

Be prepared for transfer pricing rules

By [Jean du Toit](#)

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For some time, multinational enterprises have been bracing for the impending enforcement by the South African Revenue Service (Sars) of transfer pricing rules. This has resulted in these enterprises going to great lengths to ensure that they have thorough transfer pricing policies in place to survive any level of scrutiny from Sars, often at great cost.



Yet, in the case of *Crookes Brothers Ltd vs Commissioner for the South African Revenue Service*, the first South African case dealing with transfer pricing provisions, it was an unpolished contract that handed victory to the Commissioner.

The facts

Agricultural group Crookes Brothers Ltd advanced loans to its Mozambican subsidiary (MML) and pursuant to the terms of the loan, as well as in its return for the 2015 year of assessment, the group made transfer pricing adjustments to its taxable income.

Thereafter Crookes Brothers Ltd requested Sars to issue reduced assessments, claiming that the adjustments were made in error. The basis for their claim being that the terms of the loan were aligned with the requirements of section 31(7) of the Income Tax Act No. 58 of 1962 (the Act), which would exempt the loan from the application of transfer pricing rules. To support its claim, they also furnished Sars with the loan agreements.

Upon Sars' interpretation of the loan agreements, it concluded that the terms are in contravention of section 31(7) of the Act and decided to reject the request for reduced assessments. This resulted in Crookes Brothers making an application to the High Court to review and set aside Sars' decision.

Outcome

The nub of the dispute revolved around one clause. The terms of the loan agreements were completely aligned with the exemption, but for the inclusion of what was effectively a boilerplate acceleration clause.

The author of the contract, perhaps inadvertently, inserted a clause in the loan agreement that accelerated the debt in the event of bankruptcy, liquidation, business rescue or judgment against MML. The inclusion of this clause foiled the application of the exemption, the Crookes Brothers Ltd's application was dismissed with costs and the transfer pricing adjustments had to endure.

The court gave effect to the wording of the agreements, irrespective of what the parties may have intended and, ultimately, Crookes Brothers Ltd paid a heavy price for what was a poorly drafted agreement.

The takeaway

This case shows that these efforts will be in vain if a company has a weak underbelly. It illustrates that robust, conscientiously drafted agreements outrank opulent transfer pricing policies. If the underlying agreements that orchestrate the dealings between connected entities are not up to spec, such entities stand to be snared by the transfer pricing provisions.

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