Intragroup financial assistance is an important mechanism for Multinational Entities to meet financing needs by group entities. Revenue authorities and taxpayers alike have therefore been focusing on intragroup loans and other intragroup financial transactions, from a transfer pricing perspective, because intragroup financial transactions have been identified as a common mechanism for Multinational Entities to shift profits into tax favourable jurisdictions, thereby eroding the local tax base. Consequently, guidance on how to determine and demonstrate that an intragroup financial transaction is arm’s length was needed as financial transactions transfer pricing is a complicated, technical and sometimes subjective area.

Globally, the Organisation for Economic Cooperation and Development, for the first time ever, released transfer pricing guidance on financial transactions in 2020 only, and this was then incorporated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration in the recent update, in January 2022.

In South Africa, the transfer pricing law underwent a significant change when in 2012 the legislation was amended and the country moved from a thin capitalisation safe harbour based rule relying on a three to one debt to equity ratio, to a broader system whereby the focus shifted to an overall arm’s length requirement regarding the financial assistance transaction(s). Thus, since then the interest rate applied as well as the debt capacity of the lender must be in compliance with the arm’s length principle. Then, in 2013, a draft interpretation note was released by SARS providing some guidance on how SARS would expect a taxpayer to confirm arm’s length nature of an intragroup financial transaction. Most notably, the draft guidance included a risk ratio as to when SARS would consider a financial loan transaction riskier from a South African perspective – A debt to EBITDA ratio of the (South African) borrower of more than three to one identified the taxpayer as higher risk.
However, the obligation to prove arm’s length nature remained with the taxpayer. This draft interpretation note was never finalised although in practice SARS tended to rely on the guidance provided.

On 11 February 2022, SARS then released the updated and, effectively, new draft interpretation note on intragroup loans, a copy of which can be accessed here. The 2022 draft interpretation note does not contain the risk threshold rule and was updated to also align with the South African interest limitation rules, which were introduced subsequent to the 2013 draft, and it clarifies that the transfer pricing rules should be applied before the interest limitation rules. Other guidance relates to withholding taxes and the note now aligns with the new financial transactions guidance in the OECD Transfer Pricing Guidelines.

The 2022 draft interpretation note on intragroup loans is a welcome step towards providing guidance to taxpayers, especially because it now aligns with global principles and guidance. Comments on the draft interpretation note on financial loans has been requested and is due by 29 April 2022.

If you have any questions regarding the above or wish to speak to one of our Senior Transfer Pricing Specialists, please contact either of the below:

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Regards  
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