services to a foreign related party and had not charged for those services. Thereafter, it is determined that the value of those services, during a specific tax year, was one million Rand. The South African taxpayer would be required to make a primary adjustment of one million Rand, which would result in additional taxable income of that amount. Although it is appropriate that a primary adjustment should be sanctioned in such circumstances, it should only apply ‘if there are special conditions that have been made or imposed between the enterprises.’<sup>28</sup> No adjustment or ‘re-writing of the accounts of the associated enterprises is authorised if the transactions between such enterprises have taken place on normal open market commercial terms (on an arm’s length basis).’<sup>29</sup>

---

23 Victor H Miesel, Harlow H Higinbotham and Chun W Yi ‘International Transfer Pricing: Practical Solutions for Inter-Company Pricing – Part II’ (2003) 29 *International Tax Journal* 2.

24 OECD TPG n 14 Glossary 23.

25 G Cottani, ‘Transfer Pricing, Topical Analyses’ (2016) *IBFD* 42.

26 UN, *Practical Manual* (n 1) para A.4.6; see also Radhakishan Rawal, *Radhakishan Rawal’s Analysis of the Finance Acts of 2019 and More* (Bloomberg Publishing 2019) para 7.4.2; Andersen Tax, ‘Review of Transfer Pricing Development in Africa: A Study of Key Sub-Saharan African Countries’ 32–33

<[https://andersentax.ng/docs/review\\_of\\_transfer\\_pricing\\_development\\_in\\_africa\\_10042019.pdf](https://andersentax.ng/docs/review_of_transfer_pricing_development_in_africa_10042019.pdf)> accessed 25 September 2020.

27 OECD MTC (n 8) para 2; George Kofler, ‘Article 9: Associated Enterprises’ in Ekkehart Reimer and Alexander Rust (eds), *Klaus Vogel on Double Taxation Conventions* (Kluwer Law International 2015) 579 et seq.

28 OECD MTC (n 8) para 2.

29 *ibid.* See also Cottani n 25, 52.

*The Legal Basis for Primary Adjustments in South Africa*

In South Africa, the arm's length principle is set out in section 31 of the Income Tax Act.<sup>30</sup> Although this Act does not explicitly provide for the application of the OECD TPG and although South Africa is not an OECD member country, South African Revenue Service's (SARS) Practice Note 7, refers to the application of the transfer pricing methods used in the OECD TPG when determining an arm's length price.<sup>31</sup> Although Practice Note 7 does not constitute legislation or a regulation, and is therefore not legally binding,<sup>32</sup> it provides broad guidelines to taxpayers 'about the business and economic concepts which serve to indicate what information, data and other evidence would support a contention that a transaction has occurred at arm's length.'<sup>33</sup> SARS has indicated that in determining whether relevant transactions satisfy the arm's length principle, it will be guided by the OECD TPG and the UN Practical Manual.<sup>34</sup> Section 31(2) of the Income Tax Act provides for the primary adjustment in that where any transaction, operation, scheme, agreement or understanding constitutes an 'affected transaction,' any term or condition thereof results or will result in a tax benefit for a party to that transaction, the taxable income of that person must be calculated as if that transaction had been entered into in an arm's length dealing. 'Affected transactions' essentially comprise transactions between residents and non-residents who are connected persons or associated enterprises in relation to one another. Section 31 defines the term 'associated enterprises' as contemplated in Article 9 of the OECD MTC (as defined above).<sup>35</sup> Section 31(2) essentially gives SARS the power to effect an upward adjustment to the taxable income of the taxpayer which invariably results in additional taxable income.

The legal basis of primary adjustments was ruled upon in 2021 case of *ABC (Pty) Ltd v Commissioner: SARS*.<sup>36</sup> The facts of the case are: ABC, a company incorporated in South Africa, was in the business of manufacturing and selling catalysts which are used in the decrease of harmful exhaust emissions from motor vehicles. To produce the catalysts, ABC purchased some Precious Group of Metals (PGMs) from a connected Swiss entity, after which the catalysts were sold to customers in South Africa, known as the original equipment manufacturers (OEMs). In 2014, SARS carried out an audit of ABC's transactions for the 2011 year of assessment and it transpired that ABC Ltd had not tested whether the transfer prices of the transactions involving the purchase of the PGMs from the Swiss entity were in line with the arm's length standard. SARS raised an additional assessment on ABC's taxable income by effecting an upward

---

30 Income Tax Act 58 of 1968.

31 SARS Practice Note 7 (n 5) para 9.2.

32 ITC 167, 62 SATC 219.

33 SARS Practice Note 7 (n 5) para 7.5.

34 SARS 'Guide on Mutual Agreement Procedures – Issue 3' (20 March 2020 SARS) para 2.1.3.

35 The definition of the term 'associated enterprises' was inserted in the Income Tax Act by s 37 (1) (b) of Taxation Laws Amendment Act 34 of 2019, effective from 1 January 2022 and applicable in respect of years of assessment commencing on or after that date.

36 *ABC (Pty) Ltd v Commissioner: SARS* (IT 14305) [2021] ZATC 1.

adjustment which resulted in an increase in ABC's taxable income for the 2011 year of assessment. ABC appealed the additional assessment arguing that section 31(2) only permitted SARS to adjust the arm's length price for the purchase and supply of PGMs and not to adjust the price paid between ABC and third parties. ABC argued that the transactions involving the PGMs had no transfer pricing implications as they were 'flow through transactions,' which did not require testing for the arm's length standard. SARS argued that section 31(2) required a factual analysis which commences with a determination as to whether the transaction between ABC and the Swiss entity was at arm's length, which included the transactions involving the PGMs. Deciding in favour of SARS, the court ruled that SARS could only determine the correct manner of effecting the adjustment once it had determined whether the transactions between ABC and the Swiss entity were at arm's length. Therefore, SARS was empowered under section 31(2), to consider whether the PGM transactions were at arm's length. This case illustrates the circumstances that SARS takes into account when testing the arm's length compliance of a transaction, before it effects a primary adjustment.

Although primary adjustments can be applied to prevent tax avoidance, the UN Practical Manual cautions against an implicit assumption by tax authorities that there is profit manipulation simply because a primary adjustment is made to approximate to the arm's length transaction, as a primary adjustment may arise irrespective of the contractual terms between the entities.<sup>37</sup> In South Africa, the transfer pricing provisions apply, irrespective of a tax avoidance motive. Section 31 of the Income Tax Act which is entitled: 'Tax payable in respect of international transactions to be based on arm's length principle,' requires that taxpayers account for transfer pricing on an arm's length basis, without intervention from SARS.

### *The Importance of Carrying out Comparability Analysis to Ensure Effective Primary Adjustments*

As mentioned above, taxpayers are required to carry out a comparability analysis in order to determine an arm's length price. The basic approach of the 'comparability analysis' is that the conditions of controlled transactions among associated parties are compared to those which would have applied between independent enterprises carrying on uncontrolled comparable transactions in comparable circumstances.<sup>38</sup> This requires identifying certain comparability factors that can have an impact on the commercial transactions between associated entities in order to accurately delineate the transaction in issue.<sup>39</sup> The OECD TPG provides for five comparability factors that could be considered: the characteristics of the property or service; the functions performed (taking into account the risks assumed by each party and the assets used); the contractual terms; the economic circumstances and market conditions; and the business strategies.<sup>40</sup>

---

37 UN, *Practical Manual* (n 1) para B.1.4.11.

38 OECD TPG (n 14) para 1.33.

39 *ibid* para 1.35.

40 *ibid* 1.36; SARS Practice Note 7 (n 5) para 8.1.6



These factors depend very heavily on the facts and circumstances of each case. As a general rule, the taxpayer has to select a ‘tested party’ to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found.<sup>41</sup> South Africa’s transfer pricing legislation does not contain a specific provision on comparability analysis or comparability adjustments. However, they are referred to in SARS Practice Note 7 which follows the OECD TPG.<sup>42</sup> SARS indicates that in the light of the difficulties in obtaining local comparables, use of foreign country comparables (for example: data from the Australian, United Kingdom and United States markets) in taxpayers’ transfer pricing, analyses is often permitted. However, taxpayers would have to assess the impact of geographic differences on the price and exercise caution to ensure that appropriate adjustments reflect differences between the South African and foreign markets.<sup>43</sup> Where taxpayers fail to carry out a proper comparability analysis this can pose risks to primary adjustments, as illustrated by the South African case of *ABC (Pty) Ltd v Commissioner: SARS*,<sup>44</sup> discussed above.

### *Comparability Adjustments*

The concept of ‘comparability adjustments’ (despite the use of the word adjustments) is not a separate category of transfer pricing adjustments but it is part of the process of carrying out primary adjustments. Once suitable comparables have been obtained, an arm’s length price can be determined. Controlled and uncontrolled transactions are comparable if there are no differences between the transactions being compared that could materially affect the price, otherwise, reasonable adjustments may have to be made by the taxpayer to eliminate the effects of such differences.<sup>45</sup> Adjustments could thus be made to cater for differences such as financing costs, payment terms, working capital, contract terms, market conditions, currency exchanges, levels of risk and purchase volumes. These adjustments are referred to as ‘comparability adjustments,’ and they are normally made to the final set of comparables in order to increase the accuracy and reliability of applying the arm’s length principle.<sup>46</sup> The resultant arm’s length price may not necessarily constitute a single price but it may be a range of prices, depending on the facts of each case. Where the range comprises relatively equal results, any point within that range, may constitute an arm’s length price but where the range includes a sizeable number of results, the interquartile range (values between the 25th and 75th percentile) is applied to enhance the reliability of the analysis.<sup>47</sup>

The question as to whether ‘comparability adjustments’ should be performed (and if so, what adjustments should be performed) in a particular case, is a matter of judgment that should be evaluated by the taxpayer. In general, if the price of the controlled transaction

---

41 *ibid* para 3.18.

42 SARS Practice Note 7 (n 5) paras 7.7, 8.1.6.

43 *ibid* para 11.2.3–11.2.3.

44 *ABC (Pty) Ltd v Commissioner: SARS* (IT 14305) [2021] ZATC 1.

45 OECD TPG (n 14) para 3.1.

46 *ibid* para 3.2.

47 UN, *Practical Manual* (n 1) 163.

falls within the arm's length range of prices, no adjustment should be made but if the price falls outside the arm's length range of prices asserted, tax administration should give the taxpayer the opportunity to present arguments in support of their assertions.<sup>48</sup>

Depending on the transfer pricing method that the taxpayer uses, comparability adjustments fall into three broad categories: accounting adjustments; balance sheet/working capital adjustments; and other adjustments.<sup>49</sup>

- Accounting adjustments: These adjustments are designed to eliminate differences that may arise from differing accounting standards and practices between the tested party and the third parties that are used as comparables, so as to avoid measurement errors if adjustments are not made.<sup>50</sup> This could happen where certain operations are recorded in different accounting lines depending upon the accounting practice of the entity. For example: a sales rebate granted to a customer may require an adjustment if it is recorded as a negative sales or marketing expenses. Likewise, research and development expenditure may be reflected either in operating expenses or in the cost of sales. The lack of a clear distinction between direct costs and indirect costs may affect gross margins, which may also require adjustment.<sup>51</sup>
- Balance sheet or working capital adjustments: These adjustments can be made to reflect differing levels of accounts receivable, accounts payable and inventory.<sup>52</sup>
- Other adjustments: These comprise specific economic circumstances proposed by the taxpayer or the tax administrator that may affect the transactions being compared. This could be due to significant differences in the functions performed, assets used, risks assumed or capital employed by the potential comparables vis-à-vis the tested party.<sup>53</sup> When such differences exist and are not adjusted, they may affect the reliability of the comparables in establishing an appropriate arm's length profit range.<sup>54</sup>

South Africa's administrative practices for carrying out comparability adjustments are in line with the OECD TPG, as explained in SARS Practice Note 7.<sup>55</sup>

## **Challenges in Carrying out Primary Adjustments**

### *Challenges to Primary Adjustments Relating to Carrying out Comparability Analysis*

Internationally, taxpayers are often not sure whether and when 'comparability adjustments' should be made as the process is generally ad hoc and depends on

---

48 OECD TPG (n 14) 125.

49 OECD (n 11) para 3.48; UN, *Practical Manual* (n 1, para B.2.3.5.2.

50 UN, *Practical Manual* (n 1) para B.2.3.5.2.

51 *ibid.*

52 OECD TPG (n 14) para 3.49; UN, *Practical Manual* (n 1) para B.2.3.5.6.

53 OECD TPG (n 14) para 3.48.

54 UN, *Practical Manual* (n 1) para B.2.3.5.10.

55 SARS Practice Note 7 (n 5) para 8.

subjective judgment, leaving sizeable room for discretion. Although the OECD TPG provide that ‘comparability adjustments’ can be done in practice,<sup>56</sup> taxpayers are often not quite certain if such adjustments should be performed on a routine or mandatory basis.

The only guidance that the OECD TGP provides is that ‘comparability adjustments’ should be considered only if they are expected to increase the reliability of the results<sup>57</sup> and that they are appropriate only in cases where differences will have a material effect on the reliability of the comparison.<sup>58</sup> The UN Practical Manual explains that ‘comparability adjustments’ should be made ‘only if the effect of the material differences on price or profits can be ascertained with sufficient accuracy to improve the reliability of the results.’<sup>59</sup>

The OECD TPG sets out the following factors that can be considered to determine if ‘comparability adjustments’ could be performed. These are: the materiality of the difference for which an adjustment is being considered; the quality of the data subject to adjustment; the purpose of the adjustment and the reliability of the approach used to make the adjustment.<sup>60</sup> If the taxpayer needs to perform numerous or substantial adjustments to key comparability factors, this may be an indication that the third-party transactions are in fact not sufficiently comparable.<sup>61</sup> An adjustment for differences in accounts receivable may not be warranted if major differences in accounting standards cannot be resolved.

In South Africa, SARS Practice Note 7, provides that the determination of an arm’s length price is a practical exercise and should not deal with immaterial differences.<sup>62</sup> SARS explains that the purpose of a functional analysis should be to understand the qualitative nature of the MNEs’ functions, assets and risks and not about allocating actual income to specific functions, assets and risks; as this may lead to unnecessary complexities in the analysis.<sup>63</sup> Many factors should be assessed as part of the business risks and comparisons should be made based on those factors; with the purpose of creating a comparability analysis that is capable of producing a quantifiable result. In so doing, some factors that cannot be quantified may need to be addressed indirectly instead.<sup>64</sup>

---

56 OECD TPG (n 14) para 3.49.

57 *ibid* para 3.50.

58 *ibid* para 3.51.

59 UN, *Practical Manual* (n 1) para B.2.1.5.

60 OECD TPG (n 14) para 3.50.

61 *ibid* para 3.51.

62 SARS Practice Note 7 (n 5) para 11.7.1.

63 *ibid*.

64 *ibid* 11.7.3.

### *Challenges Regarding the Reliability of Comparability Adjustments*

The other challenge is that in practice, tax administrations often hold different views about reliability of comparability adjustments made by taxpayers. Some taxpayers carry out sophisticated adjustments, which could create an impression that the outcome of the comparables is reliable and accurate, but this may not necessarily be the case.<sup>65</sup> Some tax administrations view some comparability adjustments, such as the differences in levels of working capital, as ‘routine’ and uncontroversial, while other tax administrations view other adjustments, such as country risks, as more subjective and therefore require additional proof and reliability.<sup>66</sup>

The OECD recommends that views about the reliability of comparability adjustments are not appropriate and that the only adjustments that should be made are those that are expected to improve comparability.<sup>67</sup> This is because, the level of the reliability of comparability adjustments may depend upon the availability of documentation to support any adjustments performed.<sup>68</sup>

In South Africa, SARS Practice Note 7 does not set views regarding reliability of comparability adjustments.<sup>69</sup> SARS notes that since precise calculations cannot be made and the application of any method involves elements of judgment, there is, ‘a need to avoid making adjustments to account for minor or marginal differences in comparability.’<sup>70</sup>

### *Challenges to Primary Adjustments when Tax Administrations use Secret Comparables*

Taxpayers often express concern about the use of ‘secret comparables’ by tax administrations when they use information or data about a taxpayer to form the basis of a transfer pricing scrutiny of another taxpayer, but the taxpayer under scrutiny is not given access to that information.<sup>71</sup> Although tax authorities believe that ‘secret comparables’ are a source of comparable third-party data, which they consider useful in their initial risk assessment procedures, there is no economic or legal basis for doing so.<sup>72</sup> In most cases, secret comparables are derived from a poor comparability analysis

---

65 OECD TPG (n 14) para 3.52.

66 *ibid* para 3.53.

67 *ibid*.

68 *ibid* para 3.54.

69 SARS Practice Note 7 (n 5) para 8.1.2.

70 *ibid* para 8.1.3.

71 UN, *Practical Manual* (n 1) para B.2.4.8.2.

72 Barsalou Lawson Advocates – Canada, ‘Reply to the Invitation to Comment on the OECD’s New Project on Administrative Aspects of Transfer Pricing’ (30 June 2011) 7. <<https://www.oecd.org/ctp/transfer-pricing/48323702.pdf>> accessed 23 October 2020.

and/or inadequate adjustments which may lead to wrong conclusions when faulty external comparables are used.<sup>73</sup>

Use of secret comparables hampers confidence in the tax system if data about other taxpayers is secretly used as a basis of a transfer pricing scrutiny of the taxpayer in issue, as this may result in the exposure of taxpayers' sensitive information to their competitors (for instance about their profitability, business strategies and contracts).<sup>74</sup> Use of secret comparables is also against the principle of equity, as the taxpayer's controlled transactions are benchmarked with comparables that are not available to them.<sup>75</sup> If the taxpayer is reassessed and the matter goes to court, it would be unfair to expect a taxpayer to formulate their defence on the basis of a reassessment which has never been disclosed to the taxpayer.<sup>76</sup> It would also be unfair for taxpayers to suffer consequences of adjustments to their income, (often coupled with interest and penalties) based on such secret comparables, if the taxpayer's rebuttal to such an assessment is denied.<sup>77</sup> Furthermore, any double taxation that may result, may not be relieved as in principle, the secret comparables would not be disclosed to the Competent Authority of the other contracting state.<sup>78</sup> The UN Manual cautions tax administrations against the use of secret comparables unless they are able, within the limits of their domestic confidentiality requirements, to disclose the data to the taxpayer so that they can defend their position in a court.<sup>79</sup>

In South Africa, SARS transfer pricing practices show that it does not use secret comparables.<sup>80</sup> SARS Practice Note 7 explains that SARS's primary source of information is from the taxpayer itself. Although SARS may have external information (such as on: taxpayers within the same or similar industry; financial databases; publicly available industry information; internet sources; comparable foreign entities; and information from other jurisdictions obtained through exchange of information provisions in tax treaties),<sup>81</sup> SARS does not, as a matter of course, use publicly undisclosed information.<sup>82</sup> Nevertheless, the Commissioner of SARS does not rule out the possibility that publicly undisclosed information would not be used in administering the transfer pricing rules.<sup>83</sup> It is recommended that if such a possibility arises, SARS

---

73 *ibid.*

74 UN, *Practical Manual* (n 1) para B.2.4.8.1.

75 OECD TPG (n 14) para 3.36.

76 Barsalou Lawson Advocates (n 72).

77 UN, *Practical Manual* (n 1) para B.2.4.8.3.

78 UN, *Practical Manual* (n 1) para B.2.4.8.3.

79 *ibid.*

80 Republic of South Africa 'Transfer Pricing Country Profile' (n 68) in s 9 of the table.

81 SARS Practice Note 7 (n 5) para 12.2.1.

82 *ibid* para 12.3.1.

83 *ibid* para 12.3.2.

should adhere to the recommendation in the UN Manual to disclose the data to the taxpayer so that they can defend their position in a court.<sup>84</sup>

### *Challenges to Primary Adjustments Regarding Downward Primary Adjustments*

Where a taxpayer unintentionally over-reports taxable income and a primary adjustment is affected based on that taxable income, the increased tax liability may cause the taxpayer to seek a reduction in the primary adjustment.<sup>85</sup> However, there is no clear international guidance on downward adjustments. The OECD TPG provides that tax administrations may or may not grant the request for downward adjustment at their own discretion.<sup>86</sup> Consequently, countries follow different approaches, in that some countries allow them while others do not. However, the challenge is that, countries that do not permit downward adjustments, do not often make it categorically clear in their legislation or administrative practices.

Examples of countries with clear legal provisions permitting downward adjustments are the following. The Republic of Korea's the tax legislation permits a downward adjustment in cases where a tax adjustment is made under a transfer pricing method using multiple year data.<sup>87</sup> In Canada, the court confirmed in the case of *Dow Chemical Canada ULC v The Queen*,<sup>88</sup> that a downward adjustment is permitted if the Canadian tax administration determines that the circumstances are such that it would be appropriate for the adjustment to be made.<sup>89</sup> Other countries make it clear in their administrative practices (such as in tax rulings) that downward adjustments are permitted. For example, Germany,<sup>90</sup> Israel,<sup>91</sup> Kenya,<sup>92</sup> Seychelles,<sup>93</sup> Netherlands<sup>94</sup> and Singapore<sup>95</sup> have tax rulings regarding downward adjustments of taxable income. For countries with such rulings, it should be noted that Action 5 of the OECD BEPS Report which deals with countering harmful tax practices recommended inter alia, that countries should ensure transparency regarding cross-border rulings including those dealing with downward adjustment of taxable profits.<sup>96</sup> Action 5 entails BEPS minimum standards that OECD Inclusive Framework countries are expected to implement in cases where no action by some countries would create negative spill-overs on other

---

84 UN, *Practical Manual* (n 1) para B.2.4.8.3.

85 *ibid* para B. 8.9.1.

86 OECD TPG (n 14) in para 3.17.

87 UN, *Practical Manual* (n 1) para B. 8.9.2.

88 *Dow Chemical Canada ULC v The Queen*, 2020 TCC 139.

89 Scott J Wilkie, 'Canada – Downward Transfer Pricing Adjustments: Dow Chemical Canada ULC v The Queen' (2021) *International Transfer Pricing Journal* 28(3) 3.

90 OECD/G20 BEPS Project 'Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance: Action 5' (2015) 159 para 432.

91 *ibid* para 556.

92 *ibid* 234 para 646.

93 *ibid* 342 para 966.

94 *ibid* 280 para 771.

95 *ibid* 346 para 976.

96 *ibid* para 91 and 125.

countries.<sup>97</sup> To ensure transparency, countries are expected to disclose cross-border tax rulings which provide for unilateral downward adjustments to the taxpayer's taxable profits that is not directly reflected in the taxpayer's financial or commercial accounts.<sup>98</sup>

Examples of countries that do not permit downward adjustments are the following. The United Kingdom's legislation does not permit downward adjustments to taxable profits in the tax computations if the arm's length principle has not been followed and the taxpayer is not a potentially advantaged person.<sup>99</sup> In South Africa, the legislation and administrative practices do not permit downward adjustments due to over-reporting of taxable income. Section 31 of the Income Tax Act, which requires that terms and conditions should be adjusted to those that would have existed had the parties been dealing at arm's length, is limited to situations where the taxpayer derives a 'tax benefit', which is defined in section 1 of the Act, as including any tax avoidance, postponement or reduction of any liability for tax. Over-reporting of taxable income is not covered in the meaning of a 'tax benefit' in South Africa.<sup>100</sup> As a member of the OECD Inclusive Framework, South Africa's 2019 Action 5 peer review report clearly show that it does not have rulings on downward adjustments.<sup>101</sup>

Where a country (like South Africa) does not allow a downward adjustment and a taxpayer thinks that their unintentionally over-reported taxable income has not been taxed in accordance with the treaty, they may refer the matter for resolution under the 'mutual agreement procedure' (MAP) in article 25 of treaties based on the UN and OECD MTC.<sup>102</sup> Article 25(1) provides that a taxpayer that is a resident of one of the contracting States, who believes that they have not been taxed in accordance with the treaty rules for the allocation of taxing rights between the two contracting States, has a right to request that they are taxed according to those rules.<sup>103</sup> Indeed MAP is often used to resolve disputes regarding transfer pricing adjustments.<sup>104</sup>

---

97 OECD, 'Implementing the BEPS Package: Building an Inclusive Framework' (February 2016) <<https://www.oecd.org/.../flyer-implementing-the-beps-package-building-an-inclusive->> accessed 10 October 2019. For details on the BEPS minimum standards see OECD/G20 BEPS Project 'Explanatory Statement' para 11.

98 OECD 'BEPS Action 5 on Harmful Tax Practices: Transparency Framework: Peer Review Documents (February 2021) 10–11.

99 Oskar Paladini Söderberg, 'Compensating Adjustments – An international Perspective' (Master of Laws, Lund University 2018) 19; OECD TPG (n 14) para 4.38.

100 UN, *Practical Manual* (n 1) para B. 8.9.2.

101 OECD/G20 BEPS Project 'Harmful Tax Practices – 2019 Peer Review Reports on the Exchange of Information on Tax Rulings: Inclusive Framework on BEPS: Action 5 (2020, OECD Publishing) 362.

102 UN, *Practical Manual* (n 1) para B. 8.9.1.

103 Commentary on Art 25(1) of the OECD MTC (n 8) para 7; *UN Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (UN 2013) 311.

104 Commentary on Art 25(1) and (2) of the OECD MTC (n 8); UN (n 103) 323.

*Challenges to Primary Adjustments Regarding Compensating/Year-end Adjustments*

The concept of ‘compensating adjustments’ (despite the use of the word adjustments) is not a separate category of transfer pricing adjustments but can be part of a taxpayer’s transfer pricing policy in determining an arm’s length price. The OECD TPG define a ‘compensating adjustment’ (pricing adjustments or year-end adjustments) as ‘an adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer’s opinion, an arm’s length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises.’<sup>105</sup> Compensating adjustment are usually part of a MNEs transfer pricing policy, and are normally made by taxpayers prior to submission of the tax return in order to report the right arm’s length price of the transaction for tax purposes, when it differs from the original amount of transaction. A compensating adjustment is normally carried out as a two-sided transaction by two associated parties and is recorded in both of their accounts to reflect an adjustment to the actual price of goods and has an accounting impact on the selling party’s sales figures and the purchasing party’s cost of goods sold.<sup>106</sup>

Compensating adjustments are carried out because information about comparable uncontrolled transactions may not be available at the time associated parties establish the prices for their controlled transactions. When carrying out a compensating adjustment, taxpayers adjust the accounting entries after the transaction is carried out. This is usually done at the end of the financial year, but prior to submission of tax returns,<sup>107</sup> when taxpayers have knowledge of the circumstances that might have affected the profitability of their intra-group transactions during the given year. Such circumstances may include exchange rate fluctuations or the actual cost of the transaction (if was only estimated during the year).<sup>108</sup>

Compensating adjustment can help taxpayers achieve targeted operating margins as determined by their inter-company agreements. Often this involves the issue of debit or credit notes that enable the taxpayer to lodge a correct tax return that has got the actual price recorded by both parties in their own accounts.<sup>109</sup> Taxpayers often record such

---

105 OECD TPG (n 14) in the Glossary 25.

106 Billy Joubert and Neeren Isaac, ‘Transfer Pricing: Arm’s Length Standard – Secondary Transfer Pricing’ <[https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/ZA\\_Secondaryadjustment\\_090615.pdf](https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/ZA_Secondaryadjustment_090615.pdf)> accessed 20 October 2020.

107 KPMG, ‘Tax and Legal News Letter’ <<https://assets.kpmg/content/dam/kpmg/pdf/2016/05/LV-Tax-Legal-ENG-May-2016.pdf>> accessed 22 October 2020; BDO Global Customs and Transfer Pricing: Year-end Adjustments (7 December 2020) <<https://www.bdo.global/en-gb/insights/tax/transfer-pricing/realise-customs-and-transfer-pricing-year-end-adjustments>> accessed 12 April 2021.

108 Maciej Preiss and Katarzyna Szymańska, ‘Transfer Pricing Adjustments in Multinational Enterprises: Yet Another Challenge for Taxpayers’ (16 September 2019) <<https://home.kpmg/pl/en/home/insights/2019/09/transfer-pricing-adjustments-in-multinational-enterprises-yet-another-challenge-for-taxpayers.htm>> accessed 22 October 2020; OECD TPG (n 11) para 4.38.

109 OECD TPG n 14, Chapter III para 4.38.



adjustments in a variety of ways so as to recognise them in the accounting books of the financial year, to which it relates—for example through posting a reserve (accrual) which may still be issued in that financial year or after year-end.<sup>110</sup> The recording of the actual transactions between the parties ensures conformity with the arm’s length principle.<sup>111</sup>

The OECD TPG approves of the use of compensating adjustments, as they reduce the need for primary adjustments by allowing the taxpayer to report a transfer price that is, in the taxpayer’s opinion, an arm’s length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises.<sup>112</sup> Compensating adjustments can also ensure a fair international distribution of taxable profits between countries without adjustments being made on a state initiative.<sup>113</sup> This ensures relief of administrative burdens, especially for companies that operate in very unstable markets and companies that do not have the recourse or competence to conduct a complete forecast to stay compliant with the arm’s length price prior to the transaction.<sup>114</sup>

### *Challenges When It is not Clear Whether a Country Accepts Compensating Adjustments*

Despite the above advantages, opponents to the practice of compensating adjustments argue that, although they bring the financial results of associated parties in line with their transfer pricing study, they do not represent typical arm’s length behaviour between independent third parties acting at arm’s length as they would not share information on profits made from their transactions.<sup>115</sup> There are also concerns that compensating adjustments may be related to particular transactions and yet the deductions claimed based on such adjustments may not have been in the production of income.<sup>116</sup> In addition, since a compensating adjustment may result in an increase in revenue in one country, and a decrease in revenue in another, the latter may not accept decreased revenue, and often tax deductions by taxpayers as a result of such adjustments may be disallowed.<sup>117</sup> Countries’ perceptions of what may be considered as acceptable and unacceptable evaluations of the transaction price, after it has been implemented, also differ.<sup>118</sup> Thus, in practice, taxpayers are often uncertain about applying

---

110 Preiss and Szymańska (n 108); OECD TPG (n 14) para 4.38.

111 Söderberg (n 99) 19.

112 OECD TPG n 14, para 4.38; Söderberg n 99 22.

113 Söderberg n 99 26.

114 *ibid.*

115 F Schoeneborn, ‘Outcome Testing: Why Year-end Adjustments Cannot be the First Choice to Bring Intercompany Margins to an Arm’s Length Level’ (2015) *International Transfer Pricing Journal* 22(3) 153.

116 VS Dirk and K Lim, ‘Year-end Adjustments: What Tune is the EU Singing?’ (2012) *Tax Management Transfer Pricing Report* 20 1014.

117 *ibid* 1016.

118 EU Joint Transfer Pricing Forum ‘Report on Compensating Adjustments’ (2014) DOC: JTPF/009/FINAL/2013/EN in para 3.

compensating adjustments as most countries' legislation or administrative practices are not clear as to whether they are permitted.<sup>119</sup>

Examples of countries with legislation that clearly permits compensating adjustments, include Sweden<sup>120</sup> and Poland.<sup>121</sup> However, in most OECD member countries, compensating adjustments are not recognised as it is reasoned that the tax return should reflect the actual transactions.<sup>122</sup>

In South Africa, the Income Tax Act does not provide for compensating adjustments.<sup>123</sup> SARS Practice Note 7 states that 'the use of hindsight is inconsistent with the arm's length principle in setting or reviewing a transfer price. At arm's length, events occurring after a taxpayer has determined its prices would not affect the determination of those prices, unless they could be reasonably predicted at the time those prices were set.'<sup>124</sup> However, SARS transfer pricing practices shows that year-end adjustments, would generally be considered and evaluated based on the arm's length principle as provided for in section 31 of the Income Tax Act.<sup>125</sup> SARS Practice Note 7 advises taxpayers to keep contemporaneous documentation and that if a taxpayer can demonstrate that it has developed a sound transfer pricing policy 'the Commissioner is more likely to conclude that its transfer pricing practices are acceptable and the risk of possible adjustments will be diminished.'<sup>126</sup> No compensating adjustments have however been made by SARS so far in the settlement of transfer pricing claims.<sup>127</sup>

### *Challenges When it is not Clear as to When Compensating Adjustments Should be Concluded*

Even where compensating adjustments are permitted, there is no clearly set guidance in the OECD TPGs as to when compensating adjustments are to be conducted.<sup>128</sup> Thus, in countries where these adjustments are permitted, the approaches to granting the same often differ due to differences in transfer pricing practices relating to time gaps, access

---

<[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/company\\_tax/transfer\\_pricing/forum/jtpf/2013/jtpf\\_009\\_final\\_2013\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf/2013/jtpf_009_final_2013_en.pdf)> accessed 22 October 2020.

119 Jens Wittendorf, 'Transfer Pricing Timing Issues Revisited' *Tax Notes International* (2012) 68(1) 89.

120 Söderberg (n 99) 19.

121 Preiss and Szymańska (n 108); OECD TPG (n 14) para 4.38.

122 European Commission, 'EU Joint Transfer Pricing Forum, Member States' Responses to Questionnaire on compensating adjustments/Year-end adjustments, JTPF/019/REV1/2011/EN (2011), 71.

123 Webber Wentzel and Chambers, 'Corporate Tax 2020 Guide Guide: South Africa' (2020) 8.

124 SARS Practice Note 7 (n 5) para 11.15.1.

125 Republic of South Africa 'Transfer Pricing Country Profile' n 68.

126 SARS Practice Note 7 (n 5) para 10.2.4 – 10.2.5.

127 Webber Wentzel (n 123) 8.

128 Wittendorf (n 119) 89.

to data bases and the quality of comparable data studies from commercial data bases such as AMADEUS.<sup>129</sup>

The OECD TPGs, recognise two approaches that could be applied: the ‘ex-post’ (outcome setting) and the ‘ex-ante’ (price setting) approach; as well as combinations of the two approaches.<sup>130</sup> Under the ‘ex-post’ approach, taxpayers may incorporate information that becomes available after the close of the tax year to determine arm’s length conditions and report results on the tax return.<sup>131</sup> Taxpayers are required to check the actual outcome of related party transactions to demonstrate that their prices corresponded with the arm’s length principle.<sup>132</sup> Countries that apply this approach accept that at the end of the financial year, the taxpayer will check the outcome of related party transaction and make price adjustments, if necessary. When applying this approach, it is often permissible to use the data for the time when the transaction was carried out, but which was not available at the time of transaction.<sup>133</sup>

Under the ‘ex-ante’ approach, taxpayers use historical data that is updated to reflect any change in economic conditions through the date of the contract.<sup>134</sup> Taxpayers have to demonstrate that at the time of the transaction, they had attempted to set market level prices based on the information available at the time.<sup>135</sup> Countries that follow this ex-ante approach, hold the view that when the prices are set by parties, based on the information at their disposal that is similar to conditions between unrelated parties, these prices would be binding on the parties and it would not be necessary to adjust them later.<sup>136</sup> However, the transfer prices of taxpayers that follow the ‘ex-ante’ approach may be challenged by tax authorities if there are big variances between their budget setting processes and the actual prices.<sup>137</sup> Given the difficulties of settling transfer prices based on current information, the ‘ex-ante’ approach is considered more logical because it mimics the behaviour of arm’s length parties who are likely to make prospective adjustments.<sup>138</sup>

Although the OECD recognises that both the ex-post and the ex-ante approaches could be applied to determine when compensating adjustments are to be conducted, the diverging approaches that countries follow create potential for double taxation disputes,

---

129 EU Joint Transfer Pricing Forum ‘Report on Compensating Adjustments’ (n 118) para 3.

130 OECD TPG (n 14) para 3.71.

131 *ibid* para 3.70.

132 EU Joint Transfer Pricing Forum ‘Report on Compensating Adjustments’ (n 118) para 4.1.

133 KPMG (n 98).

134 OECD TPG (n 11) para 3.69; Kofler (n 18) 639.

135 KPMG (n 104).

136 *ibid*.

137 Wittendorf (n 119) 88–89.

138 J Hanken and R Doward, ‘A Fresh View on the Out-come Testing Approach Versus Price Setting Approach Discussion and Recommendations Regarding the Benchmarking Studies’ (2014) *International Transfer Pricing Journal* 21(6) 411–412.

if no primary adjustment is made.<sup>139</sup> Even though the OECD TGP provide that the MAP in Article 25 of the OECD MTC can be used to resolve such disputes,<sup>140</sup> MAP may not yet be available or may not provide a solution for a dispute at the time when the taxpayer is obliged to file their tax return.<sup>141</sup> For European Union (EU) countries, the EU Joint Transfer Pricing Forum provides some guidance to ensure that compensating adjustments are in line with the arm's length standard.<sup>142</sup> It notes that tax administrations should accept compensating adjustment only if taxpayers:

- have made reasonable effort prior to the transaction, to ensure that the prices are at arm's length;
- apply the same method consistently from year to year, regardless of whether it is beneficial in a given year;
- make compensating adjustments prior to submission of their tax declarations;
- are able to explain why previously estimated prices did not correspond to the arm's length principle; and
- both member States should have made symmetrical adjustments to their accounting (one taxpayer increases the taxable income and the other decreases it by the same amount).<sup>143</sup>

The EU cautions that it is not acceptable for related parties to carry out transactions at deliberately incorrect prices which at any given time cannot be considered as market-related prices, and at the end of the financial year price adjustments are made by issuing an invoice for the difference between the market price and the price actually applied.<sup>144</sup> As indicated in above, the South African Income Tax Act does not provide for compensating adjustments.<sup>145</sup> Although SARS transfer pricing practices show that year-end adjustments would generally be considered and evaluated based on the arm's length principle,<sup>146</sup> no compensating adjustments have so far been made by SARS.<sup>147</sup> Taxpayers will have to await clear guidance on the matter, which could be clarified by updating the SARS Practice Note.

### *Challenges Regarding Compensating Adjustments when Taxpayers face Economic Crisis*

The question of whether compensating adjustments would be granted to taxpayers could be quite uncertain in an economic crisis, owing to the practical challenges for MNEs in

---

139 OECD TPG (n 11) para 3.71.

140 *ibid* para 4.38.

141 EU Joint Transfer Pricing Forum, 'Report on Compensating Adjustments' (n 109) para 4.1.

142 *ibid*.

143 EU Joint Transfer Pricing Forum 'Report on Compensating Adjustments' (n 118) para 4.2.

144 *ibid*.

145 Webber Wentzel (n 123) 8.

146 Republic of South Africa 'Transfer Pricing Country Profile' (n 68).

147 Webber Wentzel (n 123) 8.

carrying out a comparability analysis.<sup>148</sup> This is exemplified by the economic crisis posed by the COVID-19 virus breakout which began in November 2019 in Wuhan, China and was declared a global pandemic by the World Health Organization on 11 March 2020.<sup>149</sup> The lockdown measures that governments imposed to stop the spread of the virus, wreaked havoc on the inter-connectedness of countries' economies, causing unprecedented disruptions in demand and supply chains across various sectors.<sup>150</sup> In many jurisdictions, some businesses were temporarily closed and many of them became insolvent.<sup>151</sup> Many businesses faced unprecedented market risks such as the collapse in demand for certain products and services and operational risks when the disruption of supply chains inhibited production. Financial risks increased when borrowing costs for some industries spiked as customers delayed or defaulted on payments.<sup>152</sup> These disruptions significantly impacted on the availability of contemporaneous data to enable the pricing of transactions between independent enterprises, which reduced the reliance that could be placed on historical data when performing comparability analyses.<sup>153</sup> These disruptions highlighted taxpayers' need for certainty as to whether tax administrations will accept compensating adjustments.<sup>154</sup>

The OECD's 'Guidance on Transfer Pricing Implications of the COVID-19 Pandemic'<sup>155</sup> recommends that a potential solution would be for tax administrations to provide for flexibility by allowing 'compensating adjustments' to be made before the tax return is filed and to permit any available contemporaneous information to be evaluated by taxpayers and tax administrations, provided that taxpayers ensure consistency with the arm's length principle within their particular facts and circumstances.<sup>156</sup> For countries applying the 'ex-post' approach, there should be no uncertainties, as they already permit compensating adjustments.<sup>157</sup> For countries that apply the 'ex-ante' approach, the OECD recommends that, where domestic law permits and on a temporary basis during the pandemic, tax authorities could consider allowing taxpayers to take into account information (about controlled transactions affected by the

---

148 OECD Guidance on Transfer Pricing Implications of the Covid-19 Pandemic (2020) para 9.

149 WHO, 'Virtual Press Conference on COVID-19' (11 March 2020) <[https://www.who.int/docs/default-source/coronaviruse/transcripts/who-audio-emergencies-coronavirus-press-conference-full-and-final-11mar2020.pdf?sfvrsn=cb432bb3\\_2](https://www.who.int/docs/default-source/coronaviruse/transcripts/who-audio-emergencies-coronavirus-press-conference-full-and-final-11mar2020.pdf?sfvrsn=cb432bb3_2)> accessed 3 September 2020.

150 Tania Ajam and Denis Davis, 'The Consequence of Near-total Cessation of Economic Activity and then a Somewhat Haphazard Partial Opening up of the Economy is Wreaking Havoc with South Africa's Tax Base' *Daily Maverick* (14 May 2020).

151 ATAF, 'Tax Administration and Policy Developments in Response to the Coronavirus (COVID-19) Pandemic in Africa' (July 2020) 5.

152 OECD TP Implications of the COVID-19 Pandemic (n 148) para 7.

153 *ibid* para 9.

154 BDO Global Customs (n 107); Juan Dosal and Michael Kratz COVID-19 and Transfer Pricing: Year-end Adjustments (27 January 2021) <<https://www.rsm.global/insights/tax-news/covid-19-and-transfer-pricing-year-end-adjustments>> accessed 12 April 2021.

155 OECD TP Implications of the Covid-19 Pandemic (n 148) para 30.

156 *ibid* para 30.

157 *ibid*.

pandemic) that becomes available after the close of the taxable year when filing their returns (where such information is legally permissible and properly described in the transfer pricing documentation).<sup>158</sup> Tax administrations could provide flexibility to allow amendments to the tax returns of the 2020 financial year such that transfer prices are set on an arm's length basis using the available information.<sup>159</sup> The OECD however cautions that given the scope of the potential adjustments, care should be taken to ensure their appropriate characterisation so as not to impact the comparability analysis for the following financial year.<sup>160</sup> Given the potential for double taxation and the disputes that may arise as a result of unilateral adjustments, the OECD further recommends that tax administrations should ensure that taxpayers get access to the MAP in Article 25 of treaties based on the OECD MTC or any non-adversarial alternative dispute resolution so as to achieve a negotiated settlement in the interests of all parties.<sup>161</sup>

This guidance should be followed in South Africa, as SARS would want to ensure compliance with the arm's length principle.<sup>162</sup> South Africa's double tax treaties,<sup>163</sup> which are largely based on the OECD MTC, contain the MAP article. And in terms of section 103 of the Tax Administration Act 28 of 2011 (TAA), South Africa has domestic Alternative Disputes Resolution processes which can be applied to resolve such disputes.<sup>164</sup>

### *Challenges to Primary Adjustments Posed by Differences between the Tax and Accounting Treatment of Income*

In most countries, the transfer pricing analysis is determined by using the financial accounts of an entity based on the International Financial Reporting Standards (IFRS) or local 'Generally Accepted Accounting Principles' (GAAP),<sup>165</sup> rather than the tax accounts. The challenge, however, is that financial accounts based on the IFRS and local GAAP have differences.<sup>166</sup> Financial accounts based on local GAAP may also differ from that of the parent country's local GAAP. These differences need to be reconciled

---

158 *ibid* para 23.

159 *ibid*.

160 *ibid* para 30.

161 *ibid* para 23.

162 Republic of South Africa 'Transfer Pricing Country Profile' (n 68) table s 26.

163 SARS 'Double Taxation Agreements and Protocols' <<https://www.sars.gov.za/legal-counsel/international-treaties-agreements/double-taxation-agreements-protocols/>> accessed 12 May 2021.

164 SARS Alternative Dispute Resolution: What to do if you Dispute your Tax Assessment and the Dispute Resolution Guide: Guide on the Rules Promulgated in terms of Section 103 of the Tax Administration Act, 2011; Republic of South Africa 'Transfer Pricing Country Profile' (n 60) table s 28.

165 OECD/G20, Public Consultation Document – Global Anti-Base Erosion Proposal ('GloBE'): Pillar Two (8 November 2019 – 2 December 2019), p. 10 (OECD 2019) <<https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf>> accessed 23 Aug. 2020.

166 *ibid* 10.

to ensure accuracy and consistency in any analysis as the financial accounts may have been treated differently, if they were posted above or below the operating profit line, which influences the measurement of the tax base. Financial accounts also often include uncertain tax benefits and may need to be adjusted to cater for over- or under-estimates of net profits.

In order to better align financial accounts with tax accounts, the calculation of the 'taxable income' is normally adjusted to cater for 'temporary differences'<sup>167</sup> and 'permanent differences.'<sup>168</sup> 'Temporary differences' arise when income or loss is recognised in a different year for financial accounting and tax. This covers timing of expenses like loss carry-forward, depreciation and deductions for reserves.<sup>169</sup> 'Permanent differences' entail financial accounting and tax computation that will not be reversed. This could cover: net taxes expense; excluded dividends; excluded equity gain or loss; gain or loss from the disposition of assets and liabilities; asymmetric foreign currency gains or losses; policy disallowed expenses; prior period errors and changes in accounting principles; and accrued pension expense.<sup>170</sup> To reconcile these differences, most businesses use deferred tax accounting (liability is deferred due to the differences in timing between when the tax was accrued and when it is due to be paid).<sup>171</sup>

Even though adjustments can be made for temporary and permanent differences, it should be noted that financial accounts have a different objective and purpose from that of tax accounts which have been built for tax systems.<sup>172</sup> This is why financial accounts are generally not suitable for determining the tax base, as tax accounts are designed for that purpose.<sup>173</sup>

In South Africa, taxpayers are required to provide financial data reporting when they submit transfer pricing documentation (the country-by-country report, the master file and local file). Submission of the country-by-country report requires the ultimate holding company of the group to prepare consolidated financial statements under general accounting principles as applied in South Africa.<sup>174</sup> The experience of the European Commission to abandon the GAAP financial accounts and develop a common

---

167 *ibid* 12.

168 *ibid* 11.

169 *ibid* 12.

170 *ibid* 11.

171 *ibid*.

172 Annet Oguttu, *Base Erosion and Profit Shifting: A Blue Print for Africa's Response* (IBFD, 2021) 603.

173 PWC, Comment Letter in Response to OECD Consultation Paper on the Unified Approach under Pillar 1 (12 November 2019) 11 <<https://www.pwc.com/us/en/tax-services/publications/insights/assets/OECD-Pillar-1-Paper-PwC-Response-Final.pdf>> accessed 27 April 2020.

174 'Return to be Submitted by Persons in Terms of Section 25 of The Tax Administration Act, 2011 (Act No 28 of 2011)' (20 October 2017) GG 41186 para 1 and 2.

consolidated tax base ‘CCCTB’ illustrates the importance of using tax accounts to calculate the tax base.<sup>175</sup>

## Secondary Adjustments

### Contextualising Why and How Secondary Adjustments Arise

The second category of transpiring adjustments is ‘secondary adjustments.’ A secondary adjustment arises from a primary adjustment and is a consequence thereof.<sup>176</sup> The reason why countries impose secondary adjustments is because primary adjustments tend not to place the financial position of the parties to the transaction on an arm’s length basis, because primary adjustments only account for taxable income, not actual income. In order to make the actual allocation of profits consistent with the primary adjustment, some countries require secondary adjustments, whereby the excess profits resulting from a primary adjustment are treated as having been transferred in some other form or character and taxed accordingly.<sup>177</sup> Thus, a secondary adjustment entails a re-characterisation of the primary adjustment amount by assuming (hypothesising) that a secondary (constructive) transaction took place which could explain why the cost is different from what it would have been, had the arm’s length principle been applied from the onset by the related party. Thus, a ‘secondary transaction’ is defined as ‘a constructive transaction that some countries will assert under their domestic law after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment.’<sup>178</sup> Since a secondary transaction is deemed to have taken place, the income derived therefrom is characterised differently. Thus, the ‘secondary adjustment’ arises from imposing tax on a secondary transaction.<sup>179</sup>

Since secondary adjustments are required to establish the situation exactly as it would have been had transactions been at arm’s length, they may serve to prevent tax avoidance, but the exact form of the transaction depends on the facts of the individual case.<sup>180</sup>

### *Models of Secondary Transactions*

The following are the Models or forms of secondary (constructive) transactions applied by tax authorities internationally:

---

175 EC Common Consolidated Corporate Tax Base Working Group (2007) <[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ccctbwp057\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ccctbwp057_en.pdf)> accessed 5 August 2022.

176 Andersen Tax (n 26) 32–33.

177 OECD TPG (n 14) para 4.68; Kofler (n 27) 623; National Treasury ‘Explanatory Memorandum to the Taxation Laws Amendment Bill, 2011 para 4.8 (1B).

178 OECD TPG (n 14) ‘Glossary’ 30.

179 *ibid* 30.

180 *ibid* para 4.68.



## The Constructive Dividend Model

A secondary transaction that could be deemed to have taken place is that the entity subscribed for shares in the associated entity, and so the character of income derived, would be classified as a distribution of dividend to its shareholders. Since the character of the income would not actually be classified or labelled as dividend in the entity's books, it is referred to as a 'constructive dividend.'<sup>181</sup> Where the country that makes a primary adjustment to the income of a subsidiary of a foreign parent treats the secondary transaction as a constructive dividend, the excess profits in the hands of the foreign parent is treated as having been transferred as a dividend, resulting in the levying of a withholding tax.<sup>182</sup>

Example: Assume that South African Company A received a loan of ZAR 100,000 from its offshore related Company B on which it is required to pay interest at seven per cent per annum (ZAR 7,000). Upon examination, Company A determined that the arm's length interest rate should have been five percent per annum (ZAR 5,000), which means that it has paid ZAR 2,000 in excessive interest to its related party. Company A would be required to make a primary adjustment so as to increase its taxable income by ZAR 2,000 in order to account for the excessive interest expense. Furthermore, a secondary adjustment will result. If the offshore-related Company B owns stock directly or indirectly in the South African company then a constructive dividend distribution in the amount of ZAR 2,000 would be deemed to arise from South African company to the Offshore related company B, which will be subject to dividends tax.

Constructive dividends can however only apply when the parent company holds excess cash. When the subsidiary holds the excess cash, the secondary adjustment takes the form of a constructive capital contribution, as explained in 3.1.1.2 below.<sup>183</sup> The OECD notes that 'it would be inappropriate for minority shareholders that are not parties to the controlled transactions and that have not received excess cash to be considered recipients of a constructive dividend, even though a non-pro-rata dividend might be considered inconsistent with the requirements of applicable corporate law.'<sup>184</sup>

## The Constructive Equity/Capital Model

As alluded to above, the other secondary transaction that could be deemed to have taken place is that, an equity/capital contribution is made to an entity by an associated party. In that case, the excess profits derived by the entity would be treated or characterised as 'deemed equity.' Since the distribution would not actually be classified as equity in the

---

181 *ibid* para 4.68; UN, *Practical Manual* (n 1).

182 *ibid* para 4.68; Kofler (n 27) 624; Thomas E Jenks, 'Constructive Dividends Resulting from Section 482 Adjustments' (1970) *Tax Lawyer* 84.

183 JM O'Brien and MA Oates, 'Why Triangular Constructive Dividends/Capital Contributions Have No Place in Code Sec 482 Cases' (2009) *International Tax Journal* 35(6) 21.

184 OECD TPG (n 14) para 4.72.

entity's books, it is referred to as a 'constructive equity' contribution.<sup>185</sup> The assumption could be that a shareholder transferred property or funds to a company in order to increase their participation in the management and to eventually share in the profits of the company, without any contractual obligation on the company to make repayments to the shareholder.<sup>186</sup>

Example: It could for example be assumed that a domestic company directly or indirectly owns stock in a foreign related party. A capital contribution from the domestic company to its related party, increases the domestic company's basis in the related company's stock. In such cases, there are no immediate tax consequences except for the standard tax that is levied on the primary adjustment and therefore no secondary adjustment arises.<sup>187</sup> As the equity contribution is capital in nature, tax will only be payable when the equity contribution is distributed to the owners as a return of capital, and so a base cost adjustment of the investment may be required.<sup>188</sup> This simplifies the tax administration and the constructive equity contribution may lead to tax savings for the taxpayer.<sup>189</sup>

### The Constructive Loan Model

The other secondary transaction that could be deemed to have taken place, is that the entity loaned the associated entity some funds and so the character of income derived would be classified as interest, which is taxable. Since the amount would not be classified as such in the entity's books, it is referred to as a 'constructive loan'.<sup>190</sup> Where the secondary transaction is treated as a 'constructive loan', the country that makes a primary adjustment treats the excess profits as a loan from one enterprise to its associated enterprise. Since an obligation to repay the loan would be deemed to arise, the tax administration that makes the primary adjustment may seek to apply the arm's length principle to this secondary transaction to impute an arm's length rate of interest.<sup>191</sup> The constructive loan approach may have an effect not only for the year to which a primary adjustment relates, but also on subsequent years, until such time as the constructive loan is considered by the tax administration to have been repaid.<sup>192</sup>

---

185 *ibid* para 4.68; UN, *Practical Manual* (n 1).

186 Lana H Harmse, 'Alternatives for the Treatment of Secondary Transfer Pricing Adjustments in South Africa' (Mini-dissertation, Potchefstroom NWU 2014) 86.

187 OECD TPG (n 14) para 4.72.

188 Farmid Khan, 'The Relationship Between Transfer Pricing Adjustments and Withholding Tax on Interest in South Africa' (Mini-dissertation, Potchefstroom: North-West University 2020) 76.

189 Harmse (n 186) 50.

190 OECD TPG (n 14) para 4.68; UN, *Practical Manual* (n 1).

191 *ibid* para 4.69; Kofler (n 27) 624.

192 OECD TPG (n 14) para 4.69.

## The Practical Challenges of Carrying out Secondary Adjustments

The OECD MTC does not prevent secondary adjustments from being made where they are permitted under the domestic laws of Contracting States.<sup>193</sup> However, the OECD TPG does not prescribe the approach for secondary adjustments and leaves it to domestic law treatment.<sup>194</sup> The Commentary on Article 9(2) of the OECD MTC makes it clear that it does not deal with secondary adjustments and that it neither forbids nor requires tax administrations to make secondary adjustments.<sup>195</sup> Thus, internationally, countries' policies regarding secondary adjustments differ, some apply them while others do not.

For example, in the United States of America, secondary adjustments are applied depending on who the transacting party is. The adjustments may be treated as a constructive dividend or a constructive capital contribution.<sup>196</sup> Other countries do not carry out secondary adjustments based on the reasoning that Article 9(2) does not categorically require countries to do so,<sup>197</sup> while others do not permit them as a matter of practice or because their domestic provisions do not permit them to do so.<sup>198</sup> For example, the United Kingdom's legislation does not provide for secondary adjustments.<sup>199</sup>

One of the main reasons why some countries do not permit secondary adjustments is the practical difficulties hindering their application.<sup>200</sup> For example, if a primary adjustment is made between related companies, the secondary adjustment may involve a hypothetical (constructive) dividend from one of the companies up in the chain of a common parent company, followed by constructive equity contributions down the chain of ownership to reach the company involved in the transaction. Where many hypothetical transactions are created, this raises questions as to whether tax consequences should be triggered in other jurisdictions besides those involved in the transaction for which the primary adjustment was made.<sup>201</sup> This challenge could be resolved if the secondary transaction were a loan, but constructive loans are not used by most countries as they carry complications relating to compounded imputed interest.<sup>202</sup> To avoid such complications, in most EU countries, secondary adjustments are treated

---

193 OECD MTC, Commentary on Article 9(2) para 9.

194 OECD TPG (n 14) para 4.77; Rawal (n 26) para 7.4.2.1.

195 OECD TPG (n 14) para 4.71; Kofler (n 27) 623.

196 O'Brien and Oates (n 183) 19-22; Harmse (n 186) 4.

197 OECD TPG (n 14) para 4.71.

198 *ibid.*

199 HMR & C Consultation Document, 'Introduction of secondary adjustments into the UK's domestic transfer pricing legislation' (26 May 2016). The proposals in this consultation document have not been taken forward.

200 OECD TPG (n 14) para 4.72.

201 *ibid* para 4.72.

202 *ibid.*

as hidden profit distributions which are considered as constructive dividends that are potentially subject to withholding tax.<sup>203</sup>

These complications are exemplified by South Africa's changing position regarding secondary adjustments over the years. For years of assessment before 31 March 2012, South Africa applied the constructive dividend model in that the then section 64C of the Income Tax Act (now repealed) deemed any amount, adjusted or disallowed in terms of section 31 of the Act, to be distributed to a recipient by the company and subject to Secondary Tax on Companies (now repealed). From 1 April 2012, South Africa moved from the constructive dividend model to the constructive loan model, when it enacted section 31(3) (also repealed) which provided that until such time as the difference between the price charged and the arm's length price is settled through the repatriation of funds, the difference would be regarded as a loan advanced by the resident party to the other party.<sup>204</sup> However, the operation of the constructive loan model caused uncertainties and administrative burdens for taxpayers and tax administration as it was not clear who owed the deemed loan. The provision also created an indefinite loop of interest-bearing loans and yet there was no guidance on how to extinguish the loan.<sup>205</sup> The accounting treatment of the deemed loan's repayment and interest also proved difficult, because there was no legal obligation to repay the loan.<sup>206</sup> The Davis Tax Committee, which was appointed in 2013 by the Minister of Finance to review South Africa's tax system, recommended in its 2014 Interim Report that as the secondary adjustment represents a distribution of value from South Africa to the foreign company, it is economically similar to outbound payments of dividends to foreign related parties and should be treated as a withholding tax on dividends.<sup>207</sup> Thus, in terms of the Taxation Laws Amendment Act 25 of 2015, section 31(3) of South Africa's Income Tax Act was amended by reinstating the constructive dividend model.<sup>208</sup> Currently, section 31(3)(i) of the Income Tax Act provides that if the resident is a company, the difference between taxable income and the arm's length amount is deemed to be a dividend *in specie* (a dividend consisting a distribution of an asset) declared and paid by that resident to the non-resident and so, the resident company will be liable for

---

203 European Commission, EU Joint Transfer Pricing Forum Final Report on Secondary Adjustments (2013) 3.

204 National Treasury Explanatory Memorandum (n 177) 177; Johan Kruger, 'South African Transfer Pricing – a Paradigm Shift in the Dark' (2012) TaxFind 1–2.

205 Jens Brodbeck and Carmen Gers, 'South Africa: The New South African Transfer Pricing Rules may be Risky' International Tax Review (2012) 1-7; Lana Harmse and Pieter van der Zwan, 'Alternatives for the Treatment of Transfer Pricing Adjustments in South Africa' (2016) De Jure 49(2) <<http://dx.doi.org/10.17159/2225-7160/2016/v49n2a6>>

206 Joubert and Isaac (n 106).

207 DTC, 'BEPS Interim Report on Action Plan 13: Transfer Pricing Documentation' (2014) 19; OECD TPG (n 14) para 4.68.

208 Harmse (n 186) 56.

dividends tax at a rate of twenty per cent.<sup>209</sup> If the resident is a person other than a company, section 31(3)(ii) provides that the difference between taxable income and the arm's length amount is deemed to be a donation made by the resident to the non-resident person and so, the resident will be liable for donations tax on the deemed donation at a rate of twenty per cent (this deemed donation approach is not provided for in the OECD TPG).<sup>210</sup>

A South African case in which the constructive dividend model was ruled upon, is the 2018 case of *Crookes Brothers Ltd v Commissioner for the South African Revenue Service*.<sup>211</sup> In this case, the taxpayer, which was part of a group of companies operating in Southern Africa, extended what it purported to be an ordinary shareholder loan to one of its subsidiaries in Mozambique (Mozco) to enable it to establish a nut farm. Clause 7 of the loan agreement stipulated that in the event of Mozco being liquidated, going under business rescue or becoming bankrupt, the loan would be due and payable with immediate effect. In the 2015 tax year, the taxpayer made a primary adjustment to its taxable income as well as a 'secondary adjustment' in terms of section 31(3) of the Act, which resulted in a deemed dividend *in specie* being declared and paid to Mozco. After filing the tax return, the taxpayer contended that the secondary adjustment had been made in error. The taxpayer reasoned that clause 7 of the loan agreement fell outside the application of the transfer pricing provisions since section 31(7)(b) of the Income Tax Act stated that a debt will not be subject to transfer pricing provisions if the foreign company is not obliged to repay the loan within thirty years of the date the debt is incurred. SARS disputed this argument. The court ruled in favour of SARS, noting that in terms of clause 7 of the loan agreement, a liquidation, business rescue or bankruptcy taken against Mozco would result in the termination of the agreement, and the loan would become due and payable if it remained unsatisfied. If a situation arises that obliges the foreign company to repay the loan before the expiry of thirty years, then the loan agreement does not comply with the requirement of section 31(7)(b). Thus, the constructive deemed dividend *in specie* in terms of section 31(3) was applicable.

### **The Challenges of Secondary Adjustments when Reduced Tax Burdens or Double Taxation Results**

Another challenge regarding secondary adjustments is that the interaction of a country's foreign tax credit system and the secondary adjustment may result in an excessively reduced overall tax burden of the MNE group.<sup>212</sup> In other instances, the structure of the secondary adjustments may create a potential of double taxation, unless a corresponding credit or some other form of relief is provided by the other country for the additional

---

209 Section 64E(1) of the Income Tax Act, provides for the levying of dividends withholding tax at a rate of twenty per cent of the amount of any dividend paid by any company, other than a headquarter company.

210 South Africa Income Tax Act s 54-64 provides for the levying of Donations Tax.

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

212 OECD TPG (n 14) para 4.72.

tax liability that may result because there may not be a deemed receipt under the domestic legislation of the other country.<sup>213</sup>

If such situations arise for South African taxpayers, it is recommended that South Africa should adhere to the OECD TPG and provide a corresponding credit to relieve such double taxation except where the taxpayer's behaviour suggests an intent to disguise a dividend for purposes of avoiding withholding tax.<sup>214</sup>

### **Challenges of Permitting Profit Repatriation Practices Instead of Carrying out Secondary Adjustments**

To address the challenges posed by secondary adjustments, some countries give the taxpayer receiving the primary adjustment an option to avoid the secondary adjustment by having the taxpayer arrange for the MNE group, of which it is a member, to repatriate the excess profits so that the taxpayer can conform its accounts to the primary adjustment.<sup>215</sup> In the USA for example, taxpayers may choose to repatriate the excess profits.<sup>216</sup>

The OECD TPG recognise that repatriation could be effected either by setting up an account receivable or by reclassifying other transfers, such as dividend payments between parent and subsidiary, as a payment of additional transfer price (where the original price was too low) or as a refund of transfer price (where the original price was too high).<sup>217</sup> Where a repatriation involves re-classifying a dividend payment, the amount of the dividend (up to the amount of the primary adjustment) would be excluded from the recipient's gross income as it would be already accounted for. The recipient would then lose any indirect tax credit (or benefit of a dividend exemption in an exemption system) and a credit for withholding tax which would have been allowed on the dividend.<sup>218</sup> However, in a double tax treaty context, double taxation may arise where constructive dividends are non-deductible.

When the repatriation involves establishing an account receivable, the adjustments to actual cash flow will be made over time, although domestic law may limit the time within which the account can be satisfied. This approach is identical to using a constructive loan as a secondary transaction to account for excess profits in the hands of one of the parties to the controlled transaction.<sup>219</sup> As the accrual of interest on the account often complicates the process, depending upon when interest begins to accrue

---

213 *ibid* para 4.70.

214 OECD TPG (n 14) para 4.73.

215 Harmse (n 186) 4.

216 O'Brien and Oates (n 183) 19–22.

217 OECD TPG (n 14) para 4.74; Kofler (n 27) 623.

218 OECD TPG (n 14) para 4.75.

219 Kofler (n 27) 623.

under domestic law, some countries may waive the interest charge on these accounts as part of a competent authority agreement.<sup>220</sup>

Where repatriation is sought, a question arises about how payments should be recorded in the accounts of the taxpayer repatriating the payment to its associated enterprise so that both it and the tax administration are aware that a repatriation has occurred. Ultimately, the actual recording of the repatriation depends on the form the repatriation takes. Where a dividend receipt is to be regarded as a repatriation, it may not be specially recorded in the accounts of the associated enterprise paying the dividend, as such an arrangement may not affect the amount or characterisation of the dividend in its hands.<sup>221</sup> However, where an account payable is set up, both the taxpayer and the tax administration need to be aware that it relates to a repatriation so that any repayments from the account can be clearly identified and treated according to the domestic laws of that country.<sup>222</sup>

As most OECD member countries do not have much experience with repatriation, the OECD recommends that agreements between taxpayers and tax administrations for a repatriation can be discussed in a MAP that is initiated for the related primary adjustment.<sup>223</sup> In such cases, it is recommended that where feasible under domestic legislation, tax authorities should refrain from issuing reassessments concerning withholding taxes on the secondary adjustment until the matter is settled by the competent authorities.<sup>224</sup> In South Africa, the Income Tax Act and SARS Practice Note 7 do not provide for profit repatriation.<sup>225</sup>

## Corresponding Adjustments

### **Contextualising Why and How Corresponding Adjustments Arise**

The third category of transfer pricing adjustments is ‘corresponding adjustments’ sometimes referred to as correlative adjustments. As noted in paragraph 2.1 above, Article 9(1) of the OECD MTC, requires countries to adjust the terms and conditions between related parties to ensure an arm’s length result. However, an adjustment in one country may affect transactions between the related entity in the other state, which might increase the aggregate tax payable by the two entities, since they are treated as separate legal persons. This could be as a result of the use of divergent transfer pricing methods applied by the affiliates of the same MNE. However, economic double taxation could arise as when tax is charged by two countries on the same income in the hands of

---

220 *ibid* para 4.76.

221 *ibid* para 4.77.

222 *ibid*.

223 *ibid* para 4.78.

224 Barsalou Lawson Advocates (n 72).

225 Harmse and Van der Zwan (n 205).

different persons.<sup>226</sup> Economic double taxation could for instance arise where one state imposes a primary adjustment on the profits of an entity on one jurisdiction, which is not considered in the taxation of an associated entity in the other jurisdiction.<sup>227</sup> To relieve such double taxation, Article 9(2) of the OECD MTC requires that where one state makes a primary adjustment on the profits of its taxpayer to reflect what in its judgment, the appropriate transfer price should be, the other state ‘shall’ make an appropriate adjustment (the corresponding adjustment) to its taxation of the related party in its jurisdiction.<sup>228</sup> Thus, if one tax administration increases a company’s taxable profits (the primary adjustment) as a result of applying the arm’s length principle to transactions involving an associated enterprise in a second tax jurisdiction, the corresponding adjustment could be a downward adjustment to the tax liability of an associated enterprise, made by the tax administration of the second jurisdiction, so that the allocation of profits between the two jurisdictions is consistent with the primary adjustment.<sup>229</sup> It is also possible that the first tax administration will agree to decrease (or eliminate) the primary adjustment as part of the consultative process with the second tax administration, in which case the corresponding adjustment would be smaller (or perhaps unnecessary).

#### *The Validity of Using Corresponding Adjustments to Prevent Economic Double Taxation*

Even though Article 9(2) of the OECD MTC permits the use of corresponding adjustments to prevent double taxation, their validity is questioned. Granting corresponding adjustments in order to prevent economic double taxation requires that a double tax treaty be interpreted in accordance with the view of the contracting state in which the income was sourced. This approach is, however, questioned by some authors as it is arguably an arbitrary method of preventing the economic double taxation that arises from transfer pricing adjustments because the arm’s length principle is not a distributive rule and the source of the income is irrelevant to whether the arm’s length principle has been followed.<sup>230</sup>

It is also contended that the primary adjustment may arguably even be an adjustment made to an expense as opposed to income, which means that there may not even be

---

226 UN, *Practical Manual* (n 1) para B.1.8.3; OECD TPG (n 14) para 4.37; Kofler (n 27) 596–597.

227 Note that double taxation could either be ‘juridical’ or ‘economic’ double taxation. The latter is defined in the text. ‘Juridical double taxation’ occurs when two states impose the same or comparable taxes on the same taxpayer, in respect of the same subject matter and for identical periods occurs when two states impose the same or comparable taxes on the same taxpayer, in respect of the same subject matter and for identical periods. See Arnold and McIntyre (n 4) 29; R Rohatgi *Basic International Taxation* (2002) 12.

228 UN *Handbook on Selected Issues* (n 103) 322.

229 UN, *Practical Manual* (n 1) para B.1.8.3; OECD ‘Glossary of Tax Terms’ <<https://www.oecd.org/ctp/glossaryoftaxterms.htm>> accessed 22 October 2020.

230 International Bureau of Fiscal Documentation ‘Avery Jones Bulletin – Tax Treaty Monitor’ (2001) 21.



income (or a source of income) to consider. Based on this assertion it is argued that the corresponding adjustment may not solve the issue of economic double taxation in cases regarding the computation of income.<sup>231</sup>

The validity of corresponding adjustments is also questioned by some authors who contend that whereas Article 9 allows a tax authority to adjust the accounts of an enterprise within its jurisdiction, by applying the ‘independent entity’ test according to its own judgement, Article 9(2) creates an obligation to consider the allocation of the combined profits of that entity and its associated enterprises in other countries, and to accept an adjustment made by the other party. It is argued that this contradicts the ‘independent entity’ principle, and yet current transfer pricing guidelines do not provide clear rules for allocation of combined profits.<sup>232</sup>

### *Requirements and Format for Requesting for a Corresponding Adjustment*

Article 9(2) ‘permits an adjustment only in cases where double taxation would arise as a result of the adjustment, generally only in shareholding (including voting rights and interests in partnerships) and managerial relationships.’<sup>233</sup> A corresponding adjustment is not intended to provide a benefit to the MNE group greater than would have been the case if the controlled transactions had been undertaken at arm’s length conditions in the first instance.<sup>234</sup> Taxpayers seeking a corresponding adjustment have to request it as part of the MAP under article 25 of a double tax treaty.

Since a corresponding adjustment is applied in a state with respect to an adjustment made by the other state, it does not apply unless there is an adjustment by one of the states. This implies that a corresponding adjustment can only be made by a state if in principle, it agrees with the primary adjustment made by the other state.<sup>235</sup> The state from which a corresponding adjustment is requested, should comply with this request only if that state ‘considers that the figure of adjusted profits correctly reflects what the profits would have been if the transactions had been at arm’s length.’<sup>236</sup> A corresponding adjustment is therefore not automatic or mandatory as it is only due if the state that is being requested to make a corresponding adjustment considers the initial primary adjustment made by the other state to be justified in principle as well as the amount.<sup>237</sup> The non-mandatory nature of corresponding adjustments is necessary to maintaining

---

231 Jones (n 230) 21.

232 The BEPS Monitoring Group ‘Explanation and Analysis of the MLI’ (2016) 19.

233 Cottani (n 25) 52.

234 OECD TPG (n 14) para 4.32.

235 Para 6 of the commentary on Art 9 of the OECD MTC (n 8).

236 OECD TPG (n 14) para 4.17.

237 OECD MTC Commentary on Art 9 Para 6 (n 8); UN, *Practical Manual* (n 1) B.1.8.3; Michael Lang, ‘Qualification Conflicts’ in Richard Vann (ed), *Global Tax Treaty Commentaries* 3; Kofler (n 27) 580.

the fiscal sovereignty of states, so that one tax administration is not forced to accept the consequences of an arbitrary or capricious adjustment by another state.<sup>238</sup>

Where countries hold diverging views on whether the primary adjustment is justified in principle and the amount in question, economic double taxation may arise. These diverging views may arise due to the application of different methods to determine an arm's length price, which may give rise to varied results. Contracting states may also not agree on what constitutes a justified transfer pricing adjustment and other countries may be unwilling to provide corresponding adjustments that could result in a loss to the fiscus. In such cases, the UN Practical Manual recommends that the competent authorities of the contracting states may have to consult with each other regarding the adjustment to avoid the risk of economic double taxation.<sup>239</sup>

Although corresponding adjustments are not mandatory, they are granted by most OECD countries.<sup>240</sup> Corresponding adjustments are also provided for in the transfer pricing legislation of a number of African countries, especially where a DTA is in place. For example, in Nigeria, Regulation 2(c) of the Transfer Pricing Regulations provides that it is imperative for the Federal Inland Revenue Service to grant an automatic corresponding adjustment where a primary adjustment has been sustained for a domestic transaction.<sup>241</sup> In 2017, the Malawi Revenue Authority issued the Taxation (Transfer Pricing) Regulations 2017 in a Government Notice,<sup>242</sup> which provide that a corresponding adjustment shall be granted if it is consistent with the arm's length principle both in principle and as regards the amount.<sup>243</sup> In Tanzania, the Tax Administration (Transfer Pricing) Regulations of 2018 (Regulation 14(1) provide for corresponding adjustments as a unilateral approach (in the absence of treaty) to relieving double taxation as a result of an adjustment in another country.

In South Africa, SARS has indicated that it allows corresponding adjustments in pursuance of Article 9(2) in its DTAs in order to prevent economic double taxation.<sup>244</sup> However, SARS Practice Note 7 indicates that even through 'South Africa's treaties generally incorporate such adjusting mechanisms, the wording of the relevant article in the treaties may not oblige South Africa to make a corresponding adjustment in all cases.'<sup>245</sup>

---

238 OECD TPG (n 14) para 4.35.

239 UN, *Practical Manual* (n 1) in para B.1.8.3.

240 OECD TPG (n 14) para 4.34.

241 Andersen Tax (n 26) 32–33.

242 Malawi General Notice 36 of 2017.

243 Orbitax 'Malawi Publishes Transfer Pricing Regulations 2017' <<https://www.orbitax.com/news/archive.php/Malawi-Publishes-Transfer-Pric-26259>> accessed 26 September 2020.

244 SARS 'Guide on Mutual Agreement Procedures' (n 34) para 2.1.3.

245 SARS Practice Note 7 (n 5) para 6.3; SAICA 'International Tax: Transfer Pricing'. <[https://www.saica.co.za/integritax/2000/763\\_Transfer\\_pricing.htm](https://www.saica.co.za/integritax/2000/763_Transfer_pricing.htm)> accessed 22 October 2020.

## Challenges Regarding Corresponding Adjustments

### *Challenges Regarding the Method of Conducting Corresponding Adjustments*

The OECD Commentary on Article 9 does not provide a specified method by which corresponding adjustments are to be made and it leaves it open for contracting states to agree on.<sup>246</sup> The Commentary to Article 9(2) provides two possible methods. One method operates by letting the assessment stand and giving the associated enterprise relief against the tax paid in that state for the additional tax charged to the associated enterprise as a consequence of the revised transfer price.<sup>247</sup> Article 23 of OECD MTC which is used to relieve juridical double taxation can then be used to give effect to a corresponding adjustment so as to prevent economic double taxation from arising. This approach is, however, considered incompatible with Article 9 because its purpose is not to deal with distribution of taxing rights, but to adjust the profits of two associated enterprises that have entered into an arrangement on a non-arm's length basis.<sup>248</sup>

Under the second method, an enterprise's taxable income is adjusted upwards, resulting in its associated enterprise in the other state, being deemed to have over-stated its taxable income, a corresponding adjustment can be effected by re-opening the associated enterprise's tax assessment and reducing its taxable income accordingly.<sup>249</sup> This method is common among OECD member countries.<sup>250</sup> This is arguably the most reliable and generally the most preferred method to alleviate economic double taxation.

In South Africa, although Practice Note 7 indicates that corresponding adjustments can be made, it does not specify the method by which they are to be made. SARS however indicates that it may consult with the competent authorities of the other contracting state over matters concerning corresponding adjustments,<sup>251</sup> which could include the method by which corresponding adjustments would be made.

### *Challenges Regarding the Year When Corresponding Adjustments Should be Attributed*

The other challenge for tax administrations that agree to make a corresponding adjustment, is the uncertainty as to whether the adjustment should be attributed to the year in which the controlled transaction giving rise to the adjustment took place or to an alternative year, such as the year in which the primary adjustment is determined. The approach of attributing the corresponding adjustment in the year the primary adjustment is determined, raises the issue as to whether the taxpayer is entitled to interest on the overpayment of tax in the jurisdiction which has agreed to make the corresponding

---

246 OECD MTC Commentary on Art 9 (n 8).

247 OECD TPG (n 14) para 4.34.

248 Para 7 of the commentary on art 9 of the OECD MTC n 8.

249 *ibid.*

250 OECD TPG (n 14) para 4.34.

251 SARS Practice Note 7 (n 5) para 6.3

adjustment.<sup>252</sup> The OECD TPGs recommend that the corresponding adjustment should be attributed to the year in which the controlled transaction giving rise to the adjustment took place as this achieves a matching of income and expenses and better reflects the economic situation as it would have been if the controlled transaction had been at arm's length.<sup>253</sup>

However, taxpayers may be caught up in domestic law time limits in cases involving lengthy delays between the year covered by the adjustment and the year of its acceptance by the taxpayer or a final court decision. In such cases, the OECD TPGs recommend that tax administration should be flexible and agree to make corresponding adjustment for the year of acceptance thereof or the year when the primary adjustment was made.<sup>254</sup> To ensure certainty for taxpayers on the approach a country would follow, it is important that the domestic law is clear on this matter. The OECD TPGs also provide that while not ordinarily preferred, it could be appropriate as an equitable measure, in exceptional cases, that the relevant provisions avoid time limit barriers.<sup>255</sup> In South Africa, section 99(1) of the TAA which sets out the 'period of limitations for issuance of assessments' provides that an assessment may not be made after three years of the original assessment (subject to certain exceptions as discussed below).

#### *Challenges Regarding Domestic Time Limitations and Corresponding Adjustments*

Article 9(2) does not specify whether there should be a time limit after which corresponding adjustments should not be made.<sup>256</sup> It leaves it for countries to set the time limits. However, the 'statutes of limitations' in countries' domestic legislation, which set the time allowed for tax administrations to complete transfer pricing audits, may result in a corresponding adjustment not being available if the time limit has expired.

The OECD TPGs recommend that time limits for finalising a taxpayer's tax liability are necessary to provide certainty for taxpayers and tax administrations.<sup>257</sup> Indeed, some countries grant exceptions to time limits due to the compliance and administrative burdens on taxpayers and tax authorities.<sup>258</sup> For example in South Africa, although section 99(1) of the TAA provides that SARS may not issue a reduced assessment after three years from the date of the original assessment, section 99(4) provides certain exceptions to this period of limitations. Section 99(4)(iv) provides that the Commissioner may, by prior notice of at least sixty days to the taxpayer, extend a period under section 99(1) before the expiry thereof, by three years in the case of an assessment

---

252 OECD TPG (n 14) para 4.36.

253 *ibid.*

254 *ibid.*

255 *ibid.*

256 *ibid* para 4.45.

257 *ibid* para 4.46.

258 UN, *Practical Manual* (n 1) para B.1.7.12.

by SARS or two years in the case of self-assessment, where an audit or investigation relates to the transfer pricing provisions in section 31 of the Income Tax Act.

The UN Practical Manual cautions that the use of an open-ended time limits to mitigate double taxation can be unreasonable for administrative purposes.<sup>259</sup> The UN Practical Manual recommends that countries should keep the balance between the interests of the revenue and the interests of taxpayers in mind when setting an extended period during which adjustments can be made.<sup>260</sup>

### *Challenges Regarding Treaty Time Limitations and Corresponding Adjustments*

Time limits can also be problematic in a treaty context when it comes to the three-year time limit within which a taxpayer must invoke the MAP under Article 25(1) of the OECD MTC. Since the three-year period begins to run from the first notification that taxation is not in accordance with the provisions of the Convention, this can be deemed the time when the tax administration first notifies the taxpayer of the proposed adjustment. The Commentary on Article 25 indicates that the time limit must be regarded as a minimum so that contracting states could agree upon a longer period in the interest of taxpayers. Article 25(2) further provides that the MAP shall be implemented notwithstanding the time limits in domestic law. To ensure certainty for taxpayers, the OECD encourages countries to extend domestic time limits for purposes of making corresponding adjustments when MAP has been invoked<sup>261</sup> and to allow the suspension of time limits on determining tax liability until MAP discussions are concluded.<sup>262</sup> The minimum standard in Action 14 of the OECD BEPS Report also provides that countries should ensure that domestic law time limits do not prevent the implementation of MAP.<sup>263</sup> If a country cannot include Article 25(2) in its treaties, (for example if it has a reservation or position with respect to time limits in the domestic law); then it should be willing to accept an alternative treaty provision that limits the time during which a Contracting State may make an adjustment pursuant to Article 9(1), in order to avoid late adjustments with respect to which MAP relief will not be available.<sup>264</sup>

The OECD BEPS Action 14 peer review report for South Africa,<sup>265</sup> shows that although its treaties are largely consistent with the Action 14 minimum standard, almost twenty-five per cent of its tax treaties do not contain a provision stating that the MAP shall be implemented, notwithstanding any time limits in domestic law (as required under

---

259 *ibid.*

260 *ibid.*

261 OECD TPG (n 14) para 4.47.

262 *ibid* para 4.48.

263 OECD/G20 BEPS Project Make Dispute Resolution Mechanisms More Effective: Action 14 (OECD Publishing, 2015) para 38; OECD TPG (n 14) para 4.49.

264 OECD/G20 BEPS Project: Action 14 (n 270) para 39; OECD TPG (n 14) para 4.50–4.52.

265 OECD/G20 BEPS Project ‘Making Dispute Resolution More Effective – MAP Peer Review Report, South Africa (Stage 1): Inclusive Framework on BEPS: Action 14 (OECD Publishing, 2019) 9.

Article 25(2)).<sup>266</sup> SARS indicates in its MAP Guide that a MAP request will be denied if it is not submitted within the time limits provided for in the double tax treaty or in terms of the domestic tax law, if applicable.<sup>267</sup> SARS notes that, the time limit in which a MAP request should be submitted, will depend on the specific terms of the particular treaty but generally South African treaties follow the times set out Article 25(1) of the OECD MTC.<sup>268</sup>

In some cases, the time limits under domestic law may make corresponding adjustments unavailable if the relevant DTA does not override those limits.<sup>269</sup> Thus, relief may depend on whether the applicable treaty overrides domestic time limitations, establishes other time limits, or links the implementation of relief to the time limits prescribed by domestic law.<sup>270</sup> Some countries, however, may be unwilling or unable to override their domestic time limits in this way and have entered explicit reservations on this point. The OECD recommends that where a DTA does not override domestic time limits for the purposes of the MAP, tax administrations should be ready to initiate discussions quickly upon the taxpayer's request, well before the expiration of any time limits that would preclude the making of an adjustment.<sup>271</sup>

In South Africa, the SARS' Guide on the MAP indicates that '[i]f the MAP article in the DTA does not provide for the limitation period under the domestic law to be overridden by the DTA, then the MAP cannot be accepted if the MAP request exceeds the domestic prescription period of three years after the date of assessment of an original assessment under section 99(1) of TAA Act.'<sup>272</sup> SARS Guide to the MAP provides that if the time limit in the MAP article allows for a longer period than the period in the domestic law, then the longer period in the DTA will apply.<sup>273</sup>

#### *4.2.5 Challenges Regarding Resolving Treaty Disputes Involving Corresponding Adjustments*

Article 9(2) specifically provides that the competent authorities shall consult each other if necessary to determine appropriate corresponding adjustments. Treaty disputes concerning corresponding adjustments can be resolved using the MAP under Article 25 of the OECD or UN MTCs. Paragraph 10 of the Commentary on Article 25 makes it clear that corresponding adjustments made in terms of Article 9(2) falls within the scope

---

266 OECD/G20, MAP Peer Review Report, South Africa (Stage 1) (n 265) 9–14.

267 SARS Guide on Mutual Agreement Procedures (n 35) para 3.2.

268 *ibid* para 3.2.1.

269 OECD TPG (n 14) para 4.42

270 *ibid* para 4.45.

271 *ibid* para 4.47.

272 SARS Guide on Mutual Agreement Procedures (n 35) para 3.2.3.

273 *ibid* para 3.2.1.

of the MAP both as concerns assessing whether they are well-founded and for determining their amount.<sup>274</sup>

However, taxpayers have historically found the MAP not very effective in resolving corresponding adjustment disputes because of the complexity of issues and the fact that there were no sufficient safeguards in the MAP against double taxation.<sup>275</sup> Often, taxpayers are denied access to the MAP in cases relating to corresponding adjustments.<sup>276</sup> Even though the arbitration provision in Article 25(5) could enable the competent authorities to resolve issues within two years of the initiation of the case, the arbitrarily decision (which is binding on both states) could be unimplementable because corresponding adjustments are not mandatory in terms of article 9(2). To address these concerns, the EU has a multilateral Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (the Arbitration Convention) which provides for an arbitration mechanism to resolve transfer pricing disputes between EU member states.<sup>277</sup>

The overlap between Article 9(2) and Article 25 also poses doubts as to whether the MAP can be used to achieve corresponding adjustments where a treaty does not contain Article 9(2). Most OECD member countries hold the view that the MAP can apply to corresponding adjustment even if the treaty does not contain Article 9(2).<sup>278</sup> The OECD recommends that states that do not agree with this view can find means of remedying economic double taxation for *bona fide* companies by using their domestic laws.<sup>279</sup> It should also be noted that Action 14 of the OECD BEPS Report, entitled ‘Make Dispute Resolution Mechanisms More Effective,’ sets out minimum standards which inter alia require countries to make appropriate corresponding adjustments under Article 9(2)<sup>280</sup> so as not to frustrate the primary objectives of tax treaties.<sup>281</sup>

Regarding South Africa, the 2019 OECD Inclusive Framework’s peer review report of Action 14 indicated that it ‘will always provide access to MAP for transfer pricing cases and is willing to make corresponding adjustments, regardless of whether the equivalent of Article 9(2) of the OECD MTC is contained in South Africa tax treaties, unless the relevant treaty does not contain a MAP provision.’<sup>282</sup> This is in line with SARS Guide on the MAP which clarifies that taxpayers are eligible to the MAP in order to resolve transfer pricing disputes relating to corresponding adjustments.<sup>283</sup> South Africa has also

---

274 Commentary on Article 25 of the OECD MTC (n 8) para 10.

275 OECD TPG (n 14) para 4.40.

276 *ibid* para 4.42.

277 EU ‘Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises’ 90/436/EEC.

278 Commentary on Article 25 of the OECD MTC (n 8) para 11 and 12.

279 *ibid* para 12; OECD TPG (n 14) para 4.33.

280 OECD/G20 BEPS: Action 14 (n 263) para 11–13.

281 OECD TPG n 14, para 4.43.

282 OECD/G20, MAP Peer Review Report, South Africa (Stage 1) (n 265) para 43.

283 SARS Guide on Mutual Agreement Procedures (n 35) para 2.1.3.

indicated its willingness to include Article 9(2) in all of its future tax treaties when it signed the OECD Multilateral Instrument which updates double tax treaties to implement the tax treaty-related BEPS measures.<sup>284</sup> South Africa opted into Article 17(2) which stipulates that Article 9(2) of the OECD MTC would apply in place of or in the absence of a provision in tax treaties that is equivalent to Article 9(2). However, this provision only applies if both parties to the applicable tax treaty have listed the treaty as a covered tax agreement under the Multilateral Instrument and both have not reserved the right for Article 17(2) not to apply.<sup>285</sup>

It should be noted that although Article 25(5) includes arbitration as part of the MAP procedure, and although some countries agreed to mandatory arbitration under BEPS Action 14,<sup>286</sup> the use of arbitration to resolve treaty disputes is not popular among developing countries like South Africa. This is because of: capacity constraints; concerns about the secretiveness of the procedure; the fact that arbitral decisions cannot be appealed or reviewed; the lack of transparency of the arbitration process; the lack of experience in arbitration procedures; and concerns that arbitration impacts on sovereignty of tax affairs as it requires giving discretionary powers to individuals who are third parties to the treaty.<sup>287</sup> It is noteworthy that South Africa has arbitration clauses in only three of its DTAs, which are with Canada,<sup>288</sup> the Netherlands<sup>289</sup> and Switzerland.<sup>290</sup>

---

284 OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2016); South Africa signed the MLI instrument on 7 June 2017—see National Treasury Republic of South Africa ‘Status of List of Reservations and Notifications the Time of Signature’ <<https://www.oecd.org/tax/treaties/beps-ml-position-south-africa.pdf>> accessed 14 May 2021.

285 OECD/G20 BEPS Project MAP Peer Review Report, South Africa (Stage 1) (n 272) para 47.

286 These are Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States. See OECD/G20 BEPS Project: Action 14 (n 270) para 62.

287 Annet Oguttu, ‘Resolving Double Tax Treaty Disputes: The Challenges of Mutual Agreement Procedure with a Special Focus on Addressing the Concerns of Developing Countries in Africa – The South African and Ugandan Experience’ SAYIL (2015) 188–191.

288 Convention Between The Republic of South Africa and Canada For the Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes on Income (30 April 1997) (Treaties & Models IBFD, SA GG) 17985) (entered into force 07 May 1997).

289 Convention Between the Republic of South Africa and The Kingdom of The Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Government (10 October 2005) (Treaties & Models IBFD SA GG 31797) (entered into force 28 December 2008).

290 Convention Between the Republic of South Africa and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (8 May 2007) (Treaties & Models IBFD, SAGG 31967) entered into force 27 January 2009.



*Challenges to Corresponding Adjustments Due to Reluctancy from Developing Countries*

Corresponding adjustments are criticised for ‘restricting a state’s right to make income adjustments under domestic law’<sup>291</sup> as this may result in countries giving up taxing rights over income that they would have been entitled to tax had the treaty not existed. Indeed, most developing countries have historically been reluctant to provide the corresponding adjustments ever since Article 9(2) was included in the OECD MTC in 1977,<sup>292</sup> and is now also in the UN MTC.

Unlike developed countries where local group entities have consolidated accounts and are audited at the group level, in most developing countries, group companies are audited at the company level, with tax administrators who are often ill-equipped to perform corresponding adjustments to eliminate the economic double taxation risk.<sup>293</sup> Developing countries have been insisting on flexibility to apply their own approach to intra-group transactions.<sup>294</sup> They argue that the obligation to accept an adjustment could be used to pressurise weaker countries to apply transfer pricing methods, which they consider inappropriate or unacceptable for their circumstances.<sup>295</sup>

Indeed, a number of non-OECD member countries—largely developing countries—have set out positions on Article 9(2) of the OECD MTC, which limit its application. Examples of non-OECD member countries that have reserved the right not to include Article 9(2) in their double treaties are Brazil, Thailand and Vietnam.<sup>296</sup> Some OECD member countries have also set out observations on Article 9(2) which limit its application. For example, the Czech Republic reserves the right not to include Article 9(2) in its DTAs but is prepared to include the same in bilateral negotiations.<sup>297</sup> Italy reserves the right to make corresponding adjustments only in accordance with MAP in relevant DTA.<sup>298</sup> For such countries that still hold reservations about corresponding adjustments, it should be noted that unlike the OECD MTC, the UN MTC has an additional Article 9(3) which stipulates that a Contracting State is not required to make the Article 9(2) corresponding adjustment; where judicial, administrative or other legal proceedings have resulted in a final ruling that, by the actions giving rise to an adjustment of profits under article 9(1), one of the enterprises concerned is liable to a penalty with respect to fraud, or to gross or wilful default.<sup>299</sup>

---

291 Kofler (n 27) 597.

292 The BEPS Monitoring Group (n 232) 19.

293 Andersen Tax (n 26) 32–33.

294 The BEPS Monitoring Group (n 232) 19.

295 *ibid.*

296 OECD MTC, Position on Art 9(2) para 1 P(9)-(1).

297 *ibid* para 16 C(9).

298 *ibid* para 17.1 C(9).

299 UN, *Practical Manual* (n 1) para B.1.8.5; Kofler (n 27) 623.

## Insights Derived, Conclusions and Recommendations

In this article, the author has explained the different types of transfer pricing adjustments as well as the tax policy and practical challenges that arise from the same. The international guidelines to address the ensuing challenges were explained and where there is lack of clear international guidance, the different approaches that countries use for the different transfer pricing adjustments, were explained. The article places focus on South Africa as an emerging economy on the African continent, which serves as a base for many MNEs that invest in the rest of Africa. Foreign investors may find it helpful to understand South Africa's position on the transfer pricing adjustments. Where uncertainties may still prevail regarding South Africa's approach, the following recommendations are made:

With respect to primary adjustments it is recommended that the following is done to address the uncertainties that may still prevail:

- Secret comparables can hamper confidence in the tax system. Whereas SARS does not use publicly undisclosed information, it does not rule out the possibility that such information would not be used in administering the transfer pricing rules.<sup>300</sup> It is recommended that if such a possibility arises, SARS should adhere to the recommendation in the UN Manual to disclose the data to the taxpayer so that they can defend their position in a court.<sup>301</sup>
- Even though the Income Tax Act does not provide for compensating (year-end) adjustments, SARS transfer pricing practices show that compensating adjustments, would generally be considered and evaluated based on the arm's length principle.<sup>302</sup> However, no compensating adjustments have been made by SARS so far in the settlement of transfer pricing claims.<sup>303</sup> To ensure certainty for taxpayers on this matter, it is recommended that SARS sets out a clear statement on its approach in a Practice Note, including what its approach would be regarding when compensating adjustments are to be conducted.

With respect to secondary adjustments, the following is recommended to address any uncertainties that may still prevail regarding constructive dividends:

- It is the author's view that the structure of a country's secondary adjustments may create a potential for double taxation, unless a corresponding credit or some other form of relief is provided by the other country for the additional tax liability that may result because there may not be a deemed receipt under the domestic legislation of the other country.<sup>304</sup> If such a situation arises for South African

---

300 SARS Practice Note 7 (n 5) para 12.3.2.

301 UN, *Practical Manual* (n 1) para B.2.4.8.3.

302 Republic of South Africa 'Transfer Pricing Country Profile' (n 68).

303 Webber Wentzel (n 123) 8.

304 OECD TPG (n 14) para 4.70.

taxpayers, it is recommended that South Africa should adhere to the OECD TPGs and provide a corresponding credit to relieve such double taxation except where the taxpayer's behaviour suggests an intent to disguise a dividend for purposes of avoiding withholding tax.<sup>305</sup>

With respect to corresponding adjustments the following is recommended to address any uncertainties that may still prevail:

- It was found that time limits under domestic law may make corresponding adjustments unavailable if the relevant DTA does not override those limits.<sup>306</sup> South Africa takes a firm approach on this matter in that if the DTA does not provide for the domestic law time limit to be overridden by the DTA, then the MAP request cannot be accepted if it exceeds the domestic time limit of three years under section 99(1) of TAA.<sup>307</sup> Since transfer pricing matters can be quite uncertain, it is recommended that SARS adopts a softer approach by following the recommendation in the UN Practical Manual which calls on countries to keep a balance between the interests of the revenue and the interests of taxpayers in mind when setting periods during which adjustments can be made.<sup>308</sup>

With the increasing uncertainties associated with transfer pricing adjustments, the above uncertainties regarding transfer pricing adjustments can be settled by SARS updating its Practice 7, which was issued as far back as 1999, as a matter of urgency. This will ensure that South Africa's approach is in line with international best practices and the latest updates to the OECD TPG and the UN Practical Manual. It is hoped that this article will be found instrumental for tax administrators, tax policymakers, tax practitioners, researchers and academics; especially those in developing countries where the legislation, administration and practice of transfer pricing is not yet well developed.

## References

Ajam T and Davis D, 'The Consequence of Near-Total Cessation of Economic Activity and then a Somewhat Haphazard Partial Opening up of the Economy is Wreaking Havoc with South Africa's Tax Base' *Daily Maverick* (14 May 2020).

Andersen Tax, 'Review of Transfer Pricing Development in Africa: A Study of Key Sub-Saharan African Countries'  
<[https://andersentax.ng/docs/review\\_of\\_transfer\\_pricing\\_development\\_in\\_africa\\_10042019.pdf](https://andersentax.ng/docs/review_of_transfer_pricing_development_in_africa_10042019.pdf)> accessed 25 September 2020.

Arnold B and Mclntyre JM, *International Tax Primer* (The Hague, Kluwer Law International 2002).

---

305 *ibid* para 4.73.

306 *ibid* para 4.42.

307 SARS Guide on Mutual Agreement Procedures (n 35) para 3.2.3.

308 UN, *Practical Manual* (n 1) para B.1.7.12.

Arnold BJ, *International Tax Primer* (3rd edn, Wolters Kluwer 2016).

ATAF, 'Tax Administration and Policy Developments in Response to the Coronavirus (COVID-19) Pandemic in Africa' (July 2020).

BDO, Global Customs and Transfer Pricing: Year-end Adjustments (7 December 2020) <<https://www.bdo.global/en-gb/insights/tax/transfer-pricing/realise-customs-and-transfer-pricing-year-end-adjustments>> accessed 12 April 2021.

Barsalou Lawson Advocates – Canada, 'Reply to the Invitation to Comment on the OECD's New Project on Administrative Aspects of Transfer Pricing' (30 June 2011) <<https://www.oecd.org/ctp/transfer-pricing/48323702.pdf>> accessed 23 October 2020.

Brodbeck J and Gers C, 'South Africa: The New South African Transfer Pricing Rules may be Risky' *International Tax Review* (2012).

Cottani G, 'Transfer Pricing, Topical Analyses' (2016, IBFD).

DTC, 'BEPS Interim Report on Action Plan 13: Transfer Pricing Documentation' (2014).

Dirk VS and Lim K, 'Year-end Adjustments: What Tune is the EU Singing?' (2012) *Tax Management Transfer Pricing Report* 20, 1014.

Dosal J and Kratz M, COVID-19 and Transfer Pricing: Year-end Adjustments (27 January 2021) <<https://www.rsm.global/insights/tax-news/covid-19-and-transfer-pricing-year-end-adjustments>> accessed 12 April 2021.

Dwarkasing RSJ, 'Associated Enterprises: A Concept Essential for the Application of the Arm's Length Principle and Transfer Pricing' (LLD dissertation, Tilburg University 2011).

EC Common Consolidated Corporate Tax Base Working Group (2007) <[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ccctbwp057\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ccctbwp057_en.pdf)> accessed 5 August 2022.

European Commission, 'EU Joint Transfer Pricing Forum Final Report on Secondary Adjustments' (2013).

European Commission, 'EU Joint Transfer Pricing Forum, Member States' Responses to Questionnaire on compensating adjustments/Year-end adjustments, JTPF/019/REV1/2011/EN (2011).

EU Joint Transfer Pricing Forum, 'Report on Compensating Adjustments' (2014) DOC: JTPF/009/FINAL/2013/EN <[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/company\\_tax/transfer\\_pricing/forum/jtpf/2013/jtpf\\_009\\_final\\_2013\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/company_tax/transfer_pricing/forum/jtpf/2013/jtpf_009_final_2013_en.pdf)> accessed 22 October 2020.

HMR&C Consultation Document, 'Introduction of secondary adjustments into the UK's domestic transfer pricing legislation' (26 May 2016).

Hanken J and Doward R, 'A Fresh View on the Out-come Testing Approach Versus Price Setting Approach Discussion and Recommendations Regarding the Benchmarking Studies' (2014) *International Transfer Pricing Journal* 21(6).

Harmse L and Van der Zwan P, 'Alternatives for the Treatment of Transfer Pricing Adjustments in South Africa' *De Jure* 49(2) (2016) <<https://doi.org/10.17159/2225-7160/2016/v49n2a6>>

Hay D, Horner F and Owens J, 'Past and Present Work in the OECD on Transfer Pricing and Selected Issues' (1994) *Intertax* <<https://doi.org/10.54648/TAXI1994058>>

Jenks TE, 'Constructive Dividends Resulting from Section 482 Adjustments' (1970) *Tax Lawyer*.

Jones A *Bulletin – Tax Treaty Monitor*, International Bureau of Fiscal Documentation (2001).

Joubert B and Isaac N, 'Transfer Pricing: Arm's Length Standard – Secondary Transfer Pricing Adjustments' <[https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/ZA\\_Secondaryadjustment\\_090615.pdf](https://www2.deloitte.com/content/dam/Deloitte/za/Documents/tax/ZA_Secondaryadjustment_090615.pdf)> accessed 20 October 2020.

KPMG, 'Tax and Legal News Letter' <<https://assets.kpmg/content/dam/kpmg/pdf/2016/05/LV-Tax-Legal-ENG-May-2016.pdf>> accessed 22 October 2020.

Khan K, 'The Relationship Between Transfer Pricing Adjustments and Withholding Tax on Interest in South Africa' Potchefstroom: North-West University (Mini-dissertation) (2020).

Kofler G, 'Article 9: Associated Enterprises' in Ekkehart Reimer and Alexander Rust (eds), *Klaus Vogel on Double Taxation Conventions* (Kluwer Law International 2015).

Kruger J, 'South African Transfer Pricing - a Paradigm Shift in the Dark' (2012) *TaxFind*.

Lang M, 'Qualification Conflicts' in R Van (ed) *Global Tax Treaty Commentaries* (2008).

League of Nations, 'Taxation of Foreign and National Enterprises: Vol IV, Methods of Allocating Taxable Income' Document No C425(b) M 217(b)1933.II.A (1933).

Mckinley J and Owsley J, 'Transfer Pricing and its Effect on Financial Reporting' (1 October 2013) *Journal of Accountancy*.

Miesel HV, Higinbotham HH and Yi WC, 'International Transfer Pricing: Practical Solutions for Inter-Company Pricing – Part II' (2003) 29 *International Tax Journal*.

National Treasury, 'Explanatory Memorandum to the Taxation Laws Amendment Bill' (2011).

OECD, 'BEPS Action 5 on Harmful Tax Practices: Transparency Framework: Peer Review Documents (February 2021).

OECD, 'Guidance on Transfer Pricing Implications of the Covid-19 Pandemic' (2020).

OECD, 'Implementing the BEPS Packaged: Building an Inclusive Framework' (February 2016) [https://www.oecd.org/.../flyer-implementing-the-beps-package-building-an-inclusive->](https://www.oecd.org/.../flyer-implementing-the-beps-package-building-an-inclusive-) accessed 10 October 2019.

OECD, 'Model Tax Convention on Income and on Capital' (Commentary on Article 9) (2017).

OECD, *Issues in International Taxation No 2 Thin Capitalisation: Taxation of Entertainers, Artists and Sportsmen* (OECD Publishing 1987).

OECD, Review of Comparability and of Profit Methods: Revision of Chapters I-III of The Transfer Pricing Guidelines (2010) para 1.13 <<http://www.oecd.org/tax/transfer-pricing/45763692.pdf>> accessed 5 November 2018.

OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* Paris, (2022, OECD Publishing).

OECD/G20 BEPS Project, 'Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance: Action 5' (OECD Publishing 2015).

OECD/G20 BEPS Project, 'Harmful Tax Practices – 2019 Peer Review Reports on the Exchange of Information on Tax Rulings: Inclusive Framework on BEPS: Action 5 (OECD Publishing 2020).

OECD/G20 BEPS Project, 'Making Dispute Resolution More Effective – MAP Peer Review Report, South Africa (Stage 1): Inclusive Framework on BEPS: Action 14 (OECD Publishing 2019).

OECD/G20 BEPS Project, *Aligning Transfer Pricing Outcomes with Value Creation: Actions 8-10* (OECD Publishing 2015).

OECD/G20, 'Public Consultation Document – Global Anti-Base Erosion Proposal ('GloBE'): Pillar Two (8 November 2019 – 2 December 2019)' <<https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf>> accessed 23 August 2020.

O'Brien JM and Oates MA, 'Why Triangular Constructive Dividends/Capital Contributions have no place in code Sec. 482 cases' *International Tax Journal* 35(6) (2009).

Obitax 'Malawi Publishes Transfer Pricing Regulations 2017' <<https://www.orbitax.com/news/archive.php/Malawi-Publishes-Transfer-Pric-26259>> accessed 26 September 2020.

Oguttu A, 'Base Erosion and Profit Shifting: A Blue Print for Africa's Response' (IBFD 2021).

Oguttu A, 'Challenges of Applying the Comparability Analysis in Curtailing Transfer Pricing: Evaluating the Suitability of Some Alternative Approaches in Africa' (2020) Intertax 48(1) <<https://doi.org/10.54648/TAXI2020006>>

Oguttu A, 'Developing South Africa as a Gateway for Foreign Investment in Africa: A Critique of South Africa's Headquarter Company Regime' (2011) 36 South African Yearbook of International Law.

Oguttu A, 'Resolving Double Tax Treaty Disputes: The Challenges of Mutual Agreement Procedure with a Special Focus on Addressing the Concerns of Developing Countries in Africa — The South African and Ugandan Experience' (2015) South African Yearbook of International Law..

PWC, 'Comment Letter in Response to OECD Consultation Paper on the Unified Approach under Pillar 1 (12 November 2019) 11e' <<https://www.pwc.com/us/en/tax-services/publications/insights/assets/OECD-Pillar-1-Paper-PwC-Response-Final.pdf>> accessed 27 April 2020.

Plasschaert SRF, *Transfer Pricing and Multinational Cooperation: An Overview of Concepts, Mechanisms and Regulations* (Farnborough, Saxon House 1979).

Preiss M and Szymańska K, 'Transfer Pricing Adjustments in Multinational Enterprises: Yet Another Challenge for Taxpayers' (16 September 2019) <<https://home.kpmg/pl/en/home/insights/2019/09/transfer-pricing-adjustments-in-multinational-enterprises-yet-another-challenge-for-taxpayers.htm>> accessed 22 October 2020.

Rawal R, *Radhakishan Rawal's Analysis of the Finance Acts of 2019 and More* (Bloomberg Publishing 2019).

'Return to be Submitted by Persons in Terms of Section 25 of The Tax Administration Act, 2011 (Act No. 28 of 2011)' (20 October 2017) GG 41186.

SAICA, 'International Tax: Transfer Pricing' <[https://www.saica.co.za/integritax/2000/763\\_Transfer\\_pricing.htm](https://www.saica.co.za/integritax/2000/763_Transfer_pricing.htm)> accessed 22 October 2020.

SARS, 'Alternative Dispute Resolution: What to do if you Dispute your Tax Assessment and the Dispute Resolution Guide: Guide on the Rules Promulgated in terms of Section 103 of the Tax Administration Act, 2011' (2014).

SARS, 'Guide on Mutual Agreement Procedures – Issue 3' (SARS 20 March 2020).

SARS, 'Practice Note: No 7 Section 31 of the Income Tax Act 1962: Determination of Taxable Income of Certain Persons from International Taxation: Transfer Pricing' (6 August 1999).

Schoeneborn F, 'Outcome Testing: Why Year-end Adjustments Cannot be the First Choice to Bring Intercompany Margins to an Arm's Length Level' (2015) 22(3) International Transfer Pricing Journal.

Söderberg Oskar Paladini, 'Compensating Adjustments - An international Perspective' (Master of Laws, Lund University 2018).

The BEPS Monitoring Group, 'Explanation and Analysis of the MLI' (2016).

UN, *Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries* (UN New York, UN 2013).

UN, *Practical Manual on Transfer Pricing for Developing Countries* (New York, UN 2017).

WHO, 'Virtual Press Conference on COVID-19' (11 March 2020)  
<[https://www.who.int/docs/default-source/coronaviruse/transcripts/who-audio-emergencies-coronavirus-press-conference-full-and-final-11mar2020.pdf?sfvrsn=cb432bb3\\_2](https://www.who.int/docs/default-source/coronaviruse/transcripts/who-audio-emergencies-coronavirus-press-conference-full-and-final-11mar2020.pdf?sfvrsn=cb432bb3_2)> accessed 3 September 2020.

Webber Wentzel, Chambers Global Practical Guide 'Corporate Tax: South Africa' (2020).

Wilkie JS, 'Canada – Downward Transfer Pricing Adjustments: Dow Chemical Canada ULC v The Queen' (2021) 28(3) International Transfer Pricing Journal.

Wittendorf J, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (Kluwer Law International 2010).

Wittendorf J, 'Transfer Pricing Timing Issues Revisited' Tax Notes International (2012) 68(1).

## Cases

*ABC (Pty) Ltd v Commissioner: SARS* (IT 14305) [2021] ZATC 1.

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

*Dow Chemical Canada ULC v The Queen*, 2020 TCC 139.

*ITC 167*, 62 SATC 219.

## Statutes

Income Tax Act 58 of 1968.

Malawi Government Notice 36 of 2017.

Taxation Laws Amendment Act 34 of 2019.



## Treaties, Conventions

Convention Between the Republic of South Africa and Canada For the Avoidance of Double Taxation and The Prevention of Fiscal Evasion with Respect to Taxes on Income (30 April 1997) (Treaties & Models IBFD, SA GG) 17985) (entered into force 07 May 1997).

Convention Between the Republic of South Africa and The Kingdom of The Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Government (10 October 2005) (Treaties & Models IBFD SA GG 31797) (entered into force 28 December 2008).

Convention Between the Republic of South Africa and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income (8 May 2007) (Treaties & Models IBFD, SAGG 31967) entered into force 27 January 2009.

OECD ‘Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting’ (2016).

EU ‘Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises’ 90/436/EEC.