

BASE EROSION AND PROFIT SHIFTING WORKSHOP

*PRESENTERS: NATIONAL TREASURY & SARS
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GLOBAL ISSUE

- Many countries face the problem of businesses exploiting gaps in the international tax system to artificially shift profits and avoid paying tax
- Examples that are in the public domain include Apple, Caterpillar, Google, Microsoft and Starbucks
- The challenge is that a country acting on its own cannot close the gaps and address the mismatches that arise in the interaction between multiple countries' tax systems
- As a result, during the G20 leaders summit in Mexico in 2012, the Heads of State explicitly referred to the need to prevent base erosion and profit shifting

GLOBAL RESPONSE

- G20/OECD launched the Base Erosion and Profit Shifting (BEPS) Action Plan in July 2013, which aims at addressing mismatches, gaps and weaknesses in international tax and treaty law that permit double non-taxation
- Focus is on transfer pricing, transparency (country-by-country reporting) and other aspects affecting international taxation (treaties, controlled foreign company rules, hybrids, etc.)
- Of 15 action items in the BEPS Action Plan, 4 are directly related (**) to transfer pricing and a further 5 action items may impact (*) on transfer pricing

BEPS ACTIONS (1)

- Action 1 * Address the tax challenges of the digital economy
- Action 2 * Neutralise the effects of hybrid mismatch arrangements
- Action 3 * Develop recommendations regarding the design of CFC rules
- Action 4 * Limit base erosion via interest deductions / other financial payments
- Action 5 Counter harmful tax practices, including compulsory spontaneous exchange of rulings
- Action 6 Prevent treaty abuse

BEPS ACTIONS (2)

- Action 7 * Prevent artificial avoidance of PE status
- Action 8 ** Ensure that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation
- Action 9 ** Prevent BEPS by transferring risks or allocating excessive capital to group members, align returns with value creation
- Action 10 ** Other high risk transactions, including base eroding management fees & head office expenses
- Action 11 Establish methodologies to collect and analyse data on BEPS

BEPS ACTIONS (3)

- Action 12 Recommendations for mandatory disclosure rules for aggressive tax planning & design model for exchange of information on tax schemes between tax administrations
- Action 13 ** Re-examine transfer pricing documentation, including country-by-country reporting
- Action 14 Make dispute resolution mechanisms more effective
- Action 15 Develop a multilateral instrument

BEPS OUTCOMES - 2014

- Outcomes on 7 of the actions were presented to G20 Finance Ministers in September 2014, with remaining outcomes scheduled for 2015
- Outcomes on 2 of the actions directly related to transfer pricing – intangibles and country-by-country reporting
- Finance Ministers endorsed outcomes and mandated OECD and Global Forum on Transparency and Exchange of Information to:
 - develop toolkits to support developing countries addressing BEPS
 - launch pilot projects to assist developing countries to move towards automatic exchange of information

BEPS OUTCOMES - 2015

- Outcomes on remainder of the actions to be presented to G20 Finance Ministers in October 2015
- A small number of actions will require additional work, which will take place in the short to medium term
- Implementation of outcomes will be monitored at the global level
- G20 Finance Ministers have called on OECD to establish a framework for non-G20 jurisdictions, particularly developing economies, to participate in monitoring on an equal footing

SOUTH AFRICAN RESPONSE (1)

BEPS

Digital economy

Hybrid instruments

CFCs

Interest limitation

Transfer pricing

Mandatory disclosure

SOUTH AFRICA

VAT Act s1 definition of
“electronic services”: 2013

Regulations : 2014

ITA ss8E & 8EA : 2012

ITA s9D : 1997

ITA ss23K, 23M, 23N : 2011 - 14

ITA s31 : 1995

ITA s76A : 2003

SOUTH AFRICAN RESPONSE (2)

- On 17 July 2013, the Davis Tax Committee (DTC) was appointed to enquire into the role of South Africa tax system in the promotion of inclusive economic growth, employment creation, development and fiscal sustainability
- On the international front, the DTC is required to address concerns about BEPS, especially in the context of international tax, as identified by the G20/OECD
- On 30 September 2014, the DTC issued an interim report entitled “Addressing Base Erosion and Profit Shifting in South Africa”, which:
 - notes the legislative interventions made by South Africa over the past years to counter BEPS, and
 - makes recommendations in other areas that need to be addressed, such as the reconsideration of section 6quin of the Income Tax Act and documentation requirements for transfer pricing purposes

TRANSFER PRICING (1)

- Transfer pricing legislation introduced in 1995; most recent amendments in principle in 2011 and 2014
- Section 31 of Income Tax Act, 1962, provides that transfer prices must be at arm's length (i.e. MNE entities need to transact at terms and conditions that would have prevailed had they been independent of each other); SARS may adjust if not (primary adjustment)
- Arm's length principle is rooted in Article 9 of double tax agreements and guidance at a generic and transactional level on its application is contained in OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
- Section 31 goes further than many jurisdictions; 2012 – 2014 excess funds flowing offshore treated as interest bearing loans, from 2015 as taxable dividends *in specie* or donations (secondary adjustment)

TRANSFER PRICING (2)

- As foreshadowed in the 2015 Budget Review, SARS has modified the company income tax return to obtain more detailed information with respect to transfer pricing and to place a greater focus on potential BEPS issues
- Amendments have been proposed in the draft Taxation Laws Amendment Bill, 2015, to regulate the obtaining of information held offshore and to extend the period SARS has to revisit an assessment that incorporates a transfer pricing issue in certain cases
- SARS is also in the process of drafting a public notice under section 29 of the Tax Administration Act, 2011, requiring large corporates with cross-border transaction with connected persons to maintain specific transfer pricing documentation

TRANSFER PRICING (3)

- Large Business Centre transfer pricing capability:
 - 55% increase in resources over past year
 - Additional 7 appointments pending
 - Graduate recruitment in place
 - OECD training – 70 people attended
- Game Changers:
 - Leveraging technology (expedited audit)
 - Engaging government agencies (SARB, the dti, etc.)
 - International collaboration – tax administrations (UK, Canada, India, etc.)
 - International experts

TRANSFER PRICING (4)

- Achieved to date:
 - Last reported – Just over R20bn in transfer pricing adjustments, with an income tax impact of over R5bn, over three years
 - Current – 33 case in audit (3 cases due for assessment – each exceeding R1bn)
 - Field audits – 30 (taxpayer engagement underway)
 - Risk assessment – focus on outbound fees and sector investigations underway (automotive, pharmaceutical and technology sectors)

TRANSPARENCY

- Information is the lifeblood of any tax administration
- Just as robust tax rules are required, so access to information to apply the rules correctly is required
- South Africa's legislation and international treaties have catered for exchange of information (EOI) for decades
- Enhanced focus on EOI since 2000, with establishment of Global Forum on Transparency and Exchange of Information for Tax Purposes
- First Global Forum standard was EOI on request, new standard of automatic EOI endorsed by G20 in 2013

FATCA

- Foreign Account Tax Compliance Act (FATCA) regarding reporting on US citizens' accounts in foreign jurisdictions introduced in USA in 2010
- Inter-governmental agreement (IGA) negotiated with USA in 2013/14 for automatic exchange of information obtained from financial institutions under the existing double taxation agreement with the USA
- IGA signed on 9 June 2014, finally ratified by South Africa on 1 October 2014 and took effect on 28 October 2014
- Amendments to Tax Administration Act, 2011, to underpin implementation of IGA included in Tax Administration Laws Amendment Act, 2014
- Information from financial institutions for the first period of 1 June 2014 to 28 February 2015 was due to SARS by 30 June 2015 and is due to be exchanged by 30 September 2015

COMMON REPORTING STANDARD

- G20 Finance Ministers endorsed the Common Reporting Standard (CRS) for automatic exchange of tax information on 23 February 2014
- Multilateral competent authority agreement with respect to the automatic exchange of information under the CRS signed on 29 October 2014, along with 51 other jurisdictions
- Exchange of information will take place under existing double taxation agreements and international treaties
- Amendments to Tax Administration Act, 2011, to facilitate implementation of CRS included in draft Tax Administration Laws Amendment Bill, 2015
- As South Africa is part of the early adopters group, information will be required from financial institutions for the first period of 1 March 2016 to 28 February 2017, which is due to be exchanged by 30 September 2017

CbC REPORTING (1)

- Major challenge for tax administrations reviewing cross border transactions is lack of information to identify risk
- G20/OECD Country by Country (CbC) report will provide overview of group revenues, profitability, tax, employees and assets around the world for this purpose
- Transfer pricing “master file” and CbC report filed with tax administration of group’s headquarters
- Reports will be provided to other tax administrations through automatic EOI
- Competent authority agreements still to be concluded with other jurisdictions

CbC REPORTING (2)

- First reports, for financial years starting in 2016, required in 2017/18 and due to be exchanged from 2018
- No amendments to Tax Administration Act, 2011, currently envisaged; existing powers to prescribe returns and EOI framework appear sufficient
- Threshold for reporting is global group revenues (i.e. turnover) of over €750 million; focusses on largest groups making up the bulk of global revenue
- Review of CbC content, threshold, etc. in 2020
 - Until then, what about regional headquartered groups with a lower but regionally significant group revenue?
 - Scope for a lower threshold for these groups, without undermining global approach?

Questions?

